Public non-financial corporations: 2014–15 financial statements

Report 7: 2015–16

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QUEENSLAND

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December 2015

The Honourable P Wellington MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Mr Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled Public non-financial corporations: 2014–15 financial statements.

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

Yours sincerely

Andrew Greaves
Auditor-General

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Summary

Who is covered in this report

Public non-financial corporations (PNFCs) include government owned corporations (GOCs) and statutory bodies that operate primarily across the energy, water and transport sectors.

Most PNFCs sell goods and services on commercial trading terms; they pay taxes and return dividends to the state government. Figure A shows the major PNFCs by industry sector.

Figure A
Major entities in PNFC by industry

Energy	CS Energy Limited Energex Limited Ergon Energy Corporation Limited Queensland Electricity Transmission Corporation Limited (PowerLink) Stanwell Corporation Limited
Water	Gladstone Area Water Board Mt Isa Water Board Queensland Bulk Water Supply Authority (Seqwater) SunWater Limited
Ports	Gladstone Ports Corporation Limited North Queensland Bulk Ports Corporation Limited Far North Queensland Ports Corporation Limited Port of Townsville Limited
Rail	Queensland Rail
Other	Stadiums Queensland Queensland Treasury Holdings Pty Ltd

Source: Queensland Audit Office

While we continue to report on each entity and sector separately, this report also summarises the combined results for all PNFCs to better understand how they affected the financial aggregates of the state for 2014–15.

These results should however be understood in the context of the fact that PNFCs operate inherently different businesses. This limits comparisons of financial performance, position, and sustainability between entities and industry sectors.

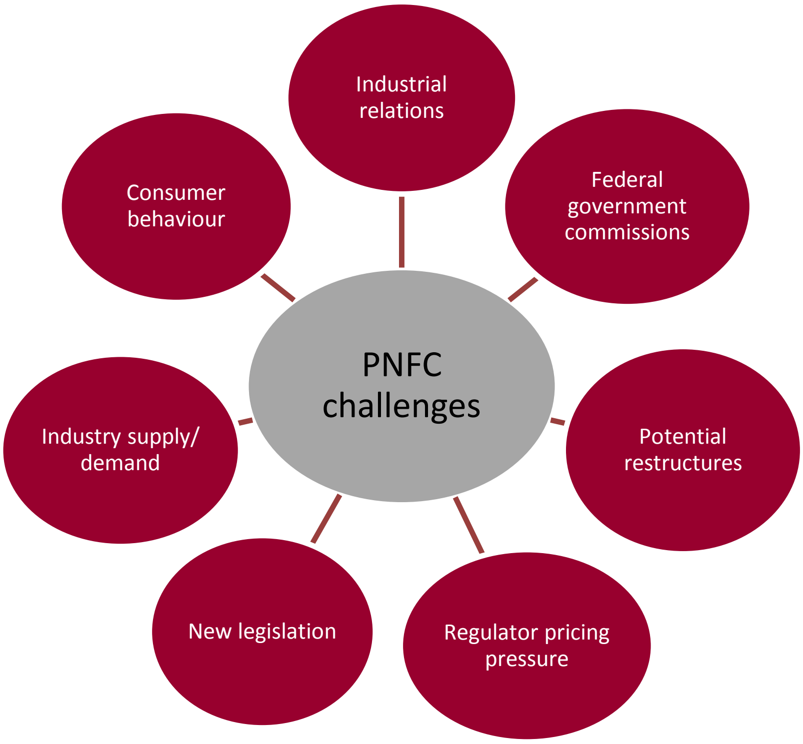
What is covered in this report

This report covers our 2014–15 financial and regulatory audit results for PNFC entities. It also provides a snapshot of PNFC finances at 30 June 2015, and expands on the significant financial accounting issues we reviewed this year in concluding our audits.

What's shaping the PNFC sector

Stakeholders and other industry participants are having a significant influence on the way PNFC entities shape their businesses and position themselves to remain sustainable. Figure B shows the significant challenges that the PNFC sector is facing.

Figure B
Significant challenges faced by the PNFC sector



Source: Queensland Audit Office

The energy businesses dominate the PNFCs and the energy sector is facing the most significant external challenges of all PNFCs. We report on how these industry wide reforms and events have affected financial performance, sustainability and returns to government.

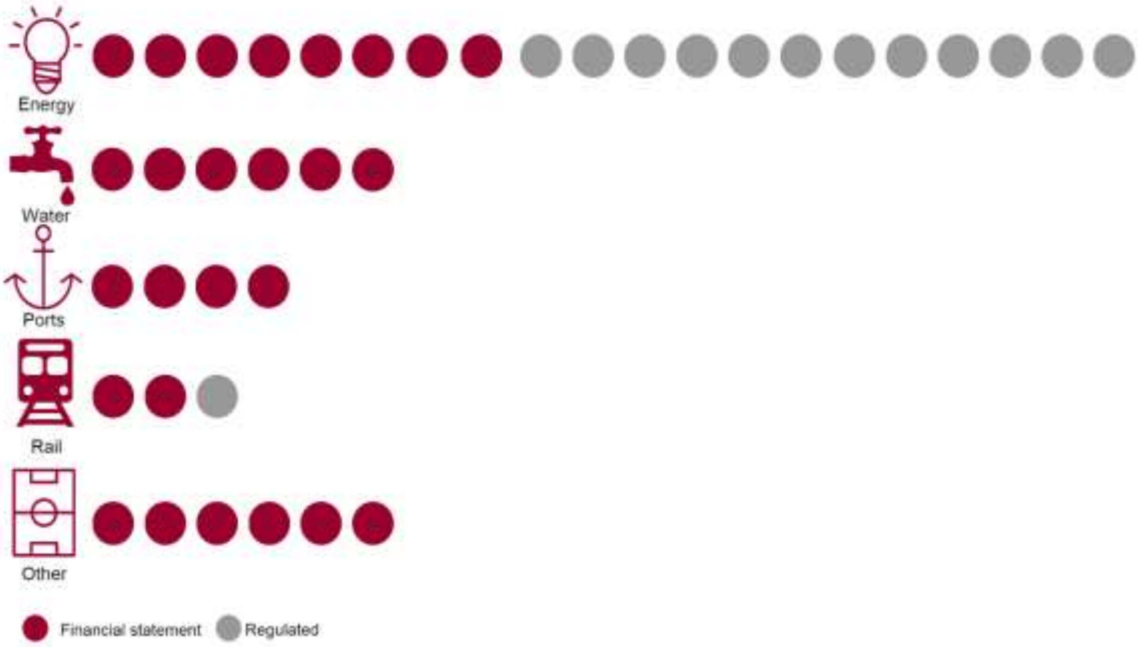
Audit results

Financial reports

We issued unqualified audit opinions for all PNFC entities. This is consistent with 2013–14 and confirms financial reports have been prepared according to requirements of legislation and relevant accounting standards.

Figure C shows the number of audit opinions and conclusions issued for each sector.

Figure C
Number of audit opinions and conclusions issued



Source: Queensland Audit Office

Of the 39 audit opinions and conclusions issued, three opinions received an emphasis of matter and 13 related to energy and rail sector regulatory engagements.

We included an emphasis of matter on the audit opinion for the Australian Water Recycling Centre of Excellence Limited, a controlled entity of Seqwater. This was in relation to the significant uncertainty over the company's ability to continue to exist and operate as a going concern post September 2016.

We also issued an emphasis of matter for Eungella Water Pipeline Pty Ltd to highlight that we used only certain accounting standards in the preparation of their report. This is because the sole shareholder of this non-reporting entity is the only user of the report.

City North Infrastructure Pty Ltd received an emphasis of matter as it is unlikely to continue as a going concern beyond 30 June 2016 due to the company's expected closure.

For the energy sector, in our regulatory certificates we drew attention to their purpose of issue and their basis of preparation. This was key to understanding the assumptions used to calculate the regulatory data.

The certificate we provided for the below rail services highlighted that the special purpose report is for use by the Queensland Competition Authority and is therefore not suitable for other purposes.

Audits certified by statutory deadline

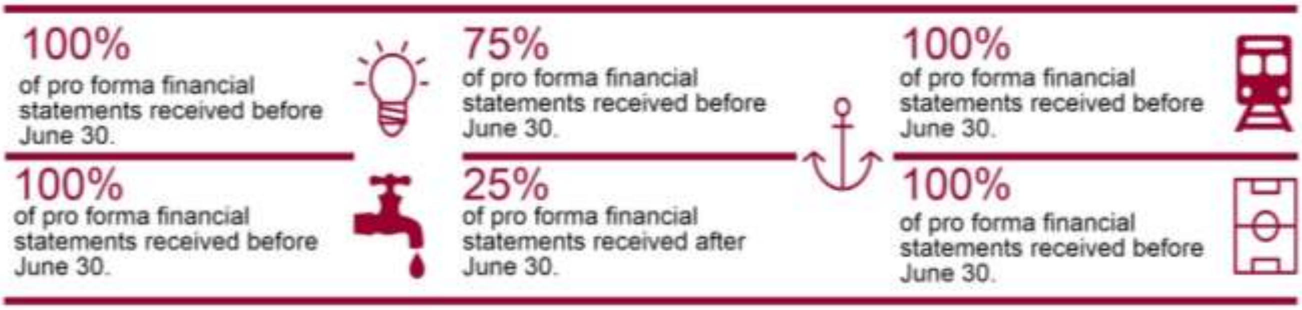
Management and audit certified financial reports for all entities, except Seqwater, by legislative deadlines. Because of issues identified with respect to the valuation of assets, QAO was not able to provide an unqualified audit opinion on the 2014–15 financial statements of Seqwater until 11 September 2015.

Use of pro forma financial statements

All major entities provided a template set of financial statements to their auditors before the year end period.

Going through a pro forma process is important as it allows entities to finalise disclosure formats and wording to be included in their financial statements before the busy year end period.

Figure D
Percentage of pro forma financial statements received before 30 June 2015



Source: Queensland Audit Office

The pro forma process this year simplified financial statements by removing immaterial disclosures, duplication and re-grouping like information.

Draft financial statements received by agreed dates

Sixteen out of 25 entities provided their first draft financial reports to audit by agreed milestones. Most entities did not make material changes to their draft financial reports in 2014–15. The changes that were made reclassified between line items to make the statements more readable. These did not affect the net operating result or net assets disclosed. Most changes aimed to improve quality and understanding of the financial reports.

Adjustments to 2013–14 financial statement figures

Overall, prior period adjustments decreased both PNFC sector net profit after tax and net assets. Ergon and Energex made adjustments to 2013–14 figures disclosed in the 2014–15 financial reports, reflecting de-recognition of assets booked in past years for under recovery of revenues. Powerlink also elected to discontinue deferral accounting for these balances.

Figure E
Adjustments to 2013–14 financial statement figures

Source: Queensland Audit Office

Seqwater amended their 2013–14 figures disclosed in the 2014–15 financial report to reflect the restatement of asset valuations on a post-tax basis, which were previously calculated on a pre-tax basis.

Key audit matters we raised with entities

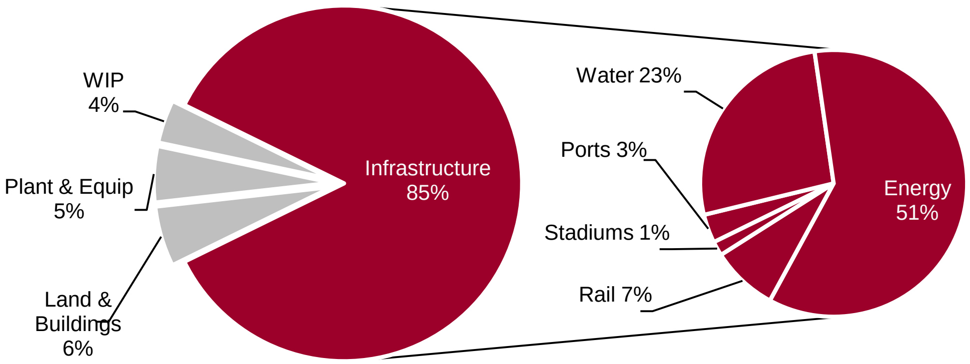
In forming our audit opinions, we must resolve any key audit matters we identify during an audit to ensure the financial report is not materially misstated. A key matter we encountered across all sectors was the financial reporting of non-current assets. Other key matters affecting the financial results of the PNFCs related to the energy sector around restructure of businesses and the accounting treatment for under recovery of revenues.

Financial reporting of property, plant and equipment

Overview of property, plant and equipment

Queensland's PNFC sector operates and maintains $57.1 billion in property, plant and equipment, representing a two per cent increase on the value of assets they held in 2013–14. Figure F shows a breakdown of these assets by asset class at 30 June 2015.

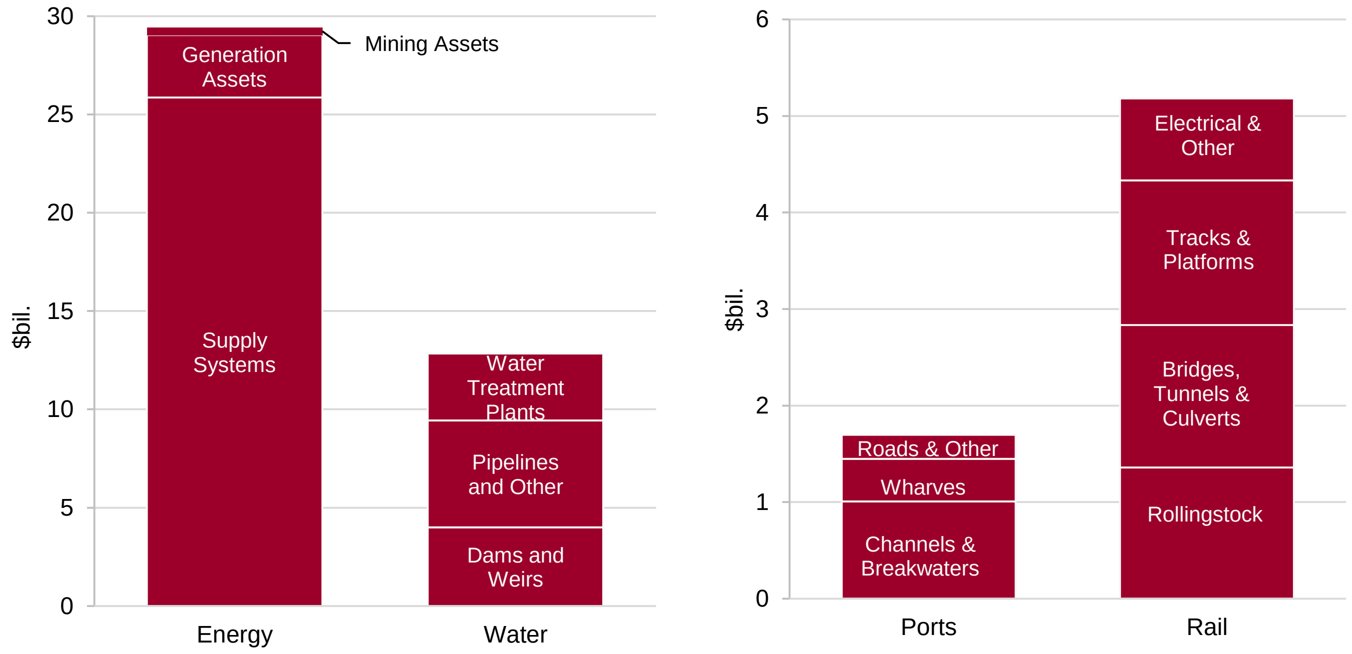
Figure F
PNFC sector assets by asset class at 30 June 2015



Source: Queensland Audit Office

At $48.8 billion, infrastructure represents the most significant component of PNFC assets. Energy holds 51 per cent of this with water making up the second largest component at 23 per cent. Figure G shows the type of infrastructure assets the PNFC sector held at 30 June 2015.

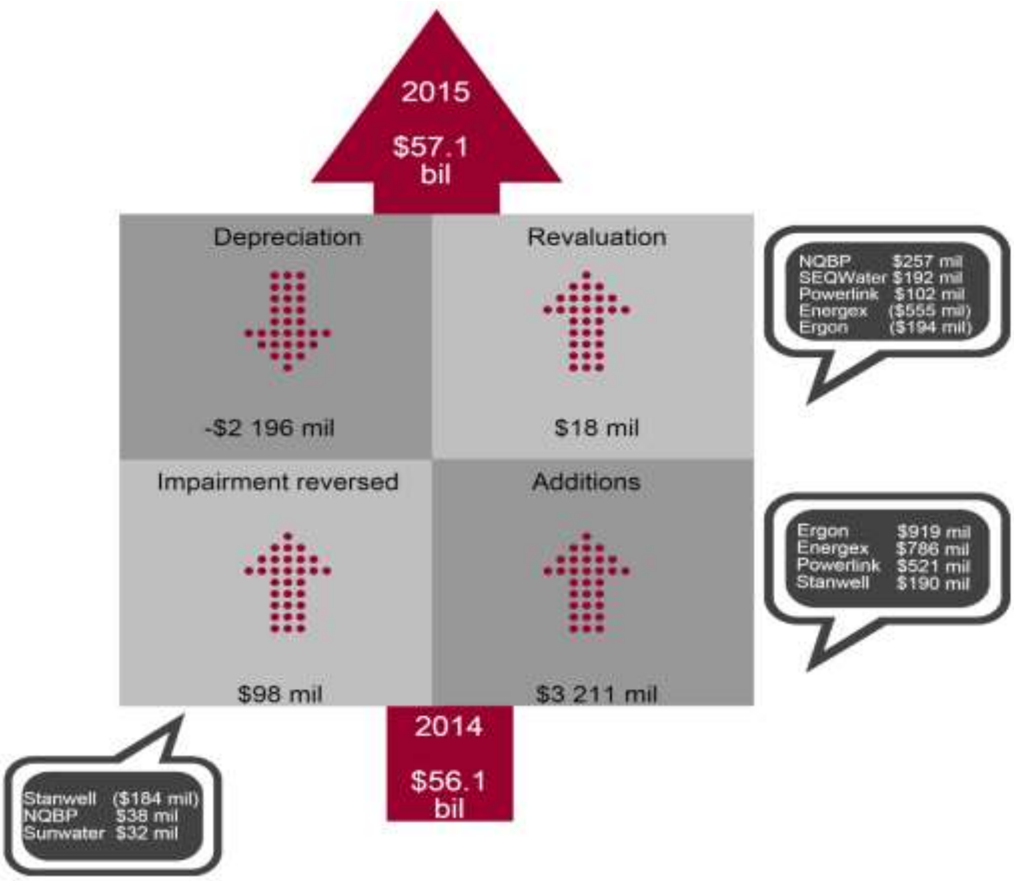
Figure G
Significant infrastructure assets at 30 June 2015



Source: Queensland Audit Office

Figure H shows that apart from renewal and construction of new assets, significant movements were attributable to revaluations and impairments in 2014–15.

Figure H
Significant movements in property, plant and equipment balances 2014–15



Source: Queensland Audit Office

Valuation of assets

AASB 116 *Property, Plant and Equipment* prescribes the accounting treatment for property, plant and equipment so that users of a financial report can discern information about an entity's investments in its property, plant and equipment and the changes in these investments. In the context of PNFCs, AASB 116 gives entities the choice of adopting either the cost or revaluation model when deciding how to value a class of assets for financial reporting purposes. The revaluation model is another way of describing assets recognised at their current fair values.

Where an entity decides to adopt the revaluation model for a class of assets, it is required to choose a valuation technique that will result in the valuation of those assets best approximating their fair values.

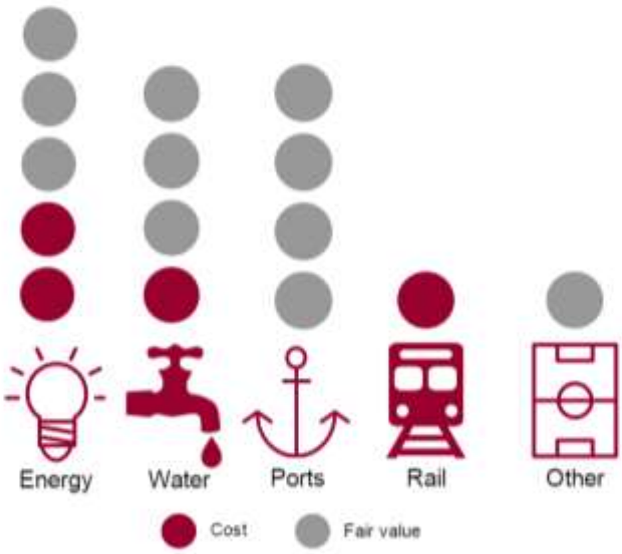
In the PNFC sector, valuing assets for either revaluation or impairment purposes is complex because:

- market based evidence is not available because of the specialised nature of assets
- items are rarely sold, except as part of a continuing business therefore recorded property, plant and equipment balances may not reflect their underlying value
- economic obsolescence or over capacity of the existing assets needs to be factored in
- for ports, changes to dredging cost profiles affecting replacement cost estimation.

Valuations therefore rely on management making appropriate assumptions and reasonable estimates.

PNFC entities use different methods to record their assets in their financial statements. Figure I shows the proportion of those recording at cost compared to fair value.

Figure I
Entities recording assets at cost or fair value



Source: Queensland Audit Office

Appendix I specifies the methods used by each PNFC entity.

Energy generators, SunWater and rail all record their assets at cost. All four ports recorded their assets at fair value. Three of the four incorporated the income-based approach into their valuations. Ports North continues to use depreciated replacement cost to approximate fair value.

In 2014–15 energy network assets were devalued by $645.03 million, while Stanwell reversed previously impaired assets by $184.26 million. Water, ports and stadium assets increased in value by $455.13 million. There were no indicators of potential impairment in the value of rail assets.

Key matters considered by energy and water entities in performing these valuations at 30 June 2015 included:

- differences between allowed rates of return and discount rates used by each entity
- the use of a regulatory rate of return as the discount rate from a market participant perspective under AASB13 *Fair Value Measurement*
- Regulatory Asset Base (RAB) multiples applied in calculating terminal value
- the treatment of under and over recoveries of rate regulated revenue in the entity's forecast of future cash flows.

With respect to Seqwater, we identified an issue surrounding the historical use of pre-tax cash flows and discount rates in infrastructure asset valuations. Prior year figures were amended in the financial report to reflect the restatement of asset valuations using a post-tax basis rather than a pre-tax basis.

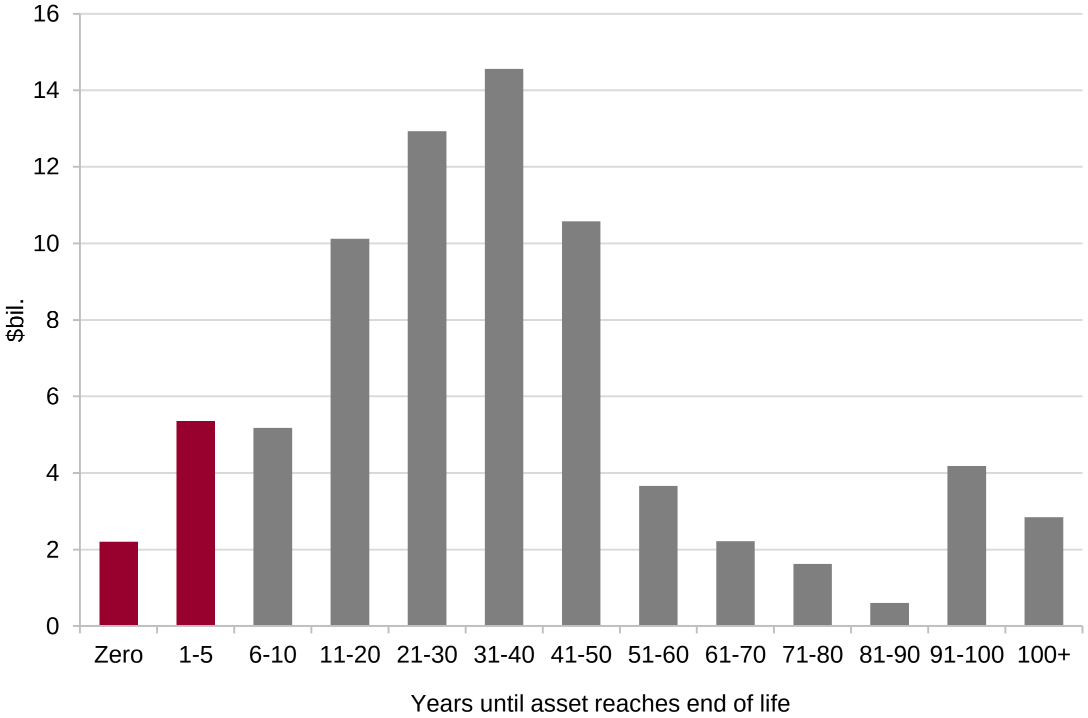
We recommended that ports look into how they can better store the evidence to validate their inputs, estimates and judgements used in cash flow forecasting. Our audit of cash flow models identified common documentation problems of inputs and estimates, these are summarised in Appendix I.

Overall, we accepted the inputs and assumptions used in PNFC 2014–15 valuation models. The methodology and approaches used by PNFC entities complied with accounting standards requirements for fair value measurement at 30 June 2015 and our view of generally accepted valuation techniques.

Useful life of infrastructure assets

As part of our financial statement audit, we examine assumptions used by management about the remaining useful lives of their property, plant and equipment balances. From the data collected this year, we profiled the remaining life of infrastructure assets. Figure J shows the cost and timing of when these assets are estimated to reach the end of their useful lives. We used accumulated depreciation and written down values to approximate cost in the absence of actual replacement costs.

Figure J
Cost and remaining life of PNFC infrastructure assets at 30 June 2015



Note: We have excluded channel related infrastructure assets from our analysis as we have assumed these assets are maintained continuously and therefore costs will not be incurred to replace these assets.

Source: Queensland Audit Office

Although the cost to replace these assets in the future may differ from that recorded in asset registers, we identified that assets with a total recorded cost of $6.38 billion (9.5 per cent) will reach the end of their accounting life by 2020. Of this, $1.93 billion (2.8 per cent) already have a zero value recorded in the asset registers at 30 June 2015.

The energy sector dominates the graph due to the size of its portfolio, with spikes through the 20 to 50 year range. For energy generation, $3.88 billion (62.7 per cent) of infrastructure assets will expire 20 to 30 years from now. For energy networks, $18.71 billion (46.1 per cent) of infrastructure assets will reach the end of their life in 30 to 50 years.

In the water sector, Seqwater has assets of $689 million expiring over the next 10 years. A significant portion of this amount relates to assets at Mount Crosby. These assets are critical to the water network, supplying the majority of drinking water to the Brisbane and Ipswich regions. Additional assets that will reach the end of their life within 10 years include those at Gibson Island ($51 million), North Pine ($75 million), Sparkes Hill to Green Hill ($35 million) and components of the Tugun Advanced Water Treatment Plant ($48 million). We acknowledge that there has been a significant program of maintenance undertaken to the water treatment plants to ensure a continued safe, secure and reliable water supply.

Our analysis also found that $913 million (49 per cent) of port infrastructure assets (excluding channel assets) need replacing over the next 20 years.

Due to the strategic importance of the maintenance dredging programs for channel assets at each significant port, the condition of channel assets will not deteriorate to the point where replacement is required. Channel assets represent 98 per cent ($931.2 million) of the gross value of all port assets that have remaining lives of more than 50 years. It is expected that these assets will provide service potential well beyond 50 years.

For rail, nearly 20 000 infrastructure assets with a total gross cost of $1.5 billion will reach the end of their useful life by 2025. Rollingstock assets make up 72 per cent of the gross value of infrastructure assets reaching the end of their useful life in the next five years. This is primarily due to the planned early retirement of Citytrain Rollingstock with the introduction of the New Generation Rollingstock (NGR) fleet, scheduled to commence in 2016.

As at 30 June 2015, Queensland Rail (QR) had more than 9 000 infrastructure assets in use that have reached the end of their expected useful life. These assets have a reported gross historic cost of $218 million, however their expected current replacement cost is more than $1 billion.

While these assets have an accounting book value of nil or scrap value, we acknowledge that QR asset management practices include the regular assessment of the expected remaining operational lives of these assets.

Energy restructure

Since our last report the new government has committed to retaining the energy commercial businesses in state government ownership. The government as part of its 2015 election commitments is considering options of merging energy businesses.

On 29 June 2015 network entities received a shareholding Ministers direction requiring the payment of special dividends totalling $3.13 billion plus 100 per cent of net profit after tax totalling $1.36 billion for the 2014–15 year. Dividends are from both realised and unrealised gains in the form of retained earnings of $3.08 billion and asset revaluation reserves of $1.41 billion.

Before GOC boards declared dividends at 30 June 2015, they satisfied themselves that they met the solvency tests of section 254T of the *Corporations Act 2001* in that:

- assets exceeded liabilities immediately before the dividends were declared and the excess was sufficient for the payment of the dividend
- the payment of dividends is fair and reasonable to shareholders as a whole
- the payment of dividends does not materially prejudice ability to pay creditors.

We found the treatment of dividends by network entities to be in accordance with legislative requirements and accounting standards.

Payments made through increased loans under the state borrowing program in November 2015 will substantially increase the regulated asset base (RAB) gearing ratios for all network entities. The Australian Energy Regulator (AER) sets a benchmark of 60 per cent, expecting that efficient network businesses would fund their investments by borrowing 60 per cent of the required funds, while raising the remaining 40 per cent from equity.

Where the AER allowance does not match, the regearing by the state government may set the ratios at levels above that used by the AER. This means that entities may need to re-prioritise capital programs or seek alternate approaches to close the gap where the AER allowance does not match the network entities' desired level of capital works. Where entities are unable to re-prioritise or fund projects, higher maintenance costs may be incurred to extend the life of existing assets.

Energy under-recovery of revenue

In January 2015 the Australian Accounting Standards Board (AASB) formalised their position on rate regulated activities, stating that they do not believe regulatory deferral account balances meet the definition of assets and liabilities. This provided a firm position for Australian entities to consider and triggered a change in accounting treatment of the $1.48 billion recognised across network entities at 30 June 2014. Distributors derecognised their balances retrospectively, while Powerlink will apply the change during the 2014–15 financial year due to immateriality of their balance. Now, revenue is recognised in income statements when it is billed, rather than accruing for differences between revenue caps and actual electricity consumed.

A description of the event highlighting the triggers for change was included in the financial report of each entity.

Financial snapshot

In forming our audit opinion on the financial report of each entity, we must assess its ability to operate as a going concern. As part of this process, we assess its financial performance, position and sustainability.

PNFCs have been, and remain, financially sustainable in the short to medium term.

The longer-term financial sustainability of CS Energy Limited (CS Energy), Seqwater, QR and Stadiums Queensland remains dependent on a number of pricing, funding and other business factors.

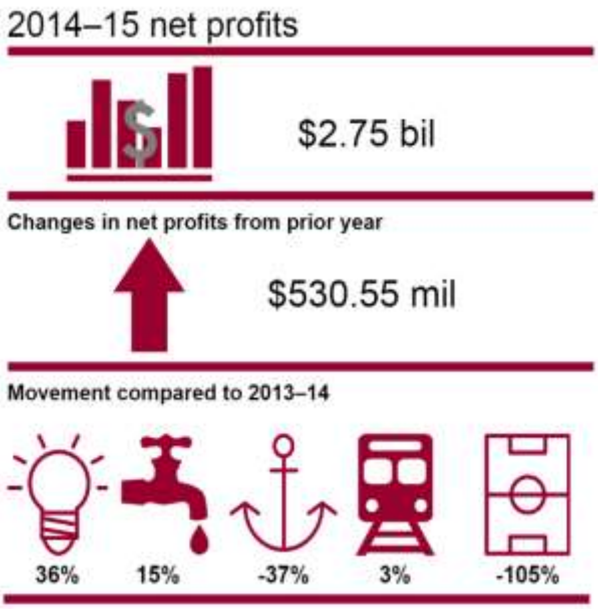
The sustainability of energy networks is dependent on future revenue allowed by the AER, their ability of adapt to the new dividend payout ratio and future directions given by shareholding ministers.

PNFCs agree upon a number of financial ratio benchmarks with shareholding ministers in their annual statements of corporate intent and operational plans. This year we gathered key financial data and ratios for all entities within the PNFC report as detailed in Appendix E and F.

Net profit before tax

Figure K provides a snapshot of the movement in the net profit before tax at the whole of PNFC sector level and by industry, compared to the financial year 2013–14.

Figure K
PNFC sector movement in net profit before tax



Source: Queensland Audit Office

The PNFC sector as a whole recorded a net profit before tax of $2.75 billion ($1.90 billion after tax) for the 2014–15 financial year. Of this, $12.66 billion flowed in as revenue and $9.91 billion was expended in delivering services to Queensland. This represents a 24 per cent increase on net profit before tax recorded in 2013–14.

Energy sector net profit increased this year by $661.9 million compared to 2013–14. Increases in revenue resulted from generator reversal of past asset impairment, and from the re-measurement of onerous contract and rehabilitation provisions. Decreases in electricity pool sales, contract settlements (because of the repeal of carbon tax) and coal sharing rebates were offset by increases in pass through costs and gas trading. Expenditure savings also resulted from the removal of carbon tax legislation.

CS Energy continues to report underlying losses in their income statement. The profit position in 2014–15 results only from the onerous contract provision movement of $194.58 million, and without this CS Energy would be in the loss position as initially forecasted by management. A net loss before tax would have been recorded of $17.13 million, and the return on equity ratio would be -2.97 per cent instead of 30.58 per cent shown in appendix E. CS Energy's future sustainability continues to depend on ongoing access to undrawn debt facilities with Queensland Treasury Corporation (QTC) and continued state government support.

Changes in energy network revenue resulted from the de-recognition of under recovery accruals offset by gains on derivative instruments after Ergon's implementation of hedge accounting. It also resulted from increased AER approved revenue allowance impacts on distribution tariff rates and electricity consumption charges.

For the water sector, revenue increased by $95.7 million due to rises in bulk water prices recommended by the Queensland Competition Authority and accepted by the state government, as well as increases in industrial water charges. This was offset by reduced income tax credits utilised by Seqwater and impairment of assets held by SunWater with substantial damage to infrastructure assets, which will not be recovered through customer charges, and low water demand.

Net profit before tax achieved by the ports sector decreased by $80.1 million on the previous year with NQBP incurring further financial losses with further project costs written-off. Gladstone Ports Corporation performed less work on behalf of other companies resulting in $194 million less revenue this year.

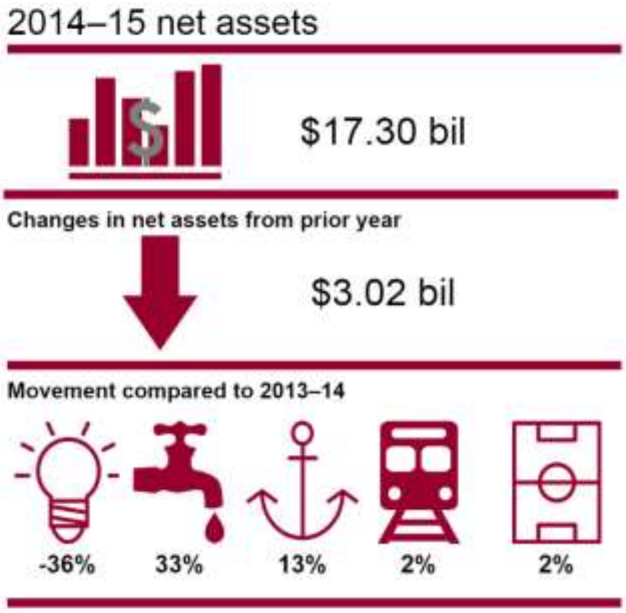
QR reported a $10 million increase in net profit before tax due in part to reduced employee expenses despite earning $35 million less in transport services contract revenue from government.

Stadiums Queensland incurred a $37.9 million operating loss for 2014–15, which included government grant revenue of $32.1 million and depreciation expense of $54.8 million.

Net assets

Figure L provides a snapshot of the movement in the net assets at the whole of PNFC sector level and by industry, compared to the financial year 2013–14.

Figure L
PNFC sector movement in net assets



Source: Queensland Audit Office

The PNFC sector as a whole held $17.3 billion in net assets at 30 June 2015. Of this, $64.01 billion was recorded for assets and $46.71 billion for liabilities. This represents a decrease of 17.4 per cent compared to 2013–14.

For the energy sector, net assets decreased compared to 2013–14. Liabilities substantially increased after a direction by shareholding ministers for network entities to declare additional dividends at 30 June 2015. Asset balances decreased marginally due to revaluation movements offset by new assets constructed this year.

Net assets increased by $5.6 million across the water sector. While a revaluation increment was recognised in the 2014–15 financial statements for Seqwater, the company also borrowed a further $110 million.

Port sector net assets increased by 13 per cent due mainly to increases in the reported value of physical assets through revaluation adjustments.

No significant movements occurred for the rail and other PNFC entities.

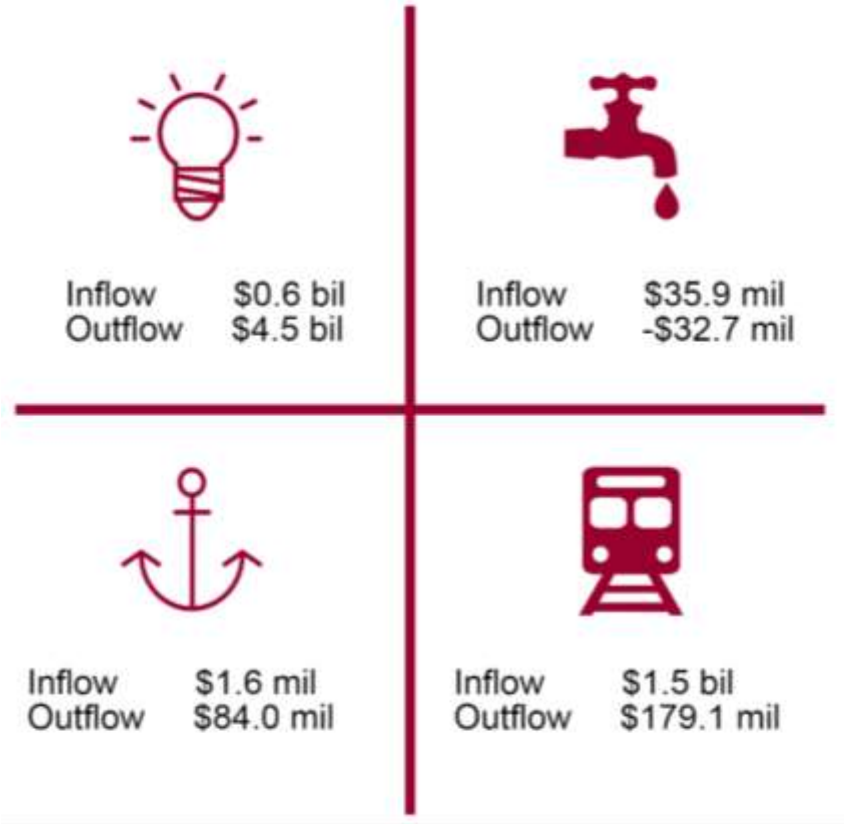
Net flows with government

Most PNFCs pay dividends, income tax and competitive neutrality fees (CNFs) to the government and receive community service obligation (CSO) payments, grants and net equity contributions from government for selected activities.

The PNFC sector provided total net returns to government of $3.69 billion in 2014–15 compared to $1.16 billion in 2013–14.

Figure M shows the inflow of monies received from government and outflow of monies remitted back to government from major PNFC entities during 2014–15.

Figure M
PNFC flows with government 2014–15



Note: Amounts represent accrual figures unless otherwise stated. Amounts also exclude coal royalties and payroll tax remitted to state government. Total outflows for the water sector included $66.86 million in income tax credits for Seqwater, resulting in an overall negative outflow for the water sector.

Source: Queensland Audit Office

The energy sector returned $4.58 billion in declared dividends after a direction by the shareholding minister to increase the dividend payout ratio from 80 to 100 per cent of net profit after tax and pay special dividends to regear network entities in 2015–16. Returns are likely to reduce in future years with the AER's regulatory decision to cut revenue significantly for both the Energex and Ergon businesses.

CSO payments, transport service contracts and other grant payments of $2.22 billion were the significant contributions that government made into the PNFC sector. Energy distributors were paid $626 million, SunWater $11.2 million and Seqwater $2.1 million to deliver services that cost more than they could collect in tariff revenue. QR received $1.53 billion for transport services it provided this year.

Entities paid $226.6 million in CNFs to government. CNFs are designed to compensate for the net competitive advantage that GOCs enjoy over their competitors as a result of public sector ownership. The energy businesses and QR contributed 80 per cent of CNFs paid to government.

Sustainability

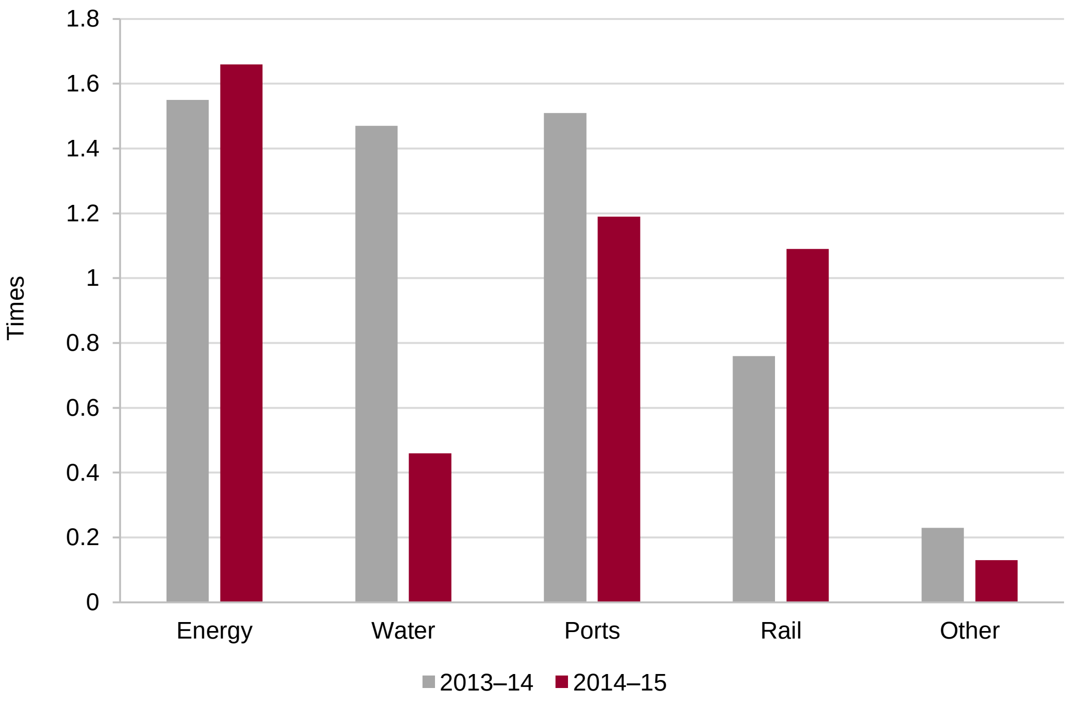
Current year performance and position are important indicators of financial health. Recent experience is also a leading indicator for identifying adverse trends and possible weaknesses that could affect future sustainability. We used the following ratios derived from the published financial reports to conduct this analysis — capital replenishment ratio, debt to revenue ratio and return on equity.

When considered together, the results of these three ratios indicate that PNFCs are financially sustainable in the short to medium term. As a sector, PNFCs are generally generating sufficient income to replace and add to their stock of assets at a rate faster than they are depreciating, and they are maintaining stable debt levels when compared to the revenue generated.

Capital Replenishment Ratio

The capital replenishment ratio compares the annual net investment in non-current assets to the annual depreciation charge. An average ratio below one, over time, indicates that assets are being built or replaced slower than the asset base is depreciating. Figure N shows the results from our capital replenishment ratio analysis.

Figure N
Capital replenishment ratio by industry



Note: QR's ratio does not account for capital spend in the wider rail sector on new generation rolling stock. Queensland Treasury Holdings Pty Ltd (QTH) does not hold any PPE or Intangibles, therefore the capital replenishment ratio for entities included in the 'other' sector relates to Stadiums Queensland only.

Source: Queensland Audit Office

Across the PNFC sector, the capital replenishment ratio has decreased marginally from 1.36 to 1.34 times in 2014–15. As a sector, we note that PNFCs are replacing their assets at a rate faster that their existing assets are been depreciated, spending $1.34 on new assets for every dollar of depreciation in 2014–15.

The ratio for water decreased significantly from 2013–14 with significant investment ending in SunWater water supply assets at Woleebee Creek.

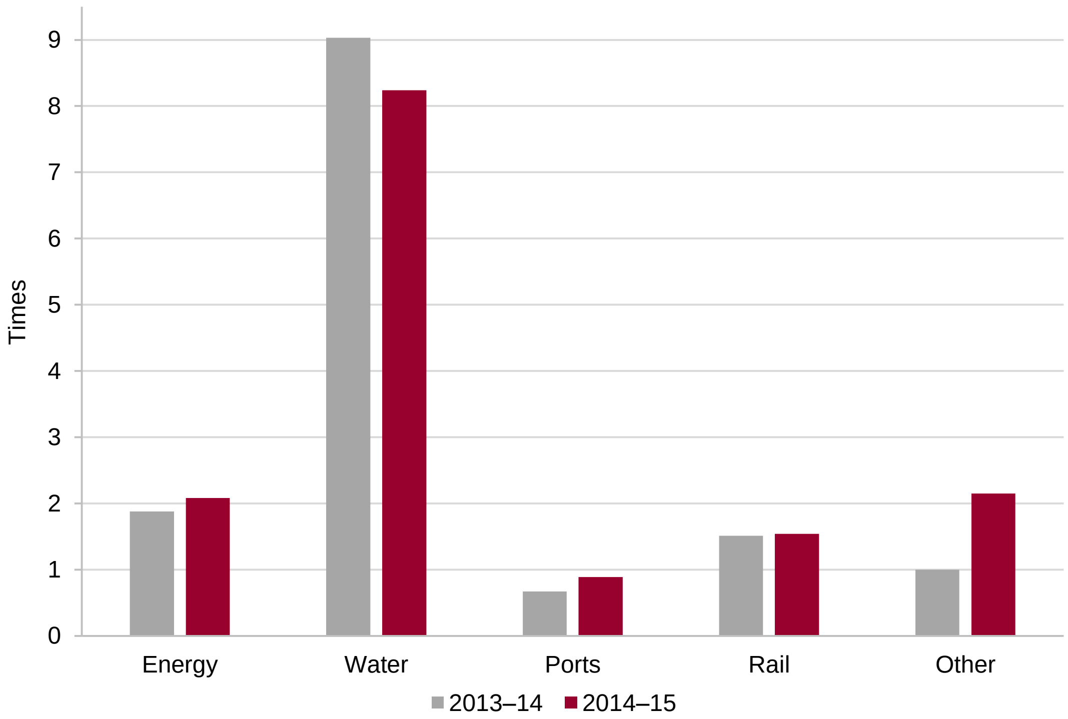
The ratio for ports decreased through higher depreciation expenses in 2014–15 as a flow on from increased asset values in 2013–14. Reduced expenditure on non-current assets in 2014–15 and a higher value of capital projects completed in 2013–14 also contributed to a lower capital replenishment ratio.

The ratio for rail increased through 2014–15 capital expenditure on the Lawnton to Petrie third track.

Debt to Revenue Ratio

The debt to revenue ratio assesses an entity's ability to pay the principal and interest on borrowings when they fall due from the funds that the entity generates. Debt for the purposes of this ratio includes only borrowings through QTC and does not include other liabilities such as trade creditors. Figure O shows the results from our debt to revenue ratio analysis.

Figure O
Debt to revenue ratio by industry



Source: Queensland Audit Office

Across the PNFC sector, the debt to revenue ratio has increased from 2.30 to 2.51 times in 2014–15. The value of debt held by all PNFCs as at 30 June 2015 was 2.5 times that of the combined revenues earned by all PNFCs in 2014–15. These ratios have proved to be sustainable because PNFCs have generally been able to fund their ongoing expenditure, and replace and grow their assets, without incurring any significant increases in the level of debt they hold as a proportion of revenue they generate.

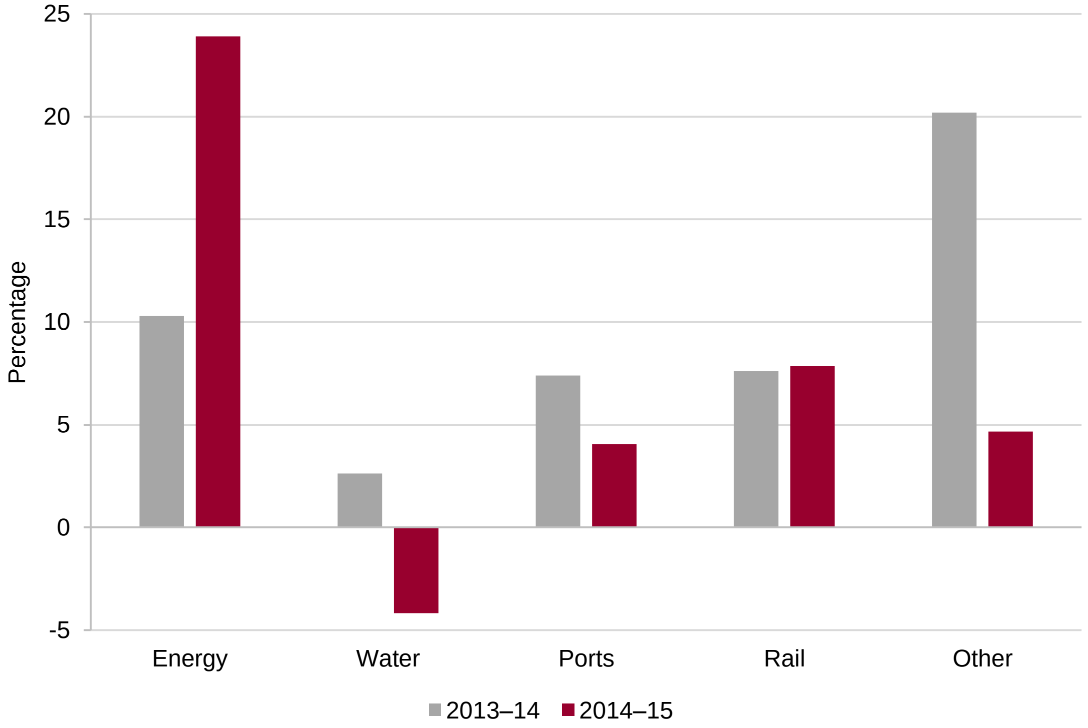
Debt to revenue for the energy sector has declined marginally. It will increase in 2015–16 when network entities make 2014–15 dividend payments funded primarily through increased borrowings with QTC where cash is not available to fund these payments. The sustainability of network entities over the next five years will be dependent on their ability to fund new dividend payout ratios, outcomes of AER revenue determinations and any further directions given by shareholding ministers over that period.

The water sector continues to have the highest debt to revenue ratio (8.24 times as at 30 June 2015). This is largely because of the $9.3 billion of loans held by Seqwater to fund the construction of its manufactured water assets, combined with borrowings it incurred because the bulk water prices it charges in South East Queensland continue to be less than the cost of supplying this water. This would not be a sustainable position for a fully commercial entity.

Return on Equity

Return of equity is a measure of total surplus or deficit after tax as a percentage of shareholder's equity. Figure P shows the results from our analysis of return of equity.

Figure P
Return on equity by industry



Note: The return on equity ratio for entities included in the 'other' sector relates to Queensland Treasury Holdings Pty Ltd only.

Source: Queensland Audit Office

Across the PNFC sector, the return on equity has increased from 8.65 times to 11 times in 2014–15. From the five groups of PNFCs in this report, water and other PNFCs recorded a negative return attributed to the operating losses incurred respectively by Seqwater and Stadiums Queensland. Seqwater utilised more tax credits in 2013-14 in comparison to 2014–15. In 2013–14, the tax credits resulted in an operating profit of $2.8 million and was a contributing factor for a positive return on equity in 2013–14.

Energy businesses provided the higher reported ratios with a return on equity of 23.9 per cent in 2014–15. The ratio increased by 13.6 per cent because of the liabilities for dividends declared at 30 June 2015 together with higher 2014–15 profits.

The ports sector ratio decrease was driven largely by a reduction in Gladstone Ports revenue earned for infrastructure projects on Curtis Island, and the impact of NQBP's asset valuation increment in 2014–15.

The substantial decrease in return on equity for QTH (included in 'other' entities) is largely attributable to a 75 per cent decrease in net profit. The reduction in profits is primarily due to a one-off sale of Aurizon shares in the 2013–14 year causing a spike in QTH revenues for that year.

Reference to comments

In accordance with s.64 of the *Auditor-General Act 2009*, we provided sections of this report to relevant entities, with a request for comment.

We provided sections of this report to the Minister for Main Roads, Road Safety and Ports and Minister for Energy and Water Supply; the Minister for Transport, Minister for Infrastructure, Local Government and Planning and Minister for Trade; the Minister for Agriculture and Fisheries and Minister for Sport and Racing. Treasurer, Minister for Employment and Industrial Relations and Minister for Aboriginal and Torres Strait Islander Partnerships, the Director-General, Department of Energy and Water Supply; the Director-General, Department of Transport and Main Roads; the Director-General, Department of National Parks, Sport and Racing; and the Under Treasurer, Queensland Treasury for comment.

We provided copies of the report to the Premier, the Treasurer and the Department of the Premier and Cabinet for information.

We have considered all comments received within 21 days and incorporated these in this report to the extent warranted. Comments received or a fair summary are included at Appendix A.

1. Context

This chapter provides information on the scope of this report, the financial reporting framework and audit requirements of entities in the public non-financial corporation (PNFC) sector. We provide context about the audit results and key matters sections of each chapter.

Scope of report

The PNFC sector comprises bodies that provide non-regulatory, non-financial market goods and services. Sales to consumers finance PNFCs, while government subsidises community service obligations and other services. PNFCs are legally distinct from the governments that own them.

Queensland Treasury and Trade determines the entities included in the PNFC sector.

This report does not include the results of PNFC entities ceasing to exist before 1 July 2014.

Entities in this report have different functions and regulatory requirements within the PNFC sector and the industries in which they operate. This limits the comparability of their financial performance and financial position.

Some accounting standards allow entities to choose between accounting treatments. The accounting policies entities choose may measure or report transactions and balances differently.

This report excludes the results of our audits of Queensland local governments, universities, grammar schools, Hospital and Health Services, general government sector entities, public financial corporations and the Queensland state government financial report, all of which we report separately to parliament.

Our report on state public sector entities contains the results of our audits of the financial reports for departments, statutory bodies and government owned corporations (GOC) excluding PNFCs, with a 30 June 2015 balance date. It also includes results of other audits of entities that are not public sector entities.

PNFC responsibilities

Legislative framework

The Auditor-General of Queensland, supported by the Queensland Audit Office, provides parliament with independent assurance on the financial statements of public sector entities to ensure public sector accountability. Our financial audits form our audit opinions and our reports to parliament on the results of our financial audits deliver this assurance.

This report to parliament relates to the result of financial audits of 2014–15 public sector financial statements—specifically state statutory bodies and GOCs within the PNFC sector and the entities that they control.

These public sector entities prepare their financial statements and annual reports under:

- the Financial and Performance Management Standard 2009—statutory bodies
- Government Owned Corporation Regulation 2004 (GOC Regulation)—government owned corporations
- Corporations Act 2001 (Cth)—controlled entities that are public companies.

Legislated deadlines

The Financial and Performance Management Standard 2009 requires statutory bodies to have their financial statements finalised and audited no later than two months after the end of the financial year to which the statements relate, that is, by 31 August 2015. This is also the deadline for GOCs, as required by the GOC Regulation.

The appropriate Minister must table annual reports of statutory bodies in parliament no later than three months after the end of the financial year. The Minister may extend the tabling period for the annual report by notice given to the department or the statutory body.

The *Corporations Act 2001* requires most controlled entities of statutory bodies and government owned corporations to issue their annual reports no later than four months after the end of the financial year.

Queensland Treasury requires annual reports of controlled entities of statutory bodies to be tabled in parliament.

Other reporting requirements

In addition to 30 June financial reports and whole of government reporting, energy generators and Ergon Energy submit financial reports to the Australian Securities and Investments Commission (ASIC) as part of maintaining their Australian Financial Services Licences.

Audit responsibilities

Section 40 of the *Auditor-General Act 2009* requires the Auditor-General to audit the annual financial reports of all PNFC entities and to prepare an auditor's report. The auditor's report, which includes the audit opinion, provides assurance about the reliability of the financial reports, including compliance with legislative requirements.

The Auditor-General also performs other engagements over information not included in annual financial reports. For the purposes of this report, these other engagements include:

- audit of historical actual financial information
- review of historical estimated financial information
- review of historical non-financial information.

We issue a combination of audit opinions and conclusions for other information engagements. Audit opinions are issued over actual historical financial information based on an evaluation of the work performed by the auditor. A conclusion provides the reader with less assurance and indicates whether anything has come to the attention of the auditor which users of the information should be made aware. The different types of audit opinions and review conclusions issued for annual financial reports and other information engagements are listed in Figure 1A.

Figure 1A
Types of audit opinions and conclusions issued

Type of information	Report issued	Auditing standard	Basis of opinion or conclusion
Annual financial report	Audit	Auditing Standard ASA 700—Forming an Opinion and Reporting on a Financial Report	Whether the report is prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework.
Other historical actual financial information	Audit	ASA 805 Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement	Whether information is presented fairly in accordance with requirements and the entity's basis of preparation.
Other historical estimated financial information	Review	ASRE 2405 Review of Historical Financial Information Other than a Financial Report	Whether or not anything has come to the auditor's attention that causes it to believe that the estimated financial information is not, in all material respects, presented fairly in accordance with the requirements and the entity's basis of preparation.
Non-financial actual and estimated information	Review	ASAE 3000 Assurance engagements other than audits or reviews of historical financial information	Whether or not anything has come to the auditor's attention that causes it to believe that the historical non-financial information is not, in all material respects, presented fairly in accordance with the requirements and the entity's basis of preparation.

Source: Queensland Audit Office

When issuing an audit opinion, we may report one or more of the audit opinion types outlined in Figure 1B.

Figure 1B
Audit opinions

Opinion	Description
Unqualified	We issue an unqualified opinion where the financial reports comply with relevant accounting standards and prescribed requirements.
Qualification	We issue a qualified opinion when the financial reports as a whole comply with relevant accounting standards and legislative requirements, but with particular exceptions.
Adverse	We issue an adverse opinion when the financial reports as a whole do not comply with relevant accounting standards and legislative requirements.
Disclaimer	We issue a disclaimer of opinion when we are unable to express an opinion as to whether the financial reports comply with relevant accounting standards and legislative requirements.

Source: Queensland Audit Office

We may include an emphasis of matter paragraph with an audit opinion to highlight an issue of which we believe the users need to be aware of. These paragraphs can also be included in review reports. The inclusion of an emphasis of matter paragraph does not modify the opinion or conclusion made.

For annual financial reports, after we issue the audit opinion we are required under the *Auditor-General Act 2009* to provide a copy of the certified statements and the auditor's report to the Chief Executive Officer of the entity and the appropriate Minister. For other engagements, we provide certified information direct to the Chief Executive Officer.

The Act also requires the Auditor-General to prepare a report to parliament on each audit. The report must state if the audit has been completed and the financial reports audited. It must also include details of significant deficiencies where financial management functions were not performed adequately or properly and any actions taken to improve deficiencies reported in previous reports.

This report satisfies these requirements.

Sector chapters

Audit results

Timeliness and quality of financial reports

Each entity should establish financial management systems that identify and manage financial risks, including risks to reliable and timely reporting. Entities must review the performance of financial management systems regularly.

Effective financial systems can produce timely and reliable financial information for management, directors and users of electricity services. An efficient system will integrate internal management reporting with external accountability reporting.

To show accountability in the use of public monies, entities should prepare and publish their financial information as soon as possible after the end of the financial year. The later entities produce and publish financial reports after their balance date, the less useful financial reporting is to stakeholders and for the purpose of informed decision making.

Each entity agrees with us the dates to provide draft financial reports for audit. This is usually through an audit strategy document we give to the entity at the end of our planning visit, confirmed with a letter to the entity before our final visit for the audit year.

Financial report process

Most PNFC entities have pro forma financial reports agreed by their external auditors and their audit committees each year. This practice helps detect qualitative errors before 30 June, reduces entities' workload at year end and allows enough time to consider disclosure issues in a methodical and timely manner.

Financial results may still require adjustments to year end disclosure. We raise errors reported in financial data with management, as we are required to correct any material errors to issue an unqualified audit opinion. The entity may also change its draft financial reports after submitting them to audit, to correct or complete reported information or improve readability.

Key audit matters we raised with entities

In forming our audit opinion, we must resolve any key audit matters we identify during an audit to ensure the financial report is not materially misstated. This report covers the significant matters we reviewed in forming our opinions during the 2014–15 audits.

Report structure and cost

The remainder of this report is structured as follows:

Chapter	Description
Chapters 2 to 6	Discuss the results of the each sector's audits for the reporting entities across energy (chapter 2), water (chapter 3), ports (chapter 4), rail (chapter 5) and other PNFCs (chapter 6), including the timeliness and quality of their draft financial reports and key audit matters we identified. We also provide a snapshot of PNFC finances at 30 June 2015 for major entities within each sector identifying issues affecting their financial sustainability and their position to meet their future financial obligations.
Appendix A	Contains responses received.
Appendix B	Contains a glossary.
Appendix C	Lists sector entities for which we will not issue audit opinions in 2014–15.
Appendix D	Summarises audit opinions issued in 2014–15.
Appendix E	Details financial data used in our analysis of financial statements.
Appendix F	Details the net flows between government and PNFC entities.
Appendix G	Summaries our observations about discounted cash flow models used by the ports sector.
Appendix H	Summaries the accounting techniques used by PNFC entities to account for property, plant and equipment in their financial statements.

The cost of preparing this report was $230 000.

2. Energy sector

In brief

In Queensland, a combination of government owned and privately owned generators contribute to the east coast national electricity grid.

The main suppliers are Stanwell Corporation Limited (Stanwell) and CS Energy Limited (CS Energy). Queensland Electricity Transmission Corporation (trading as Powerlink) transports electricity at high voltage between generators and distributors who connect to businesses and households, and some direct connect high voltage customers. In South East Queensland, Energex Limited operates the distribution network. Outside South East Queensland, Ergon Energy Corporation Limited (EECL) operates the distribution network. The main interfaces between distributors and customers are retailers. All retailers in Queensland are privately owned, except for Ergon Energy Queensland Pty Ltd, a subsidiary of EECL, which provides retail services outside South East Queensland and generators selling direct to some large industrial customers.

This chapter details the results of our audits and key matters we looked at in forming our opinions.

Conclusion

The financial reports of all energy government owned corporations (GOCs) and controlled entities were timely and of good quality.

Energy GOCs are financially sustainable, except for CS Energy. CS Energy's future sustainability continues to depend on ongoing access to undrawn debt facilities with Queensland Treasury Corporation (QTC) and continued state government support. The sustainability of network entities is dependent on future revenue allowed by the Australian Electricity Regulator (AER), their ability to adapt to the new dividend payout ratio and future directions given by shareholding ministers.

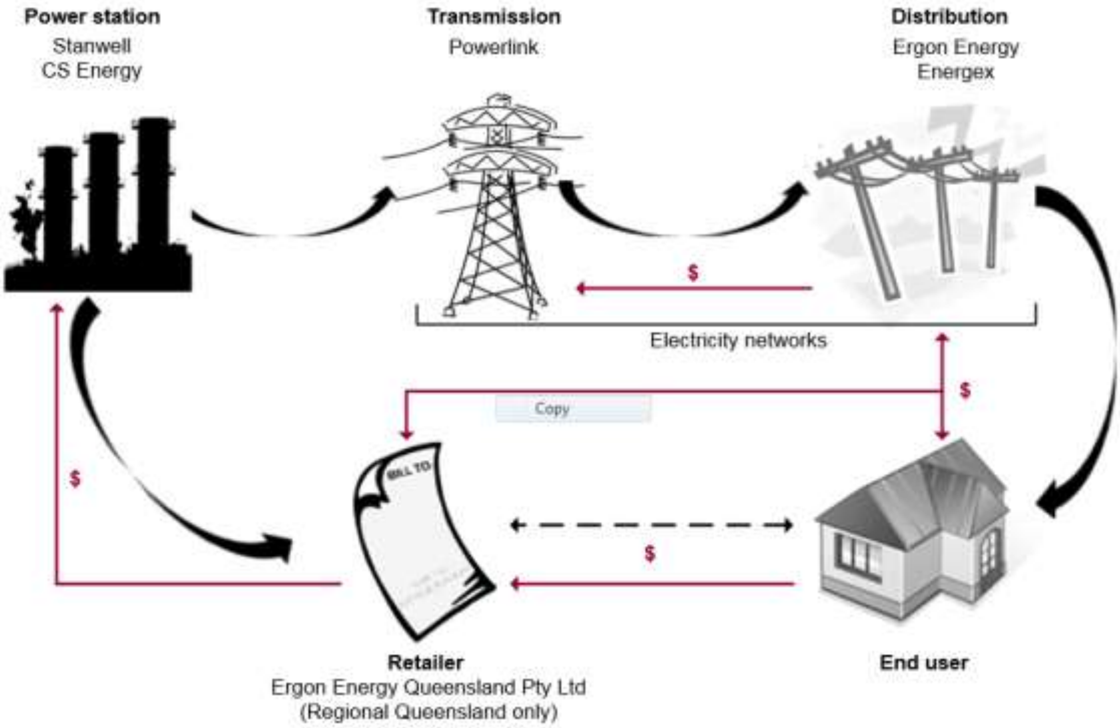
Audit results and key matters

- All entities reviewed pro forma financial statements prior to 30 June. Five out of eight entities provided draft financial reports for audit by their agreed milestones. We certified all reports by legislative deadlines and issued unqualified opinions for all entities.
- We conducted six regulatory engagements across Ergon and Energex, issuing six audit opinions and six conclusions. Emphasis of matters were included in all certificates highlighting their basis of preparation and intended use.
- The Australian Accounting Standards Board (AASB) position on rate-regulated activities saw network entities derecognise $1.48 billion accrued under recovery of revenue this year. Networks devalued their assets by $645.03 million, while Stanwell reversed impairment totalling $184.26 million.
- We identified that 12.5 per cent of energy infrastructure assets with a total recorded cost of $5.88 billion, will reach the end of their life by 2020. Of this, $1.9 billion (4.1 per cent) have a zero value recorded in the asset registers at 30 June 2015.
- Approximately $3.88 billion (62.7 per cent) of generation infrastructure assets will expire 20 to 30 years from now. For networks, $18.71 billion (46.1 per cent) of infrastructure assets will reach the end of their life in 30 to 50 years.
- Expenditure decreased this year largely due to the removal of carbon tax legislation, accounting re-measurement of provisions and hedged transactions. Liabilities substantially increased after shareholding ministers directed network entities to declare special dividends totalling $3.13 billion plus 100 per cent of their net profit after tax as dividends totalling $1.36 billion for the 2014–15 year. Dividends are sourced through realised and unrealised gains.
- Sustainability ratios will decline in 2015–16 with network entities funding 2014–15 dividends primarily through increased borrowings with QTC. CS Energy's sustainability continues to depend on ongoing access to undrawn debt facilities with QTC and continued state government support.

Energy sector

In Queensland, five GOCs are involved in generating, transmitting and distributing electricity. Figure 2A shows these five and the flow of payments for electricity through the supply chain.

Figure 2A
Queensland electricity GOCS and payment flow through the supply chain



Source: Queensland Audit Office

Generator and network businesses have different revenue streams. Market forces drive generator revenue streams, while the AER determines network revenue in five-year periods leading to a more predictable revenue stream.

Across the state, a combination of government owned electricity generators and privately owned electricity generators contribute to the east coast national electricity market (NEM). The main generators are the state-owned Stanwell and CS Energy.

Once electricity has been generated and sold in the NEM, Queensland Electricity Transmission Corporation Limited (trading as Powerlink) transfers power around Queensland at high voltage between the generators, and the lower voltage networks of Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy) plus some direct connect high voltage customers.

For the purpose of this report, we have referred to Powerlink, Energex and Ergon Energy as network businesses. These three state-owned entities do not have any competition from private sector operators in providing regulated network services.

The main interface between the electricity industry and their customers, such as households and businesses, are the energy retailers. In Queensland, these retailers are privately owned, except for Ergon Energy Queensland Pty Ltd which services regional Queensland and generators selling direct to some large industrial customers.

Current sector context

Queensland electricity sector pricing and demand is changing in response to industry wide reforms and events:

- outcomes of Federal and Queensland government productivity commission inquiries
- state government intention to restructure electricity GOCs to obtain increased productivity and efficiency in service delivery
- AER five-year revenue determinations
- Liquefied Natural Gas (LNG) operations commence as projects are completed
- review of national renewable energy target (RET)
- rooftop photovoltaic (PV) systems.

There is pressure from the AER Senate inquiry into Electricity Networks and State government for the sector to reduce electricity prices.

On 28 April 2015 the Queensland Government announced that it will defer the switch to deregulated pricing (or price monitoring) for South East Queensland for 12 months while the Productivity Commission examines the electricity industry.

The AER in its efforts to reduce pricing is significantly cutting operational and capital expenditure budgets in revenue determinations. In Queensland, final cuts to revenue allowances for distributors are 21.7–23.6 per cent less than initial regulatory proposals. The state government announced on 29 October 2015 that it would direct the energy distributors not to further appeal the final AER decision released in October 2015. The cuts will have a substantial effect on network operations, funding and asset management practices will have to change to accommodate such large reductions in revenue.

On the demand side, Australian Energy Market Operator (AEMO) in June 2015 forecasted consumption by the Queensland LNG projects to increase from 1 063 GWh to 9 075 GWh (104.4 per cent annually) as all three projects become operational and reach estimated production capacity in 2017–18. Excluding LNG, industrial consumption is expected to decrease at an average annual rate of 0.2 per cent, mainly attributable to the closure of the Bulwer Island refinery. Ongoing generator profits in Queensland remain largely dependent on LNG demand.

The National Renewable Energy Target (RET) scheme aims to meet a renewable energy target of 20 per cent by 2020. The scheme requires electricity retailers to source a proportion of their electricity from renewable sources developed after 1997. Under this banner, the ongoing existence of coal-fired generators is being questioned. The state government is also seeking to increase the number of rooftop and large industrial site solar panel installations further affecting the way our state generates electricity. AEMO expects daily maximum demand to shift to later in the day due to demand being offset by rooftop PV generation. The way we consume electricity coupled with the continued uptake of rooftop PV means that the change between low and high demand periods during the day is more significant and happens more quickly.

Generators need the capability to respond—ramping up electricity production to cope with these sudden and significant changes in demand. For distributors PV introduces the need for the poles and wire network to effectively deal with two-way electricity flow, stabilising voltage availability for consumers. As an industry, addressing demand and pricing issues will aim to ensure services delivered are efficient and effective through demand smoothing and consumer price signalling.

Entities covered in this chapter

The Queensland energy sector comprises five GOCs, one jointly controlled entity established to provide information and communications technology services to the two electricity distributors, and 31 controlled entities. Due to reasons listed in Appendix C, only eight of these entities prepare financial reports. The sector also includes seven joint venture interests and a foreign-based entity, all audited by private sector firms. All entities have a 30 June balance date.

This report does not include the results of other energy sector PNFCs which ceased to exist before 1 July 2014.

Conclusions

We certified unqualified audit opinions of all energy PNFCs included in this report. Readers can rely on the results in the audited financial reports of these entities.

We completed audits within legislative deadlines and we received good quality draft financial reports as part of this process.

When forming an audit opinion on the financial report of an entity, we assess the entity's financial performance, position and sustainability to operate as a going concern. CS Energy's future sustainability continues to depend on ongoing access to undrawn debt facilities with QTC and continued state government support.

We found that the treatment of special dividends by network entities is in accordance with legislative requirements and accounting standards, with GOC Boards having considered solvency requirements at 30 June 2015.

The payment of special dividends by network entities will substantially increase their gearing ratios. The AER sets a benchmark of 60 per cent, expecting that efficient network businesses would fund their investments by borrowing 60 per cent of the required funds, while raising the remaining 40 per cent from equity. Where funding allowed by the AER does not match the network entities desired level of capital works, they will need to source funding from alternative means to close the gap.

Audit results

Financial reports

Figure D1 in Appendix D summarises opinions issued for the sector during 2014–15.

Five out of eight entities provided draft financial reports for audit by their agreed milestones. Management and audit certified financial reports for all eight entities by their legislative deadlines.

The Queensland Audit Office (QAO) reviewed pro forma financial statements for all entities prior to 30 June 2015, and simplified financial statements through the removal of immaterial disclosures and duplication and re-grouping like information.

At year end, entities did not make material changes to draft financial reports in 2014–15. However, entities did make changes to reclassifications between line items to make the statements more readable. These did not affect the net operating result or net assets disclosed. Most changes aimed to improve quality and understanding of the financial reports.

Distribution entities made adjustments to 2013–14 figures disclosed in the 2014–15 financial reports, reflecting de-recognition of under recovery of revenue balances. Powerlink also elected to discontinue deferral accounting for these balances. Stanwell adjusted prior period figures to account for retail contracts using AASB 118 as opposed to AASB 139.

Overall, prior period adjustments decreased net profit after tax reported in 2013–14 by $369.29 million and decreased net assets by $1.03 billion.

We issued unqualified audit opinions for all five GOCs and the three reporting entities they control. This is consistent with 2013–14 and confirms financial reports have been prepared according to requirements of legislation and relevant accounting standards.

Regulatory information notices

The AER requires network businesses to provide, prepare and maintain information in the manner and form specified in each notice. Certain aspects of the information are subject to either audit or review. The information is separated into both financial and non-financial, with QAO undertaking only the financial information component of the regulatory information notice (RIN) engagements as in prior years.

Energex and Ergon engaged us in 2014–15 for regulatory work outlined in Figure D2 of Appendix D.

Across six engagements, QAO issued six audit opinions and six conclusions. Emphasis of matters were included in all opinions and conclusions to highlight the basis of preparation. This was key to understanding the assumptions used to calculate the RIN data. The emphasis of matter also highlighted the reports were only prepared to fulfil the entity's reporting responsibilities in accordance with the RIN. The information is not intended for other uses.

Key audit matters we raised with entities

Under recovery of revenue

Previously network entities (Energex, Ergon Energy and Powerlink) recognised a receivable in their balance sheets when the amount of revenue they have collected during the year was below the revenue cap allowed by the AER.

At 30 June 2014, a total $1.48 billion was recognised as under recovery receivables across network entities. Rapid installation of solar PV in excess of forecasts had resulted in significant increases in the under recovery balances for distributors during 2013 and 2014.

In January 2015 in response to an International Accounting Standards Board discussion paper, the AASB formalised their position on rate regulated activities, stating that they do not believe regulatory deferral account balances meet the definition of assets and liabilities. This provided a firm position for Australian entities to consider. It triggered a review of the accounting treatment to questioning whether it would be more reliable and relevant to recognise revenue as it is collected from customers rather than on an accrual basis.

The network entities agreed to derecognise balances by 30 June 2015, through change in accounting policy provisions of AASB 108. Distributors accounted for this change retrospectively while Powerlink will apply the change from the 2014–15 financial year due to immateriality.

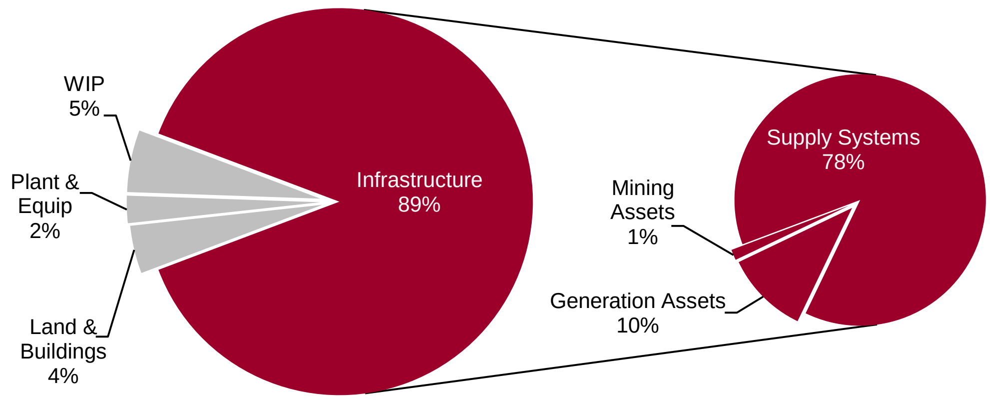
QAO accepted the proposed de-recognition of the under recovery of revenue receivables recognised in the financial reports of these entities. A description of the event highlighting the triggers for change was included in the financial report of each entity.

Financial reporting of property, plant and equipment

Overview of property, plant and equipment

Queensland's energy sector operates and maintains $33.2 billion in property, plant and equipment, including $29.4 billion of infrastructure assets. Figure 2B shows a breakdown of these assets by asset class at 30 June 2015.

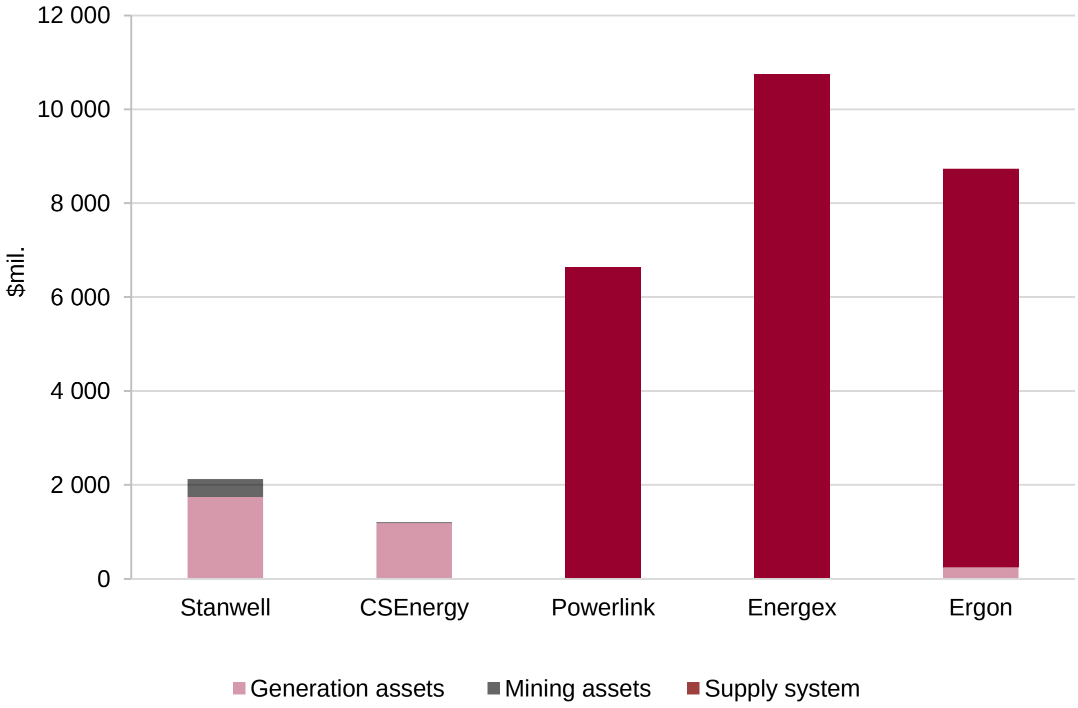
Figure 2B
Energy sector property, plant and equipment assets at 30 June 2015



Source: Queensland Audit Office

Figure 2C shows the type and value of infrastructure operated by each entity.

Figure 2C
Infrastructure assets at 30 June 2015



Source: Queensland Audit Office

Valuation of network assets

Network entities value property, plant and equipment assets using an income approach. Appendix H details the methods used by these entities.

Risk of appropriately valuing the assets is increased as there is no market based evidence of fair value due to the specialised nature of the regulated assets, and the items are rarely sold, except as part of a continuing business. Property, plant and equipment balances may not reflect their underlying value, due to Regulated Asset Base (RAB) multiples not being readily observable in the market. For Energex and Ergon Energy, key assumptions including revenue, costs and weighted average cost of capital (WACC) were influenced by 2015 regulatory determinations. For Powerlink movements in CPI drove valuations.

In 2014–15, network assets were devalued by $645.03 million. Key matters considered by distributors in performing the valuation at 30 June 2015 included:

- differences between the allowed rate of return in the AER's determinations (preliminary and established) and the discount rate used by each entity
- RAB multiples applied in calculating terminal value
- the treatment of under and over recoveries of rate regulated revenue in the entity's forecast of future cash flows.

Key inputs and assumptions used (revenue, capital and operating expenditure, tax, discount rates and terminal values) in the 2014–15 valuation models are reasonable having regard to the best information available to determine fair value. Through crosscheck with similar companies we have determined that RAB multiples are within an acceptable range for terminal value purposes.

Overall, methodology and approaches used comply with accounting standards requirements for fair value measurement and our view of generally accepted valuation techniques.

Valuation of generation assets

Generation assets are recorded at cost and were impaired to recoverable amount in 2010–11 by $1.02 billion. The trigger for the impairment of these assets was the proposed introduction of the Federal Government's carbon pricing regime, and significant judgements relating to:

- market factors — demand, fuel price, spot price, generation and contract assumptions
- carbon price scenarios and discount rates.

In 2014–15 we considered the eventuality and effect of LNG on the Queensland electricity market, RET changes and any new environmental/carbon measurements for impact on valuations. Stanwell reversed impairment previously recorded for Stanwell Power Station totalling $184.26 million. CS Energy had partially reversed impairment in 2013–14 of $266.9 million, with no further movement recorded in 2014–15.

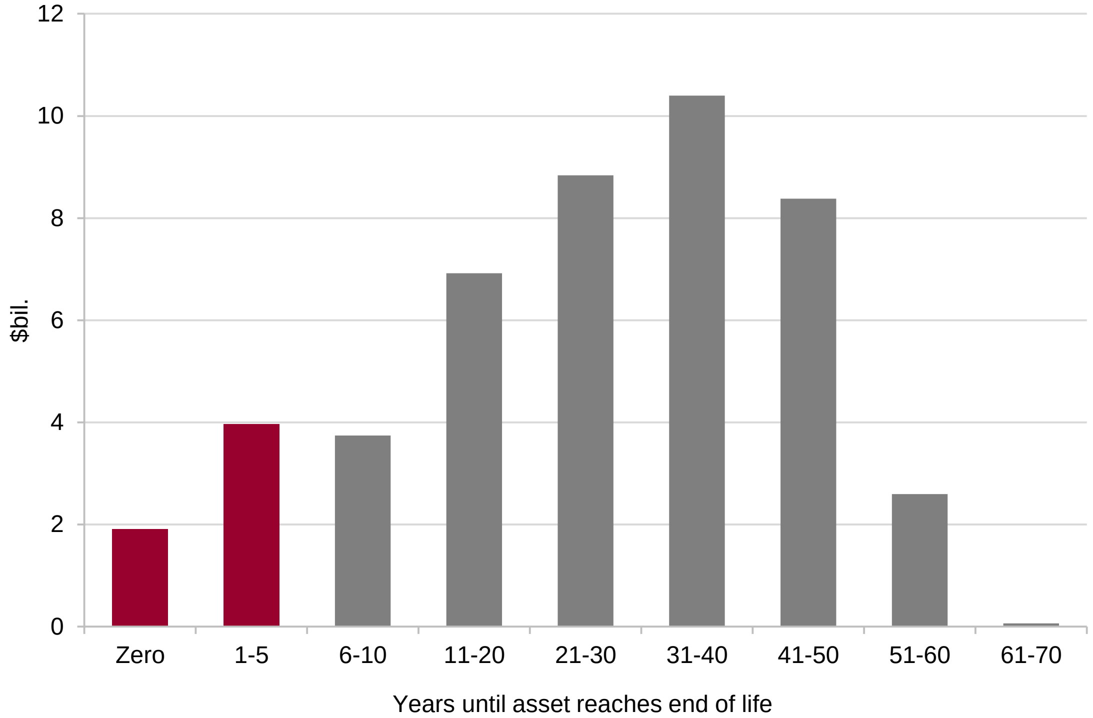
Key assumptions analysed included discount rates, forecast electricity demand and price, fuel pricing and supply, plant reliability and forecast operating and capital expenditure requirements. As the valuation models are sensitive to variations in input variables, there is a risk that the estimates and judgements included in the discounted cash flow model may not be reflective of the environment and circumstances as at 30 June 2015.

We supported the reversal of the previous impairment expense for Stanwell Power Station as the value in use models prepared by management, which incorporate current market assumptions indicate a value higher than the impaired amount reported in prior years. There are no indicators of impairment for the other cash generating units.

Useful Life of infrastructure assets

As part of our financial statement audit, we examine assumptions used by management about the remaining useful lives of their property, plant and equipment balances. From the data collected this year we profiled the remaining life of infrastructure assets. Figure 2D shows the cost and timing of when these assets are estimated to reach the end of their useful lives. We used accumulated depreciation and written down values to approximate cost in the absence of actual replacement costs.

Figure 2D
Cost and remaining life of infrastructure assets at 30 June 2015



Source: Queensland Audit Office

Although the cost to replace these assets in the future may be different to that recorded in asset registers, we identified that 12.5 per cent of assets with a total recorded cost of $5.88 billion, will reach the end of their life by 2020. Of this, $1.9 billion (4.1 per cent) have a zero value recorded in the asset registers at 30 June 2015.

For generation, $3.88 billion (62.7 per cent) of infrastructure assets will expire 20 to 30 years from now. For networks, $18.71 billion (46.1 per cent) of infrastructure assets will reach the end of their life in 30 to 50 years.

Energy sector restructure

Since our last report, the new government has committed to retaining the commercial energy businesses in state government ownership. Doing so means that as a shareholder the government needs to decide what it wants to achieve through the ownership of the businesses. As part of its 2015 election commitments the government is considering options of merging energy businesses.

On 29 June 2015, network entities received a shareholding Ministers direction requiring the payment of special dividends totalling $3.13 billion, plus 100 per cent of net profit after tax totalling $1.36 billion for the 2014–15 year. The source of dividends comes from both realised and unrealised gains in the form of retained earnings of $3.08 billion and asset revaluation reserves of $1.41 billion.

Section 254T of the *Corporations Act 2001* imposes a solvency test for the declaration and payment of dividends. A company must not pay a dividend unless:

- the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend
- the payment of the dividend is fair and reasonable to the company's shareholders as a whole
- the payment of the dividend does not materially prejudice the company's ability to pay its creditors.

We found the treatment of dividends by network entities to be in accordance with legislative requirements and accounting standards, with GOC Boards having considered solvency requirements at 30 June 2015.

Entities will make payment through increased loans under the state borrowing program in November 2015 where cash is not available to fund these payments.

The payment of special dividends will substantially increase the gearing ratios for all network entities. State shareholding minister directions have stated the intention to increase the net debt to RAB gearing ratio to not more than 70 per cent for distributors and 75 per cent for Powerlink. Consistent with their Rate of Return Guideline, the AER sets a benchmark gearing for the RAB at 60 per cent, expecting that efficient network businesses would fund their investments by borrowing 60 per cent of the required funds, while raising the remaining 40 per cent from equity.

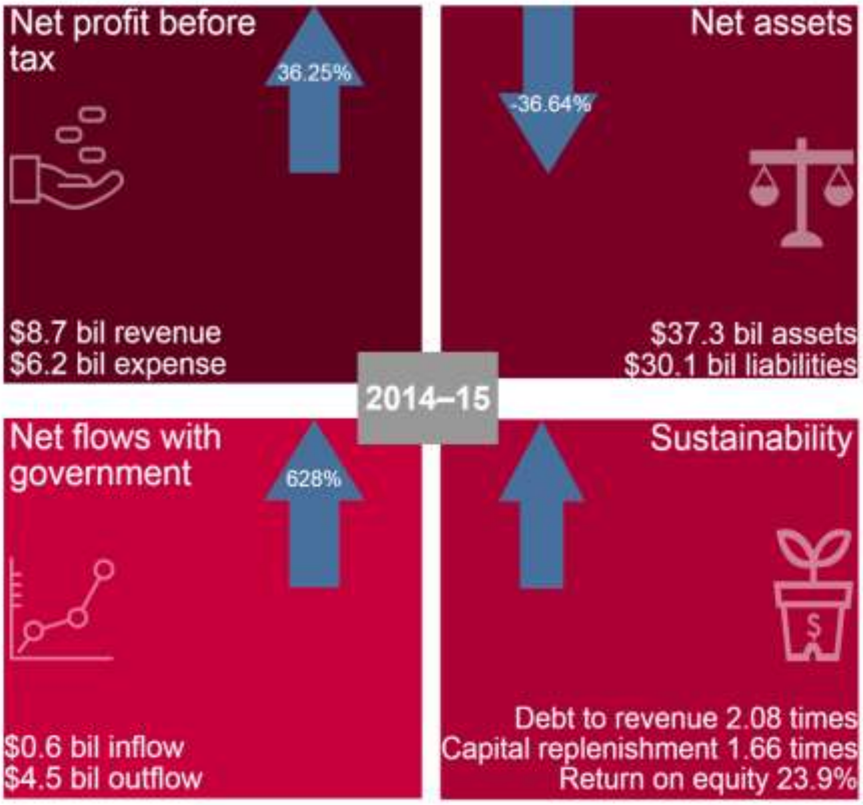
The regearing by the state government may set the ratios at levels above that used by the AER. This means that entities may need to re-prioritise capital programs or seek alternate approaches to close the gap where the AER allowance does not match the network entities desired level of capital works. Where entities are unable to re-prioritise or fund projects, higher maintenance costs may be incurred to extend the life of existing assets.

The government is finalising whether further restructure of the sector will occur. Any further changes may impact sustainability ratios.

Financial snapshot

Energy sector GOCs agree a number of financial ratio benchmarks with shareholding ministers in their annual statements of corporate intent. This year we gathered key financial data and ratios for all entities within the PNFC report as detailed in Appendix E and F. Figure 2F provides a snapshot of this information for the energy sector and shows results compared to 2013–14.

Figure 2E
Energy sector financial snapshot 2014–15



Source: Queensland Audit Office

Net profit was up this year by 23.8 per cent compared to 2013–14. Expenditure savings were higher in 2014–15 than the four per cent decrease in revenue this year.

An overall increase in revenue for generators resulted from Stanwell's asset impairment reversal, re-measurement of its rehabilitation provision and CS Energy's re-measurement of its onerous contract. Decreases in electricity pool sales, contract settlements (because of the repeal of carbon tax) and coal sharing rebates offset increases in pass through costs and gas trading.

Changes in network revenue resulted from de-recognition of under recovery accruals offset by gains on derivative instruments after Ergon's implementation of hedge accounting. Also, increased AER approved revenue allowance impacts on distribution tariff rates and electricity consumption charges.

Significant decreases in electricity sector expenditure resulted from the removal of carbon tax legislation, accounting re-measurement of provisions and hedged transactions.

Net assets decreased compared to 2013–14. Liabilities substantially increased after a direction by shareholding ministers for network entities to declare additional dividends at 30 June 2015. Asset balances decreased marginally due to revaluation movements offset by new assets constructed this year.

Net flows to government were higher with $3.4 billion more being accrued for dividends and $258 million more income tax this year. Returns are likely to reduce in future years with the AER's regulatory decision to cut revenue significantly for both the Energex and Ergon businesses. Community service obligations that the state government paid to Ergon this year were 14.8 per cent higher than the $519 million paid last year.

The sector's sustainability across two key ratios improved compared to 2013–14. The capital replenishment ratio increased in 2014-15 from 1.55 to 1.66, primarily due to increased capital expenditure in 2014-15. A ratio greater than 1.0 indicates that the asset base is expanding or renewed faster than it is depreciating.

Debt to revenue has declined marginally. It will increase in 2015–16 when network entities make 2014–15 dividend payments funded primarily through increased borrowings with QTC. Increases in return on equity for the sector have resulted from increased profits, but lower net assets with the inclusion of 2014–15 declared dividends in liabilities at 30 June 2015. The sustainability of network entities over the next five years will be dependent on their ability to fund new dividend payout ratios, outcomes of AER revenue determinations and any further directions given by shareholding ministers over that period.

CS Energy continues to report underlying losses in their income statement. The profit position in 2014–15 results only from the onerous contract provision movement of $194.58 million and without this, CS Energy would be in the loss position as initially forecasted by management. A net loss before tax would have been recorded of $17.13 million, and the return on equity ratio would be -2.97 per cent instead of 30.58 per cent shown in Appendix E.

With net losses incurred in 2014–15, originally forecasted losses for 2015–16 and cash assets decreasing from $42 million to $29 million during the year, CS Energy’s ability to meet debts as and when they fall due is dependent on the ongoing availability of undrawn debt facilities provided by QTC.

These facilities provide the group with sufficient undrawn cash facilities to cover the cash requirements forecasted in the next 24 months. QTC has confirmed that they will not demand repayment over the next 12 months. We have concluded based on this, and in particular the availability of facilities, that a going concern basis is appropriate for the preparation of the 2014–15 financial statements. We note that management are forecasting profits from 2016–17 onwards and have exceeded forecast results in the current year.

3. Water sector

In brief

In Queensland, households, agriculture and industry are the primary users of water.

State-owned water business such as, the Queensland Bulk Water Supply Authority (trading as Seqwater) and SunWater Limited (SunWater) dominate the bulk water supply service sector in Queensland. Additionally, there are two Category 1 water authorities, Mount Isa Water Board (MIWB) and Gladstone Area Water Board (GAWB), which perform many of the same dam storage, pipeline distribution and irrigation channel services as SunWater in regional Queensland.

Seqwater has a single controlled entity, the Australian Water Recycling Centre of Excellence Limited (AWRCEL) whose role focuses on research into water recycling technology. Outside South East Queensland, the composition of the water supply chain is different with SunWater, local government councils and other entities sharing ownership of public sector surface water storage infrastructure (dams). SunWater has three controlled entities. However, we only issued one of these entities, Eungella Water Pipeline Pty Ltd (Eungella), with an audit opinion in 2014–15.

This chapter details the results of our audits and key matters we looked at in forming our opinions.

Conclusion

The Queensland Audit Office (QAO) audited the financial reports of five of the six entities by their statutory deadlines and issued unqualified audit opinions for each of the entities covered in this chapter in 2014–15.

We considered the ability of Seqwater, SunWater, GAWB and MIWB to operate as a going concern in the context of their financial performance, position and sustainability. Overall, these entities are financially sustainable. Significant interest charges on borrowings and depreciation expenses on assets continues to affect Seqwater. Emphasis of matter paragraphs were included on the audit opinions for AWRCEL in relation to the uncertainty over the company's ability to continue as a going concern and Eungella with respect to the basis of preparation adopted (special purpose financial report).

Audit results and key matters

- All entities reviewed pro forma financial statements prior to 30 June. Five out of six entities provided draft financial reports for audit by their agreed milestones. We certified the financial reports for five out of six entities by legislative deadlines and issued unqualified opinions for all entities.
- With respect to Seqwater, material adjustments were required to account balances, including prior years' amounts, to reflect the change in assumptions and inputs used for the valuation of their infrastructure assets.
- Additional disclosure changes made to the draft financial reports provided for audit were primarily the result of entities electing to improve the quality of financial report disclosures and the simplification of their financial reports.
- Revenue across the sector increased this financial year due to the increase in bulk water prices set by the State Government and increases in industrial water charges. Expenditure also increased, mainly attributed to an impairment loss recognised by SunWater attributed to substantial damage of infrastructure assets, which will not be recovered through customer charges and lower demand for water.
- An analysis of data held in asset registers identified fifty per cent of the total number of assets in the water sector with a total recorded cost will reach the end of their life by 2025. A significant portion of this amount relates to critical water supply assets at Mount Crosby, including water pipelines, water pump station and water treatment plant.
- Sustainability across the water entities declined in 2014–15 compared to the prior year. The borrowings of $9.3 billion held by Seqwater as at 30 June 2015 are secured by a shareholder guarantee, however, Seqwater are reliant primarily on future price increases and cost reductions to address their current adverse performance and position.
- Compared to 2013-14, the capital replenishment ratio for water entities has decreased significantly. This indicates assets are depreciating faster than they are built or replaced.

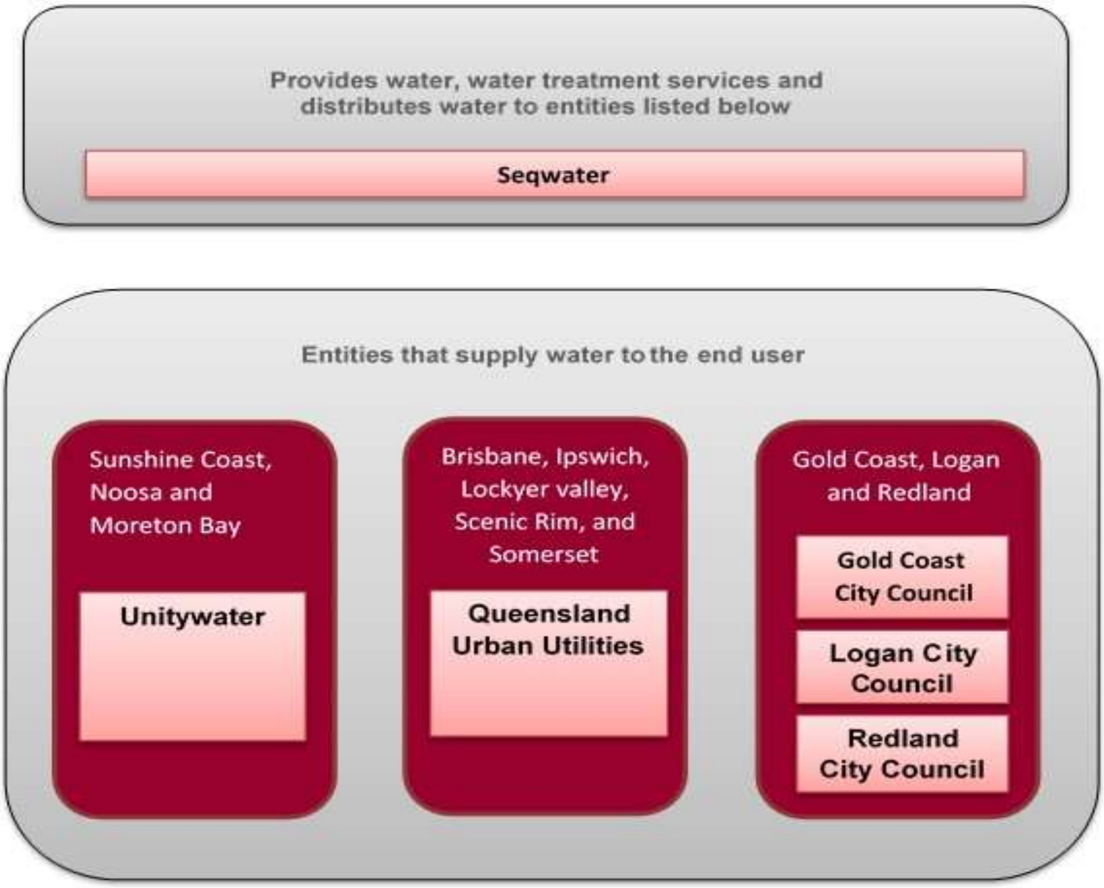
Water sector

In Queensland, households, agriculture and mining, electricity generation, tourism and manufacturing industries are the primary users of water. The Department of Energy and Water Supply (DEWS) provides direction and oversight. A number of other government departments also have a strategic role in managing the supply of water throughout the state.

South East Queensland

Within South East Queensland, Seqwater sells and distributes bulk water to entities as described in Figure 3A using rules established under the Bulk Water Supply Code and Bulk Water Supply Agreements. Seqwater owns the infrastructure to manufacture, store, distribute and treat the water it sells.

Figure 3A
Water supply chain in South East Queensland



Source: Queensland Audit Office

Central SEQ Distributor-Retailer Authority, trading as Queensland Urban Utilities (QUU), Northern SEQ Distributor-Retailer Authority, trading as Unitywater and the three local governments (Gold Coast, Logan and Redland City Councils) are responsible for distributing purchased water to water users in their respective local government areas.

Outside South East Queensland

Outside South East Queensland, SunWater, local government councils, water boards and other entities share ownership of public sector surface water storage infrastructure, irrigation channels and major pipelines to distribution points.

Outside the south east corner, Queensland has no major manufactured water supply assets or interconnecting pipelines to connect the state's dams and other assets. Instead, 22 water supply schemes operate to allocate water rights to local government councils, water boards and other entities from the state's surface and underground water sources.

Figure 3B summarises the composition of the water supply chain outside South East Queensland.

Figure 3B
Stand-alone public sector water entities that operate outside South East Queensland

Entity	Purpose
SunWater	Owns and operates the infrastructure that stores and supplies bulk water to irrigators, industrial customers and local government councils
GAWB	Category 1—owns and operates infrastructure that stores and supplies water to the Gladstone Regional Council, industry and other customers in and around the greater Gladstone region
MIWB	Category 1—sources and sells water to the Mount Isa City Council and two private sector entities
20 other water boards	Category 2—smaller water boards that source and sell water primarily to irrigation customers in designated areas throughout the state
Local government councils	Local government councils source and sell water to their ratepayers from a number of surface and groundwater sources

Source: Queensland Audit Office

In comparison to South East Queensland, drinking water provided to urban customers is primarily sourced and treated from local government owned infrastructure. Most local government councils outside South-East Queensland provide a combination of water distribution, treatment and other services to their ratepayers.

The category 1 water boards are significantly larger than their category 2 water board counterparts and operate commercialised operations.

In Queensland, the holder of the water allocation entitlement retains the risk of drought and other water shortages. SunWater does not own all the rights to sell water contained in its dams and other infrastructure. Instead, other public and private sector entities purchase and sell water allocation entitlements between each other.

Current sector context

The Treasurer and the Minister for Trade directed the Queensland Competition Authority (QCA) to investigate and recommend bulk water prices to be charged by Seqwater between 1 July 2015 and 30 June 2018. In addition to this direction, QCA also advised GAWB to conduct a price monitoring investigation for the period 1 July 2015 to 30 June 2020.

In 2008, the Queensland Government decided to phase in bulk water price increases in South East Queensland over ten years to cover the costs associated with the significant investment in manufactured water assets. During this period, it was anticipated that bulk water prices would not recover the costs of bulk water supply, therefore Seqwater is selling bulk water at a loss which is being funded by borrowings. Seqwater’s longer-term sustainability relies on increasing the price of bulk water to a point where it catches up with the cost of supply.

QCA issued final reports for Seqwater and GAWB in March 2015 and May 2015 respectively. The QCA assessed how GAWB was managing its costs and whether its proposed revenue for the next five years was reasonable. QCA identified savings in relation to the lower rate of return on investments and capital costs.

QCA recommended that Seqwater apply lower increases to bulk water prices as a result of lower operational and capital costs. Factors that contributed to this included the achievement of substantial cost savings since the merger with other government-owned water entities in 2013, and identified opportunities for further cost reductions of approximately $160 million between now and 2028.

Local management arrangements

The Queensland Commission of Audit's final report in 2013 made a number of recommendations about regional bulk water, which the State Government accepted. The first recommendation involved moving SunWater's eight irrigation channel schemes to local management arrangements, involving the transfer of water distribution assets and the operational responsibilities for those assets to irrigator-controlled, privately owned companies and/or cooperatives. The State Government has announced that four of these schemes are at a stage to commence negotiations between the State and irrigators on the transition to local management, while irrigator groups from the remaining four schemes will have the opportunity to resubmit local management proposals to the State Government.

Another recommendation of the Commission related to the divestment of SunWater's dedicated water supply infrastructure servicing commercial and industrial clients to private ownership and/or private operation, depending on the solution which provided the best value for money outcome for the government. The State Government has since advised SunWater that the activities associated with the divestment of commercial delivery infrastructure will no longer proceed.

Entities covered in this chapter

Seqwater, SunWater, GAWB and MIWB are the primary PNFC water entities included in this report. This report does not include the audit results of former PNFCs within the water sector which ceased to exist before 1 July 2014.

Seqwater has a single wholly owned subsidiary, AWRCEL. SunWater has three wholly owned subsidiaries. Only one of these entities (Eungella Water Pipeline Pty Ltd) was required to produce financial reports in 2014–15.

Conclusions

We certified unqualified audit opinions of all water PNFCs included in this report. Readers can rely on the results in the audited financial reports of these entities. Emphases of matter were included in the audit opinions of the AWRCEL in relation to the significant uncertainty over the entity's ability to continue operating as a going concern, and Eungella Water Pipeline Pty Ltd, with respect to the basis of preparation adopted.

We completed audits for five of the six entities within legislative deadlines and we received good quality draft financial reports as part of this process. We identified issues with respect to the assumptions and inputs used by Seqwater for its infrastructure asset valuations, resulting in material changes to the draft financial report.

When forming an audit opinion on the financial report of an entity, we assess the entity's financial performance, position and sustainability to operate as a going concern. We view Seqwater as not self-supporting and they will continue to have a significantly higher debt to revenue ratio than all other water entities, attributed to loans acquired from its merger with other bulk water entities. In addition, interest rate movements can affect interest payments and future borrowings if Seqwater is required to borrow to fund ongoing expenditure. Furthermore, the debt to revenue ratio is likely to continue to deteriorate until the price of bulk water matches or exceeds the cost of its supply.

Audit results

Financial reports

Figure D1 in Appendix D summarises audit opinions issued for the water sector during 2014–15.

One of the six entities did not provide its draft financial report for audit by their agreed milestones.

Management and audit certified financial reports for five out of six entities by their legislative deadlines. Because of issues identified with respect to the valuation of their assets, QAO was not able to provide an unqualified audit opinion on the 2014–15 financial statements of Seqwater until 11 September 2015.

Four of the six entities had their pro forma financial statements reviewed prior to 30 June 2015. Entities were able to simplify financial statements through the removal of immaterial disclosures, duplication and re-grouping of similar information.

We were satisfied with the quality of draft financial reports and supporting working papers provided to us for the purpose of conducting our audits. Further detail with respect to material changes made to the draft financial report received from Seqwater is provided below. All other entities in the water sector did not make material changes to account balances and disclosures in their draft financial reports for 2014–15. Any changes that were made related to the reclassification between line items to provide greater understanding and clarity to the readers of the financial statements. These changes did not affect the net operating result or net assets disclosed. The majority of changes made aimed to improve the quality and understanding to the readers of the financial reports.

We issued unqualified audit opinions on the financial reports for all four primary PNFCs within the water sector and two controlled entities in 2014–15. This is consistent with 2013–14 and confirms that the financial report complies with relevant accounting standards and legislative requirements relating to the establishment and keeping of accounts.

When forming an audit opinion on the financial report of an entity, we assess an entity's ability to operate as a going concern. We also assess an entity's financial performance, position and sustainability. Our assessment of an entity's financial sustainability includes assessing its ability to pay its ongoing expenses, to replace and grow its assets and to pay its debts as and when they fall due. Overall, we found entities in the water sector to be financially sustainable, however, Seqwater's sustainability continues to be impacted by interest on its borrowings and depreciation charges on its water supply assets.

We included an emphasis of matter on the audit opinion for the AWRCEL, a controlled entity of Seqwater, in relation to the significant uncertainty over the company's ability to continue to exist and operate as a going concern post September 2016.

We also issued an emphasis of matter for Eungella Water Pipeline Pty Ltd to highlight that only certain accounting standards are used in the preparation of their report. This is because the sole shareholder of this non-reporting entity is the only user of this report.

Key audit matters we raised with entities

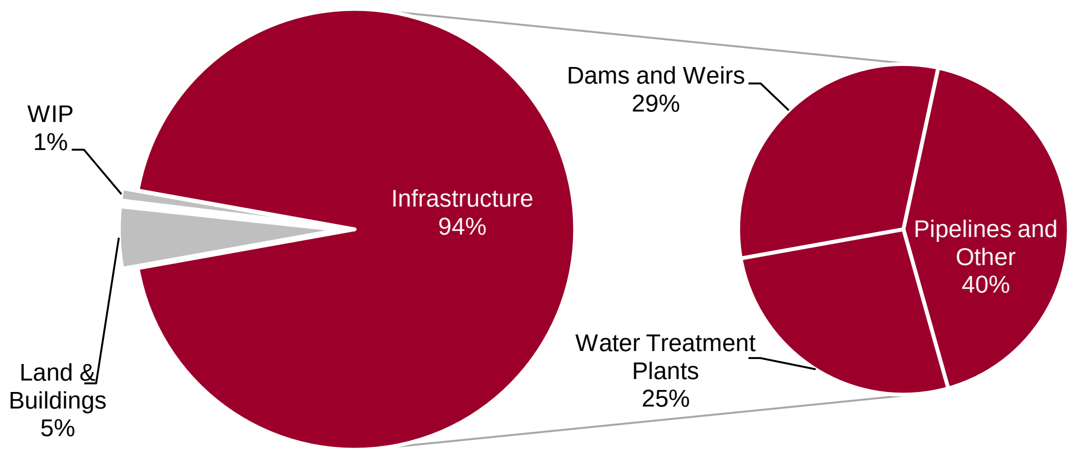
Financial reporting of property, plant and equipment

Overview of property, plant and equipment

Queensland's water sector operates and maintains property, plant and equipment with a written down value of $13.7 billion, including $12.9 billion of infrastructure assets. Seqwater operates and maintains $11.4 billion of infrastructure assets (representing 88.4 per cent of the sector's total infrastructure assets).

Figure 3C shows a breakdown of these assets by asset class as at 30 June 2015.

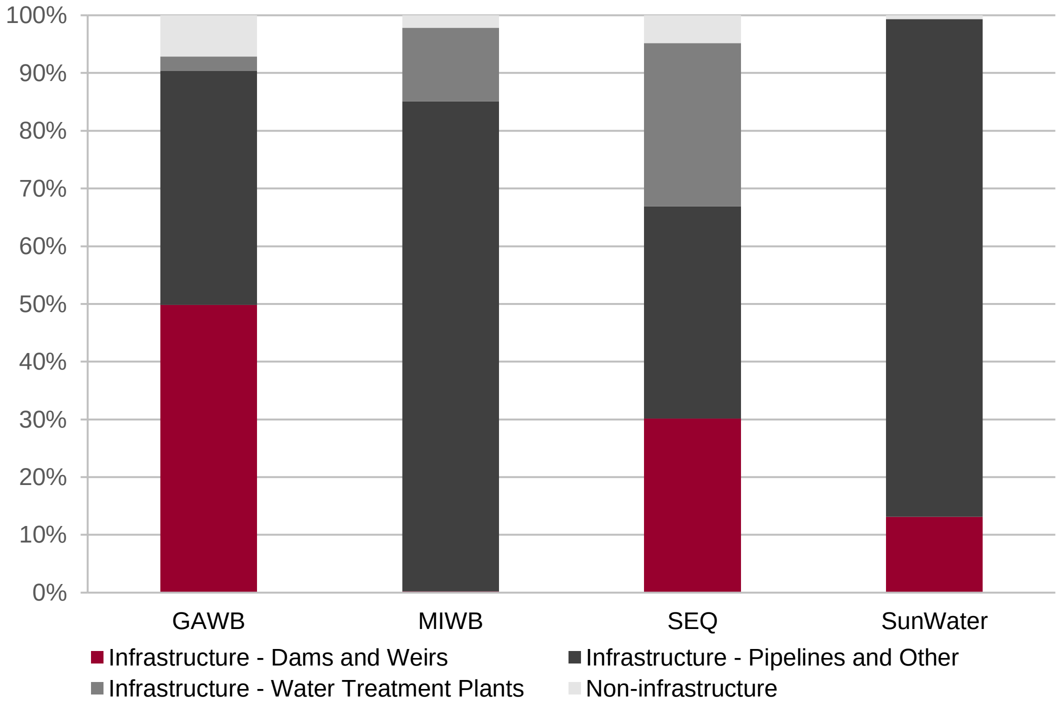
Figure 3C
Water sector property, plant and equipment assets at 30 June 2015



Source: Queensland Audit Office

Figure 3D shows the type and value of infrastructure operated by each entity.

Figure 3D
Breakdown of assets by category at 30 June 2015 class



Source: Queensland Audit Office

Valuation of assets

The reported values of property, plant and equipment increased by $42 million over the 2014–15 financial year. The main attribute for this increase was asset revaluation increments recognised for GAWB ($58 million) and Seqwater ($15 million), offset by an impairment loss recognised by SunWater ($32 million) with respect to water infrastructure assets and assets under construction.

Water entities use different techniques to report assets in their financial statements. SunWater records its assets at cost, or deemed cost, whereas the other entities record assets at fair value. Appendix H details the methods used by these entities.

Our audit of income based valuations to estimate fair values identified a range of departures from industry standard practices, in particular around the appropriateness of valuations inputs and assumptions applied. Key matters considered by entities included the use of a regulatory rate of return as the discount rate and the inclusion of under recovery balances into the valuations adopted.

QAO found key inputs and assumptions used in the 2014–15 valuation models had reasonable regard to the best information available to determine fair value and comply with the prescribed requirements with respect to fair value measurement. We concluded that the amounts disclosed for water assets across all entities were materially correct.

Valuation of assets—Seqwater

Seqwater has historically used pre-tax cash flows and discount rates as inputs for the valuation of their infrastructure assets. In 2014–15, Seqwater management amended these inputs to reflect the use of post-tax nominal cash flows discounted using a post-tax discount rate in accordance with the requirements of AASB 13 *Fair Value Measurement*. This change resulted in prior period adjustments requiring retrospective restatement to the financial report. The resulting impact on the comparative amounts disclosed in the 2014–15 financial report were as follows ($'000):

Figure 3E
Effect of Seqwater prior period adjustment

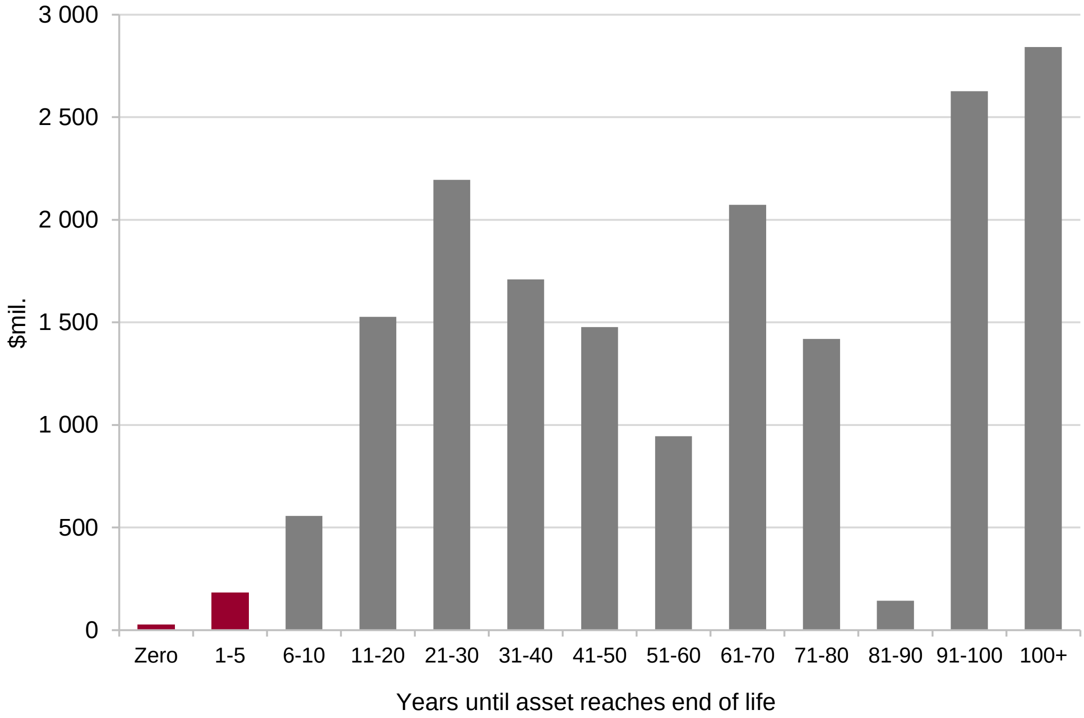
	30 June 2014 (audited)	Increase/ (Decrease)	30 June 2014 (restated)	30 June 2013 (audited)	Increase/ (Decrease)	30 June 2013 (restated)
Statement of Comprehensive Income						
Operating result after tax	(20 608)	23 361	2 753	290 448	48 927	339 375
Other comprehensive income	1 006 051	658 258	1 664 309	744 726	109 734	854 460
Statement of Financial Position						
Property, plant and equipment	10 813 001	1 200 402	12 013 403	9 658 675	158 661	9 817 336
Net assets / Total equity	1 459 745	840 280	2 300 025	473 500	158 661	632 161

Source: Queensland Audit Office

Useful life of infrastructure assets

As part of our financial statement audit, we examine assumptions used by management about the remaining useful lives of their property, plant and equipment balances. From the data collected this year we profiled the remaining life of infrastructure assets. Figure 3H shows the cost and timing of when these assets are estimated to reach the end of their useful lives. We used accumulated depreciation and written down values to approximate cost in the absence of actual replacement costs.

Figure 3H
Cost and remaining life of infrastructure assets at 30 June 2015



Source: Queensland Audit Office

Although the cost to replace these assets in the future may be different to that recorded in asset registers, we identified assets with a total recorded cost of $768.25 million will reach the end of their life by 2025. We also identified that assets with a total recorded cost of $211.5 million will reach the end of their useful life in five years. Of this, $28 million (0.2 per cent) have a zero value recorded in the asset registers at 30 June 2015.

Those assets that will reach the end of their useful lives in the next 10 years represent 50 per cent of the total number of assets across the water sector and 4.3 per cent of the total recorded cost of all assets. Of this amount, Seqwater has assets with a recorded cost of $689 million that will reach the end of their life in the next 10 years. A significant portion of this amount relates to assets at Mount Crosby, including water pipelines ($27 million), water pump station ($87 million) and water treatment plant ($71.5 million). These assets are critical to the water network which supplies the majority of drinking water to the Brisbane and Ipswich regions.

We acknowledge that there has been a significant program of maintenance undertaken to the water treatment plants to ensure a continued safe, secure and reliable water supply. In addition, Seqwater's Asset Portfolio Management Plan provides detail of planned expenditure on refurbishments and upgrades to water infrastructure assets over the next 20 years, including those assets at Mount Crosby to maintain the working condition of that plant for the foreseeable future. The work involved replacing and maintaining ageing assets to improve plant operability and reliability.

Additional assets that will reach the end of their life within 10 years include those at Gibson Island ($51 million), North Pine ($75 million), Sparkes Hill to Green Hill ($35 million) and Tugun Advanced Water Treatment Plant ($48 million).

With respect to MIWB, we observed that assets with a recorded cost of $56 million will reach the end of their useful lives in the next 10 years. This represents 25 per cent of the total fair value of assets as at 30 June 2015. A significant portion of this amount relates to assets at Lake Moondarra ($26 million).

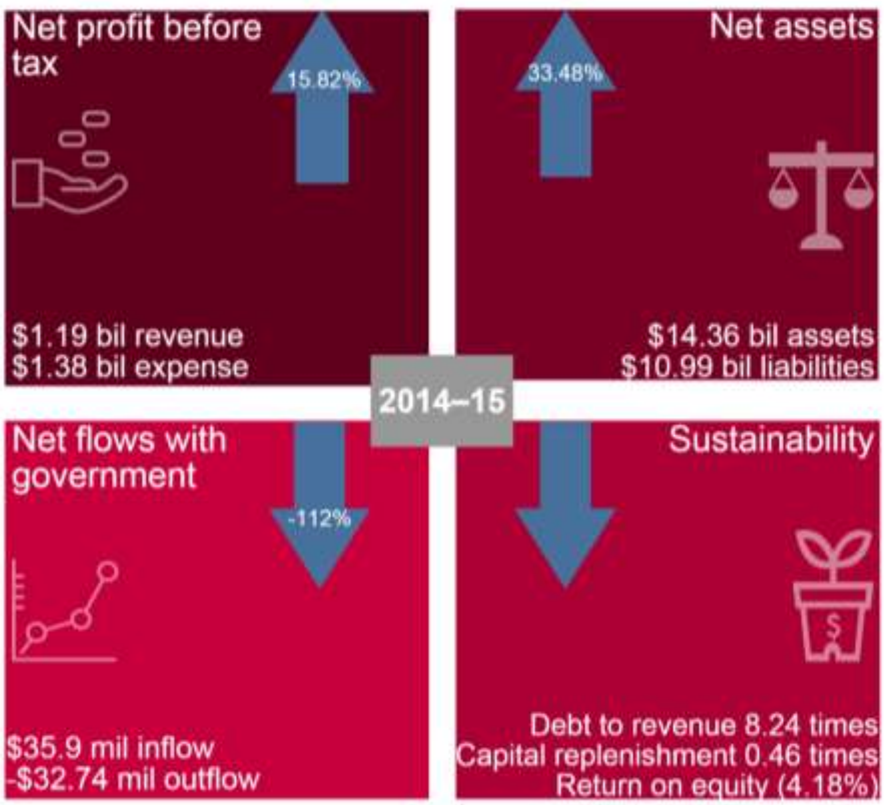
Those assets with useful lives extending beyond 2045 mainly include Seqwater's manufactured water assets such as the Gold Coast Desalination Plant (GCDP) and the Western Corridor Recycled Water Scheme (WCWRS). These assets form an integral part of maintaining water security for South-East Queensland.

Financial snapshot

Water sector entities agree upon a number of financial ratio benchmarks with shareholding ministers in the annual operational plans, performance plans and statement of corporate intent, where applicable. This year we gathered key financial data and ratios for all entities within the PNFC report as detailed in Appendices E and F.

Figure 3I provides a snapshot of the water sector financial results for 2014–15 in comparison to last year.

Figure 3I
Water sector financial snapshot 2014–15



Note: Total outflows for the water sector included $66.86 million in income tax credits for Seqwater, resulting in an overall negative outflow for the water sector.

Source: Queensland Audit Office

There was an increase in revenue from 2013–14 of $95.7 million across the six water entities. This was mainly attributed to the increase in bulk water prices set in South East Queensland by the Queensland Government, and an increase in industrial water charges primarily attributable to the commencement of billing for water transported by the Woleebee Creek to Glebe Weir Pipeline in 2014–15.

The increase in expenditure in comparison to 2013–14 ($82.7 million) is principally due to an impairment recognised for the Paradise Dam and Hydro cash generating units, owned by Burnett Water Pty Limited (a subsidiary of SunWater Limited), largely attributable to substantial damage to the infrastructure assets which will not be recovered through customer charges, and the low water demand in the region.

Overall, net assets increased by $5.6 million across the water sector. This mainly comprises a decrease in net assets for Seqwater ($31 million) offset by an increase ($34.8 million) for the GAWB. While a revaluation increment was recognised in the 2014–15 financial statements for Seqwater, borrowings continue to increase ($110 million increase from 2013–14). With respect to the GAWB, a revaluation increment of $58 million was recognised as at 30 June 2015.

Flows to and from government affect an entity's ability to meet its expenditure commitments, replace and grow its asset base, and repay debt. PNFCs in the water sector 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. PNFCs in the water sector recorded net flows from the government of $68.64 million in 2014–15, a significant decrease from the amount reported in 2013–14 ($336.9 million). Reduced income tax credits utilised by Seqwater in 2014–15 were a main contributor for this decrease.

The sectors sustainability across the three key ratios declined compared to 2013–14.

The capital replenishment ratio compares the annual net expenditure on non-current assets to annual depreciation. An average ratio below one, over time, indicates that assets are being built or replaced slower than the asset base is depreciating, as is the case with Seqwater. The capital replenishment ratio across the PNFCs within this chapter has decreased significantly from the 2013-14 financial year (1.47 times to 0.46 times). SunWater's capital replenishment ratio decreased substantially from the prior year. In 2013–14, there was significant investment in the water supply assets at Woleebee Creek.

The debt to revenue ratio assesses an entity's ability to pay the principal and interest on borrowings, when they fall due, from the funds that the entity generates. With $9.3 billion in loans, Seqwater is not regarded as self-supporting and continues to have a significantly higher debt to revenue ratio (11.56 times) than all other water entities included in this chapter as the price it charges for bulk water continues to be less than the cost of supplying this water. A supplementary measure of debt sustainability relates to an entity's ability to service its debt obligations.

In 2014–15, Seqwater's interest expense increased from 41 per cent of revenue in 2009–10 to 67.5 per cent in 2014–15 attributed to the loans it acquired from its merger with other bulk water entities. It should be noted that these loans are secured by a shareholder guarantee, which means the risk of Seqwater not paying the principal and interest on these loans is held by the state. However, interest rate movements can affect interest payments and future borrowings, if Seqwater is required to borrow to fund ongoing expenditure. Furthermore, the debt to revenue ratio is likely to continue to deteriorate until the price of bulk water matches or exceeds the cost of its supply.

As a sector, debt as at 30 June 2015 was over eight times revenue in 2014–15, which is in excess of the average ratio across the sector over the past five years. GAWB continues to have the second highest debt to revenue ratio of all four PNFCs in the water sector. The primary reason for its loans were to fund new water supply infrastructure assets.

The return on equity is the net profit after tax calculated as a percentage of net assets (equity). Seqwater's return on equity was minus 7.14 per cent because of the operating loss reported in 2014–15. Seqwater utilised more tax credits in 2013–14 in comparison to 2014–15. In 2013–14 the tax credits resulted in an operating profit of $2.8 million and was a contributing factor for a positive return on equity in 2013–14.

4. Ports sector

In brief

The Queensland government has four government owned ports corporations that service industry by transporting freight by sea: Gladstone Ports Corporation Limited (GPCL), North Queensland Bulk Ports Corporation Limited (NQBP), Port of Townsville Limited (PoTL) and Far North Queensland Ports Corporation Limited (trading as Ports North).

The volume of goods and commodities transported through these ports increased by 5.65 per cent to 294.5 million tonnes in 2014–15, mostly from coal exports through Hay Point and Abbot Point.

This chapter details the results of our audits and key matters we looked at in forming our opinions.

Conclusion

The audit opinions issued on financial reports of all ports, Government Owned Corporations (GOCs) and controlled entities were unqualified. Ports continue to be financially sustainable, although profits decreased by 38 per cent compared to the previous year.

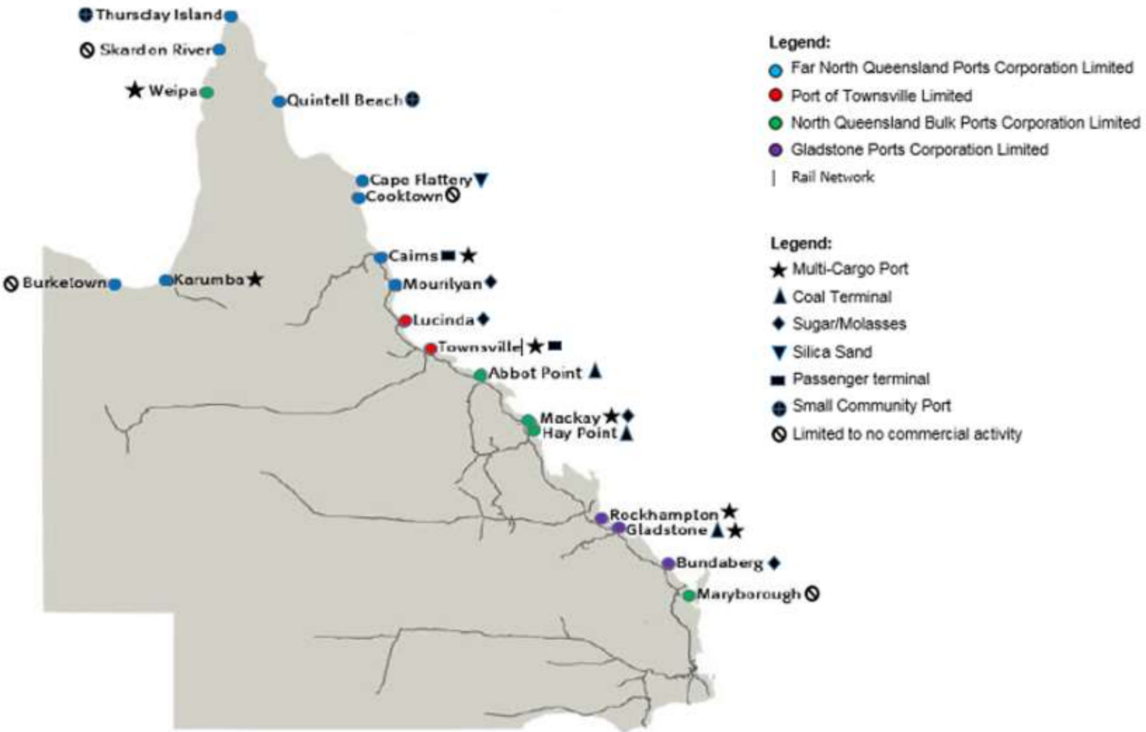
Audit results and key matters

- Half of the entities did not provide a complete first draft of the financial statements by the agreed timeframe. Earlier completion of annual valuations of physical assets would minimise delays in the presenting draft financial statements to audit.
- The outcome of annual valuations of physical assets continues to be the main driver of significant movements in the balance sheets of ports corporations.
- Recognising the strong relationship between the revenue earned from its physical assets, the three commodity based ports (GPCL, NQBP, PoTL) incorporated the income based approach to value their infrastructure assets.
- Ports using the income based approach to estimate the fair value of infrastructure assets can enhance the level of their documentation of the key inputs and estimates used in cash flow models.
- Government restrictions on the offshore disposal of capital dredge material will significantly increase the cost of dredging and recovery of these costs could affect port pricing and the valuation of infrastructure assets.
- Nearly 90 per cent of port sector assets other than channels will be due for renewal or replacement in the next 50 years. Channel and breakwater assets make a third of the value of all infrastructure assets and the ports sector expect their service potential to last longer than all other port sector assets.
- Net profits after tax decreased from the prior year by 38 per cent to $94.5 million, but sector assets increased by nearly 10 per cent to $3.62 billion in 2014–15. This is mostly due to asset revaluation adjustments arising from market based movements in the fair value of NQBP's infrastructure assets since the previous specific valuation appraisal in 2012.
- Exports of coal and imports and exports of bauxite make up nearly 90 per cent of all goods and commodities moved across these ports. The sector achieved a 5.7 per cent increase (294.5 million tonnes) in the volume of goods and commodities compared to the prior year.

Ports sector

Queensland has a network of 20 ports ranging from small community ports to large coal export terminals and a capital city multi-cargo port. These ports are a major component of Queensland's supply chain and economy, facilitating trade and the development of the regional, State and national economies. Four GOCs manage 19 ports and a private company manages the Port of Brisbane. Figure 4A summarises each GOC's area of responsibility.

Figure 4A
State owned ports map



Source: Trade Statistics for Queensland Ports 2012–13 of Transport and Main Roads (modified 2015–16 by QAO)

Each port business provides a broad range of facilities that cater for the diverse land/sea interface requirements of their trade catchment areas. They are responsible for the construction of essential port infrastructure administration and operation of certain port facilities. Local industry and the requirements of other supply chain participants are also determining factors.

The port corporations owned by the Queensland government are not subject to price regulation. Exports and imports of commodities dominate the revenue streams for three of the four port corporations, while Ports North relies more on property and services revenue.

Ninety-four per cent of commodities are imported and exported through NQPB and GPCL.

Current sector context

There are legislative, environmental and economic factors that influence the ports sector.

Effective 2 June 2015, the Australian Government has introduced a new regulation under the Great Barrier Reef Marine Park Regulations 1983, which ends the disposal of dredge material in the Great Barrier Reef Marine Park from capital dredging projects. Capital dredging means dredging designed to create new / enlarge or deepen existing channels, basins, ports, berths or other areas.

On 12 November 2015, the Queensland Parliament passed the Sustainable Ports Development Bill 2015. The Act intends to balance the development of Queensland's major ports with the protection of the Great Barrier Reef. The Act prohibits sea-based disposal of capital-dredged material from ports in the within a restricted area and limits certain port-related capital dredging.

The Act also aims to:

- require master plans that establish a long-term vision at the major ports to consider marine and land-based impacts, port and supply chain capacity and connectivity as well as community values; and
- support on-land disposal or land reclamation for dredge material.

We expect government restrictions on the offshore disposal of capital dredge material will significantly increase the cost of dredging. We expect recovery of these costs will affect port pricing and the valuation of infrastructure assets.

Historically, ports have low gearing ratios when benchmarked to other PNFC sectors such as energy. To maintain services, sustainability of infrastructure over the medium to longer term will continue to be a challenge for ports. Entities need to align asset replacement and renewal funding with the asset consumption rate over the longer term.

Conclusions

The audit opinions issued on financial reports of all ports and controlled entities were unqualified. Readers can rely on the results in the audited financial reports of these entities.

We completed audits within legislative deadlines. Half the ports corporations did not prepare draft financial statements by the agreed timeframe.

Ports are financially sustainable, although revenue and expenses for the sector decreased by nearly 25 per cent compared to the previous year. Profits were down significantly from the previous year's results due to write-offs of discontinued projects at NQBP and GPCL's gain of $24.6 million in 2013-14 from a reversal of previous asset devaluations

Reported values of physical assets increased by 15 per cent due mostly to asset revaluation adjustments arising from market based movements in the fair value of NQBP's infrastructure assets since the previous specific valuation appraisal in 2012.

Although we assessed the inputs and assumptions used by ports to estimate fair value as reasonable, there are opportunities for the sector to improve documentation to support the inputs and assumptions used in cash flow forecasting models.

We expect government restrictions on the offshore disposal of capital dredge material will significantly increase the cost of dredging. We expect recovery of these costs will affect port pricing and the valuation of infrastructure assets. The sector is estimating that half of the value of its infrastructure assets (not including channel related assets) will expire over the next 20 years.

Increased coal exports of 5.7 per cent was the main contributor for total trade volumes increasing from 2014 to 2015 by nearly 16 million tonnes.

Audit results

Financial reports

Figure D1 in Appendix D summarises opinions issued for the sector during 2014–15. We issued unqualified audit opinions for all four port GOCs and confirmed financial reports have been prepared according to requirements of legislation and relevant accounting standards.

Two out of four entities provided draft financial reports for audit by their agreed milestones. PoTL was two days late and NQBP was 12 days late in submitting their draft financial reports. In the case of NQBP, late submission was due to complexities experienced by NQBP in applying the fair value methodology to infrastructure assets.

We discuss infrastructure valuations further in the key matters section below. We certified all four corporations' financial reports within the legislative period.

All ports except Ports North provided a template set of financial statements prior to 30 June 2015. The pro forma process this year simplified financial statements by removing immaterial disclosures, duplication and re-grouping like information.

There were no significant adjustments of prior year balances in the 2014–15 financial statements.

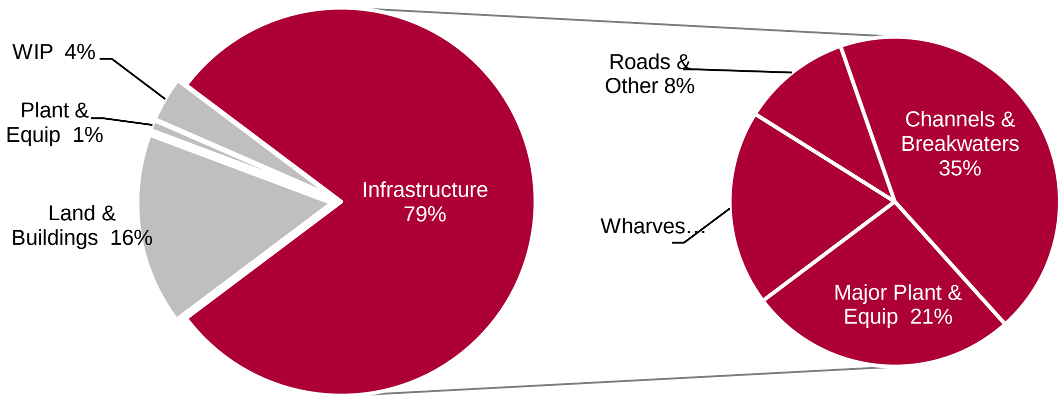
Key audit matters we raised with entities

Financial reporting of property, plant and equipment

Overview of property, plant and equipment

Queensland's port corporations operate and maintain $2 901 million of property, plant and equipment, including nearly $2 305 million of infrastructure assets. Figure 4B shows a breakdown by asset class as at 30 June 2015.

Figure 4B
Ports sector property, plant and equipment values at 30 June 2015

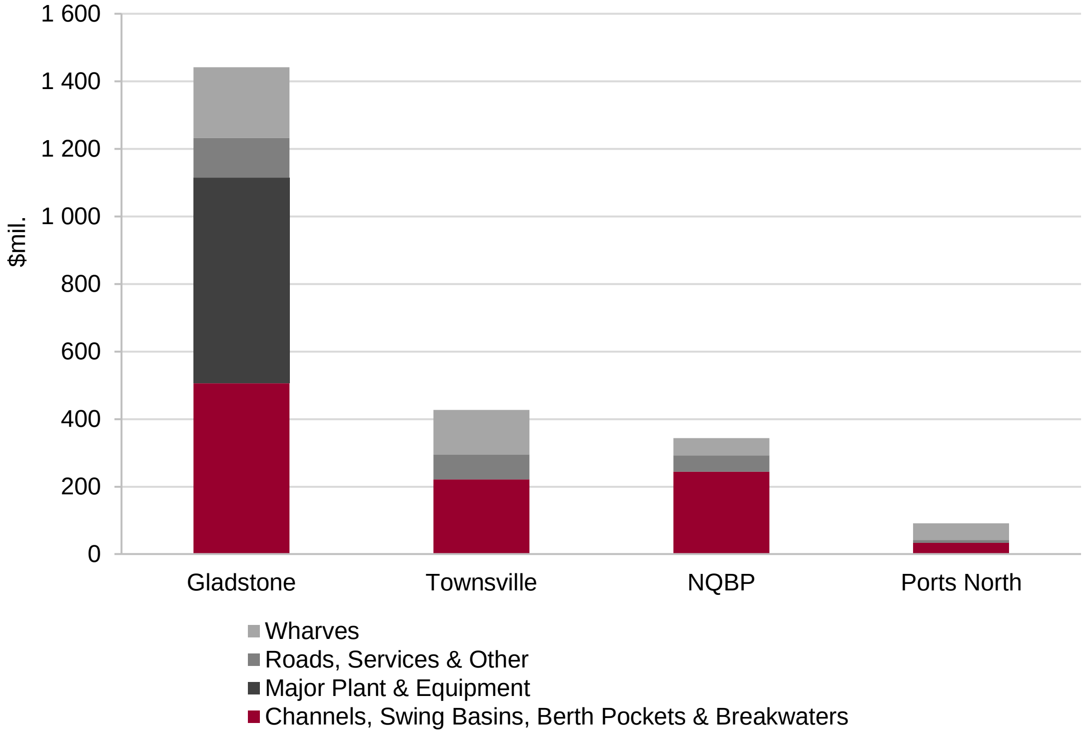


Source: Queensland Audit Office

The value of infrastructure assets at the RG Tanna coal terminal in Gladstone makes up nearly one third of the combined value of all ports sector infrastructure assets.

Figure 4C shows the type and value of infrastructure operated by each entity.

Figure 4C
Infrastructure values by major asset class at 30 June 2015



Note: Given the value and nature of Gladstone's 'Plant' assets, we have categorised these assets as infrastructure assets.

Source: Queensland Audit Office

Valuation of assets

One of the most significant aspects of our annual audits for the ports sector is looking at how ports value assets based on estimated cash flow models. As there is a strong relationship between asset values and the inputs used in cash flow models, any significant change in inputs will directly affect the reported value of physical assets.

The ports sector reported a 15 per cent increase in the value of physical assets over the 2014–15 year. The $382 million increase was mostly due to net asset revaluation increments with NQBP making up more than two-thirds of this increase for the sector.

All four ports corporations in Queensland measure their infrastructure assets using the revaluation model to estimate fair value. Three of the four ports incorporated the income-based approach to estimate fair value of infrastructure assets in 2014–15. Appendix H details the methods used by these entities.

Ports North reported a net asset revaluation increment of $32.3 million, which represented a 25 per cent increase in the reported value of physical assets from 30 June 2014.

In 2014–15, NQBP incorporated the income-based method into its valuation methodology for infrastructure assets. The increase of $245 million in reported values of NQBP's physical assets represented an uplift of 85 per cent from the prior year value. In incorporating the income-based approach to value its port infrastructure, NQBP recognised the strong relationship between the revenue earned and its physical assets.

The ports sector have incurred impairment losses of nearly $36 million in the value of assets under construction in 2014–15. NQBP impaired costs of $27 million for projects deemed unsustainable and not probable that future economic benefits associated with these project costs will flow to NQBP. NQBP has incurred financial losses from project costs written-off of nearly $36 million in the last two financial years.

We have seen in current replacement cost information provided to ports, two significant risks that makes estimating fair value by for-profit entities using replacement cost problematic.

- Over the past two years, three ports have been required to reconsider the replacement cost valuation information provided by experts and then factor in the value of economic obsolescence and the value of underutilised assets. Consequently, the more reliable method to estimate the fair value of these assets is the income-based approach.
- Changes to dredging cost profiles will further affect replacement cost estimation.

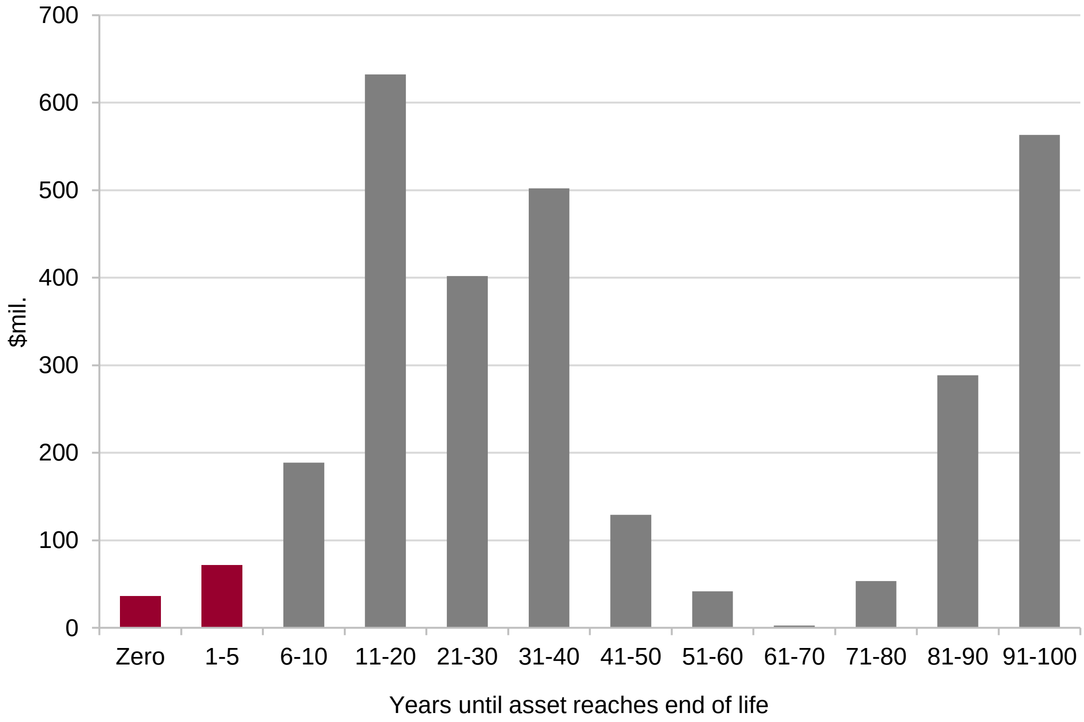
As we assessed the inputs and assumptions used by ports to estimate fair value as reasonable, we concluded that the fair values of reported ports assets were materially correct.

Ports corporations should implement valuation workbooks for their cash flow forecasting models. These workbooks store the evidence to validate inputs, estimates and judgements applied by entity management. Our audit of cash flow models identified common documentation problems of inputs and estimates, these are summarised in Appendix I.

Useful life of infrastructure assets

As part of our financial statement audit, we examine assumptions used by management about the remaining useful lives of their property, plant and equipment balances. From the data collected this year we profiled the remaining life of infrastructure assets. Figure 4D shows the cost and timing of when these assets are estimated to reach the end of their useful lives. We used accumulated depreciation and written down values to approximate cost in the absence of actual replacement costs.

Figure 4D
Cost and remaining life of infrastructure assets at 30 June 2015



Note: Channel related infrastructure assets are excluded as we have assumed these assets to be continually maintained and therefore costs will not be incurred to replace these assets.

Source: Queensland Audit Office

Although the cost to replace these assets in the future may be different to that recorded in asset registers, we identified that half of the total value of infrastructure assets (excluding channel assets) are estimated for replacement over the next 20 years.

The ports sector have assets still in use which have reached the end of their useful life, but these assets represent less than half of one per cent of the value of all sector assets.

Due to the strategic importance of the maintenance dredging programs for channel assets at each significant port, the condition of channel assets will not deteriorate to the point where replacement is required. Channel assets represent 98 per cent ($931.2 million) of the gross value of all infrastructure assets that have remaining lives of more than 50 years. These assets are expected to provide service potential well beyond 50 years.

Onshore disposal vs offshore disposal of capital dredge material

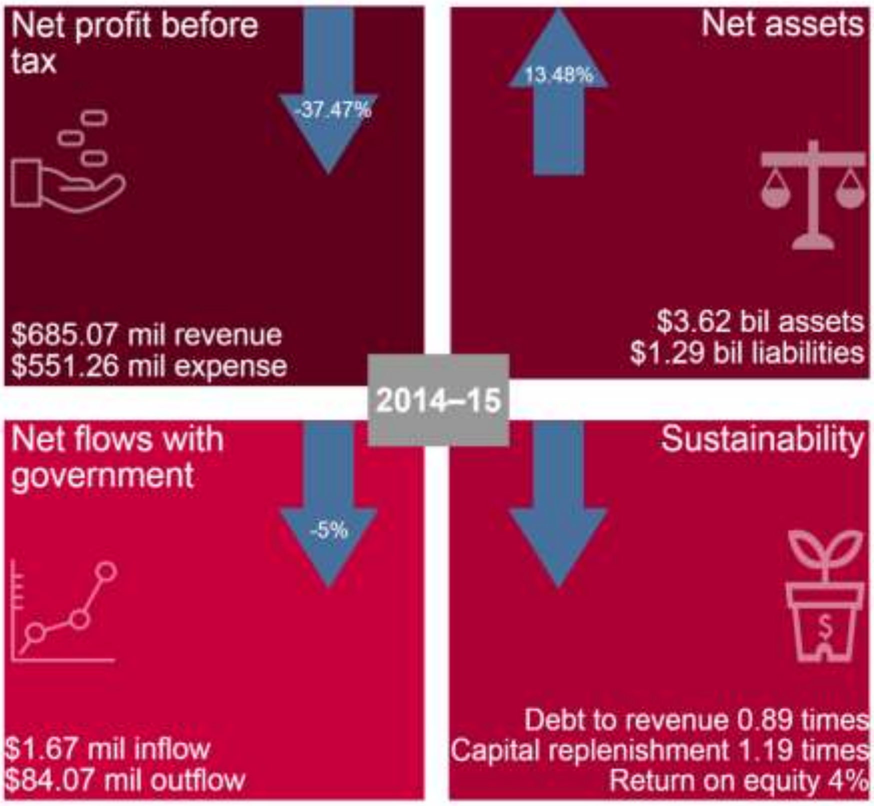
With the Australian Government introduction of the legislation banning offshore disposal of dredging material from ports in the GBRWHA, the economic impact of the change will need to be considered by ports and their shareholding Ministers on the valuation of assets.

The ports are modelling the economic impact of a change from historical offshore disposal to onshore disposal may cause the ports to incur a substantial increase in disposal costs depending on size, volume and geographical location.

Financial snapshot

Ports agreed upon a range of financial performance targets with shareholding Ministers in their annual statements of corporate intent. This year we grouped key financial data and ratios for all entities in the PNFC sector, this is shown in Appendix E, and F. Figure 4E provides a snapshot of the ports sector financial results for 2014–15 in comparison to last year.

Figure 4E
Ports sector financial snapshot 2014-15



Source: Queensland Audit Office

Net profit after tax achieved by the ports sector was $94.5 million, being a decrease of $57.3 million or 38 per cent on previous year result, with one ports corporation incurring an operating loss in 2014–15. Influencing the movement in sector profits this year was an annual increase in financial losses of nearly $30 million incurred by NQBP, relating to costs on projects written-off. In addition, the drop in GPCL profits in 2014–15 was primarily driven by a gain of $24.6 million in 2013–14 from a reversal of previous asset devaluations.

Net assets increased by 13 per cent mostly because of increases in the reported value of physical assets. Total assets were $3.62 billion, an increase of $340 million or 9.4 per cent, with property, plant and equipment increases making up 80 per cent of the increase.

The ports sector provided net inflows to government in 2014–15 of $131 million, which was 17 per cent less than last financial year. Dividends declared in 2014–15 of $84 million was 6.7 per cent less than forecasted and these flows to government reflected the lower profits achieved in 2014–15.

In 2014–15, the sector's capital replenishment ratio decreased from 1.51 to 1.19. A ratio greater than 1.0 indicates that new and replaced assets are increasing faster than the asset base is depreciating. Depreciation expense and payments for non-current assets are the key drivers of the capital replenishment ratio.

Depreciation expense increased across the sector by 11 per cent or $6.5 million from the previous year, principally due to the effect that increased asset values in 2013–14 have on the following years depreciation. This increase could have been higher, however GPCL revised its estimate of the remaining useful life of its channel assets from 40 years to 100 years. We reviewed that the extended lives were consistent with industry benchmarks and the expected future economic benefits that GPCL estimates it will obtain from these assets.

Reduced expenditure on non-current assets in 2014–15 and a higher value of capital projects completed in 2013–14 (for example–Gladstone Port's $42 million East Shores project, $38 million New Tug Facility, and $20 million Channel Duplication Environmental Impact Statement) also contributed to a lower capital replenishment ratio. We acknowledge that industry funded $35 million of the costs of the East Shores project.

The return on equity ratio calculates how much profit an entity generates as a proportion of their net assets. This ratio decreased to 4.70 per cent in 2014–15 from 7.40 per cent in 2013–14. The decrease in this ratio in 2014–15 was largely driven by the impact of NQBP's asset valuation increments in 2014–15 and GPCL experiencing lower profits in 2014–15 due to asset revaluation adjustments in 2013–14 not being repeated. Significant revaluations have increased equity balances.

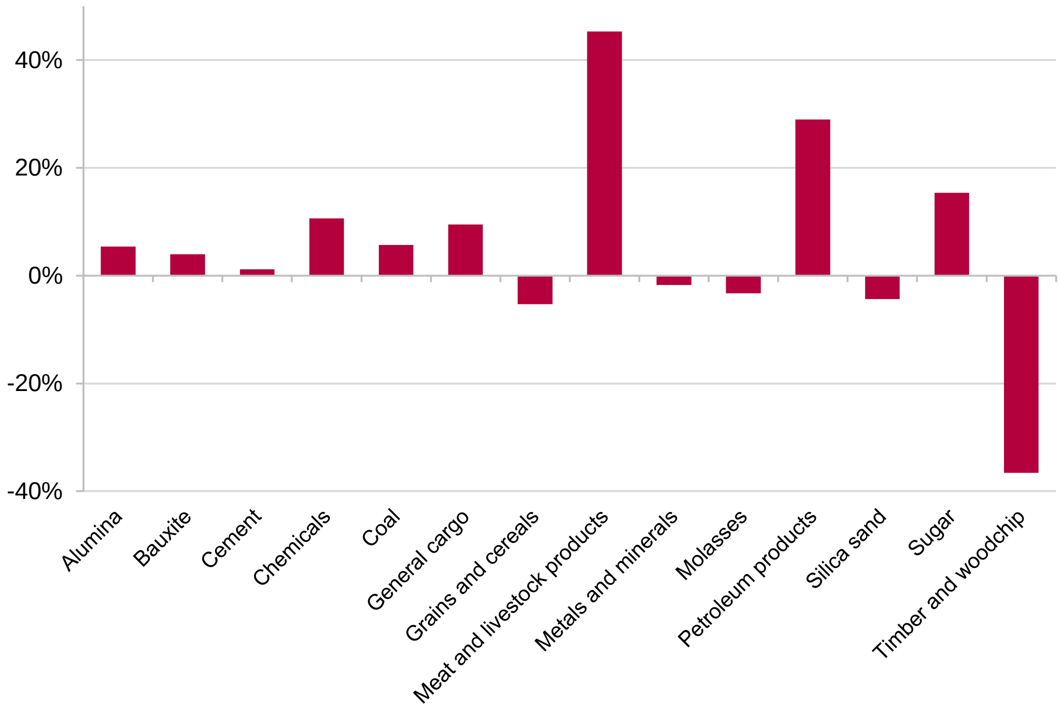
The ports sector did not source any new borrowings in 2014–15 and only the PoTL repaid debt in 2014–15.

Trade snapshot

The outlook of the resource industry in Queensland will continue to influence trade volumes and consequently, revenues generated by port corporations. The coal export industry represents nearly 80 per cent of all commodity exports. Changes in supply and demand for resources arising from oversupply (e.g. coal), declining oil prices, falling resource prices and a declining Australian currency all represent challenges for commodity-based ports. Reducing revenue streams can also have a direct impact on asset values and depreciation charges.

The volume of freight moved through the ports increased by 15.7 million tonnes or 5.65 per cent. Coal exports increased by 5.7 per cent and together with bauxite, these two commodities represent nearly 90 per cent of total volume of freight movements. Commodity volumes of exports exceed imports by a ratio of approximately 9:1. Figure 4F shows the net movement in commodities between 2014–15 and the previous year.

Figure 4F
Annual movement in trade volumes between 2014 and 2015



Source: Queensland Audit Office

5. Rail sector

In brief

Queensland Rail's (QR) role as a railway manager and operator is to service the passenger, tourism, resources and freight customer markets across more than 6 500 kilometres of track.

This chapter details the results of our 2014–15 audit and key matters we looked at in forming our opinions for QR, Queensland Rail Limited, On Track Insurance Pty Ltd (OTI) and QR's below rail services.

Conclusion

The audit opinions issued on the financial reports of each entity were unqualified.

QR continues to provide timely and quality financial statements to audit by the agreed timeframes.

QR is financially sustainable and its future sustainability depends on providing passenger rail services to the Department of Transport and Main Roads (DTMR) under a transport services contract. They also manage rail networks across Queensland by improving supply chain solutions and helping the needs of the resources, agricultural, construction and tourism industries.

Audit results and key matters

- All entities in the QR Group provided draft financial reports for audit by their agreed milestones. We certified all reports by the legislative deadlines.
- We confirmed QR's conclusion that as there were no indicators that the value of QR's physical assets were impaired, so no adjustment was required to asset values.
- More than half of QR's 44 976 infrastructure assets (including asset sub-components) still in service have been fully depreciated and have no accounting value. Consequently, the consumption of the service potential embodied in these assets is not reflected in QR's depreciation expense or its financial performance. On average QR still expects to continue to use these assets for a further 21 years.
- Another 19 746 infrastructure assets (including asset sub-components) will reach the end of their life by 2025.
- QR's operating profit for 2014–15 was reduced by $30 million due to the costs of the expected early retirement of Citytrain Rollingstock for the introduction of New Generation Rollingstock in 2016.

Rail sector

The Queensland rail sector comprises of QR, Queensland Rail Limited and On Track Insurance Pty Ltd with a 30 June balance date. Figure 5A shows the rail network across Queensland.

Figure 5A
Queensland rail network map

Source: Queensland Competition Authority

The *Queensland Rail Transit Authority Act 2013* (QRTA Act) establishes the statutory body—Queensland Rail Transit Authority (Queensland Rail). The statutory body employs all employees.

Queensland Rail Limited is a controlled entity of QR. Queensland Rail Limited is an integrated rail services provider, owning all rail infrastructure in the metropolitan network and the non-coal regional rail network. Queensland Rail Limited is responsible for construction, maintenance and operation of the infrastructure. Its three primary products are SEQ Commuter, Travel and Tourist train and Network.

OTI is a subsidiary of Queensland Rail Limited. The principal objective of OTI is to provide insurance services to and underwrite the risk of Queensland Rail Limited for events occurring up until 30 June 2010. Queensland Rail uses external insurers for events post 30 June 2010.

Current sector context

The rail sector is influenced by:

- Mount Isa Line
- Regional Australian Rail Track Corporation review
- High Court challenge
- access undertaking
- increased depreciation from the planned replacement of City Train Rollingstock by New Generation Rollingstock (NGR).

Since our report last year, the government has announced that it will not lease or sell the Mount Isa Line with Port of Townsville Limited.

There has been no announcements made in respect of the Australian Rail Track Corporation review on the viability of integrating Queensland's regional rail network with the national rail network.

On 8 April 2015 the High Court of Australia unanimously held that Queensland Rail is a trading corporation within the meaning of s 51(xx) of the Constitution, with the consequence that the relations between Queensland Rail and its employees are governed by federal industrial relations law and not Queensland industrial relations law.

Queensland Rail Transit Authority is the employer for all employees of the Queensland Rail group. These employees are provided to Queensland Rail Ltd for the operation of rail services in Queensland.

In response to the High Court ruling, Queensland Rail has continued to honour the relevant enterprise agreement terms and conditions and has been engaging in negotiations with Unions on replacement enterprise agreements under the Fair Work Act 2009.

QR has been ordered to pay the claimants' legal costs in the High Court proceedings. The quantum of those costs is yet to be agreed or assessed by the Court.

QR has continued to pay its Traincrew employees at the rates specified in a State-based enterprise agreement approved by the workforce in 2013, which are above the rates that would otherwise apply under the applicable enterprise agreement under the *Fair Work Act 2009*. QR will not be seeking reimbursement of those additional amounts from Traincrew employees. An estimate of the amounts paid to employees over and above the relevant pay rates is $8.57 million.

The Queensland Competition Authority (QCA) oversees network access tariffs collected by Queensland Rail Ltd (access revenue reported in 2014–15 was $234 million). Queensland Rail Ltd is currently operating under the network access undertaking that expired on 30 June 2015. Queensland Rail Ltd has submitted a revised access undertaking to the QCA on 5 May 2015.QCA's draft decision was published on 8 October 2015 and are seeking submissions by 24 December 2015. The QCA is expected to publish the Final Decision on QR's draft access undertaking before the end of the 2015–16 financial year.

Department of Transport and Main Roads (DTMR) and Queensland Rail are revising the Transport Services Contract which sets out QR's role and responsibilities in relation to the New Generation Rollingstock (NGR) project. Queensland Rail has estimated that the planned retirements of existing CityTrain fleet Rollingstock following the introduction of the NGR fleet will reduce the size of the maintained fleet by 42 per cent and result in increased costs of $86 million over the period 2014–15 to 2017–18.

Conclusions

We certified unqualified audit opinions of all entities in the QR group. Readers can rely on the results in the audited financial reports of these entities.

We completed audits within legislative deadlines and we received good quality draft financial reports as part of this process.

When forming an audit opinion on the financial report of an entity, we also assessed QR's financial sustainability to operate as a going concern. QR's future sustainability primarily depends on its TSC with DTMR.

QR achieved a $10 million increase to $223.7 million in net profit after tax in 2014–15 mainly due to reduced expenditures.

More than half of QR's infrastructure assets (including sub-components) still in service have a recorded accounting value of nil. QR's financial performance is boosted from the continued use of assets that do not bear a depreciation charge.

Audit results

Financial reports

Figure D1 in Appendix D summarises opinions issued for the sector during 2014–15.

QR provided pro forma and draft financial reports for audit by their agreed milestones. Management and audit certified financial reports by their legislative deadlines. QR provided pro forma financial statements for the month ending April 2015 on the 27 May 2015.

Entities in the QR group did not make material changes to draft financial reports in 2014–15.

We issued unqualified audit opinions for all entities controlled by QR.

Below rail services

We issued an emphasis of matter in our audit opinion of the 2013–14 below rail services financial report to highlight the report is a special purpose report and may not be suitable for other purposes. The audit of the 2014–15 below rail services financial report is due for completion in December 2015.

We issued an unqualified audit opinion on the Below Rail financial statements for 2013–14 on 16 December 2014.

QR and the QCA have not resolved the application of access revenue tariffs charged on the West Moreton line and the outcome is expected to have a significant impact on QR's budgeted financial performance and position.

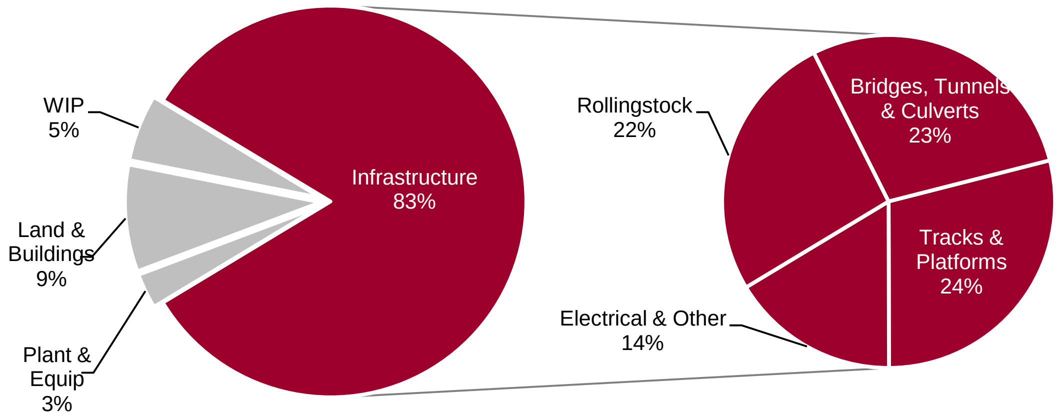
Key audit matters we raised with entities

Financial reporting of property, plant and equipment

Overview of property, plant and equipment

Queensland Rail Ltd operates and maintains $6.3 billion of property, plant and equipment, including $5.3 billion of infrastructure assets (including Rollingstock). Figure 5B below depicts the breakdown by asset class.

Figure 5B
Rail sector property, plant and equipment assets at 30 June 2015



Source: Queensland Audit Office

Valuation of assets

QR value their physical assets under the cost model. We assessed the following possible indicators of impairment to QR's assets and concluded that there was no basis to adjust the reported value of physical assets as at 30 June 2015:

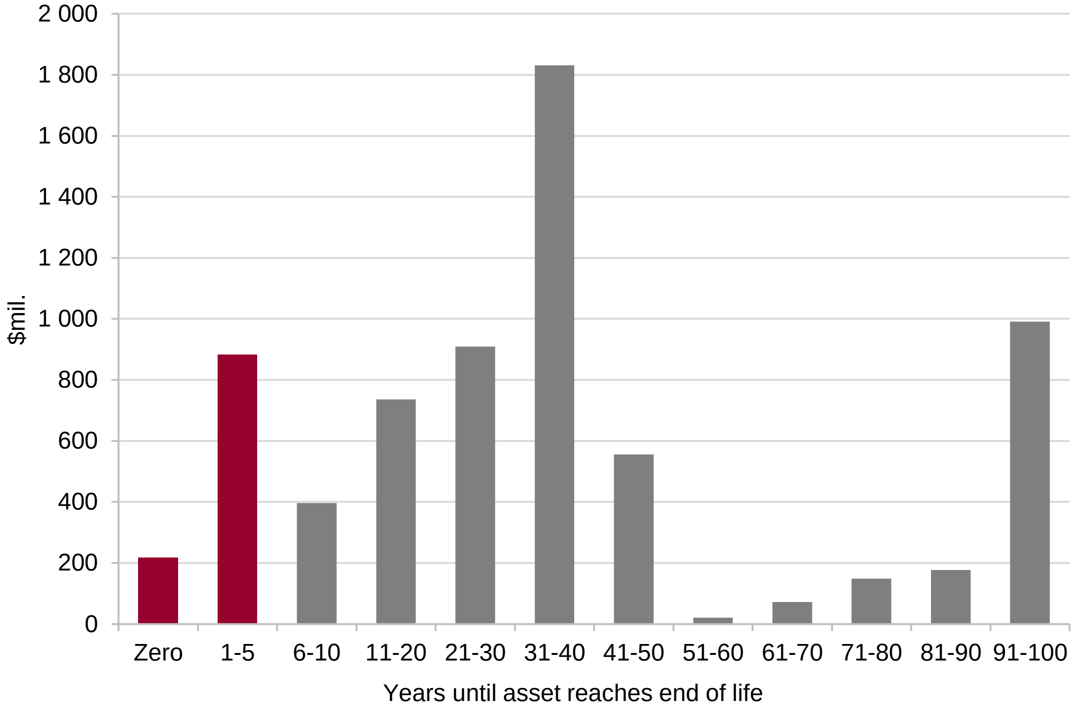
- whether there was no significant deterioration in the condition of or assessment of the useful lives of assets
- whether there were known technological, market, economic or legal conditions affecting assets
- whether QR was exposed to market capitalisation influences
- whether there were known significant plans to discontinue any QR operations, modify the way assets are used or plans to sell a material portion of assets
- whether operating cash flows remain positive, profits are estimated in each of the next four years and QR is in a position to cover its finance costs.

QR also entered into a new Transport Service Contract (TSC) (expiring 2018 with options to extend) with DTMR in June 2015 concerning the funding of above and below rail operations.

Useful life of infrastructure assets

As part of our financial statement audit, we examine assumptions used by management about the remaining useful lives of their property, plant and equipment balances. From the data collected this year we profiled the remaining life of infrastructure assets. Figure 5C shows the cost and timing of when these assets are estimated to reach the end of their useful lives. We used accumulated depreciation and written down values to approximate cost in the absence of actual replacement costs.

Figure 5C
Cost and remaining life of infrastructure assets at 30 June 2015



Source: Queensland Audit Office

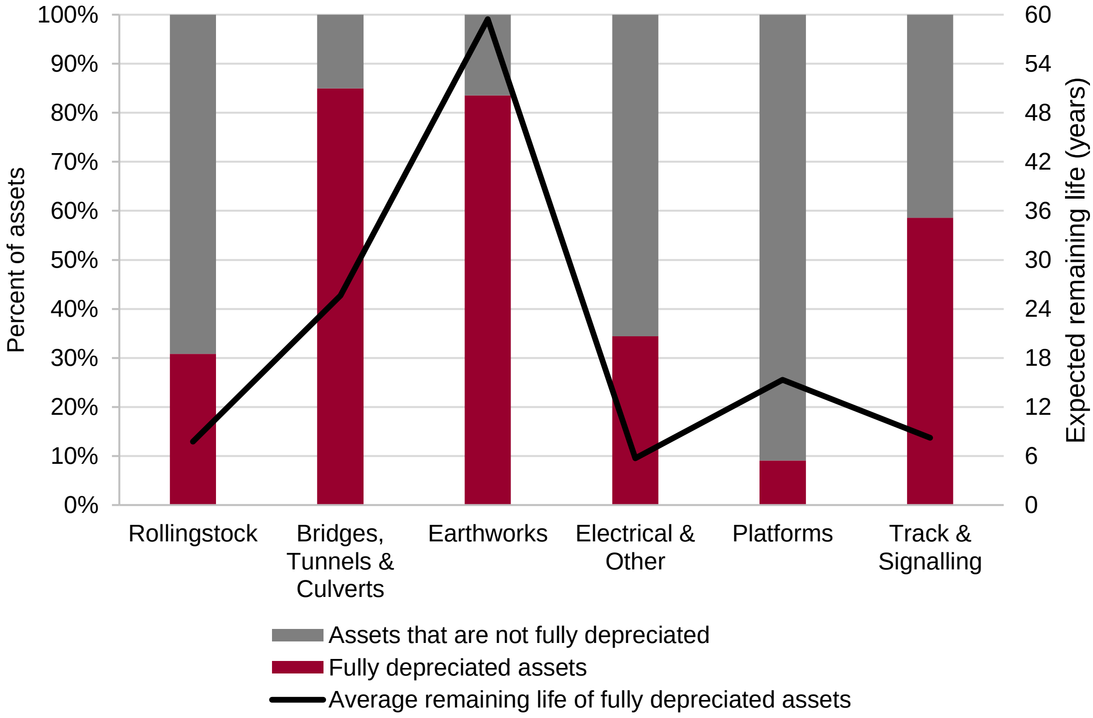
Although the cost to replace these assets in the future may be different to that recorded in asset registers, we identified that nearly 20 000 infrastructure assets with a total gross cost of $1.5 billion will reach the end of their useful life by 2025.

Rollingstock assets make up 72 per cent of the gross value of infrastructure assets reaching the end of their useful life in the next five years. This is primarily due to the planned early retirement of Citytrain Rollingstock with the introduction of the NGR fleet, scheduled to commence in 2016.

As at 30 June 2015, QR had more than 9 000 infrastructure assets in use that have reached the end of their expected useful life. These assets have a reported gross cost of $218 million, however their expected current replacement cost is more than $1 billion.

Figure 5D below identifies the number and type of assets that are still in use and fully depreciated.

Figure 5D
Useful lives by infrastructure asset sub-class



Source: Queensland Audit Office

While these assets have an accounting book value of nil or scrap value, we acknowledge that QR asset management practices include the regular assessment of the expected remaining operational lives of these assets.

Change in bond rates reduced employee benefits expenses

Accounting standards require that for-profit entities use market yields of high quality corporate bonds to discount long-term employee liabilities.

In 2014–15, a national actuarial provider reported that there is now a deep market for corporate bonds in Australia. We assessed and accepted the discount rate QR used to determine the present value of employee benefits from the 10-year Commonwealth bond rate to an Australian corporate bond rate. By applying a lower discount rate, QR increased net profit after tax by $8.5 million or (employee benefits expense reduced by more than $12 million).

Operating result impact of the planned replacement of Citytrain Rollingstock by New Generation Rollingstock (NGR)

DTMR and QR are revising the Transport Services Contract setting out QR's role and responsibilities in relation to the New Generation Rollingstock (NGR) project. Under QR's fleet transition strategy, rollingstock and other related assets will be retired from service earlier than their effective useful life. QR has estimated that the planned retirements of will reduce the size of the maintained fleet by 42 per cent. Figure 5E shows the estimated increase in cost expected over a four-year period.

Figure 5E
Estimated increased cost from early retirement of Citytrain fleet and related assets

Year	Increase in cost $ m
2014–15	30.6
2015–16	21.6
2016–17	22.9
2017–18	10.9

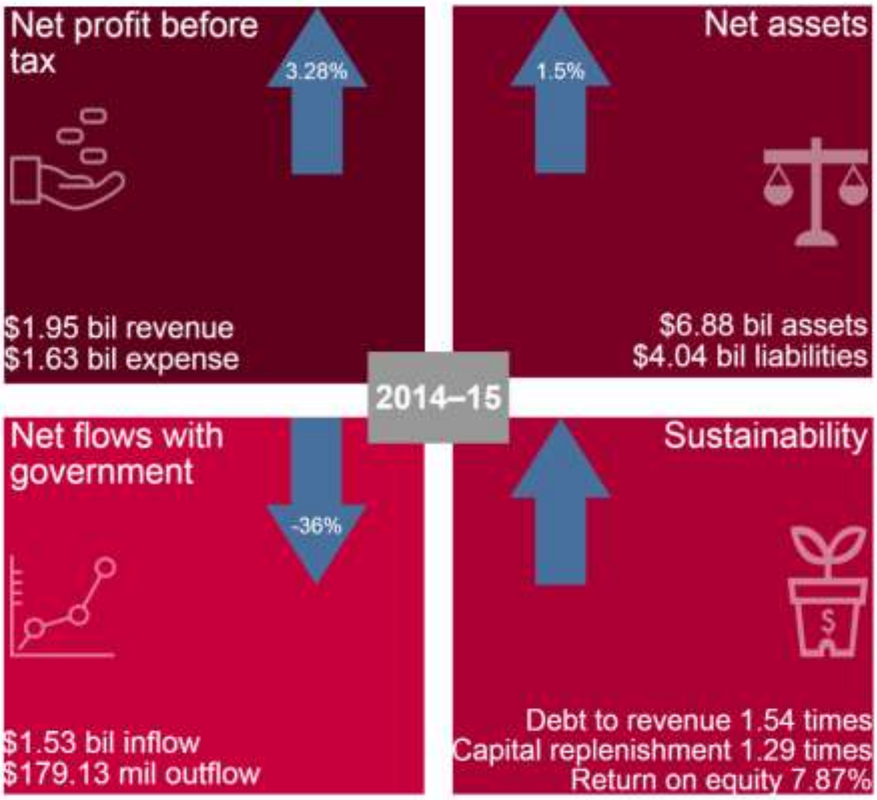
Source: Queensland Audit Office

We considered QR's position on accelerating the depreciation from replacing some of the Citytrain fleet with the NGR, and concluded that the effect on depreciation expense was reasonable and adequately supported by Board approved fleet strategies and transition plans.

Financial snapshot

Queensland Rail agrees upon a number of financial ratio benchmarks with shareholding ministers in their annual statements of corporate intent. This year we gathered key financial data and ratios for all entities within the PNFC report as detailed in Appendix E and F. Figure 5F provides a snapshot of the rail sector financial results for 2014–15 in comparison to last year.

Figure 5F
Rail sector financial snapshot 2014–15



Source: Queensland Audit Office

Queensland Rail reported a $10 million increase in net profit before tax due in part to reduced employee expenses despite earning $35 million less in TSC revenue from government.

Net flows of funds from government to QR decreased by three per cent from the prior year. The transport services contract represented $1.5 billion of the flows from government offset by flows to government of $314.3 million in dividends declared, income tax expense and competitive neutrality fees.

QRs capital replenishment ratio increased in 2014–15 from 0.99 to 1.29, primarily due to increased capital expenditure in 2014–15 such as the construction of the Lawnton to Petrie third track. QR's ratio does not account for capital spend in the wider rail sector on new generation rolling stock.

QR has been highly leveraged with inherited borrowings of $3 billion. Although QR has been able to service the interest on this debt, the debt remains unpaid at 30 June 2015.

6. Other public non-financial corporations

In brief

This chapter details the results of our 2014–15 audit and key matters examined in forming our opinions for two other public non-financial corporations (PNFCs), Stadiums Queensland and Queensland Treasury Holdings Group (QTH Pty Ltd). Stadiums Queensland manages major sporting and entertainment facilities. QTH Pty Ltd holds investments resulting in the state's privatisation of government assets.

Conclusion

We issued unqualified audit opinions to each of these other PNFCs for 2014–15.

The financial reports for Stadiums Queensland and QTH Pty Ltd were timely and of good quality in 2014–15.

Stadiums Queensland's future financial sustainability continues to rely on government to fund significant capital works, stadium redevelopment and asset replacement.

Audit results and key matters

- There were no significant issues identified in the 2014-15 audits of Stadiums Queensland and QTH Pty Lted.
- Stadiums Queensland made an operating loss of nearly $38 million for 2014–15, that included depreciation expense of $54.8 million for which Stadiums Queensland does not receive funding.
- QTH Pty Ltd 's profit for 2014–15 was $23 million but was down 76 per cent from last year's one-off sale of Aurizon shares
- Sporting and entertainment venue assets comprise 80 per cent of the value of Stadiums Queensland's reported property, plant and equipment of more than $1 billion.
- Stadiums Queensland's asset register shows nearly 1 100 infrastructure assets with a gross replacement cost of $1 458 million will reach the end of their useful life over the next 30 years.
- Stadiums Queensland's regular condition and risk management assessments of assets inform annual capital and maintenance programs so that assets remain functional to industry standards and may lead to asset lives being extended beyond their design life.

Other PNFCs

Other PNFCs include the significant entities of Stadiums Queensland and QTH Pty Ltd. They are the most significant entities in this category thus will be the only entities discussed.

The Queensland Treasury Holdings Group through QTH Pty Ltd holds residual assets resulting from the state's privatisations and other state interests including the state government's shares retained in Aurizon Holdings Ltd. Figure 6A shows the consolidated entity corporate structure of QTH Pty Ltd.

Figure 6A
Queensland Treasury Holdings Pty Ltd consolidated entity corporate structure

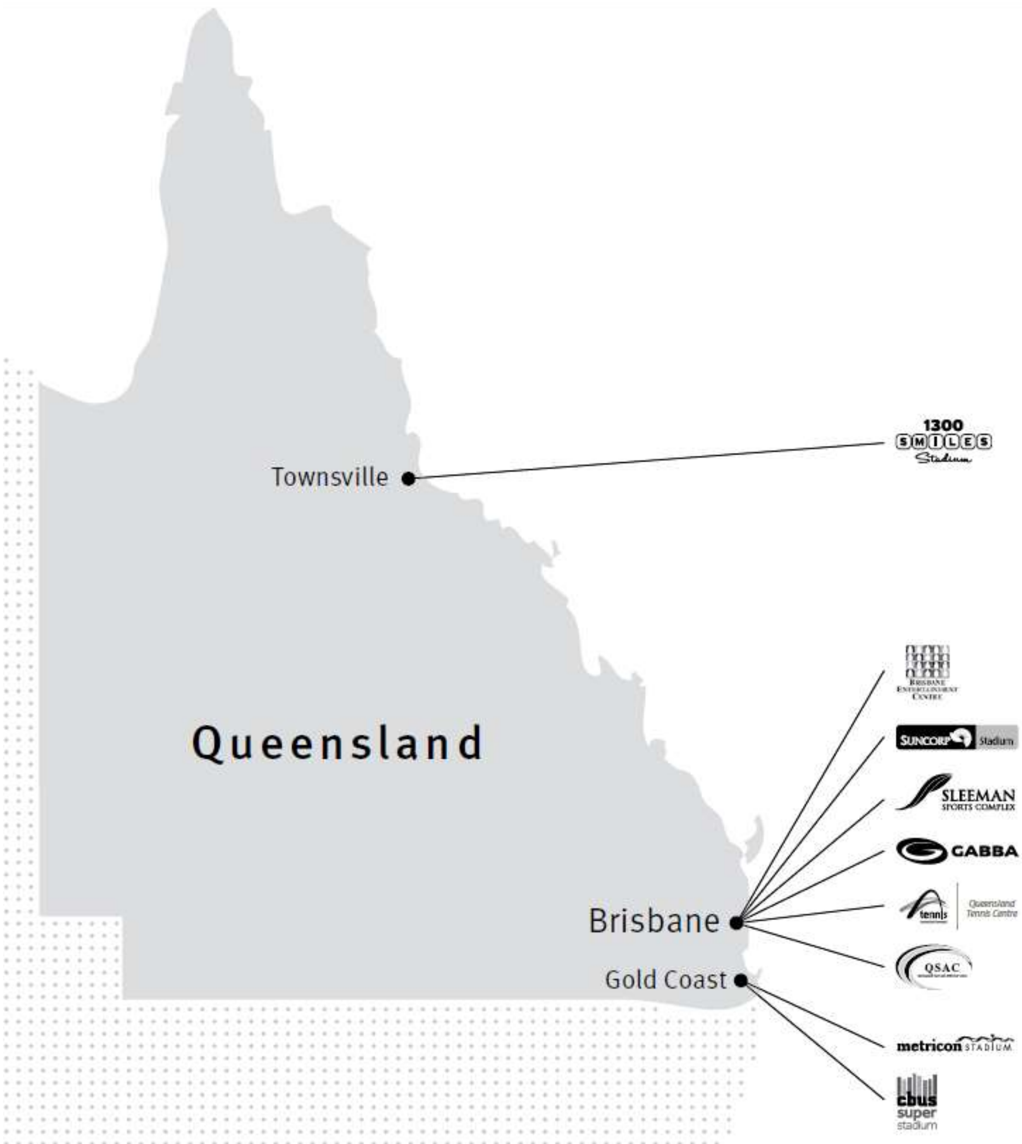
Company	Purpose
Parent entity	
QTH	The principal activity for the consolidated entity is to hold residual assets resulting from the State's privatisations. The Under Treasurer of Queensland holds a 60 per cent interest and 76 per cent of the voting rights as Trustee for the State of Queensland. A further 40 per cent interest and 24 per cent of the voting rights are held through the Queensland Treasury Corporation which is a Corporation Sole constituted by the Under Treasurer.
Controlled entities of QTH	
Brisbane Port Holdings (BPH)	BPH holds Port of Brisbane land assets acting as Port Lessor of these leased assets under a long-term leasing arrangement.
City North Infrastructure Pty Ltd (CNI)	CNI was established to manage the procurement of the Airport Link, Northern Busway and Airport Roundabout Upgrade projects. In 2013, the State transferred the project and contract management responsibilities undertaken by CNI to QTH, with the remaining activities of CNI being the finalisation of administrative and corporate matters.
DBCT Holdings Pty Ltd (DBCTH)	DBCTH owns and leases Dalrymple Bay Coal Terminal assets.
Network Infrastructure Pty Ltd (NWI)	NWI is currently dormant and has not traded since its registration date.
Queensland Airport Holdings (Cairns) Pty Ltd (QAHC), and Queensland Airport Holdings (Mackay) Pty Ltd (QAHM)	The primary objective of QAHC and QAHM is to hold land zoned for use as an airport on behalf of the State. Both entities were established to act as lessors for these leased assets under a long-term leasing arrangement.
Queensland Lottery Corporation Pty Ltd	QLC holds the Queensland Lottery Licence and Golden Casket brands and trademarks on behalf of the State Government which are licensed to Tattersall's through the Golden Casket Lottery Corporation.

Source: Queensland Treasury Holdings Consolidated Group 2014–15 Financial Reports

Figure C5 in Appendix C lists entities controlled by QTH Pty Ltd, for which we have not prepared an audit opinion.

Stadiums Queensland is a not-for-profit entity that manages, operates and promotes the use of major sporting and entertainment facilities on behalf of the Queensland Government. Six of the facilities are in Brisbane, with two on the Gold Coast and one in Townsville. Figure 6A shows the venues managed by Stadiums Queensland.

Figure 6A
Map of Stadiums Queensland venues



Source: Stadiums Queensland Annual Report 2014–15

Conclusions

We certified unqualified audit opinions of all entities in other PNFC sector. Readers can rely on the results in the audited financial reports of these entities.

We completed audits within legislative deadlines and we received good quality draft financial reports as part of this process.

When forming an audit opinion on the financial report of an entity, we also assessed that Stadiums Queensland's financial sustainability primarily depends on government grants.

QTH Pty Ltd achieved a $23 million profit in 2014–15 down 76 per cent from last year's one-off sale of Aurizon shares.

The reported value of Stadiums Queensland's property, plant and equipment does reflect fair value.

Stadiums Queensland's asset register shows nearly 1 100 infrastructure assets with a gross replacement cost of $1 458 million will reach the end of their useful life over the next 30 years.

Stadiums Queensland's regular condition and risk management assessments of assets inform annual capital and maintenance programs so that assets remain functional to industry standards and may lead to asset lives being extended beyond their design life.

Audit results

Financial reports

Figure D1 in Appendix D summarises opinions issued for other PNFC entities, in 2015.

Both entities provided draft financial statements for audit by the agreed milestones. Management and audit certified financial reports for both entities by their legislative deadlines.

Both Stadiums Queensland and QTH Pty Ltd prepared pro forma financial statements in 2015 that assisted in the timely completion of the audits of their financial statements. There were no material changes to draft financial reports presented to audit.

We issued unqualified audit opinions for both entities, confirming that financial reports have been prepared according to requirements of legislation and relevant accounting standards.

Key audit matters we raised with entities

The key matter of focus identified during the course of the 2014–15 audits of Stadiums Queensland and QTH Pty Ltd was the valuation of property, plant and equipment at Stadiums Queensland.

City North Infrastructure Pty Ltd

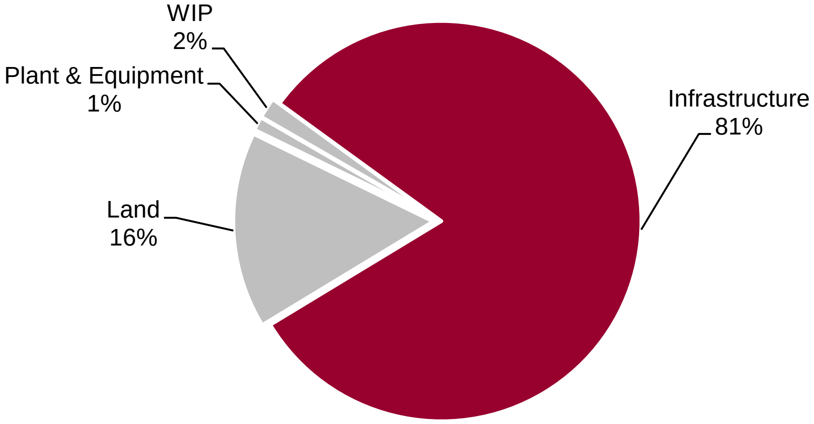
City North Infrastructure Pty Ltd is likely to cease operations in the 2015–16 financial year. We have issued an unqualified opinion for the company in the 2014–15 year and added a paragraph to our opinion, which highlights the company's expected closure. It is therefore unlikely to continue as a going concern, beyond 30 June 2016.

Financial reporting of property, plant and equipment - Stadiums Queensland

Overview of property, plant and equipment

Stadiums Queensland operates and maintains $1 047 million of property, plant and equipment, with infrastructure of Buildings and Land Improvements making up more than 80 per cent of the value of these assets. Figure 6B shows the breakdown of property, plant and equipment by asset class.

Figure 6B
Stadiums Queensland asset at 30 June 2015



Source: Queensland Audit Office

Valuation of assets

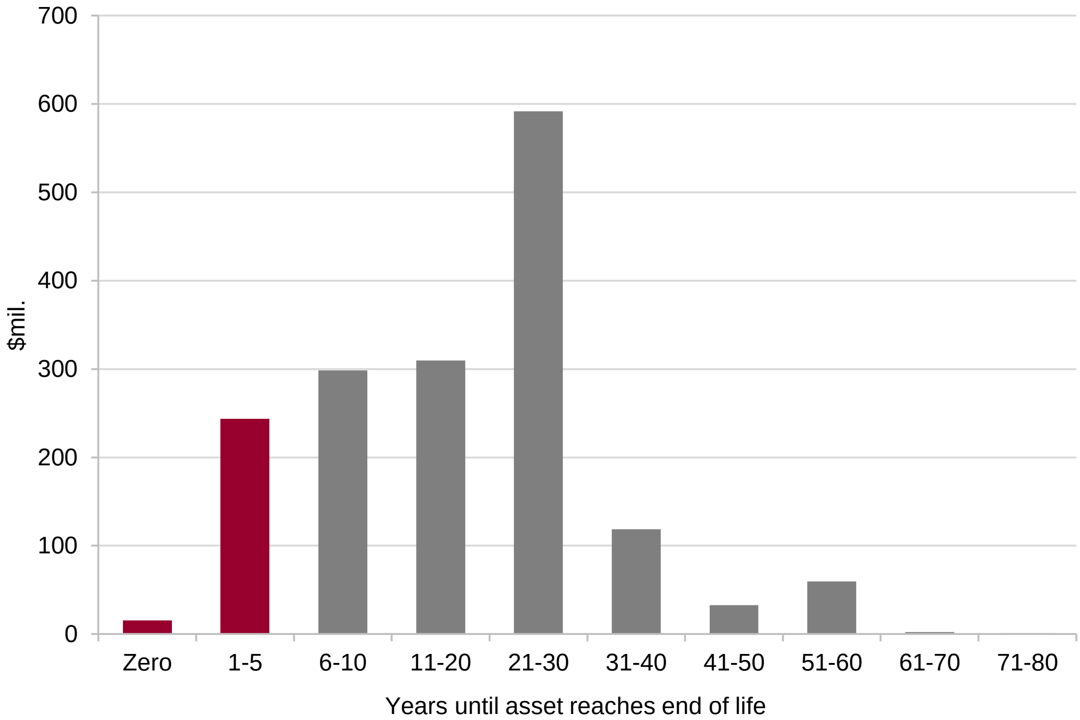
The valuation of Stadiums Queensland's land and infrastructure assets resulted in a revaluation increment of $31.139 million, however $52.134 million in depreciation expenses on infrastructure assets meant that the reported value of infrastructure assets decreased by only $17.2 million or 1.7 per cent from 2014 to 2015.

We reviewed the valuer’s reports and noted that the key assumptions adopted by the valuers used were reasonable and indicative of market trends.

Useful life of infrastructure assets

As part of our financial statement audit, we examine assumptions used by management about the remaining useful lives of their property, plant and equipment balances. From the data collected this year we profiled the remaining life of infrastructure assets. Figure 6C shows the cost and timing of when these assets are estimated to reach the end of their useful lives. We used accumulated depreciation and written down values to approximate cost in the absence of actual replacement costs.

Figure 6C
Cost and remaining life of Stadiums Queensland infrastructure assets at 30 June 2015



Source: Queensland Audit Office

Stadiums Queensland's asset register shows that nearly 1 100 infrastructure assets with a gross replacement cost of $1.46 billion will reach the end of their useful lives over the next 30 years. Assets shown in the 21–30 year band is largely attributable to stadium assets.

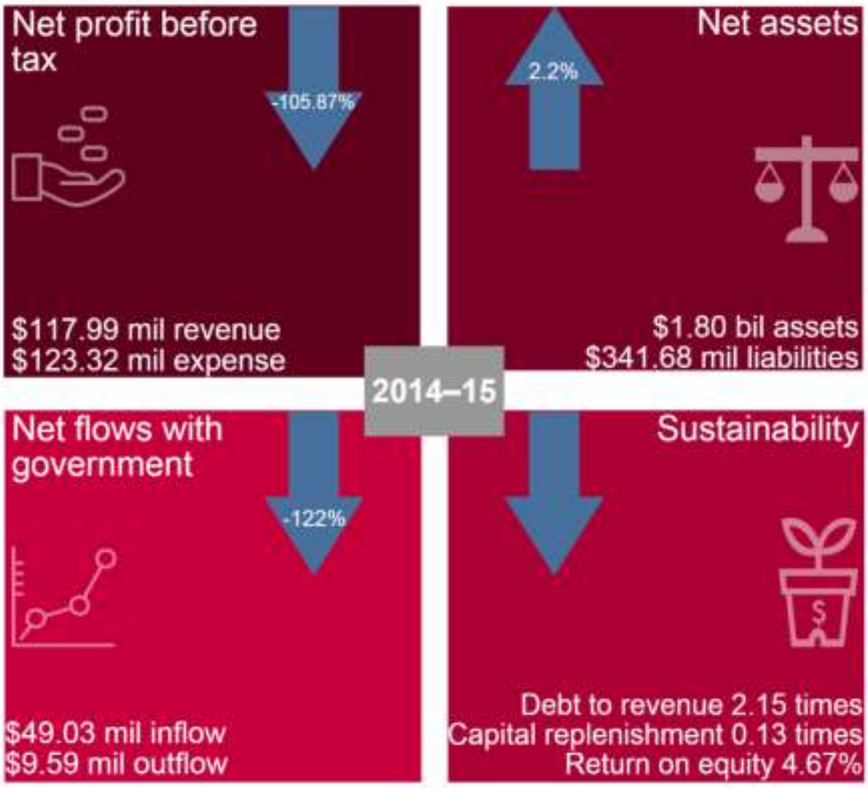
In the next ten years over 700 assets with a recorded gross replacement cost of more than $550 million that will reach the end of their life by 2025.

Stadiums Queensland’s regular condition and risk management assessments of assets inform annual capital and maintenance programs so that assets remain functional to industry standards and may lead to asset lives being extended beyond their design life. The remaining useful lives of assets are revised during the valuation process.

Financial snapshot

Figure 6D provides a snapshot of the combined financial results for 2014–15 for Stadiums Queensland and QTH Pty Ltd.

Figure 6D
Other sector financial snapshot 2014–15



Note: QTH Pty Ltd does not hold any PPE or Intangibles. The capital replenishment ratio relates to Stadiums Queensland only. The return on equity ratio relates to QTH Pty Ltd.

Source: Queensland Audit Office

Stadiums Queensland

Stadiums Queensland incurred a $37.9 million operating loss for 2014–15, which included government grant revenue of $32.1 million and depreciation expense of $54.8 million. Stadiums Queensland does not receive funding for depreciation charges.

Total assets remained steady at $1.1 billion. This included the transfer of capital works in progress costs connected with a Gold Coast 2018 Commonwealth Games venue to Stadiums Queensland from the Department of Tourism, Major Events, Small Business and the Commonwealth Games. Revaluation increments on stadium assets also boosted asset values by $31.1 million.

Government inflows to Stadiums Queensland of $47.5 million in 2014–15 included $32.1 million in operating and capital grants to help Stadiums Queensland meet venue maintenance costs, insurance costs, property costs and asset replacements, refurbishments, and other venue upgrades.

Queensland Treasury Holdings Group

QTH Pty Ltd's profit for 2014–15 was $23 million, being a decrease of $72 million or 76 per cent. The decrease mostly resulted from a significant one-off sale of Aurizon shares in 2013–14.

QTH Pty Ltd's debt to revenue ratio indicates that total borrowings is 3.5 times total operating revenue (see Appendix E).

QTH Pty Ltd's gearing has decreased by 10.3 per cent which demonstrates that borrowings have decreased as a proportion of net assets.

Return on Equity decreased by 77 per cent in 2015 and is largely attributable to a 75 per cent decrease in net profit after tax.

Flows between QTH Pty Ltd and the Queensland Government have decreased significantly by $290.9 million in 2015. QTH Pty Ltd have declared a dividend in 2015 of $10 million, which has similarly decreased by $250 million or 96 per cent, compared with the previous year.

The reduction in profits and consequent reduction in dividend and flows with government is primarily due to a one-off sale of Aurizon shares in the 2013–14 year causing a spike in QTH Pty Ltd revenues for that year.

Appendices

Appendix A—Comments

In accordance with s.64 of the *Auditor-General Act 2009*, we provided a copy of this report or parts of this report to a number of entities and parties with a request for comment; the option of providing comments; and for their information.

We provided a copy of this report to the Minister for Main Roads, Road Safety and Ports and Minister for Energy and Water Supply; the Minister for Transport, Minister for Infrastructure, Local Government and Planning and Minister for Trade; the Minister for Agriculture and Fisheries and Minister for Sport and Racing. Treasurer, Minister for Employment and Industrial Relations and Minister for Aboriginal and Torres Strait Islander Partnerships, the Director-General, Department of Energy and Water Supply; the Director-General, Department of Transport and Main Roads; the Director-General, Department of National Parks, Sport and Racing; and the Under Treasurer, Queensland Treasury for comment.

We provided relevant parts of this report to the heads of the following entities/person with an option of providing a response:

- Stanwell Corporation Limited
- CS Energy Limited
- Queensland Electricity Transmission Corporation (trading as Powerlink)
- Ergon Energy Corporation Limited
- Energex Limited
- Queensland Bulk Water Supply Authority (trading as Seqwater)
- SunWater Limited
- Gladstone Area Water Board
- Mount Isa Water Board
- Far North Queensland Ports Corporation Limited (trading as Ports North)
- Gladstone Ports Corporation Limited
- North Queensland Bulk Ports Corporation Limited
- Port of Townsville Limited
- Queensland Rail
- Stadiums Queensland
- Queensland Treasury Holdings Pty Ltd
- Department of Transport and Main Roads
- Department of Energy and Water Supply
- Department of National Parks, Recreation, Sports and Racing
- Under Treasurer, Queensland Treasury and Trade.

We provided a copy of this report to the Premier; the Treasurer and Minister for Trade; the Director-General, Department of the Premier and Cabinet; and the Chief Executive Officer, Queensland Competition Authority for their information.

We have considered all views provided to us in reaching our audit conclusions and these are represented to the extent relevant and warranted in preparing this report.

Responsibility for the accuracy, fairness and balance of the comments rests with the head of these agencies. Appendix A of this report includes comments we received within 21 days.

Comments received from Chairman, Queensland Rail

QueenslandRail

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F 07 3072 0090
ww.queenslandrail.com.au

Our ref: MCR-15-1121

QUEENSLAND RAIL COMMERCIAL-IN-CONFIDENCE

Mr Andrew Greaves
Auditor-General
Queensland Audit Office
PO Box 15396
City East QLD 4002

RECEIVED
26 NOV 2015
QUEENSLAND AUDIT OFFICE

Dear Mr Greaves

PUBLIC NON-FINANCIAL CORPORATIONS: 2014-15 FINANCIAL STATEMENTS

I refer to your letter dated 5 November 2015 and the letter of 9 November 2015 from Mr George in relation to the proposed Report to the Queensland Parliament on the Public Non-Financial Corporation (PNFC) 2014-15 Financial Statements ("the Report"). Draft Sections of the Report were provided, including the Summary Context and the Rail Chapter, with a request that Queensland Rail provide any comments in relation to those sections of the Report within 21 days.

I acknowledge that while a formal response is not required, the opportunity to provide comments on the sections of the Report concerning Queensland Rail is appreciated.

I understand that senior management at Queensland Rail has reached agreement with your officers on various factual and typographical amendments to the Report. A summary of these changes is included in ***Attachment A***. In addition to those changes to the Report, I submit the following comments:

- The Report refers to the NGR Interface Agreement that is currently being finalised between Queensland Rail and the Department of Transport and Main Roads (DTMR). The Queensland Rail Board considers the interface arrangement to be an interim arrangement pending longer term consideration of the ownership of the NGR assets, after their commissioning, as they are effectively to be operated by Queensland Rail. Queensland Rail and DTMR have agreed to a commercial review being undertaken next year which will include consideration of future ownership arrangements for the NGR fleet and the infrastructure assets comprising Moreton Bay Rail Link. The subsequent views of stakeholders will be considered concerning the financial architecture under which these assets could be transferred to Queensland Rail.

- The Report states that more than half of the 44,976 infrastructure assets are fully depreciated and have no accounting value. It should be noted that depreciation is an accounting estimate and a fully depreciated asset does not always equate with an asset reaching the end of its economic or commercial life. Such assets appropriately maintained and serviced continue to deliver economically efficient logistic services that benefit communities and commerce and facilitate the economic growth of the State.

Queensland Rail (ABN 08 556 265 526) and Queensland Rail Limited (ABN 71 132 181 090)

Comments received from Chairman, Queensland Rail

QueenslandRail

- It is important to note that at this stage the amount of increased depreciation associated with the introduction of the NGR fleet is based on forecasted useful lives of existing fleet. These estimates will be continuously reviewed based on NGR delivery programmes and the actual depreciation cost of the retirement of redundant rolling stock will be determined when decommissioning is finally affected.

The Board and senior management thank you for the opportunity to respond to the Report. If you require further clarification in relation to any of the comments in this letter, please contact Mark Hope, Chief Financial Officer and EGM Commercial and Strategy.

Yours sincerely

Michael Klug AM
Chairman
Queensland Rail

26 November 2015

Comments received from Chairman, CS Energy

CS energy

Our Ref: B/D15/24677
Letter No:

26 November 2015

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

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QUEENSLAND AUDIT OFFICE

Dear Mr Greaves

RE: Results of Audit: Public Non-Financial Corporations

Thank you for providing the draft report to Parliament on the *2014-15 Results of audit: Public non-financial corporations* for comment. CS Energy notes the substantial and important role the Auditor-General and its officers have in ensuring all public entities meet the standards expected of them in reporting and in the management of the funds entrusted to them by the taxpayers of Queensland.

CS Energy has been working with the Auditor-General's office to ensure that the report is a true and accurate representation, not only of its position individually, but also its position in relation to the other organisations to which CS Energy is compared in the report.

There are several other matters that make sensible comparison in the report difficult, and which CS Energy believes should be highlighted. Although the report recognises these issues in the commentary to varying extents, it is important to clarify CS Energy's position in relation to these matters, specifically:

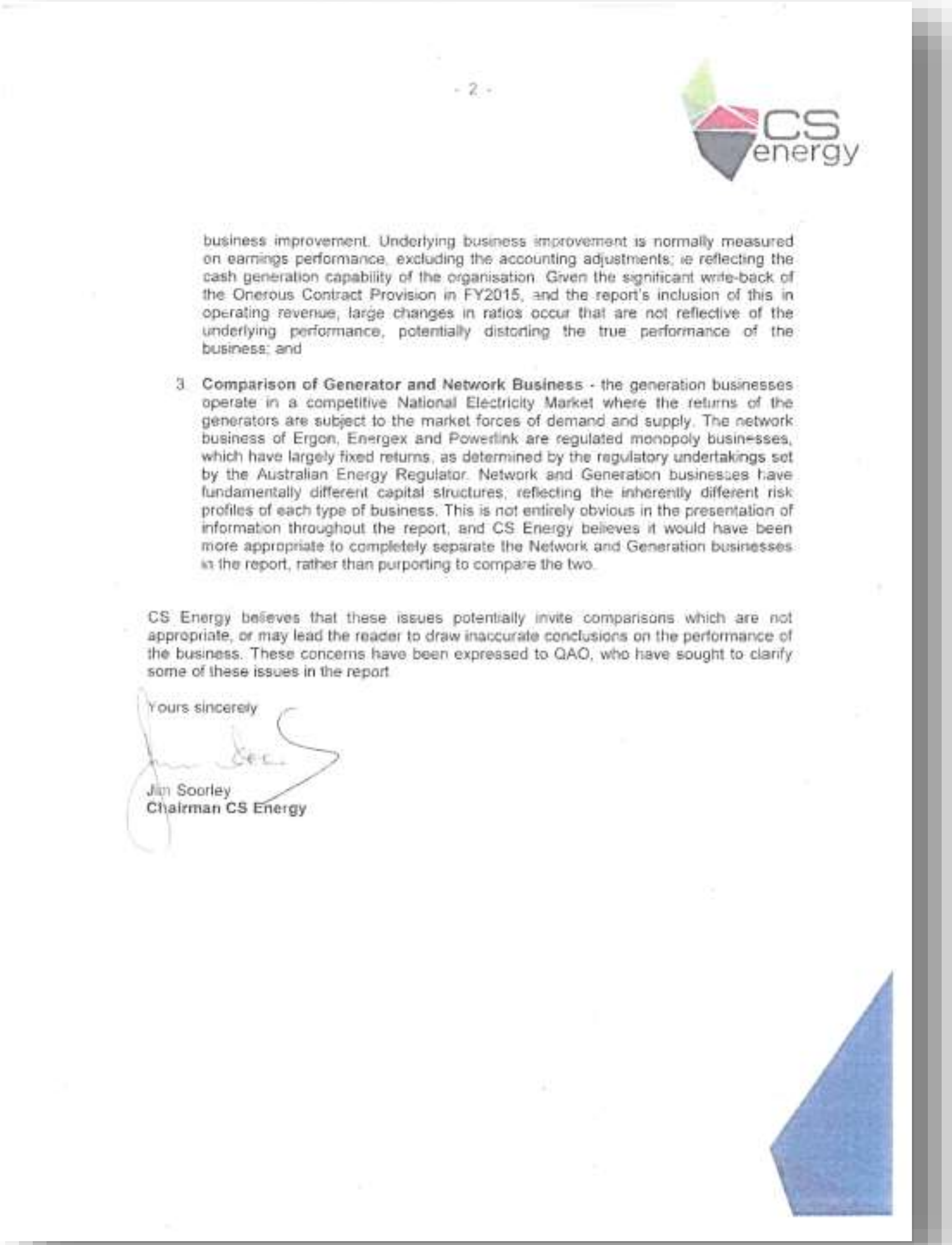
1. **Financial metrics used to compare performance** - The report notes as an objective to assess the financial sustainability of the entities including an entity's ability to pay its ongoing expenses, replace and grow its assets, and pay its debts as and when they fall due. The report utilises four key ratios to assess corporation sustainability; return on equity ratio, capital replenishment ratio, interest coverage time's ratio and the debt to revenue ratio. Many of these ratios are not relevant to the generation industry and do not reflect the manner in which sustainability and business performance is presently measured by the CS Energy management team; and

2. **Inclusion of accounting adjustments in reporting results** - One of the more problematic issues in the report is the inclusion of accounting adjustments in the operating revenue calculation. CS Energy is focused on delivering underlying

Brisbane Office | Callide Power Station | Kogan Creek Power Station | Wivenhoe Power Station

CS Energy Ltd

Comments received from Chairman, CS Energy



- 2 -

business improvement. Underlying business improvement is normally measured on earnings performance, excluding the accounting adjustments; ie reflecting the cash generation capability of the organisation. Given the significant write-back of the Onerous Contract Provision in FY2015, and the report's inclusion of this in operating revenue, large changes in ratios occur that are not reflective of the underlying performance, potentially distorting the true performance of the business; and

3. **Comparison of Generator and Network Business** - the generation businesses operate in a competitive National Electricity Market where the returns of the generators are subject to the market forces of demand and supply. The network business of Ergon, Energex and Powerlink are regulated monopoly businesses, which have largely fixed returns, as determined by the regulatory undertakings set by the Australian Energy Regulator. Network and Generation businesses have fundamentally different capital structures, reflecting the inherently different risk profiles of each type of business. This is not entirely obvious in the presentation of information throughout the report, and CS Energy believes it would have been more appropriate to completely separate the Network and Generation businesses in the report, rather than purporting to compare the two.

CS Energy believes that these issues potentially invite comparisons which are not appropriate, or may lead the reader to draw inaccurate conclusions on the performance of the business. These concerns have been expressed to QAO, who have sought to clarify some of these issues in the report.

Yours sincerely

Jim Soorley
Chairman CS Energy

Comments received from Chief Executive, Stadiums Queensland

Stadiums Queensland

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ABN 52 610 873 374

Your ref: 11385
Our ref: FIN-70-22

24 November 2015

Mr A Greaves
Auditor-General
Queensland Audit Office
PO Box 15396
City East Qld 4001

Dear Mr Greaves

In response to your letter of 5 November 2015 and the letter from Mr Nick George, Director of Audit dated 9 November 2015, please find below Stadiums Queensland's response to the draft Public non-financial corporations: 2014-15 financial statements report. Your providing an "in confidence" copy of the draft report for Stadiums Queensland's review and comment is appreciated.

Stadiums Queensland's annual capital and maintenance programs are designed to ensure its assets remain fit for purpose, are maintained to best practice industry standards through refurbishment and asset enhancement and are not managed on a "run to fail" philosophy. The programs are directed at the areas of highest priority based on asset condition assessments, risk assessments and ensuring the venues are fit for purpose. The programs ensure the venues are attractive to patrons as well as adapting to changing market and hirer demands.

The Report suggests the venues will reach the end of their useful lives over the next thirty years. This appears to be based on the assumption that further maintenance and capital enhancements would not extend the assets' life over time. Stadiums Queensland invests in capital enhancement and maintenance programs which have continued to provide venues for hosting national and international events and community sporting activities. Major developments or replacement of Stadiums Queensland venues are a function of State Government policies and initiatives and are not funded within the existing maintenance and capital programs.

It should be noted assets are re-lifed during the valuation process as a result of the capital and maintenance programs carried out to extend the life of the assets.

The report states PNFCs pay dividends, income tax and competitive neutrality fees (CNFs) to the government and receive community service obligation (CSO) payments, grants and net equity contributions from government for selected activities. Stadiums Queensland, as a statutory authority, does not pay dividends, income tax or competitive neutrality fees. Further, it does not receive CSO payments nor net equity contributions from government.

great venues. good times.

Comments received from Chief Executive, Stadiums Queensland

Two of the nine Stadiums Queensland venues are predominately community use venues (Queensland Sport and Athletics Centre and the Sleeman Sports Complex) which are used extensively for school sports carnivals, elite training and to foster participation in sport. There is little (if any) ability to attract events and users that provide a commercial return. The cost of services for community use cannot be recovered in full due to the very nature of the services.

I hope these comments are of assistance.

Yours sincerely

Kevin Yearbury
Chief Executive

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Appendix B—Glossary

Figure B1
Glossary

Term	Definition
Adverse opinion	Opinion issued when the financial statements as a whole do not comply with relevant accounting standards and legislative requirements.
Auditor-General Act 2009	An Act of the State of Queensland that establishes the responsibilities of the Auditor-General, the operation of the Queensland Audit Office, the nature and scope of audits to be conducted and the relationship of the Auditor-General with Parliament.
Australian Accounting Standards	Australian accounting standards, including interpretations, are set by the Australian Accounting Standards Board (AASB) to be applied by: ▪ entities required by the Corporations Act 2001 (Cth) to prepare financial reports ▪ governments in preparing financial statements for the whole of government and the General Government Sector (GGS) ▪ entities in the private or public, for profit or not for profit sectors that are reporting entities or that prepare general purpose financial statements.
Australian Accounting Standards Board (AASB)	An Australian Government agency that develops and maintains financial reporting standards applicable to entities in the private and public sectors of the Australian economy.
Australian Energy Market Operator (AEMO)	The National Energy Market Operator and planner. AEMO operates the energy markets and systems and also delivers planning advice in eastern and south-eastern Australia.
Capital dredging	Capital dredging is an excavation activity that enlarges a ports' existing shipping waterways by gathering up sediments and disposing of them at different locations.
Capital expenditure	Amount capitalised to the balance sheet for contributions by an entity to major assets owned by the entity, including expenditure on: ▪ capital renewal of existing assets that returns the service potential or the life of the asset to that which it had originally ▪ capital expansion which extends an existing asset at the same standard to a new group of users.
Capital replenishment ratio	Net purchases of non-financial assets to depreciation expense.
Community service obligations	Government payments for commercial entities to provide services that are not in the entity's commercial interests.
Competitive neutrality fees	A fee applied to GOC's cost of debt to offset competitive advantages they have over private sector competitors.

Term	Definition
Debt to revenue ratio	Total borrowings to total operating revenue.
Deemed cost	On first-time adoption of the Australian Equivalents to International Financial Reporting Standards 1 July 2005, entities chose to either continue recording assets at fair value or change to record property, plant and equipment at cost from that point forward. Those entities that changed over to cost accounting were allowed to deem their fair values at 1 July 2005 to be the cost amount recorded for those assets. Assets purchased or constructed after this were recorded at what it cost the entities to acquire those assets.
Depreciated replacement costs	The current replacement cost of an asset less accumulated depreciation. It reflects the level of remaining service potential embodied in an asset based on the current replacement cost.
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.
Deregulated pricing	The removal of retail price regulation.
Disclaimer of opinion	Opinion issued when the auditor is unable to express an opinion as to whether the financial statements comply with relevant accounting standards and legislative requirements.
Discount rate	Interest rate used to calculate the present day value.
Economic obsolescence	Reduction in the economic life of an asset caused by factors such as regulatory changes, technological changes and excess supply.
Emphasis of matter	A paragraph included with the audit opinion to highlight an issue of which the auditor believes the users of the financial statements need to be aware; the inclusion of an emphasis of matter paragraph does not modify the audit opinion.
Going concern	Means an entity is expected to be able to pay its debts as and when they fall due and to continue to operate without any intention or necessity to liquidate or wind up its operations.
Impairment	When an asset’s carrying amount exceeds the amount that can be recovered through use or sale of the asset.
Interest coverage ratio	Earnings before interest and tax to QTC interest expense (including QTC interest expense, administration and competitive neutrality fees).
Net assets	Total assets less total liabilities.
Net debt	Total QTC borrowings less cash.

Term	Definition
Qualified audit opinion	Opinion issued when the financial statements as a whole comply with relevant accounting standards and legislative requirements, with the exceptions noted in the opinion These exceptions could be the effect of a disagreement with those charged with governance, a conflict between applicable financial reporting frameworks or a limitation on scope that is considered material to an element of the financial report.
RAB gearing ratio	Regulatory Asset Base (standard control services and alternative control services) to total borrowings.
Return on Equity ratio	Net profit after tax to net assets (equity).
Recoverable amount	The higher of fair value less costs of disposal and its value in use.
Under recovery	Receivable recognised as the difference between revenue collected and the maximum revenue allowed to be collected as determined by the regulator.
Unmodified audit opinion	Opinion issued when the financial statements comply with relevant accounting standards and prescribed requirements.
Useful life	The useful life of an asset is not the maximum period it is possible for an asset to exist, but rather the number of years the entity expects to use it.

Source: Queensland Audit Office

Appendix C—Controlled entities for which audit opinions will not be issued

We will not issue 2014–15 audit opinions for some controlled entities in the energy sector, for the reasons listed in Figure C1.

Figure C1
Energy sector controlled entities for which no opinion will be issued for 2014–15

Entity	Parent entity	Reason
Controlled entities		
Mica Creek Pty Ltd	Stanwell	Deed of cross guarantee ASIC order
SCL North West Pty Ltd	Stanwell	Deed of cross guarantee ASIC order
Energy Portfolio 1 Pty Ltd	Stanwell	Dormant
Glen Wilga Coal Pty Ltd	Stanwell	Dormant
Goondi Energy Pty Ltd	Stanwell	Non-reporting
Tarong Energy Corporation Pty Ltd	Stanwell	Dormant
Tarong Fuel Pty Ltd	Stanwell	Deed of cross guarantee ASIC order
Tarong North Pty Ltd	Stanwell	Non-reporting
TEC Coal Pty Ltd	Stanwell	Deed of cross guarantee ASIC order
TN Power Pty Ltd	Stanwell	Deed of cross guarantee ASIC order
Aberdare Collieries Pty Ltd	CS Energy	Dormant
Callide Energy Pty Ltd	CS Energy	Dormant
CS Energy Group Holdings Pty Ltd	CS Energy	Deed of cross guarantee ASIC order
CS Energy Group Operations Holdings Pty Ltd	CS Energy	Deed of cross guarantee ASIC order
CS Kogan (Australia) Pty Ltd	CS Energy	Deed of cross guarantee ASIC order
CS Energy Kogan Creek Pty Ltd	CS Energy	Deed of cross guarantee ASIC order
CS Energy Oxyfuel Pty Ltd	CS Energy	Deed of cross guarantee ASIC order
Kogan Creek Power Pty Ltd	CS Energy	Deed of cross guarantee ASIC order
Kogan Creek Power Station Pty Ltd	CS Energy	Deed of cross guarantee ASIC order
Manzillo Insurance (PCC) Ltd- Cell Enmach	CS Energy	Overseas based entity
Harold Street Holdings Pty Ltd	Powerlink	Deed of cross guarantee ASIC order

Entity	Parent entity	Reason
Powerlink Transmission Services Pty Ltd	Powerlink	Deed of cross guarantee ASIC order
Energy Impact Pty Ltd	Energex	Deed of cross guarantee ASIC order
Metering Dynamics Business Support Pty Ltd	Energex	Non-reporting
Queensland Energy Services Team Pty Ltd	Energex	Non-reporting
Varnsdorf Pty Ltd	Energex	Deed of cross guarantee ASIC order
VH Energy Holdings Pty Ltd	Energex	Deed of cross guarantee ASIC order
VH Finance Pty Ltd	Energex	Deed of cross guarantee ASIC order
VH Operations Pty Ltf	Energex	Deed of cross guarantee ASIC order

Source: Queensland Audit Office

We will not issue 2014–15 audit opinions for some controlled entities in the water sector, for the reasons listed in Figure C2.

Figure C2
Water sector controlled entities for which no opinion will be issued for 2014–15

Entity	Parent entity	Reason
	Controlled entities	
North West Queensland Water Pipeline Pty Ltd	SunWater	Non-reporting
Burnett Water Ltd Pty	SunWater	Non-reporting

Source: Queensland Audit Office

We will not issue 2014–15 audit opinions for some controlled entities in the ports sector, for the reasons listed in Figure C3.

Figure C3
Ports sector controlled entities for which no opinion will be issued for 2014-15

Entity	Parent entity	Reason
	Controlled entities	
Ports Corporation of Queensland	NQBP	Dormant
Mackay Ports Limited	NQBP	Dormant
Gladstone Marine Pilot Service Pty Ltd	GPCL	Non-reporting
Gladstone WICET Operations Pty Ltd	GPCL	Non-reporting

Source: Queensland Audit Office

We will not issue 2014–15 audit opinions for some controlled entities in the rail sector, for the reasons listed in Figure C4.

Figure C4
Rail sector controlled entities for which no opinion will be issued for 2014–15

Entity	Parent entity	Reason
Controlled entities		
On Track Insurance Pty Ltd	Queensland Rail Limited	Non-reporting

Source: Queensland Audit Office

Other Public non-financial corporations for which we will not issue audit opinions for and their reasons are detailed in Figure C5

Figure C5
Other public non-financial corporations for which no opinion will be issued for 2014–15

Entity	Parent Entity	Reason
Controlled entities		
Queensland Airport Holdings (Cairns) Pty Ltd	QTH Pty Ltd	Dormant
Queensland Airport Holdings (Mackay) Pty Ltd	QTH Pty Ltd	Dormant
Network Infrastructure Company Pty Ltd	QTH Pty Ltd	Dormant

Source: Queensland Audit Office

Appendix D—Summary of results by sector and entity

Figure D1
2014–15 financial report audit opinions issued

Sector	Audit	First draft statements provided for audit	Financial statements signed	Opinion issued	Opinion	Certified by deadline
Energy	Stanwell Corporation Limited	27.07.2015	27.08.2015	27.08.2015	Unqualified	Y
	CS Energy Limited	19.08.2015	28.08.2015	31.08.2015	Unqualified	Y
	Queensland Electricity Transmission Corporation Limited (PowerLink)	18.08.2015	26.08.2015	31.08.2015	Unqualified	Y
	Energex Limited	24.07.2015	24.08.2015	27.08.2015	Unqualified	Y
	Ergon Energy Corporation Limited	31.07.2015	28.08.2015	31.08.2015	Unqualified	Y
	Ergon Energy Queensland Pty Ltd	31.07.2015	28.08.2015	31.08.2015	Unqualified	Y
	Ergon Energy Telecommunication Pty Ltd	31.07.2015	28.08.2015	31.08.2015	Unqualified	Y
	SPARQ Solutions Pty Ltd	20.07.2015	17.08.2015	19.08.2015	Unqualified	Y
Water	SunWater Limited	14.08.2015	28.08.2015	31.08.2015	Unqualified	Y

Sector	Audit	First draft statements provided for audit	Financial statements signed	Opinion issued	Opinion	Certified by deadline
	Seqwater	13.08.2015	11.09.2015	11.09.2015	Unqualified	N
	Australian Water Recycling Centre of Excellence Ltd	03.09.2015	25.09.2015	06.10.2015	Unqualified - emphasis of matter	Y
	Gladstone Area Water Board	27.07.2015	24.08.2015	31.08.2015	Unqualified	Y
	Eungella Water Pipeline Pty Ltd	14.08.2015	28.08.2015	31.08.2015	Unqualified- emphasis of matter	Y
	Mount Isa Water Board	07.08.2015	21.08.2015	28.08.2015	Unqualified	Y
Ports	Far North Queensland Ports Corporation Limited	06.08.2015	27.08.2015	31.08.2015	Unqualified	Y
	Gladstone Port Corporation Limited	03.08.2015	14.08.2015	27.08.2015	Unqualified	Y
	North Queensland Bulk Ports Corporation Limited	10.08.2015	27.08.2015	31.08.2015	Unqualified	Y
	Port of Townsville Limited	29.07.2015	25.08.2015	31.08.2015	Unqualified	Y
Rail	Queensland Rail	28.07.2015	27.08.2015	27.08.2015	Unqualified	Y
	Queensland Rail Limited	28.07.2015	27.08.2015	27.08.2015	Unqualified	Y
	Stadiums Queensland	31.07.2015	25.08.2015	26.08.2015	Unqualified	Y

Sector	Audit	First draft statements provided for audit	Financial statements signed	Opinion issued	Opinion	Certified by deadline
Other Public non-financial corporations	Queensland Treasury Holdings Pty Ltd	23.07.2015	04.08.2015	10.08.2015	Unqualified	Y
	Brisbane Port Holdings Pty Ltd	10.07.2015	04.08.2015	10.08.2015	Unqualified	Y
	Queensland Lottery Corporation Pty Ltd	10.07.2015	30.07.2015	10.08.2015	Unqualified	Y
	DBCT Holdings Pty Ltd	10.07.2015	04.08.2015	10.08.2015	Unqualified	Y
	City North Infrastructure Pty Ltd	20.07.2015	21.08.2015	27.08.2015	Unqualified- emphasis of matter	Y

Source: Queensland Audit Office

Figure D2
Energex and Ergon regulatory engagements conducted in 2014–15

Client	Engagement	Financial years covered	Type of information	Date reports certified	Type of report issued
Ergon	Annual performance	2014–15	Financial	29.10.15	Audit (actual information)
	Economic benchmarking	2014–15	Financial	29.10.15	Audit (actual information) Review (estimated information)
	Category analysis	2014–15	Financial	29.10.15	Audit (actual information) Review (estimated information)
			Non-financial	29.10.15	Review (actual and estimated information)
Energex	Annual performance	2014–15	Financial	28.10.15	Audit (actual information)
	Economic benchmarking	2014–15	Financial	28.10.15	Audit (actual information) Review (estimated information)
	Category analysis	2014–15	Financial	28.10.15	Audit (actual information) Review (estimated information)
			Non-financial	28.10.15	Review (actual and estimated information)

Source: Queensland Audit Office

Figure D3
Queensland Rail special purpose engagements conducted in 2014–15

Engagement	Financial years covered	First draft statements provided for audit	Financial statements signed	Opinion issued	Opinion	Certified by deadline
QR below rail services provided	2013–14	3.11.14	16.12.14	16.12.14	Unqualified - Emphasis	No

Source: Queensland Audit Office

Appendix E—Financial data and ratios

Figure E1
2014-15 financial data and ratios

Sector	Entity	Revenue $'000	Net Profit Before Tax $'000	Total Assets $'000	Borrowings $'000	Return on Equity %	Capital replenish-ment ratio times	Interest coverage times	Debt to revenue times
Energy	Stanwell	1 754 555	365 233	3 361 444	772 210	17.48	1.06	7.12	0.44
	PowerLink	995 871	224 122	8 105 313	4 444 221	10.16	1.76	1.89	4.46
	Ergon Energy	2 627 000	991 000	11 485 000	5 300 000	38.33	2.16	4.20	2.65
	Energex	2 575 000	733 000	12 475 000	6 811 000	24.70	1.66	3.16	2.65
	CS Energy *	770 887	177 454	1 919 642	812 081	30.58	0.44	3.77	1.05
Water	SunWater	290 773	7 003	1 218 871	267 460	0.97	0.79	1.39	0.92
	Seqwater	805 148	(228 939)	12 389 062	9 305 869	(7.14)	0.25	0.58	11.56
	Gladstone Area Water Board	72 358	17 930	638 071	229 725	3.85	1.17	2.05	3.17
	Mount Isa Water Board	22 175	2 539	115 263	3 970	1.82	1.27	11.12	0.18
Ports	Far North Queensland Ports	53 587	16 990	340 054	0	4.21	1.01	NA	NA

Sector	Entity	Revenue $'000	Net Profit Before Tax $'000	Total Assets $'000	Borrowings $'000	Return on Equity %	Capital replenish-ment ratio times	Interest coverage times	Debt to revenue times
	Gladstone Port	452 732	102 023	2 004 085	461 344	6.29	1.22	4.87	1.02
	North Queensland Bulk Ports	102 804	(10 498)	626 022	66 559	(1.72)	1.73	(1.87)	0.65
	Port of Townsville	75 946	25 295	648 182	80 363	3.79	0.85	5.94	1.06
Rail	Queensland Rail	1 948 345	319 905	6 884 441	3 000 000	7.87	1.09	2.58	1.54
Other PNFC	Stadiums Queensland	75 255	(37 926)	1 118 499	105 509	(3.90)	0.13	4.49	1.40
	Queensland Treasury Holdings Pty Ltd	42 734	32 592	688 932	148 302	4.67	NA	5.37	3.47
Total PNFC		**12 665 143**	**2 737 723**	**64 017 781**	**31 808 613**	**11.01**	**1.34**	**2.51**	**2.51**

* Figures included above for CS Energy include a 2014-15 onerous contract remeasurement of $194.58 million. Had this re-measurement been excluded from the above figures, total revenue would have been $576.30 million. A net loss before tax would have been recorded of $17.13 million, and the return on equity ratio would be -2.97 per cent.

Source: Queensland Audit Office

Appendix F—Net flows between government and PNFC entities

Figure F1
2014–15 Net flows between government and PNFC entities

Sector	Entity	Equity contributions $'000	Community service obligations $'000	Other government funds $'000	Dividends declared $'000	Income tax expense/ (credit) $'000	Competitive neutrality fees $'000	Equity withdrawals $'000	Net flow (to)/ from government $'000
		Flows from government			Flows to government				
Energy	Stanwell	0	0	0	89 930	110 297	12 707	0	**(212 934)**
	CS Energy *	0	0	4 133	0	53 303	14 856	0	**(64 026)**
	PowerLink	0	0	0	1 276 986	68 136	39 139	0	**(1 384 261)**
	Energex	0	30 000	0	1 295 000	221 000	55 000	0	**(1 541 000)**
	Ergon Energy	0	596 000	0	1 925 000	295 000	56 363	0	**(1 680 363)**
Water	SunWater	0	11 293	2 024	5 258	430	2 402	0	**5 227**
	Seqwater	6 966	2 154	12 222	0	(66 867)	0	0	**88 209**
	Gladstone Area Water Board	0	0	87	18 500	5 363	4 349	0	**(28 125)**
	Mount Isa Water Board	0	0	0	1 422	746	0	0	**(2 168)**
Ports	Far North Queensland Ports	0	0	1 669	5 233	4 960	0	0	**(8 524)**

Sector	Entity	Equity contributions $'000	Community service obligations $'000	Other government funds $'000	Dividends declared $'000	Income tax expense/ (credit) $'000	Competitive neutrality fees $'000	Equity withdrawals $'000	Net flow (to)/ from government $'000
	Gladstone Port	0	0	0	54 400	30 063	5 939	0	**(90 402)**
	North Queensland Bulk Ports	0	0	0	11 300	(3 147)	0	2 096	**(10 249)**
	Port of Townsville	0	0	0	13 095	7 466	1 129	0	**(21 690)**
Rail	Queensland Rail	0	0	1 531 535	178 999	96 156	39 085	2 926	**1 214 369**
Other PNFC	Stadiums Queensland	15 345	0	32 124	0	0	0	0	**47 469**
	Queensland Treasury Holdings Pty Ltd	0	0	1 562	0	9 590	0	0	**(8 028)**
Total flows		**22 311**	**639 447**	**1 585 356**	**4 875 123**	**832 496**	**230 969**	**5 022**	**(3 696 496)**

Note: Amounts represent accrued figures unless otherwise stated. Amounts also exclude coal royalties, payroll tax and pensioner rebates transacted with state government. Dividends declared for Queensland Treasury Holdings Group excludes a $10 million dividend disclosed as a post balance date event in their 2014-15 financial statements.

* Figures included above for CS Energy include a 2014-15 onerous contract re-measurement of $194.58 million. Had this re-measurement been excluded from the above figures an income tax credit of $5.07 million would have been recorded, together with a total net flow to government of $5.65 million.

Source: Queensland Audit Office

Appendix G—Cash flow forecasting models

Our audits of discounted cash flow models used by the ports sector to estimate fair value of assets or the value in use of cash generating units identified the following opportunities for entities to move closer to industry standards in documenting key model inputs and assumptions.

Figure G1
Opportunities to enhance cash flow modelling practices

Theme	Improvement opportunities
Governance	Quality control and evaluation checks need to be established, implemented and results reported through Audit Committees to Boards.
	Key inputs, estimates, assumptions and judgements and cash flow forecasts should be authorised and documented in sufficient detail.
	Minutes of governance committee meetings should detail the extent of their consideration of inputs, assumptions and estimates used in cash flow forecasts.
Evidence and documentation	Management need to be support inputs, estimates and assumptions with documentary evidence and work papers.
	Groupings of assets for revenue forecasting need to be consistent with the models used to calculate net present values of assets.
	The basis for adjusting to asset values against asset classes needs to be adequately documented.
	Management needs to document the basis for exercising significant professional judgement in estimating revenue projections due to an absence of historical data.
Benchmarking to industry	The use of rolling averages for Weighted Average Cost of Capital (WACC) discount rates is not consistent with current industry practice. Current practice recommends: ▪ use of a normalised risk-free rate in conjunction with an estimate of around 6 per cent for the market risk premium ▪ use of observed risk-free rates but with increases to estimates of the market risk premium ▪ inclusion of additional risk factors in the calculation of the cost of equity.
	Computing forecast tax payment cash outflows using accounting earnings estimates was incorrect, as companies do not pay the official corporate tax rate on their accounting profits.
	Long-term profitability margins were forecast to increase by 15% more than what has been historically achieved.
	Valuation "workbooks" can be used that detail and centrally store all evidence to support inputs used in DCF models.

Source: Queensland Audit Office

Appendix H—Methods used by PNFCs to value assets

Figure H1 lists the methods used across the PNFC by entities to measure their assets in their financial statements. Figure H2 shows the current method used by each entities.

Figure H1
Asset measurement techniques used in the PNFC sector

Model	Measurement/Valuation technique
Cost	This is generally the fair value of assets/liabilities exchanged to acquire or construct the asset, with no subsequent change to these values to reflect cost, price or market movements.
Fair value	Market Value is the price of a recent arm's length sale of similar assets, and this is the first preference as it maximizes use of externally observable inputs. This is not all that common for public infrastructure except for land and valuing buildings located in active markets that do not have a specialized purpose.
	Income approach (present value technique that takes into account the future cash flows that a market participant would expect to receive).
	Replacement cost (valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset).

Source: Queensland Audit Office

Figure H2
Principle measurement technique used to value major assets (not including land)

Sector	Entity	Measurement/Valuation technique
Energy	Stanwell	Cost
	CS Energy	Cost
	PowerLink	Income approach
	Energex	Income approach
	Ergon Energy	Income approach
Water	SunWater	Cost
	Seqwater	Income approach
	Gladstone Area Water Board	Income approach
	Mount Isa Water Board	Replacement cost
Ports	Far North Queensland Ports	Replacement cost
	Gladstone Ports	Income approach
	North Queensland Bulk Ports	Lower of replacement cost / income approach
	Port of Townsville	Income approach
Rail	Queensland Rail	Cost
Other PNFC	Stadiums Queensland	Replacement cost

Note: Cost for generators is impaired to net realisable value using a combination of income based and sale values

Source: Queensland Audit Office

Auditor-General Reports to Parliament

Reports tabled in 2015–16

Number	Title	Date tabled in Legislative Assembly
1.	Results of audit: Internal control systems 2014–15	July 2015
2.	Road safety – traffic cameras	October 2015
3.	Agricultural science research, development and extension programs and projects	November 2015
4.	Royalties for the regions	December 2015
5.	Hospital and Health services: 2014–15 financial statements	December 2015
6.	State public sector entities: 2014–15 financial statements	December 2015
7.	Public non-financial corporations: 2014–15 financial statements	December 2015

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