Queensland Audit Office

Results of audit: Queensland state government financial statements 2013-14

Report 7 : 2014–15

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QUEENSLAND

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The Honourable F Simpson MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Madam Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled *Results of audit: Queensland state government financial statements 2013–14* (Report 7: 2014–15).

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

The State of Queensland obtains its revenues through taxation, royalties, sales of goods and services, and by payments from the Australian Government. With those revenues, the Queensland Government pays for the operations of the state, provides community services including health, community safety and education, and builds state infrastructure.

Each year, the state prepares consolidated financial statements of the Government of Queensland (state government financial statements) which are accrual financial statements reporting how much the state has earned; what it cost to operate; and, together with the values of its assets, how it managed its liabilities. From this, a user of the statements can discern whether the state is spending more than it receives; how well it has managed its assets and liabilities; and what reserves it has to meet future obligations.

The Auditor-General audits the consolidated financial statements, which report on the performance and position of both the total state sector (TSS) and of the general government sector (GGS).

GGS entities are mostly departments and entities they control and they receive their revenue from parliament, known as appropriations. The annual budget establishes the amount of these annual appropriations. The GGS component of the financial statements includes a comparison of actual performance against the budget. To strengthen transparency and accountability, as required by accounting standards, each department will also report its performance against budget in its financial statements from 2014–15.

The TSS comprises GGS entities plus public financial corporations (PFCs) and public non-financial corporations (PNFCs). Both types of public corporations are self-sustaining entities with their own revenue sources, although there is often a regulatory pricing regime in place. As the state owns these entities, they provide returns to government through the dividends and taxes they pay into consolidated revenue.

This parliamentary report provides the results of our independent audit opinion; and analyses the revenue and expenses of the state and the financial viability of the GGS and TSS. This report also considers private sector funding agreements into which the state has entered to pay for infrastructure that are not included in the balance sheet; and assesses the financial sustainability of the state.

Result of audit

We issued an unqualified audit opinion on the state government financial statements. This means the state prepared its statements in accordance with Australian accounting standards, which present a true and fair view of the financial performance and position of the GGS and TSS.

Timeliness and quality of draft statements

The state met the legislative time frames to complete and audit financial statements.

The quality of the supporting working papers provided for audit and the financial statements were of a high standard.

Financial performance

The key measure of financial performance is the operating result, being the net position of revenue and expenses. This year, the GGS achieved its first operating surplus in several years of $952 million; an improvement of $5.3 billion from the 2012–13 deficit of $4.3 billion. The consolidated result for the TSS was a surplus of $2.6 billion, a $4 billion improvement on last year's deficit of $1.4 billion.

The Australian Government paid a grant in advance of need of $1.5 billion on 30 June 2014 toward ongoing natural disaster relief and recovery efforts. Without this advance, which was treated correctly as revenue, there would not have been a GGS surplus in 2013–14. The timing of these payments, which are outside the control of the state, has led to significant volatility in the GGS operating result in recent years.

The GGS surplus also includes cash inflows from PNFCs, with dividends and taxation revenue this year of $2.0 billion or 4.2 per cent of total revenue. The energy and ports sectors make the largest contribution, with payments to the GGS over the past five years totalling $4.5 billion. The GGS also makes payments to PNFCs (mainly the rail sector) to fund services to the community that do not recover their costs or charge market rates.

GGS expenses have stabilised over the last three years at $46 billion, having peaked at this level in 2011–12. The state budget for 2014–15 reports an expected increase in expenses of 7.7 per cent which are mostly non-employee related costs. Increases in expenses are offset by expected increases in revenue in the budget. However, achieving longer term operating sustainability depends on economic factors, the state's share of goods and services tax and the success of the liquid natural gas (LNG) industry to generate increased royalty revenue.

Financial position

The net worth of the state—the net position of assets less liabilities—declined by $3.7 billion for the GGS and $4.6 billion for the TSS. Assets were written down by $9.1 billion in 2013-14, partly offset by increases in value of PNFCs and the incorporation of the state's operating surplus. Borrowings increased by $3.5 billion and the state has locked in future cash outflows of $11.7 billion under public private partnership agreements (PPPs), with $4.8 billion of these net cash outflows occurring in the next ten years.

TSS net worth fell by $4.6 billion as a result of the reduction in the value of assets in the GGS. This was offset to some extent by two major asset divestments.

The state made an overall gain of $2.5 billion on its sale of Queensland Motorways, providing substantial funds to the state's long term asset portfolio of the Long Term Asset Advisory Board (LTAAB) to purchase alternative investments to meet future long term obligations to employees in accordance with the government’s fiscal principles. Accordingly, these funds were not available to improve the State’s budget position or to meet debt reduction targets. The sale of holdings in Aurizon resulted also in a net accounting profit of $305 million, $260 million of which was paid into the GGS, improving its net worth.

The state borrowed in advance of need in 2012–13 and these borrowings were used in the GGS in 2013–14.

Financial sustainability

If the state is to 'live within its means' over the long term, its revenues need to cover operating costs and most of its capital program. The state established new fiscal principles in 2012–13 aimed at improving the sustainability of the state. Stabilising and reducing debt, maintaining a competitive tax environment for business, funding long term liabilities, and achieving a fiscal balance are key government targets.

While the state has stabilised its level of operating expenses, GGS debt continues to rise, although the growth rate of the debt has decreased. The state's fiscal balance continues to be in deficit; this means that the state has been unable to pay for operating expenses and net asset purchases from its operating revenues. The fiscal deficit has improved from last year, due to less capital spending, but this included the deferral of $809 million of capital projects.

We assess financial sustainability using the audited financial statements and the state budget to derive target and actual results for four key financial ratios:

- operating ratio—indicates the capacity to meet recurrent expenditure from recurrent operating revenues
- ratio of net operating cash flow to net purchases of non-financial assets—indicates the ability to self-finance asset acquisitions from operations, rather than relying on debt
- capital replenishment ratio—indicates whether the rate of capital outlays on non-financial assets is keeping pace with the rate of depreciation of those assets
- debt to revenue ratio—indicates the capacity of the state to repay debt principal and interest.

The operating sustainability of the GGS improved, demonstrating a positive operating ratio for the first time in five years, although this ratio continues to be affected by the timing of Australian Government grants. The state's operating expenses have stabilised over the past three years, mainly due to the reductions in employees.

GGS debt grew less in 2013–14 than previous years, due to stabilised expenses and fewer capital purchases. In future years the state will spend less money on traditional capital purchases partly because significant new infrastructure is being financed through public private partnerships.

The state continues to replenish its assets at least at the rate of depreciation.

While the GGS debt to revenue ratio has stabilised for the first time in five years, the state's capacity to pay down debt from its recurrent revenues is yet to be achieved. Budget projections forecast improvement in the debt to revenue ratio; but this is tied to a number of key revenue growth assumptions beyond the state's control.

The GGS' $26 billion investment in the PNFC and PFC sectors is a sustainable investment. State owned businesses operated sustainably this year, except CS Energy and Seqwater. This investment contributes to the GGS operating result, with revenue of $2.0 billion from the sector for dividends and income tax payments this year. Energy sector payments provided over 80 per cent of this revenue.

Effects of public private partnerships

Increasingly, the state is using collaborations between public and private sectors to deliver major infrastructure and for some service delivery. Public private partnerships (PPPs) are an approach of applying efficiencies and risk management associated with private sector practices to delivering public assets. The state enters a PPP on the basis that the arrangement will deliver better value for money outcomes.

PPPs are an alternate method of financing, with assets constructed without an increase to traditional external borrowings through QTC. Because PPPs remove the need for the state to make significant upfront capital outlays and consequential borrowings, their impact on the financial statements differs from more traditional methods of financing asset investments. Some PPPs allow the state to spread capital payments to the private sector proponent over the term of the PPP, whereas for others which adopt a user pays model, the state avoids spending on the asset.

In the cases where the state makes ongoing capital payments, these do not reduce the overall debt burden although they will do so where they deliver services more efficiently through a better value for money outcome than traditional forms of procurement. The net present value of the payments are recorded as a finance lease liability.

This year, the state increased its financial commitments under PPPs by 80 per cent to $11.7 billion, with $4.8 billion of these nominal net cash outflows occurring over the next ten years. The financial commitment represents undiscounted payments relating to operating and capital costs. The state will also make capital contributions of over $1.3 billion to the private sector; these will be written off over the life of the PPPs.

Budgetary reporting

The reliability of state budgets indicates whether budgetary control and monitoring mechanisms are effective; and the analysis of actual performance to budget provides insights into the risks and key assumptions underpinning the sources of revenue and expenses that are within the control of public decision making.

Over the past five years, the state budgets have provided a reasonable forecast of the performance and position of the GGS.

In 2014–15, each department will also compare its individual budget to actual performance in its financial statements. This will increase the focus on each department's performance to budget, resulting in a more reliable budget process and reducing the risk of errors in financial statement reporting.

Public corporations are used by the government to provide essential public infrastructure in a corporatised structure. Some public corporations contribute revenue to the GGS in the form of dividends, income tax equivalents and interest, but also receive payments from the GGS to meet community service obligations.

Public financial corporations (PFC) are responsible for managing significant long term financial assets and liabilities held by the GGS. Public non-financial corporations (PNFC) are incorporated into the state budget papers in two ways: as revenue and expenses for the GGS, and with performance ratios reported on a sector basis.

PNFCs' actual performance is consistent with the budget of the last five years, except for 2010–11 where a number of material commercial businesses were sold.

1 Financial audit context

1.1 Legislative requirements

Section 25 of the *Financial Accountability Act 2009* requires that the Treasurer prepare, each financial year, financial statements for the total state sector (TSS) and the general government sector (GGS). Together, these statements are called the Audited Consolidated Financial Statements—Government of Queensland (state government financial statements).

The Treasurer, through Queensland Treasury and Trade (QTT), is responsible for preparing and presenting the state government financial statements fairly in accordance with prescribed accounting requirements identified in the *Financial Accountability Act 2009* and with Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

The state government financial statements must be prepared within six months from the end of each financial year or by a later date agreed between the Treasurer and the Auditor-General.

The Treasurer, the Under Treasurer and the most senior officer of the department responsible for preparing the state government financial statements must each sign and certify whether, in their opinions, the state government financial statements have been drawn up properly, under the prescribed requirements, to present a true and fair view of:

- the financial operations and cash flows of the Government of Queensland for the financial year
- the financial position of the Government of Queensland at the end of the financial year to which the state government financial statements relate.

As soon as practicable after the state government financial statements have been prepared and certified, the Treasurer must send the state government financial statements to the Auditor-General. The Treasurer must table the state government financial statements and report in the Legislative Assembly within 14 days of the Auditor-General returning the audited state government financial statements to the Treasurer.

1.1.1 General government sector

AASB 1049 defines the GGS as comprising all government units and non-profit institutions controlled and mainly financed by government funding. For the purposes of the Queensland Government, the GGS includes all departments and some statutory bodies as defined within ss.8 and 9 of the *Financial Accountability Act 2009*. The GGS includes 76 entities which are listed in Appendix B of this report.

1.1.2 Total state sector

The TSS includes all GGS entities, together with three public financial corporations (PFCs) and 17 public non-financial corporations (PNFCs). These entities are listed in Appendix C of this report.

AASB 1049 defines:

- PFC as comprising resident government controlled corporations and quasi-corporations mainly engaged in financial intermediation or provision of auxiliary financial services
- PNFC as comprising resident government controlled corporations and quasi-corporations mainly engaged in the production of market goods and/or non-financial services.

1.2 Scope of report

The public sector entities consolidated into the state government financial statements are those controlled by the state and considered to be material. Public sector entities are considered material if their net operating result exceeds $4 million or their net assets exceed $50 million.

Entities specifically excluded from consolidation into the state government financial statements are not directly controlled by the state, notably universities and local governments. As a result this report excludes the financial statement results of Queensland local governments, universities and grammar schools.

We report separately on the results of each state-controlled entity. Our detailed report on state public sector entities contains the results of our audits of the financial statements of 21 portfolio departments and 464 statutory bodies, government owned corporations and other public sector entities with a 30 June 2014 balance date (Report 4: 2014-15, *Results of audit: State public sector entities for 2013-14)*.

We also prepare a separate, more detailed report on the results of the public non-financial corporations which are government owned corporations (GOCs) and statutory bodies operating across the energy, water, transport and other sectors (Report 6: 2014-15, *Results of audit: Public non-financial corporations*).

1.3 Audit responsibilities

Section 42 of the *Auditor-General Act 2009* requires the Auditor-General to audit the state government financial statements and prepare a report on them. The report must state:

- whether the Auditor-General has received all the information and explanations required
- whether the Auditor-General considers the financial statements have been properly drawn up, under prescribed requirements, to give a true and fair view of the financial operations and cash flows of the state for the financial year and of the financial position at the end of that financial year.

As soon as reasonably practicable after the Auditor-General prepares the report, the Auditor-General must give the financial statements and the report to the Treasurer.

The audit report, which includes the audit opinion, provides assurance about the reliability of the financial report, including its compliance with legislative requirements. In accordance with Australian Auditing Standards, we may issue one or more of four audit opinion types:

- an *unmodified opinion* means the financial statements comply with relevant accounting standards and prescribed requirements
- a *qualified opinion* means the financial statements as a whole comply with relevant accounting standards and legislative requirements, but with particular exceptions
- an *adverse opinion* means the financial statements as a whole do not comply with relevant accounting standards and legislative requirements
- a *disclaimer of opinion* means we are unable to express an opinion as to whether the financial statements comply with relevant accounting standards and legislative requirements.

We may include an *emphasis of matter* paragraph with the audit opinion to highlight an issue of which we believe the users of the financial statements need to be aware. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.

1.4 Report structure and cost

This report is structured as follows:

- Chapter 2 discusses the results of the audit, including the audit opinion issued and overall quality and timeliness of the state government financial statements
- Chapter 3 provides an analysis of the state's financial performance and position
- Chapter 4 contains information about the state's financial sustainability, including risks that are likely to effect the future financial performance and position of the state
- Chapter 5 discusses budgetary reporting for GGS and PNFCs, including an analysis of variances between actual results and the original budget, and the potential impact of any future long-term asset leases on the GGS and TSS
- Appendix A contains responses received
- Appendix B contains a list of entities included in the GGS
- Appendix C details the PFCs and PNFCs included as part of the TSS
- Appendix D provides details of the key financial sustainability indicators used in Chapter 4.

The cost of preparing this report was $125 000.

1.5 Reference to comments

In accordance with section 64 of the *Auditor-General Act 2009*, a copy of this report was provided on 4 November 2014 to the Treasurer, and to the Under Treasurer, as the accountable officer for Queensland Treasury and Trade with a request for comments by 25 November 2014. At the request of the Treasurer an extension was granted until 3 December 2014.

The Treasurer's and Under Treasurer's views have been considered and are represented to the extent relevant and warranted in preparing this report. The comments received are included in Appendix A of this report.

2 Results of audit

In brief

Background

The Audited Consolidated Financial Statements 2013–14—Government of Queensland (state government financial statements) provide users with information about the financial performance, position and cash flows of the general government sector (GGS) and the total state sector (TSS) by the Queensland Government.

Key findings

- We issued an unqualified audit opinion on the state government financial statements for the year ending 30 June 2014 on 21 November 2014. This is more than one month in advance of statutory timeframes, although one month later than the previous year.
- The financial statements and supporting work papers were of a high standard. The financial reporting matter identified in previous reports to Parliament about the valuation and disclosure of land under roads has been resolved.
- The GGS reported a $9 billion reduction in the fair value of assets.
- Currently, public private partnership (PPP) and concession arrangements are operating within the state, with PPP collaborations are delivering significant new large scale infrastructure.
- The state is stabilising the growth of traditional forms of debt such as loans. It is experiencing significant growth in alternative forms of financing through these PPP contractual arrangements, with locked in future cash flows increasing 80 per cent this year.
- Queensland Treasury Corporation sold Queensland Motorways for $7.1 billion, with an overall gain on the transaction of $2.5 billion. The sale of Queensland Motorways provides the state's long term asset portfolio with substantial funds to purchase alternative investments in line with the strategy to fund the long term employee and insurance liabilities of the state.
- The sale of holdings in Aurizon provided a capital return to the GGS of $260 million.

2.1 Background

The state government financial statements report the financial operations, position and cash flows of the Queensland Government on an accrual basis, as required by Australian accounting standards.

The purpose of the financial statements is to provide users with information about:

- the financial management of the general government sector (GGS) and the total state sector (TSS) and accountability for the resources entrusted to them
- the financial positions, performances and cash flows of the GGS and TSS
- the performance and position of the GGS compared to the approved budget
- the statistical measures used by the Australian Bureau of Statistics.

2.2 Results of audit

For the 2013–14 state government financial statements, we issued an unqualified audit opinion that:

- the establishment and keeping of accounts have complied with prescribed requirements in all material respects
- the financial report complies with prescribed requirements and presents a true and fair view of the financial operations and cash flows of the Government of Queensland for the financial year 1 July 2013 to 30 June 2014 and of the financial position as at the end of that year.

2.3 Timeliness

The preparation and audit of the state government financial statements met the legislative time frame of 31 December 2014.

Audit received the state government financial statements on 26 September 2014, compared to 23 September 2013 for the previous state government financial statements. We issued the audit opinion on 21 November 2014, 23 days later than for 2012–13.

2.4 Quality

While Queensland Treasury and Trade (QTT) is responsible for preparing the state government financial statements, every entity included in the TSS (listed in Appendices C and D of this report) prepares a package of audited financial information to consolidate to the state's financial statements.

The quality of financial reporting by individual agencies is crucial to the state's financial statements. Our report *Results of audit: State public sector entities for 2013–14* (Report 4: 2014–15) includes recommendations to improve the process of producing financial statements, including:

- senior staff to perform and document their consistent quality assurance checks over financial statement supporting workpapers
- early preparation and approval of pro forma financial statements
- well documented analytical review of the financial statements.

The principal areas of error and resulting adjustments in agencies' financial statements relate to machinery of government changes and asset recording and valuation processes.

We assessed the consolidated financial statements and supporting work papers QTT provided to be of a high standard and did not identify any material errors in the consolidation process.

2.4.1 Prior period adjustments

The opening accumulated surplus reduced by $800 million in 2013–14. This was due to recasting of the timing of tax and royalty revenue recognition and the reclassification of certain payments, from capital to operating, in relation to the Gold and Sunshine Coast University hospitals, the Lady Cilento Children's Hospital, and Boggo Road Urban Village.

2.4.2 Changes in classifications of expenses

Agencies have reclassified expenses, previously reported as grant expenses, as other operating expenses in the current year. This reallocated $3.4 billion from grant expenses to other operating expenses (7.3 per cent of total expenses). The reclassification does not change total expenses and net operating result.

The expenses reclassified were outsourced service delivery costs which the Department of Communities, Child Safety and Disability Services ($1.5 billion) incurred; community service obligations to Queensland Rail ($1.5 billion); and contractor costs for service operators which TransLink Transit Authority ($0.4 billion) incurred.

2.5 Changes in accounting policies

One new and one revised Australian accounting standards affected the state government financial statements in 2013–14.

2.5.1 Fair value measurement

Australian Accounting Standard AASB 13 *Fair Value Measurement* took effect for the first time in 2013–14. AASB 13 sets out a new definition of fair value and new principles to determine the fair value of assets and liabilities. The revision of valuation methodologies for assets and liabilities to align with AASB 13 has not resulted in material differences, except for leasehold land administered by the Department of Natural Resources and Mines which is now valued based on the net present value of future lease income rather than replacement cost. This has resulted in a write down of $3.8 billion during 2013–14 for the GGS and TSS. The implementation of AASB 13 has led to disclosure of additional information on fair value measurements, including specific disclosure of the assumptions used for non-market based valuations.

Land under roads

We first reported issues around disclosure and valuation of land under roads in *Results of audit: State public sector entities for 2011–12* (Report 5: 2012–13). We noted financial reporting areas warranting further attention included the valuation methodology in Queensland; its contrast with other jurisdictions; and disclosure requirements.

We raised these issues again in *Results of audits: Queensland state government financial statements 2011–12* (Report 7: 2012–13) and *Results of audit: State government financial statements 2012–13 (*Report 12 for 2013–14).

The application of AASB 13 and other changes to the valuation methodology used by the Department of Natural Resources and Mines (DNRM) have resolved our valuation concerns. The value of land under roads has increased by 3.8 per cent, from $42 billion at 30 June 2013 to $43.6 billion at 30 June 2014.

Valuation methodology changes

The GGS reported the fair value of property, plant and equipment has reduced by $9.1 billion, mostly due to changes in valuation assumptions and methodologies for land under roads (increase of $1.6 billion), reserve land (decrease by $7.1 billion) and leasehold land (decrease by $3.8 billion) once AASB 13 is applied.

2.5.2 Employee benefits

Revisions to Australian Accounting Standard AASB 119 *Employee Benefits* changed the definition of 'short term benefits' to include all benefits (including termination benefits) that are expected to be wholly settled before 12 months after the end of the reporting period in which the employees provide the associated services.

The revised AASB 119 also includes changed requirements to measure employer liabilities and assets from defined benefit plans; and the measurement and presentation of changes in such liabilities and assets. In particular, the discount rate, rather than the expected rate of return, is to apply to members' fund assets. This increases the superannuation interest cost by approximately $200 million in the current and prior year for both the GGS and the TSS.

2.6 Major transactions

In forming our audit opinion we had regard to significant transactions and their effect on the financial performance and position of the state, as well as the impact on long term sustainability. The major transactions we examined this year related to the use of public private partnerships and to the divestment of two significant assets.

2.6.1 Public private partnerships

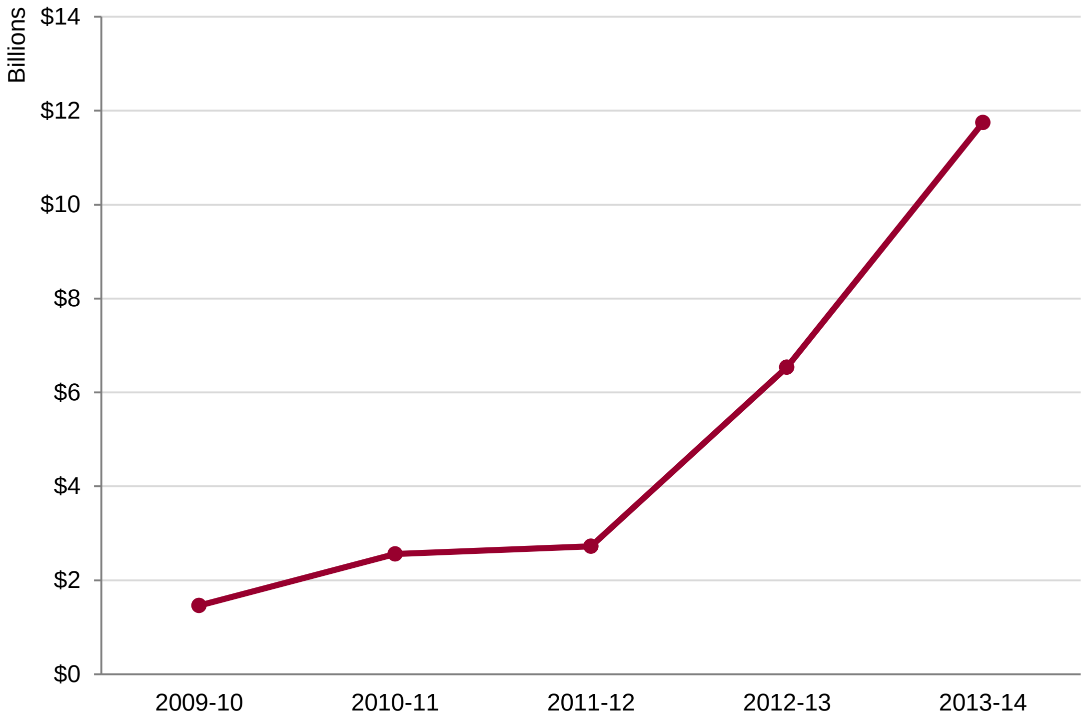
As an alternative to traditional delivery methods of capital projects and social infrastructure, public private partnerships (PPPs) are an approach to improve efficiency and cost effectiveness in the construction, maintenance and operation of infrastructure assets. The use of PPPs increases the state's access to funding arrangements and can free up public sector resources for core social services rather than infrastructure.

PPPs may allocate risk to private sector operators; however, the financing cost the state pays may be higher than if the state had sourced its own debt to fund the project. Under current policy, the state must ensure that a PPP will deliver value for money and it incorporates the extent of risk transfer to the private sector proponent in this analysis.

The net effect of PPPs on the state’s balance sheet for 2013–14 is not significant at 30 June 2014. The state is committed to future undiscounted net cash outflows of $11.74 billion under the current PPPs, with $4.76 billion of these net cash outflows occurring in the next ten years. In addition, the state has committed to operating lease payments of $1.14 billion for 1 William Street, bringing the total net cash outflows to $12.88 billion.

Figure 2A shows the growth in PPP commitments for the five-year period of 2009–10 to 2013–14.

Figure 2A
PPP estimated future net undiscounted cash outflows



Source: Queensland Audit Office

PPP commitments are significantly less than debt borrowings throughout the five-year period, but they are now growing faster than GGS debt borrowing over the five-year period.

PPP commitments will continue to increase in future years, given the PPP model is expected to be adopted for new large construction projects such as the Toowoomba Second Range Crossing and the Bus and Train (BAT) tunnel.

Accounting for PPPs

The accounting for PPPs is complex, involving multiple accounting standards and guidance papers. There are two forms of PPP arrangement: economic and social, each with different accounting treatment. The key difference between the two is typically that the user pays in an economic PPP, while the taxpayer or ratepayer pays in a social PPP.

For economic PPPs the state grants a private sector operator the right to earn revenue from public-style infrastructure which has been constructed and financed by the private sector operator. The state may also contribute to the construction of the infrastructure to ensure the economic viability of the project or to compensate for necessary upgrades to state assets.

Typically, economic PPPs do not result in an asset in the state's books as the state does not control the asset nor does it receive any benefit during the term of the arrangement—the PPP concession period. The state will receive the infrastructure asset at the end of the PPP arrangement or in the event of default of the operator if the private financiers do not first step in and exercise their rights. State entities entering into PPP arrangements need to assess the accounting treatment for any upfront contribution in terms of the nature of the payment and its classification in the financial statements as an expense or asset.

For social PPPs the state, as grantor, pays an operator of an asset for the community's use of the infrastructure. The state makes regular service payments to the operator over the life of the PPP contract in lieu of the operator being able to earn a suitable return of and on its original capital investment. The social nature of the asset is such that it is not possible to generate sufficient revenue from users of the facilities to pay back the operator of the asset.

Typically social PPPs affect the state's balance sheet as they meet the definition of a finance lease, where the state bears the risks and rewards of ownership but does not have legal control over the asset. Finance leases increase the liability of the state and, while the state may avoid increasing external borrowings through QTC by entering PPPs, the liabilities of the state will increase. Where the state bears all of the risks and rewards of the infrastructure asset and is paying for the construction and operation of the asset through concession payments, the value of the asset and the payments will be recognised on the balance sheet. The asset is written down over the period of the PPP arrangement.

Current and new PPPs

Figure 2B illustrates the key projects and the state's commitment under the major current PPP arrangements.

Figure 2B
Major PPPs and net undiscounted cashflows

Major PPP	Type	Financial commitment
New Generation Rolling Stock	Social	The financial commitment for the lease is $5.587 billion. The contractual arrangement is for 32 years for rolling stock and maintenance.
Sunshine Coast Public University Hospital	Social	The upfront capital contribution for this lease was $813 million and was recorded as work in progress. The financial commitment for this project is $3.175 billion. The lease period is for 25 years.
1 William Street	Economic	The operating lease commitment is for $1.144 billion commencing on completion of construction. The lease period is over 15 years. Land valued at $47.5 million, will be provided by the state and written down over the life of the asset.
Gold Coast Rapid Transit Project	Social	The upfront capital contribution for this lease was $365 million and was recorded as a prepaid lease asset. The financial commitment for this project is $1.161 billion in total. The operational period for this project is 15 years. The state has retained the demand risk associated with this project.
SEQ Schools—seven schools	Social	The financial commitment for this project is $600 million over the remaining life of the contract. The lease expires on 31 December 2039.
Queensland Schools Plenary—ten schools	Social	The upfront capital contribution for this lease was $190 million, recorded as a prepaid lease asset. The financial commitment for this project is $930 million. The lease period is for 30 years.

Source: Queensland Audit Office

Government wireless network

The government has selected Telstra Corporation Limited to provide the government wireless network (GWN). The project involves delivering digital radio voice and narrowband data communications for Queensland's public safety agencies and G20 events. The Department of Science, Information Technology, Innovation and the Arts (DSITIA) is responsible for GWN project implementation for the government.

DSITIA has entered into a 15-year lease arrangement with Telstra Corporation Limited to design, build, finance, operate and maintain the GWN. The state will gain exclusive control and use of some infrastructure and equipment under the agreement.

Implementation of the GWN is staged and DSITIA has accounted for the initial delivery under the arrangement as a finance lease. DSITIA valued the infrastructure and equipment assets under the first phase of the contract at 30 June 2014 at $40.2 million. The state has recognised an asset and finance lease liability with net value of $0.11 million as at 30 June 2014.

Commonwealth Games village

The Commonwealth Games village is the largest project being completed for the Gold Coast 2018 Commonwealth Games (the Games). On 14 December 2013, the government announced Grocon (Parklands) Pty Ltd as the preferred developer of the village. The developer will design, finance and construct the village at the Parklands site located at Southport, Gold Coast, and the state will contribute the land for the development.

The state will pay rent to the developer for the period of the Games. The developer will receive all of the proceeds from the Games village sale and the state will provide financial support during the sale process.

2.6.2 Accounting for leases

Leased assets are analysed under accounting standards to determine which entity controls the benefits and bears the risks associated with the asset.

The state has $600 million of leased assets from the private sector, including leases from PPPs, in its balance sheet. This means that the state controls the risks and benefits associated with these assets.

The state also leases assets to the private sector. Even though legal ownership is not transferred, the physical assets are removed from the state's balance sheet during the length of the lease in exchange for a lease receivable. This year, the lease receivable from the private sector is $469 million, which is net of upfront payments received in 2010–11 for long term leases associated with Port of Brisbane ($2.1 billion), Abbot Point Coal Terminal ($1.829 billion) and Forestry Plantations Queensland ($613 million).

2.6.3 Queensland Motorways divestment

Queensland Motorways Holding Pty Limited (Queensland Motorways) was sold to a private sector consortium for $7.057 billion on 23 April 2014. Financial close occurred 2 July 2014. The sale price included debt of $271 million taken over by the purchaser and stamp duty and transaction costs of $426 million. The recorded fair value after factoring in these reductions and a prior commitment of $305 million for motorway upgrades was $6.055 billion.

Queensland Motorways was a government owned corporation until 30 May 2011 when it was transferred to Queensland Treasury Corporation (QTC) for $3.088 billion to help fund the state's superannuation and other long term liabilities. In 2013–14, QIC Limited, as manager of the investment, acquired additional tolling rights in the Clem Jones Tunnel for $618 million (including stamp duty) and in the Go Between Bridge and Legacy Way by way of an upfront payment of $114 million with future payments dependent on traffic outcomes. The acquisition of the Clem Jones Tunnel was partly debt funded.

QTC gained $2.5 billion overall in the transaction, excluding equity and debt distributions from Queensland Motorways under QIC Limited's management. The sale provides substantial funds to the state's long term asset portfolio to purchase alternative investments in line with the fiscal principle of funding the long term liabilities associated with employees and insurance.

2.6.4 Aurizon Holdings Ltd share sale

In 2013–14, the state sold 134.3 million shares in Aurizon Holdings Ltd (AZJ) for overall gains of $305.2 million. The sale proceeds, together with the gains made, repaid associated debt and returned to $260 million to the state. The state continues to hold 55 million shares with a market value of $274 million at 30 June 2014.

3 Financial performance and position

In brief

Background

The Queensland government financial statements show the consolidated financial performance and position of the Total State Sector (TSS), and also report separately the General Government Sector (GGS), which forms part of the TSS

Financial performance relates revenues to expenditures and their consistency with principles of prudent financial management and sustainability. Financial performance is measured by the operating result for the year. The operating result is the net income from transactions adjusted for certain other economic flows such as unrealised gains or losses from financial assets and liabilities.

Financial position is represented by net worth: the value by which assets exceed liabilities.

Public corporations are integral to the financial performance and position of the GGS, as they contribute revenue and distribute community service obligations.

Public financial corporations manage significant long term financial assets and liabilities of the GGS.

Key findings

- The GGS achieved a net operating result of $952 million in 2013–14, and the TSS achieved a net operating result of $2.571 billion.
- The GGS operating result has improved by $5.3 billion from 2012–13, primarily through increases in revenues from grants, taxation, dividends and income tax equivalents.
- The Australian Government provided an unexpected advance grant of $1.5 billion which increased grants revenue; an operating surplus would not have been achieved had this advance been received after 30 June 2014.
- The net worth of the GGS at 30 June 2014 was $169.3 billion, a decrease of 2.1 per cent on 2012–13. The decrease includes a decline in the fair value of property, plant and equipment of $9 billion, offset by increases in value of PNFCs and the incorporation of the state's operating surplus. GGS borrowings increased by $4 billion or 11 per cent. Not all borrowings were funded from external debt arrangements as the state was holding funding in securities that it had borrowed but not used in previous years.
- Significant transactions between the GGS and public corporations during 2013–14 included:
  - The GGS earned income of $2.0 billion from public non-financial corporations through dividends, income tax equivalents, and competitive neutrality fees. This income represented 4.2 per cent of total revenue of the GGS.
  - The GGS paid $2.2 billion in community service obligations and transport service contracts to public non-financial corporations in 2013–14 as compensation for services provided to the public at non-commercial rates.
  - The GGS earned income of $2.4 billion from public financial corporations from interest on long term asset operations, dividends and income tax equivalents. This income represented 5 per cent of total revenue of the GGS.
  - The GGS incurred interest expenses of $2.1 billion in 2013–14 on borrowings from public financial corporations. This interest is charged on a cost-recovery basis.

3.1 Background

The Queensland Government's financial performance and position are measured by the operating result and net worth reported in the Audited Consolidated Financial Statements—Government of Queensland (state government financial statements).

The operating result comprises the net operating balance, adjusted for other economic flows not made directly against equity. The net operating balance is the difference between operating revenues and operating expenditures. Economic flows are mainly unrealised gains or losses on the revaluation of financial assets and liabilities.

The net wet worth of the State is the value by which assets owned exceed liabilities owed.

The operating results and net worth are measured for the Total State Sector (TSS) and for the General Government Sector (GGS) which is the budget-dependent part of the GGS.

The state's commercially viable enterprises are often separate entities, operating like the private sector to enhance their performance. These entities are classified as either a public financial corporations (PFC) or a public non-financial corporations (PNFC). The PFC and PNFC sectors are reported separately from the general government sector (GGS) in the state government financial statements. Public corporations pay revenue to the GGS through dividends and taxation and some receive community services obligation payments from the GGS to support any non-commercial business activities required by government.

This chapter focuses in detail on the GGS financial performance and position, because it has the most impact on the state budget. It also examines the impact of PFCs and PNFCs on the GGS, and the major changes in the consolidated performance and position of the total state sector (TSS).

3.2 Conclusions

The financial performance of the GGS improved in 2013–14, achieving an operating surplus for the first time in several years, but over the same period the financial position of the sector deteriorated marginally.

The operating surplus was largely due to an unexpected advance of grant revenue from the Australian Government for which associated expenditure will be incurred in future years. Nevertheless the underlying trend is one of steady improvement. Policies to constrain expenditure growth have been effective for this year, but GGS debt has continued to grow, albeit at a slower rate than the average of the past five years.

Achieving and sustaining operating surpluses for the GGS remain a challenge, as does achieving a fiscal balance. Capital expenditure for this sector was below budget, but much of the reason for this was delays delivering capital programs, deferring these capital commitments to future years.

The PNFC sector provides dividends and tax revenue inflows to the general government sector. The state budget projects the earnings before taxation and interest for the sector to grow by 15 per cent over the next four years. This will continue to support the long term upward trend for dividend revenue for the GGS, with 95 per cent of dividends and taxation revenue received from the sustainable energy and port entities. After community service obligations and transport service payments are considered, the GGS makes net payments to the PNFC sector. The net payment is forecast to reduce in the state's forward estimates; this will have a positive impact on the GGS operating performance.

The TSS's operating performance is improving through gains on sale of assets and steady growth in GGS results. The net worth has only increased once over the past five years due to the significant growth in debt during this time. Although the growth in debt is stabilising, in the absence of asset transactions, it will not decline without continued positive operating returns.

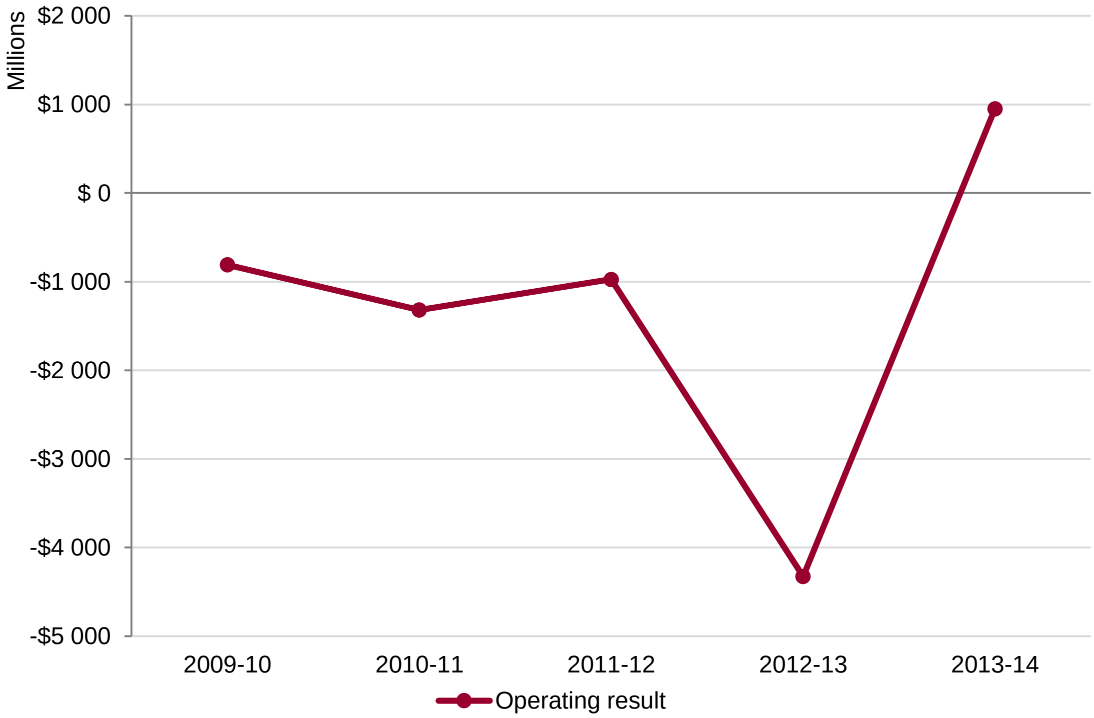
3.3 GGS financial performance

Figure 3A provides an overview of the operating result for the GGS over the past five years. It shows the GGS's operating result for 2013–14 is a surplus of $952 million, the first surplus in five years, reversing the above average deficit made in 2012–13.

This improvement is primarily due to an increases of $3.4 billion (18.7 per cent) in grants revenue, $0.9 billion (8.3 per cent) in taxation revenue, and $0.6 billion (46.2 per cent) in dividend and income tax equivalent income: whereas total expenses showed little growth.

The increase in grant revenue of $3.4 billion includes an unexpected advance grant of $1.5 billion from the Australian Government towards continuing flood and cyclone reconstruction effort under Natural Disaster Relief and Recovery Arrangements (NDRRA). A surplus would not have been achieved in 2013–14 if this advance had not been received on the last day of that financial year.

Figure 3A
GGS operating result over the past five years

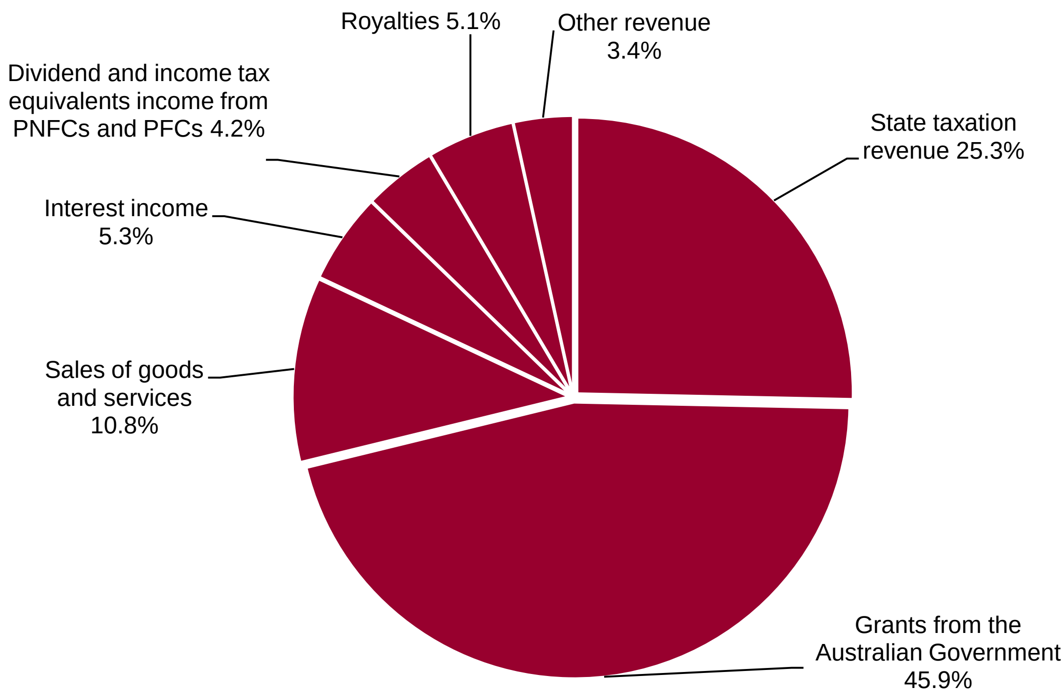


Source: Queensland Audit Office

3.3.1 GGS revenues

GGS transactions in 2013–14 generated total revenue of $46.7 billion. Figure 3B provides a breakdown of this revenue by source.

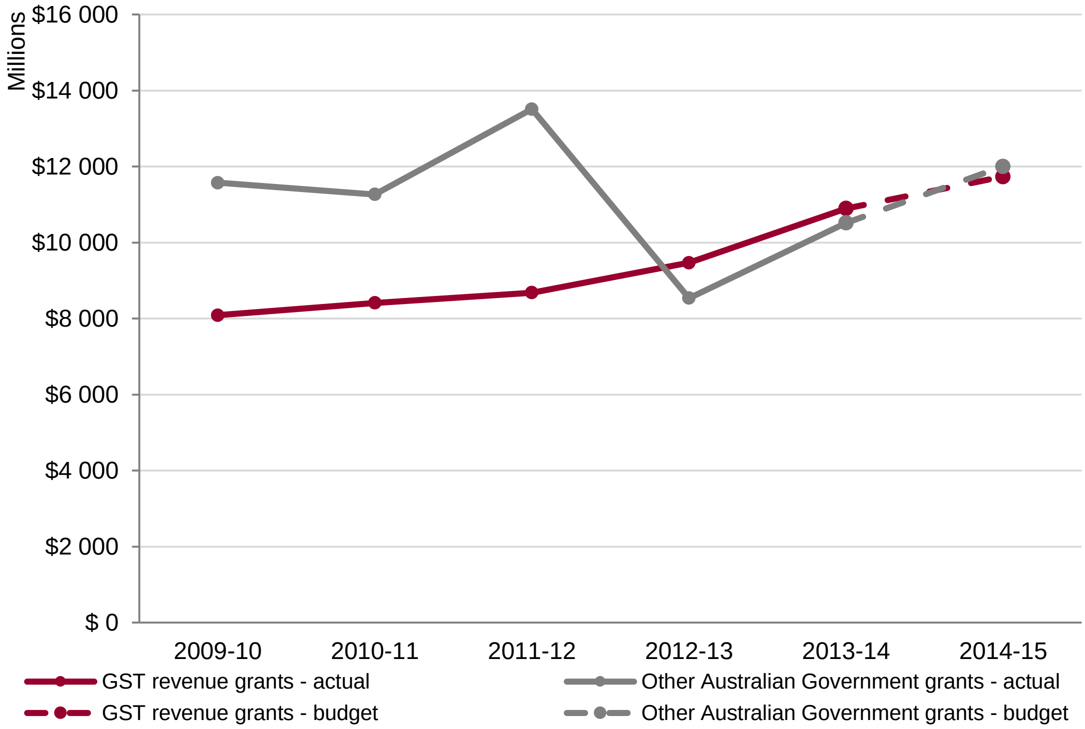
Figure 3B
GGS revenue sources in 2013–14



Source: State government financial statements 2013–14

Nearly half of GGS total revenue is grants revenue, most of which is received from the Australian Government. The GGS result depends critically on Commonwealth decisions on the allocation of goods and services tax (GST) and other income. Figure 3C shows that, while GST revenue grants have been rising steadily in the recent past, other Commonwealth grants have fluctuated significantly from year to year.

Figure 3C
GGS Commonwealth grant revenue trends



Source: State government financial statements 2010–11 to 2013–14, and 2014–15 State Budget

The main cause of the volatility in non-GST Commonwealth grant revenue relates to NDRRA funding which is received as part of National Partnership Agreement payments administered by Queensland Treasury and Trade (QTT). Figure 3D details National Partnership Agreement grants which QTT received over the last five years.

Figure 3D
National Partnership Agreement grant trends

	2009–10	2010–11	2011–12	2012–13	2013–14
NPA grant revenue administered by QTT ($ m)	4 935	4 743	6 831	1 659	3 345
Change ($ m)		192	2 088	-5 172	1 686

Source: Queensland Treasury and Trade financial statements for 2009–10 to 2013–14

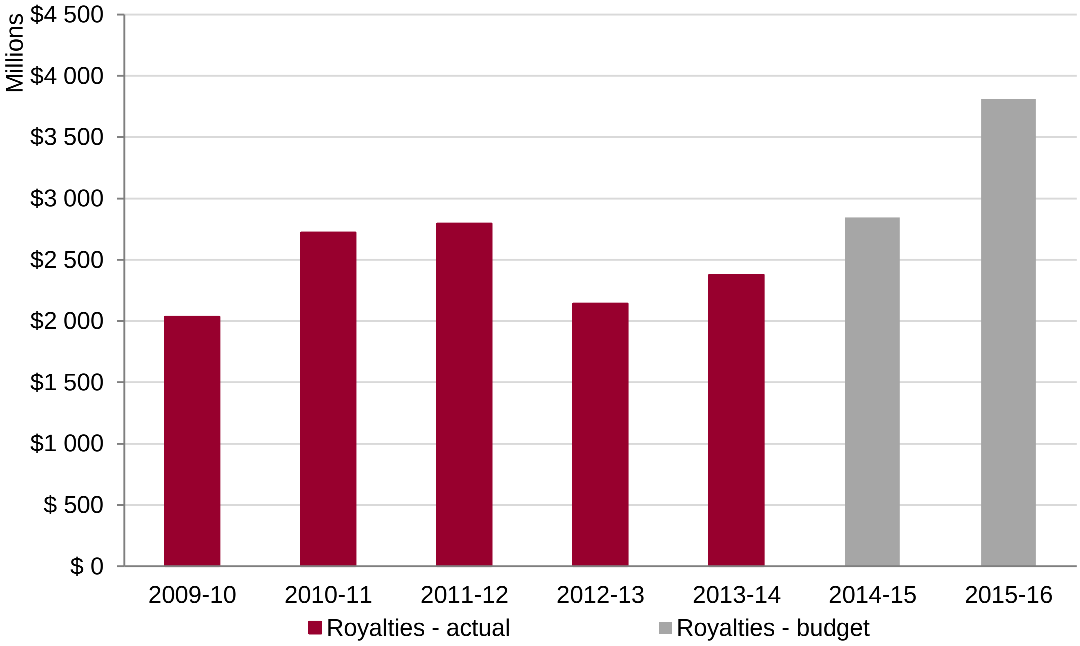
The other major source of GGS revenue is state controlled taxation, which contributed 25.3 per cent of total GGS revenue in 2013–14. Taxation revenue, which includes stamp duties, payroll tax, vehicle registration fees, gaming taxes and land tax, has grown steadily over the last five years between 3.1 per cent and 8.3 per cent annually. The 2014–15 State Budget papers forecast annual growth in taxation revenue of between 4.7 per cent and 5.7 per cent over the four years to 30 June 2018.

Earnings from royalties fluctuate each year, affecting the net operating balance for the GGS as surplus or deficit. Royalties are primarily received for coal, petroleum and land rents. The liquid natural gas (LNG) industry is expected to begin generating royalties in 2014–15 and, if successful, will contribute to higher GGS surpluses.

The variability of royalty revenue is mainly due to changes in exchange rates and commodity prices. As these factors are beyond the state's control, volatility in royalties represents a major risk for the state's financial performance.

As shown in Figure 3E, annual changes in royalties over the last five years have ranged from an increase of $686 million (33.7 per cent) in 2010–11 to a decrease of $652 million (-23.3 per cent) in 2012–13, and the projections in the 2014–15 State Budget expect growth to continue.

Figure 3E
Royalties revenue trends



Source: State government financial statements 2010–11 to 2013–14 and 2014–15 State Budget

Revenue from the sale of goods and services has been stable at 9.9 per cent to 12.2 per cent of total GGS revenue from transactions over the last five years. Sales of goods and services include recoverable works carried out by the Department of Transport and Main Roads, rental income, public transport ticketing and fees from hospitals and Technical and Further Education (TAFE) facilities.

In 2013–14, public corporations contributed $2.0 billion to the GGS through dividends and income tax equivalents, representing 4.2 per cent of GGS revenue from transactions.

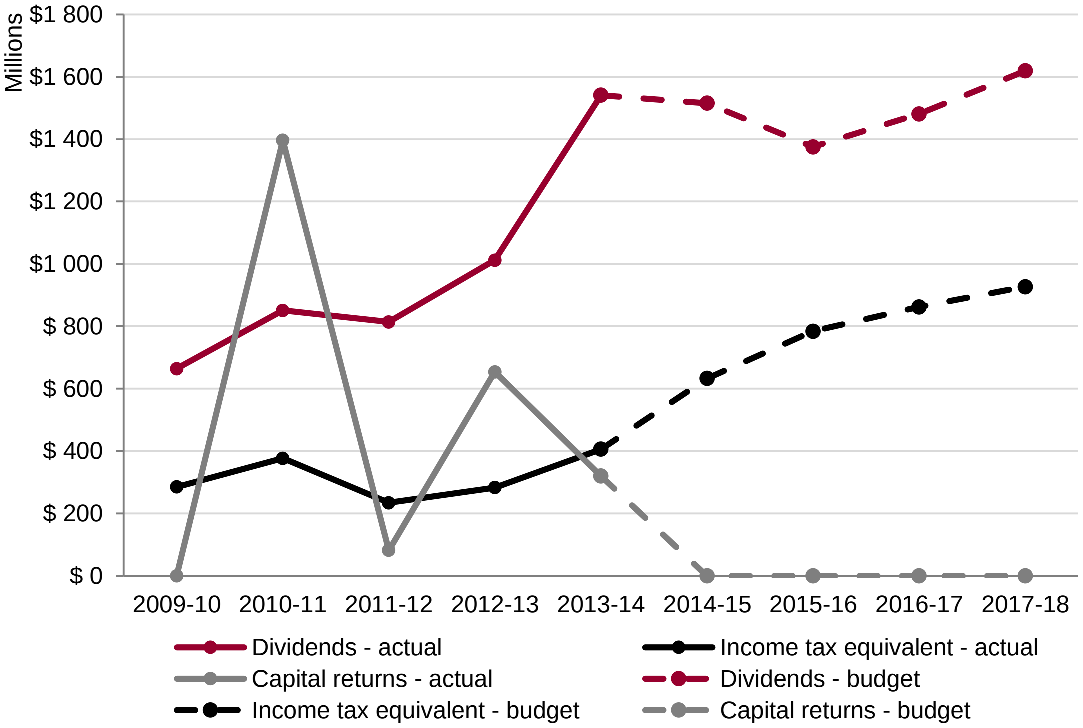
As with any company, public corporations pay dividends to their shareholders: in this case, the GGS. Each board approves dividends in consultation with the state at between 80 and 90 per cent of net profit after income tax equivalents; most public corporations continue to be sustainable with a large proportion of profit paid as a dividend.

Public corporations also provide funding to the GGS through capital returns, classified as other economic flows rather than revenues from transactions. This form of funding is ad hoc and usually occurs where the entity has generated surplus funds through asset sales that are not required for future capital investment.

In 2013–14, capital returns were $260 million and were predominantly funded from the sale by the state government of shares in Aurizon (formerly QR National).

Figure 3F illustrates actual dividends, income tax equivalents and capital returns the GGS earned from public corporations over the last five years. Dividend revenue paid to the GGS shows a consistent long term upward trend and forms a significant proportion of total inflows.

Figure 3F
Actual dividends, income tax equivalents and capital returns



Note: Asset sales in 2010–11 increased GGS revenue as they contributed large one-off capital returns in that year, and lower dividends and income tax equivalents in the following year.

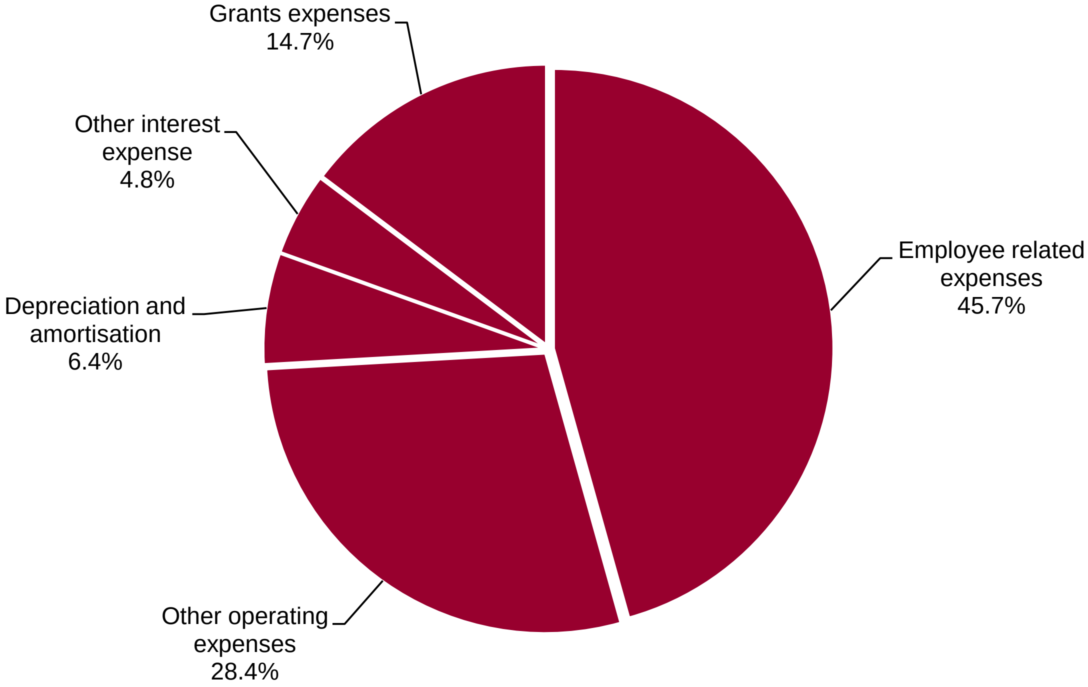
Source: Reports on State Finances of the Queensland Government and 2014–15 State Budget

3.3.2 GGS expenses

Total expenses from GGS transactions in 2013–14 were $46.1 billion, a small decline when compared to $46.3 million in 2012–13.

Figure 3G provides a breakdown of this expenditure by classification.

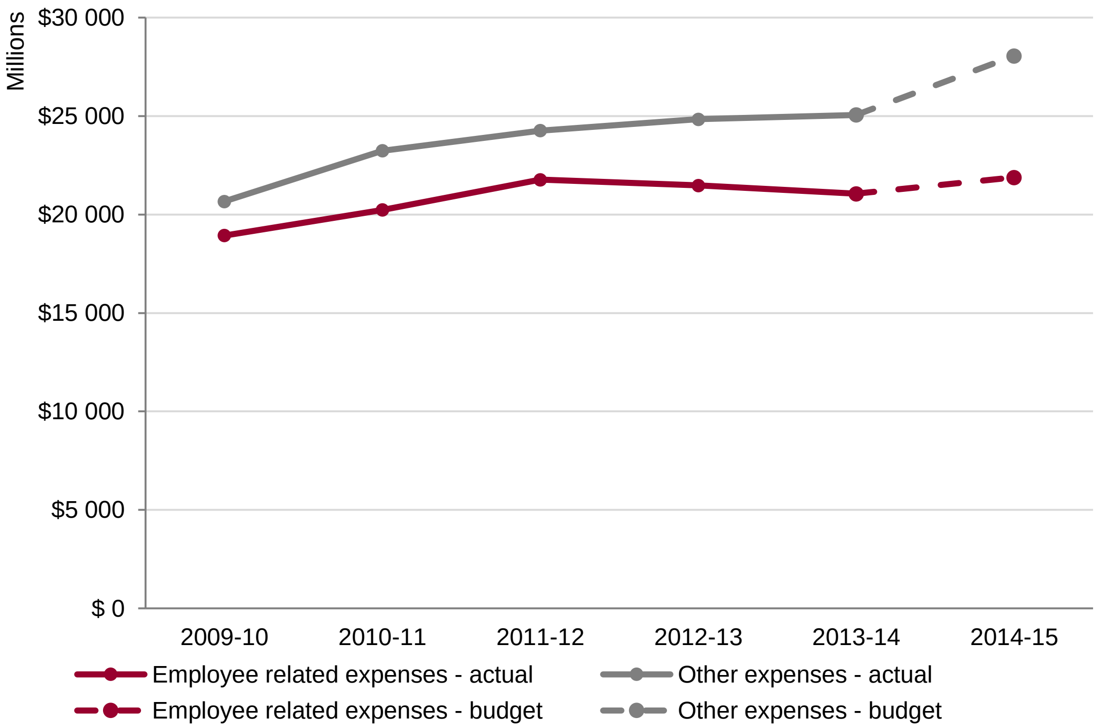
Figure 3G
GGS expenses by classification in 2013–14



Source: State government financial statements 2013–14

Figure 3H shows the trends in GGS expenses for the five years to 30 June 2014.

Figure 3H
GGS expenditure trends



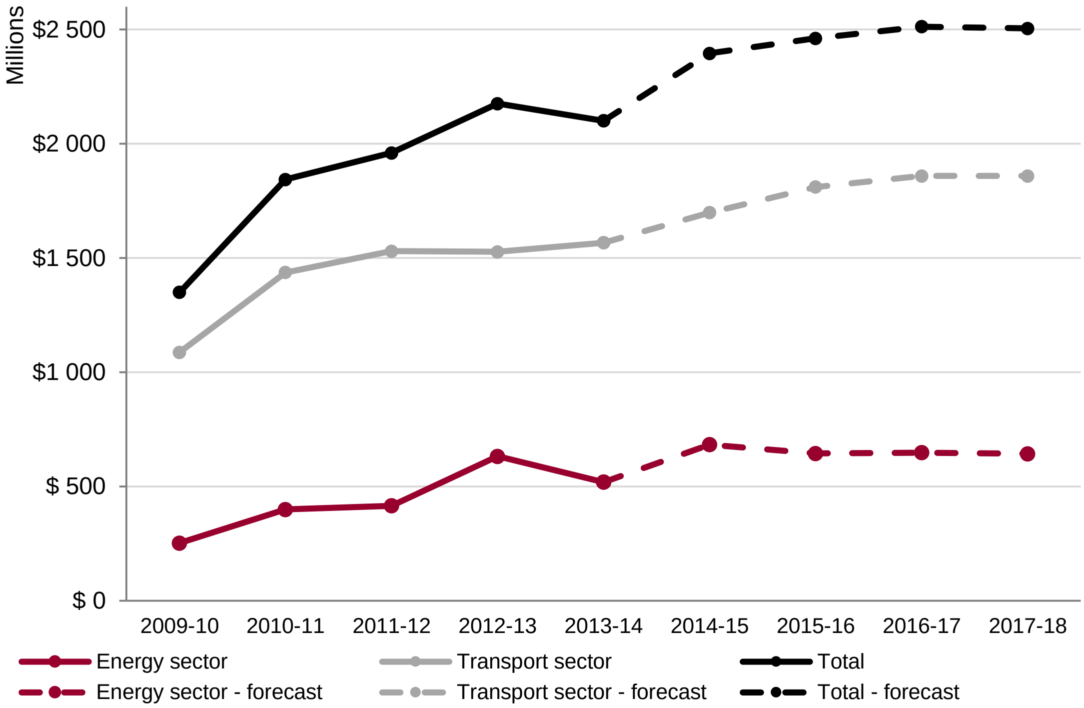
Source: State government financial statements 2010–11 to 2013–14, and 2014–15 State Budget

Employee related expenses, which include superannuation expenses, make up the largest component of GGS expenditure and so are the most important to control from a fiscal management perspective. Employee related expenses were decreased in 2012–13 and 2013–14 by reducing employee numbers; this has improved the GGS financial performance in 2013–14. The number of full time equivalent employees has reduced by 5.1 per cent from 209 949 at 30 June 2012 to 199 283 at 30 June 2014. Lower employee numbers also reduced costs of building rent, communications and electricity.

Although other expenses have increased annually since 2009–10, the rate of increase has slowed over the last two years. The government has budgeted for a significant increase in other expenses in 2014–15, primarily to fund new initiatives for health and education and reforms for child protection.

GGS grant expenditure also includes community service obligations and transport service contract payments to PNFCs to subsidise non-commercial services they are directed to provide. In 2013–14, this expenditure totalled $2.1 billion or 4.6 per cent of total GGS expenditure and has risen over the past five years, illustrated in Figure 3I.

Figure 3I
Community service obligations and transport service contracts by sector



Source: Queensland Audit Office

GGS transport service contract payments to Queensland Rail make up the shortfall between ticket sales and actual operating costs of passenger services for the commuter and tourism markets.

For the energy sector, the cost of delivering electricity to customers in certain remote locations is higher that the uniform retail electricity tariff prices, as network charges and distribution loss factors are higher in these locations. Ergon Energy's retail subsidiary receives a type of community service obligation payment as compensation for the costs it incurs above the tariff prices. This supports the government policy that all Queensland electricity users, regardless of their geographic location, pay a similar electricity price.

The state government has announced that it will not change the policy that regional Queenslanders should pay a price for electricity that is on a par with that paid by residents in south-east Queensland.

3.4 GGS financial position

The state's financial position is measured by its net worth—the total value of assets less the total value of liabilities. Figure 3J shows the GGS financial position has declined by 2.1 per cent this year. Over five years, the net worth has declined by 3.6 per cent, incorporating a decline in the value of property, plant and equipment; infrastructure acquisition; significant growth in borrowings; and the effect of natural disasters.

There were asset valuation write-downs of $9.1 billion in 2013–14, partly offset by increases in value of PNFCs and the incorporation of the state's operating surplus.

Figure 3J
GGS net worth trends

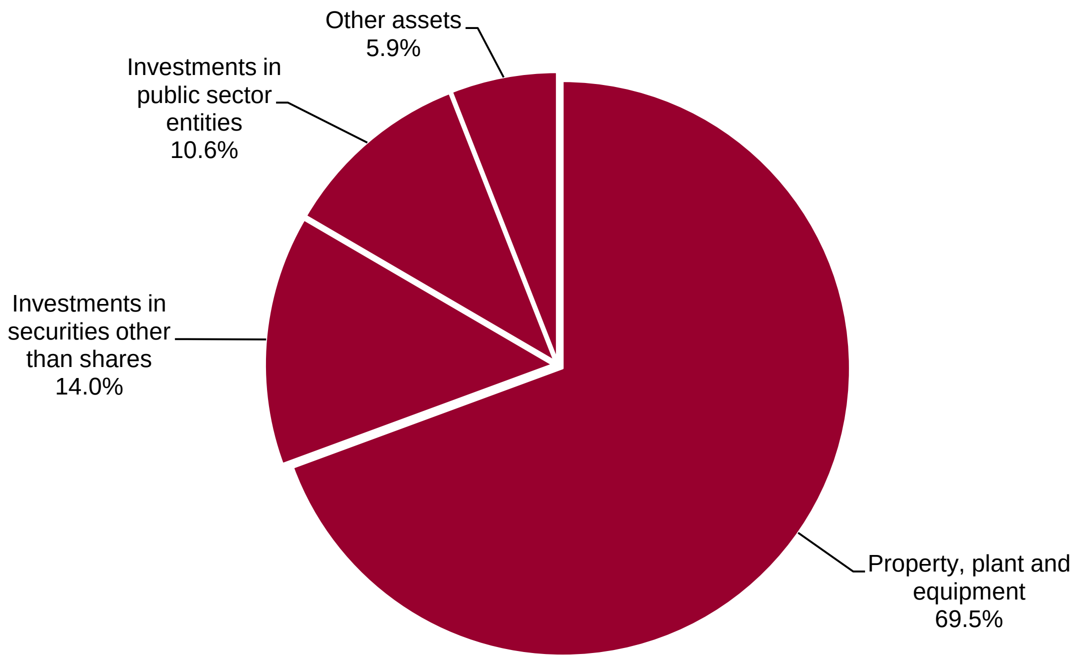
	2009–10	2010–11	2011–12	2012–13	2013–14
Net worth ($ m)	175 587	177 874	170 741	172 964	169 268
Change in net worth ($ m)	(8 690)	2 287	(7 133)	2 223	(3 696)
Change in net worth (%)	(4.7)	1.3	(4.0)	1.3	(2.1)

Source: State government financial statements for 2009–10 to 2013–14

3.4.1 GGS assets

The total value of GGS assets as at 30 June 2014 was $248.2 billion. Figure 3K provides a breakdown of this amount.

Figure 3K
GGS assets as at 30 June 2014



Source: State government financial statements 2013–14

Property, plant and equipment values recorded on the balance sheet fell by $7.1 billion, to $172.3 billion in 2013–14, a decrease of 3.9 per cent. The net decrease was due to changes in the valuation assumptions and methodologies for land under roads (increase of $1.6 billion), reserve land (decrease by $7.1 billion), leasehold land (decrease by $3.8 billion). The largest decrease, relating to reserve land administered by the Department of Natural Resources and Mines, resulted from changes to the assessment of market value on application of the new Australian Accounting Standard AASB 13 *Fair Value Measurement*.

Investments in public sector entities increased by $3.1 billion to $26.4 billion, representing the net asset value of PNFCs ($22.6 billion) and PFCs ($3.8 billion) at 30 June 2014. The valuation of these state owned corporations is based on the reported net assets of those entities. This means the underlying value of these organisations has increased by $3.1 billion.

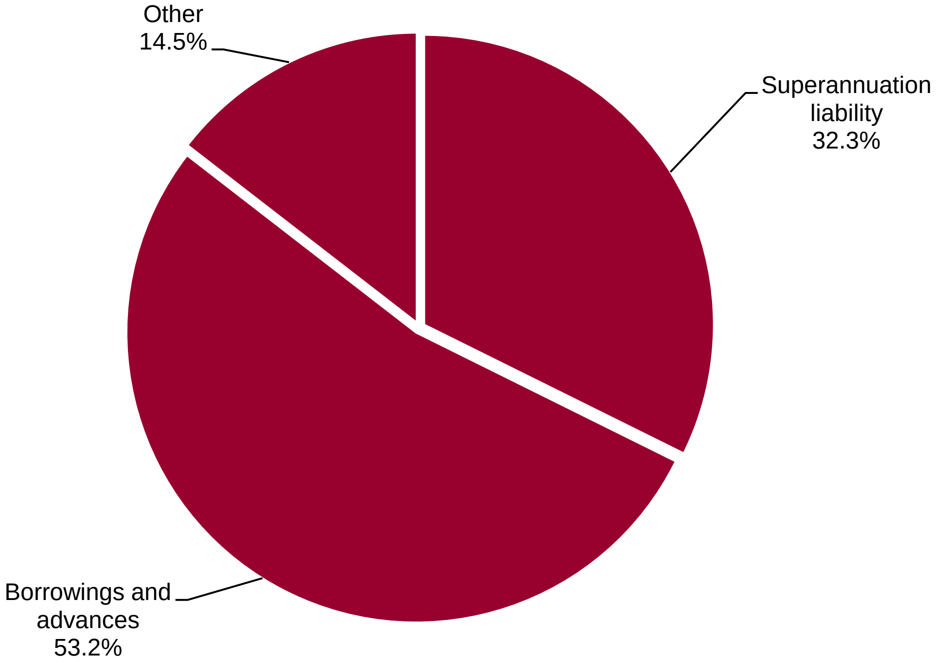
Other investments of $34.8 billion at 30 June 2014 relate to fixed rate notes receivable from Queensland Treasury Corporation (QTC). QTC manages long term assets used to fund the state's superannuation and employee entitlements; this removes any market value volatility from the GGS, aiding budget management. Under this arrangement, the returns QTC pays to the GGS represent a stable and predictable revenue stream, reflecting the long term expected return on the investments (currently set at a fixed annual rate of 7.1 per cent). Annually, the return on the related investments has fluctuated from a loss of $3.1 billion in 2008–09 to a gain of $5.3 billion in 2013–14 as they are valued at market value.

While the long term assets arrangements with QTC have had the benefit of stability for GGS budgeting and financial reporting, the risks at the whole of government level are unchanged.

3.4.2 GGS liabilities

Total GGS liabilities at 30 June 2014 were $78.9 billion, which equates to 31.8 per cent of the value of total assets. Figure 3L provides a breakdown of these liabilities.

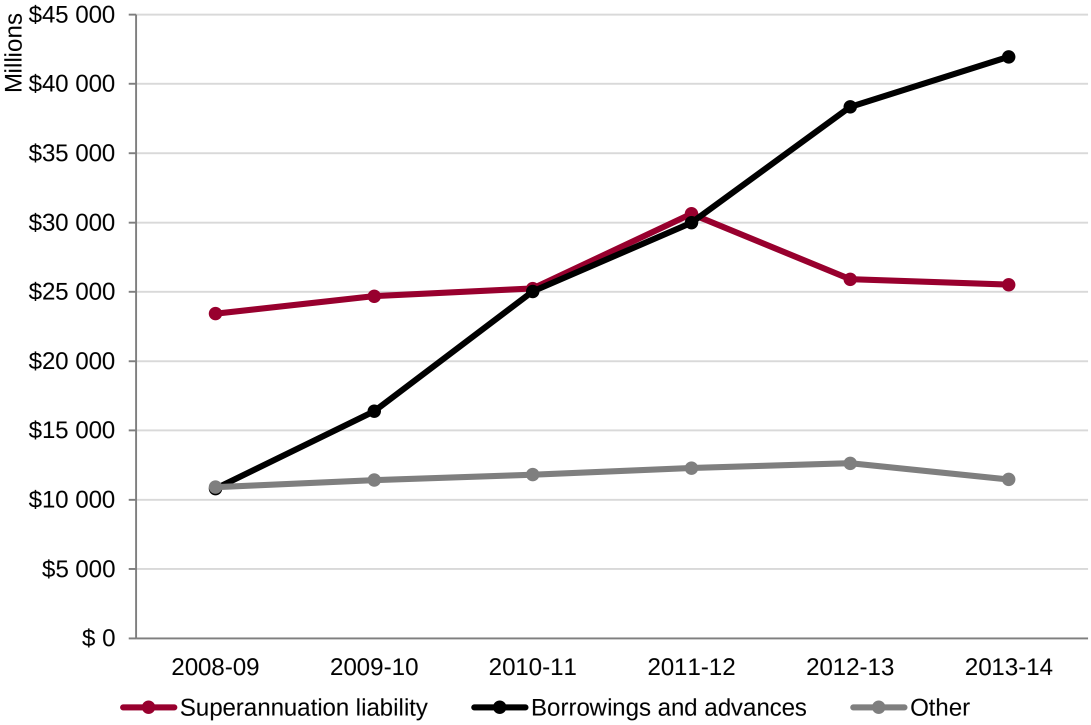
Figure 3L
GGS liabilities as at 30 June 2014



Source: State government financial statements 2013–14

Figure 3M shows the change in liabilities over the past five years.

Figure 3M
GGS liability trends



Source: State government financial statements 2010–11 to 2013–14

Borrowings and advances in the general government sector have increased by $25.6 billion or 156.2 per cent from $16.4 billion at 30 June 2010 to $42.0 billion at 30 June 2014.

Over the same period, property, plant and equipment acquisitions have totalled $37.7 billion, with new borrowings funding capital expenditure

Superannuation liabilities at 30 June 2014 were $25.5 billion and have been relatively constant over the last five years, other than a $5.4 billion increase in 2011–12 and subsequent decrease in 2012–13 of $4.7 billion. The 2011–12 change was primarily due to a significant decrease in Australian Government bond yields from 5.3 per cent to 3.2 per cent. The decrease in 2012–13 was driven by a slight reversal in the movement of bond yields to 3.9 per cent and higher than usual benefit payments, mainly due to employee terminations.

3.5 TSS financial performance

The total state sector (TSS) is the GGS, together with public financial corporations (PFCs) and public non-financial corporations (PNFCs). PFCs and PNFCs are entities funded mainly through their own sourced revenues, rather than appropriations.

The TSS recorded a net operating result of $2.6 billion in 2013–14, a $4.0 billion improvement from the $1.4 billion loss recorded in in 2012–13. Figure 3N provides a breakdown of these results by sector.

Figure 3N
TSS net operating result by sector

	2013–14 $ m	2012–13 $ m	Change $ m
General government sector	952	(4 325)	5 277
Public non-financial corporations	1 514	1 449	65
Public financial corporations	3 786	1 767	2 019
Consolidation adjustments	(3 681)	(335)	(3 346)
Total state sector	**2 571**	**(1 444)**	**4 015**

Source: State government financial statements for 2013–14

The increase in net operating result for PFCs is mainly due to a $2.1 billion increase in the value of long terms assets held by Queensland Treasury Corporation (QTC) to fund state liabilities.

While the net operating result of PNFCs did not change materially, there were a number of significant offsetting transactions within the sector, including:

- The state's electricity generation assets were impaired to their recoverable amount in 2010–11 by $1.7 billion, triggered by the proposed introduction of the federal government’s carbon pricing regime. CS Energy partially reversed this impairment, with a $275 million write-up of asset values. This reversal increased net profits of the state.
- CS Energy's onerous contract liability associated with Gladstone Power Station increased by $235 million to $388 million, representing a 125 per cent increase in value. The change in value was reported as an expense and reduced net profit.
- In 2013–14, carbon pricing continued to have a significant effect on the generators, with Stanwell Corporation Limited and CS Energy incurring $564 million ($600 million in 2012–13) in related gross expenditure during the year. Revenue will decrease and carbon expense will cease once carbon pricing legislation is removed.

The GGS and the TSS value the state's debt differently: the GGS records the borrowing at amortised cost, whereas the TSS records the debt at market value. This difference, together with inter-entity transactions, forms the basis of the consolidation adjustments.

3.6 TSS financial position

As demonstrated in Figure 3O, the state's total net worth was $163.5 billion at 30 June 2014 and has not changed materially over the last 12 months.

Figure 3O
TSS net worth

	2013–14 $ m	2012–13 $ m	Change $ m	Change %
Assets				
Property, plant and equipment	229 392	233 687	-4 295	-1.8%
Investments in securities other than shares	55 500	56 959	-1 459	-2.6%
Other	21 182	20 298	884	4.4%
Total	**306 074**	**310 944**	**-4 870**	**-1.6%**
Liabilities				
Securities and derivatives	94 410	93 667	743	0.8%
Superannuation liability	25 357	25 888	-531	-2.1%
Other	22 841	23 340	-499	-2.1%
Total	**142 608**	**142 895**	**-287**	**-0.2%**
Net worth				
Total	**163 466**	**168 049**	**-4 583**	**-2.7%**

Source: State government financial statements for 2013–14

We identified key points in our analysis of assets and liabilities held by PNFCs and PFCs:

- PNFCs have assets of $63.8 billion, with property, plant and equipment of $54.6 billion (86 per cent). This represents 21 per cent of the state's assets. Borrowings for the PNFCs at 30 June 2014 comprise $31.1 billion, or 43 per cent of the state's debt.
- Entities within the energy sector have the highest value of property, plant and equipment recorded—$32.7 billion, with the valuation of electricity generation assets containing significant management judgements and estimates. Overall, the net change in energy sector asset values resulting from revaluation ($251 million) and impairment reversals ($275 million) represented an increase of $526 million. The energy sector also has the most debt—$17.1 billion, with most borrowings held by the network businesses of Powerlink, Energex and Ergon to fund their infrastructure programs.
- The water sector has assets of $12.4 billion, but carries significant debt of $9.7 billion, mainly held by Seqwater to fund infrastructure and shortfalls in pricing of water. Seqwater has operating and debt sustainability concerns.
- QTC loans to the GGS increased by $6.5 billion or 8.2 per cent, from $79.1 billion to $85.6 billion. These new loans were predominantly funded by advance borrowings QTC undertook in 2012–13 to take advantage of favourable market opportunities and are represented by a decrease in securities assets of $5.8 billion. This means that, although the borrowings of the GGS increased, they were funded from securities already held by QTC and have not increased the external borrowings position of the TSS.
- QTC holds assets to fund the long term liabilities of the state and recorded an overall gain on sale of Queensland Motorways by the state of $2.5 billion.

4 Financial sustainability

In brief

Background

The state's long term financial sustainability ultimately depends on its revenue and expenditure policies. By analysing key indicators calculated from the state government financial statements and from forecasts within the latest state budget, users can gain critical insights into the state's financial health and long term sustainability.

These key indicators include:

- operating ratio—indicates the capacity to meet recurrent operating expenditure from recurrent operating revenues
- net operating cash flow to net purchases of non-financial assets—indicates the ability to self-finance asset acquisitions from operations, rather than relying on debt
- capital replenishment ratio—indicates whether the rate of capital outlays on non-financial assets is keeping pace with the rate of depreciation of those assets
- gross borrowings to operating revenue ratio—indicates the capacity of the state to repay debt principal and interest.

Key findings

- Negative operating ratios, predominately experienced over the past seven financial years, are not sustainable. Operating expenses have stabilised and due to an unexpected advance grant of $1.5 billion from the Australian Government, the state has recorded an operating surplus of the general government sector (GGS) in 2013–14.
- The ratio of net operating cash flows to net purchases of non-financial assets shows the state has depended on debt to fund its asset purchases since 2008. The GGS improved its ability to fund net purchases of non-financial assets from operating cash flows in 2013–14, due to the improved operating result and deferral of capital projects worth $809 million.
- The capital replenishment ratio continues to drift back from a peak in 2010, but remains well above one. Assets are currently being replaced at twice the rate that they are being depreciated; this is forecast to decline. The ratio would be higher if multiple major infrastructure projects were not completed through off balance sheet public private partnership financing arrangements.
- Debt has grown less in 2013–14 and has been matched by revenue growth for the period. Over the past five years, the state's negative net operating balances and large scale asset acquisition program has resulted in historic highs of borrowings and the associated debt to revenue ratio. Accordingly, the state continues to have limited capacity to reduce debt. Budget projections forecast improvement in the debt to revenue ratio; this is tied to key revenue growth assumptions beyond the state's control.
- The public non-financial corporation (PNFC) sector is mostly operating sustainably, with the exception of CS Energy and Seqwater.

4.1 Background

The state must manage its finances over the long term to pay its way while maintaining social services and providing the community with necessary infrastructure. Sound financial decision making will allow the state to fund its operations and a significant portion of its capital program from revenue, without burdening future generations with unnecessary debt.

Over time, the information presented in state government financial statements enables assessments of financial management and sustainability of past and current revenue and expenditure policies. This same information allows a critical assessment of the state's performance against its own fiscal principle of obtaining a fiscal balance; that is, being able to pay for expenditure and the capital program without additional borrowings.

Financial sustainability incorporates operating performance, capital expenditure and financing activity; however, the ultimate measure of financial sustainability is that the state can absorb reasonably foreseeable adverse financial risks and exposures without having to significantly alter its revenue settings. This must include any risks or outflows that may eventuate from funding capital or social programs through the use of public private partnerships (PPPs). The government must ensure PPPs are assessed, sufficiently and critically, to prove using a private operator produces greater value for the state, given the risks adopted.

4.2 Conclusions

The four key sustainability ratios analysed in this report show that while state's financial health has declined over the past decade, the current financial year has stabilised this trend.

The state has constrained expenditure growth and had a greater capacity this year to self-finance acquisitions of property, plant and equipment from operating cash flows.

Assets are being replenished without significant increases in state borrowings however the state's ability to repay the debt from existing revenue continues to be at a decade low. As a result the state's capacity to absorb and respond to any future economic downturn remains a risk.

Improving the overall sustainability of government finances remains a challenge while the state continues to record fiscal deficits. This means that the state has not been able to pay for everyday expenses and its capital program from revenue. While reducing capital spending improves the fiscal balance, it is noted that the capital replenishment ratio of the state has declined for the past five years, but it remains above benchmark.

The public non-financial corporation (PNFC) sector is operating sustainably, and corporations except for Seqwater, CS Energy and Queensland Rail contribute positively to the GGS operating performance.

4.3 Financial sustainability

The four ratios this report uses focus on information in the state government financial statements and provide information which complements the state's four fiscal principles. Figure 4A summarises results of these four key indicators of financial sustainability. Appendix D in this report provides further information about key indicators.

Figure 4A
Results of key financial sustainability indicators—GGS

<table>
<tr><th></th><th>2010</th><th>2011</th><th>2012</th><th>2013</th><th>2014</th><th>Five year average</th><th>Ten year average</th></tr>
<tr><td rowspan="2">Operating ratio (%)
Capacity to meet recurrent operating expenditure from recurrent operating revenue, with a positive ratio indicating that funds are also available for capital expenditure
= Net operating balance divided into total operating revenue</td><td>0.3</td><td>-3.5</td><td>-0.5</td><td>-10.9</td><td>1.3</td><td>-2.7</td><td>1.4</td></tr>
<tr><td colspan="7">The ratio is positive for 2013–14 but would have been negative for a fourth consecutive year if Australian Government NDRRA grant funding for 2014–15 expenditure was not received in advance in the current year.
Five-year trend—The trend is predominately negative, indicating net operating deficits.
Long term trend—The ratio has consistently decreased to being predominately negative in current years from its peak in 2004–05.</td></tr>
<tr><td rowspan="2">Net operating cash flow ratio (%)
Capacity to self-finance non-financial asset acquisitions
= Net cash flows from operations (excludes depreciation) divided into net purchases of non-financial assets (as reported in the cash flow statement)</td><td>38.9</td><td>26.3</td><td>36.3</td><td>-40.7</td><td>43.6</td><td>20.9</td><td>87.7</td></tr>
<tr><td colspan="7">The state's ability to finance non-financial assets acquisitions from operating cash flows has recovered and increased this year above the five-year average.
Five-year trend—Operating cash flows financed 21 per cent of non-financial asset purchases.
Long term trend—A lack of operating cash flows to finance infrastructure and other capital purchases since 2007–08 has driven growth in borrowings and other forms of infrastructure financing.</td></tr>
<tr><td rowspan="2">Capital replenishment ratio (times)
Net rate of replacement of non-financial assets. A ratio greater than one means assets are replaced faster than depreciation
= Net purchases of non-financial assets divided into depreciation expense</td><td>3.5</td><td>3.2</td><td>2.8</td><td>2.1</td><td>2.0</td><td>2.7</td><td>2.4</td></tr>
<tr><td colspan="7">The ratio has stabilised at 2.0 in 2013–14.
Five-year trend—The asset replenishment rate remains favourable, but is declining potentially to more sustainable levels.
Long term trend—Capital spending is stabilising after the high levels in 2010 on water grid, health and road infrastructure. This ratio will be affected by the state procuring new assets through PPPs.</td></tr>
<tr><td rowspan="2">Gross debt ratio (%)
Capacity of the state to repay debt and interest from its revenues
= Gross borrowings divided into total operating revenues</td><td>41.2</td><td>59.6</td><td>65.5</td><td>91.8</td><td>89.8</td><td>69.6</td><td>42.7</td></tr>
<tr><td colspan="7">The ratio stabilised in 2013–14; ability to repay debt and interest is largely unchanged.
Five-year trend—Borrowings have grown more than state revenues, reducing ability to repay debt and interest.
Long term trend—Debt has grown significantly more than revenues. The state's ability to withstand future economic shocks has significantly weakened.</td></tr>
</table>

Source: Queensland Audit Office

4.3.1 Operating sustainability

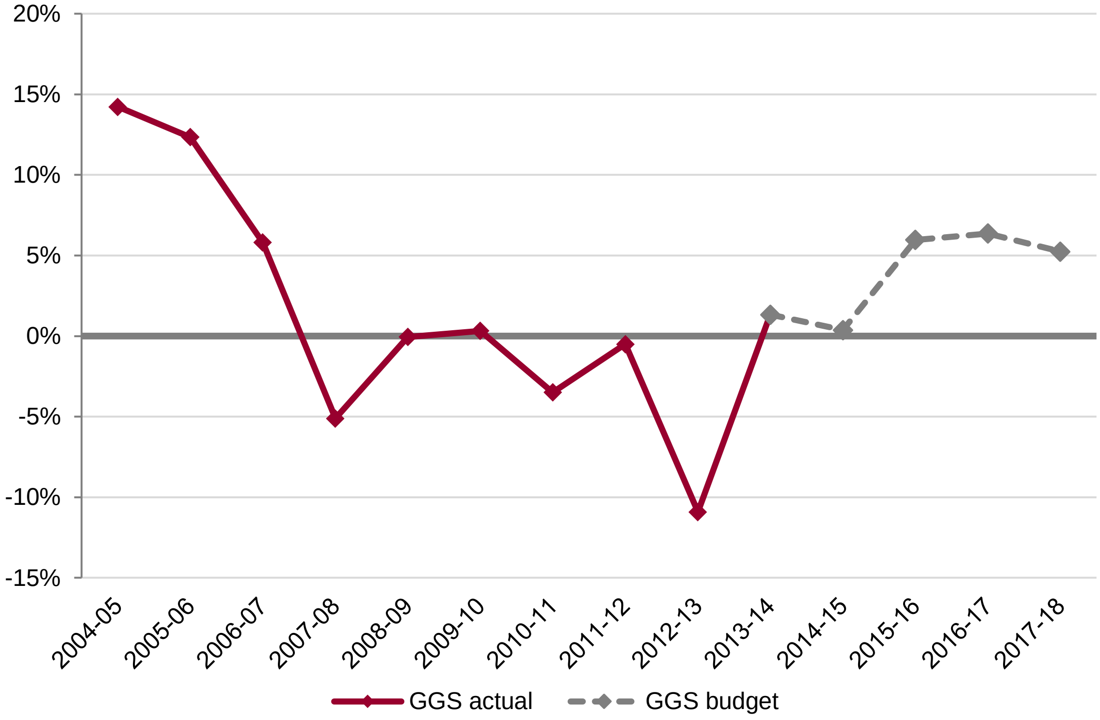
While the GGS reported a net operating balance of $619 million in 2013–14, it has produced net operating deficits in three of the past five years; with a cumulative operating deficit of $5.5 billion over this five-year period. This means the state has incurred $5.5 billion more in costs than it has earned in revenue. This is not sustainable over the long term.

Operating sustainability is able to be assessed by measuring the operating ratio and the ratio of net operating cash flows to net purchases of non-financial assets. Negative ratios indicate insufficient operating revenue, leading to fiscal deficits, depletion of cash reserves and increased borrowings.

Operating ratio

The operating ratio in Figure 4B is the net operating balance expressed as a percentage of total operating revenue. It shows the capacity of the state to meet operating expenditures from operating revenue.

Figure 4B
Operating ratio



Source: Queensland Audit Office

The operating ratio was positive for 2013–14 for the first time since 2006–07, indicating revenue is available to fund capital expenditure and pay off debt.

The ratio needs to continue to be positive over the medium term for the state to remain financially sustainable in the long term. From the peaks evident in 2004–05, the ratio has declined and been predominately negative during the past five years, with a negative 2.7 per cent ratio average.

If the ratio remains above zero, as reported in the state's *Budget Strategy and Outlook 2014–15*, the GGS will enhance its ability to replace assets using revenue generated from its own operations and will be in a better place to achieve a fiscal balance. The state forecasts the ratio will continue to increase above zero, assuming continuing revenue growth (including from liquid natural gas development) and expenditure control.

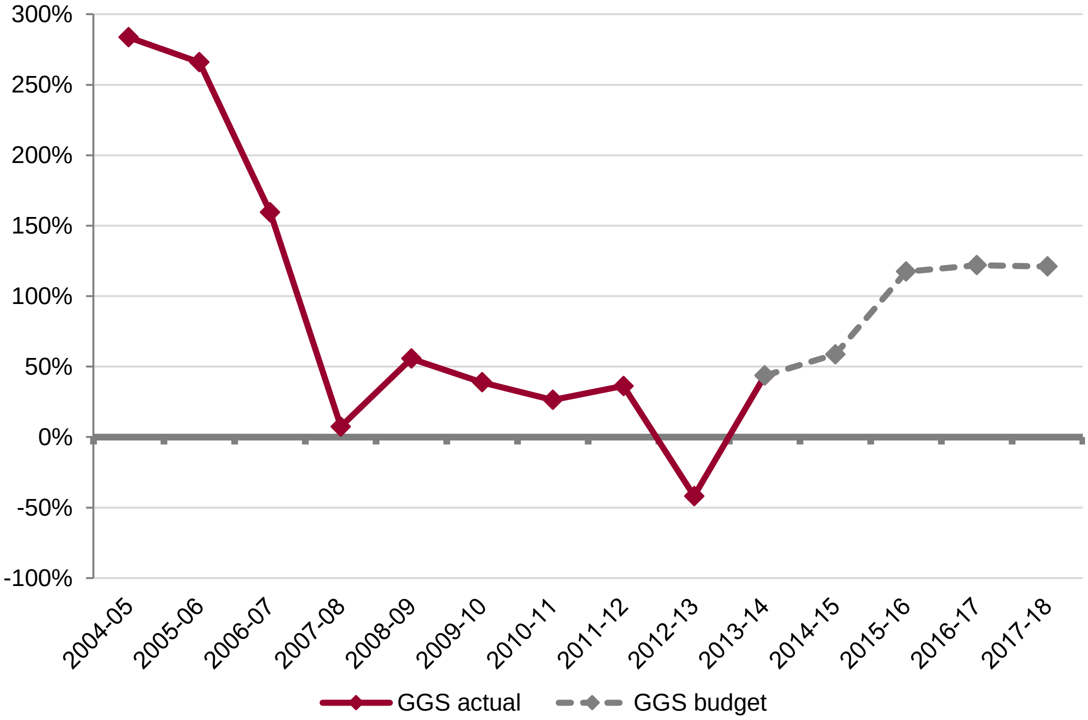
Net operating cash flow ratio

The ratio of net operating cash flow to net purchases of non-financial assets shows the state's capacity to self-finance acquisitions of property, plant and equipment from operations rather than sources such as borrowings, asset sales or PPP arrangements. This ratio has been derived from the cash flow statement.

Similar to the operating ratio, there may be temporary periods where this ratio is negative to allow the state to support economic activity; however, this ratio should generally be positive.

Figure 4C shows that the ratio of net operating cash flow to net purchases of non-financial assets has also improved and increased to 44 per cent in 2013–14, its highest level since 2008–09. The positive ratio indicates operating cash receipts were available to fund a percentage of non-financial assets purchases.

Figure 4C
Net operating cash flow to net purchases of non-financial assets ratio



Source: Queensland Audit Office

The ratio experienced a long term decline since the high point in 2004–05 before the turnaround in 2013–14. The GGS has only been able to fund, on average, 21 per cent of asset purchases from net revenue over the past five years. This has resulted in significant increases in government borrowings.

The state spent $809 million less on capital projects this year than forecast in the 2013–14 state budget by deferring projects. This capital spending will occur in future periods, but has positively affected the fiscal balance this year.

While the funding of some long term critical infrastructure through long term debt is financially sound, the state must ensure it has capacity to repay the debt, including interest.

Risks to operating sustainability

A number of risks to the state's future revenues and its operating and capital expenditures require close attention.

Revenue forecasts used to prepare state budgets are subjective and depend on many factors outside of the control of the state. Unforeseen decreases in state economic growth may affect the amount of taxes and duties collected from taxed state sources. Unfavourable movements in exchanges rates and commodity prices and volumes may affect royalty amounts collected from coal and liquid natural gas production. Australian Government goods and services tax (GST) grants may decrease under weaker national economic conditions.

Portions of future expenditure of the GGS are locked in through its social and economic PPPs and service concession agreements. The state estimates future net nominal cash outflows from these arrangements at $11.7 billion, incurring $4.8 billion of these cash outflows within the next ten years. PPP arrangements funding future state infrastructure projects will significantly increase expenditure commitments. The New Generation Rolling Stock PPP project to construct train carriages and a train maintenance centre signed in 2013–14, singularly increased the future cash flows by $5.6 billion over 32 years.

The net cost for facilities and staging of the 2018 Gold Coast Commonwealth Games (the Games) is currently estimated at $1.6 billion, with most of the costs yet to be spent. Delivering the necessary facilities, including the athletes' village requires a significant capital works program, and revenues to be earned to offset the costs are highly sensitive to economic conditions which prevail closer to, and at the time of, the Games.

During 2013–14, the state purchased $9 billion of health services from Hospital and Health Service (HHS) entities and monitors performance of each HHS. The purchase of health services is partially funded by the Australian Government, with $2.7 billion received this year. The Australian Government has changed the method of calculating this contribution from an activity based model to one linked to population growth and the consumer price index; it will no longer provide funding guarantees. If the consumer price index movements are less than the growth in the cost of medical services, there may be shortfalls beyond this period.

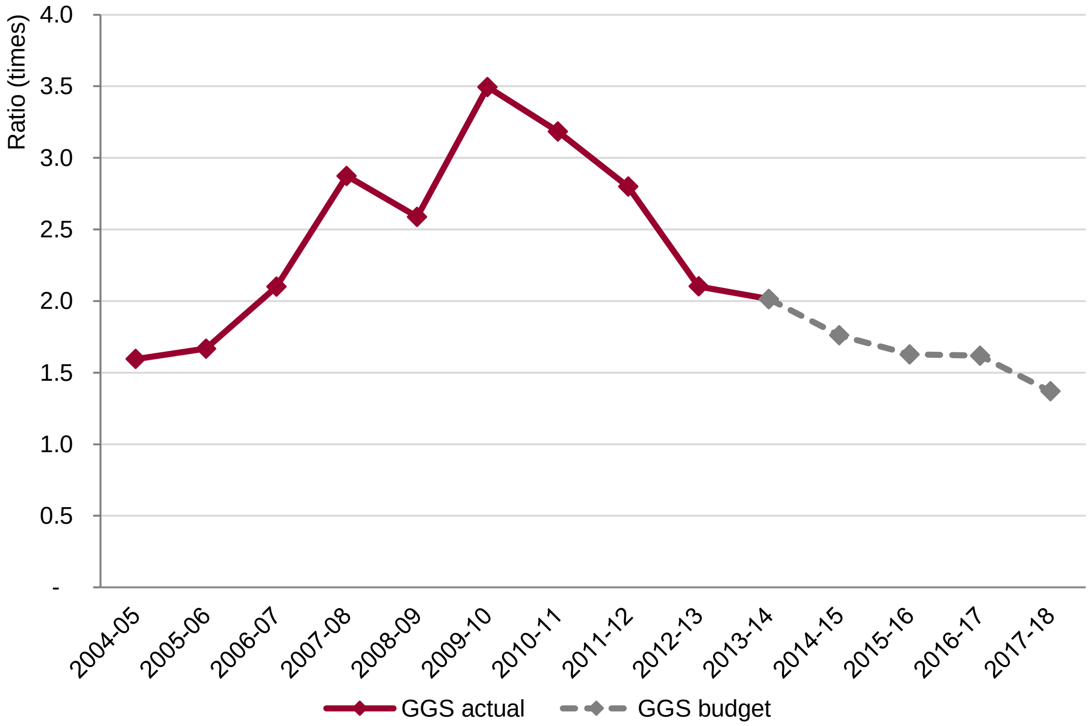
With the sale of government buildings to QIC with fixed lease terms, the construction of 1 William Street and the overall downsizing of the Queensland public sector employee base since 2012–13, the risk remains that the government will be committed to office space in Brisbane's central business district that may not be required.

4.3.2 Investing sustainability

The property, plant and equipment assets of the GGS were valued at $172.206 billion at 30 June 2014, with just under half of this balance comprising buildings and infrastructure.

The capital replenishment ratio compares annual net expenditure on non-financial assets (predominantly property, plant and equipment) to annual depreciation. Figure 4D shows the ratio over the past ten years for the GGS has been more than one—assets are being built or refurbished faster than the non-financial asset base is being depreciated.

Figure 4D
Capital replenishment ratio



Source: Queensland Audit Office

After the spike in capital spending in 2010 on items such as water grid, health and road infrastructure, capital spending is returning to longer term average levels. The asset replenishment rate remains favourable but may decline to more sustainable levels of two per cent. The ratio has been forecast to fall to an anticipated ratio of around 1.4 per cent in 2017–18, as capital spending reduces when a number of large infrastructure projects and natural disaster repairs are completed and infrastructure is delivered through PPP arrangements.

For three of the past five years, the state has spent less money than budgeted on asset purchases and construction. The variance represents capital spending which has been deferred to future years, however continued deferral of capital projects may adversely affect the replenishment of key public infrastructure.

Risks to investing sustainability

The state is replacing its existing non-financial asset base faster than it is being depreciated, with the capital replenishment ratio above one. The state should continue to consider risks to the financial sustainability of its assets and associated capital program, including:

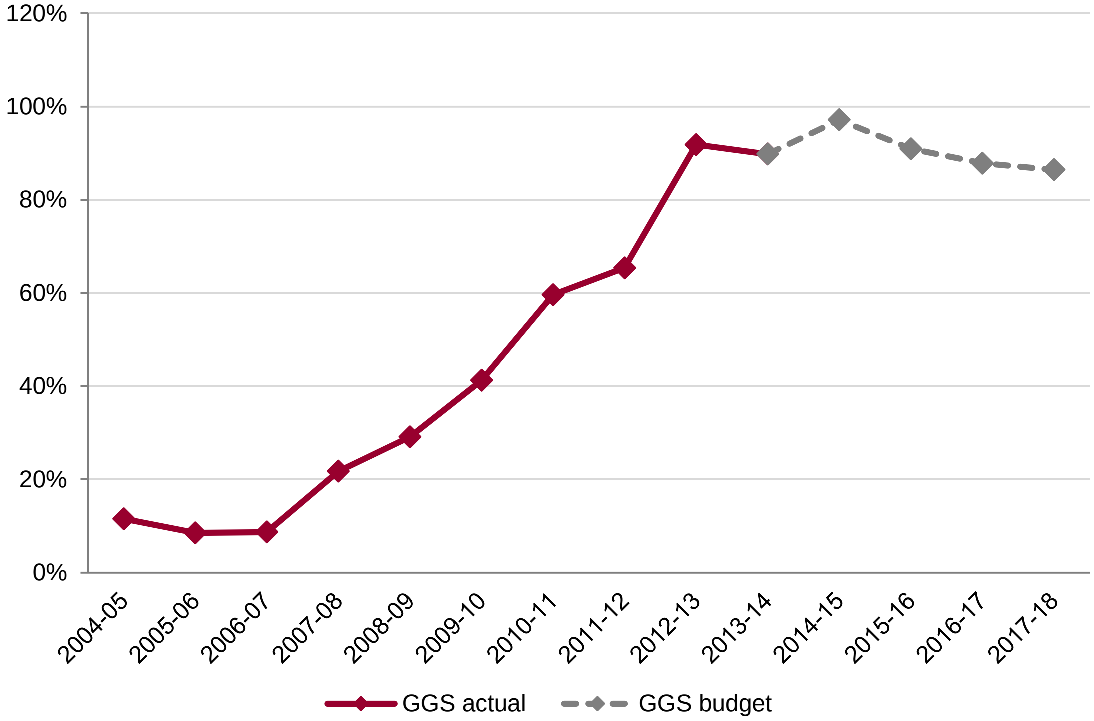
- subjecting the state's capital works program—including $5.97 billion of works forecast in 2014–15 across the health, energy, transport and main roads sectors—to rigorous project planning, evaluation and management controls to avoid cost overruns
- funding associated future maintenance costs as the non-current asset base grows.

4.3.3 Debt sustainability

Debt sustainability is an assessment of whether the state can pay principal and interest charges and meet its long term obligations to employees and insurance schemes while maintaining its assets and community services. The ratio of gross debt to operating revenue indicates the capacity of the state to repay debt and interest from its revenues. The state has sufficient investments in place to pay for its long term employee and insurance obligations and these investments are excluded for this analysis of gross debt.

Figure 4E shows that debt has grown faster than state revenues since 2006–07, primarily because borrowings have increased. Increased borrowings have funded buildings and infrastructure and operating costs; they also have contributed to the state's downgraded credit rating. The ratio stabilised in 2013–14 with the ratio decreasing slightly by two per cent as revenue growth has matched debt growth. The ratio in 2013–14 would have increased to 93 per cent, as opposed to decreasing, if $1.37 billion of the unexpected Australian Government advance grant of $1.5 billion had not been temporarily offset against borrowings levels by the state. Based on the state’s *Budget Strategy and Outlook 2013–14*, the ratio for the GGS is forecast to peak at 97 per cent in 2014–15 before trending downwards.

Figure 4E
Gross debt to operating revenue ratio



Source: Queensland Audit Office

Despite 2009's downgrade of the state's credit rating, the additional cost of debt for the state, compared to AAA-rated state and Australian governments, has diminished as yield spreads between Commonwealth and state government bonds have narrowed. The state may face higher costs of debt in the future, should the Queensland economy weaken.

Risks to the sustainability of the state's debt

GGS borrowings increased by 156 per cent in the five years to 2014, and 1 217 per cent in the last decade. Annual interest expenses increased from $803 million in 2010 to more than $2.2 billion this year. This cost must be met by revenue which has not grown at the same rate as borrowing costs, with more revenue being spent on interest each year.

There are factors affecting the state's ability to repay debt and meet interest costs:

- Currently, Queensland is the largest issuer of bonds of any Australian state or territory.
- The state may pay higher costs for funding while it holds a long term AA+ credit rating, compared with the AAA rating previously held.
- Some PPPs defer up front capital outlays however, the state has committed to undiscounted future net cash outflows of $11.7 billion over the life of the current arrangements. The $11.7 billion will be met from the state's revenue, thereby reducing the ability to reduce debt and pay interest.
- The state intends to replace information and communications technology (ICT) through direct capital outlays or purchasing ICT services. Implementing complex systems across multiple agencies is costly and purchase of ICT services is a significant commitment.

4.4 Sustainability of PNFC sector

The state’s PNFCs are not funded by appropriations; rather, they source their own revenue, usually through service charges to access their assets and services. Queensland Rail also receives payments from the state to support passenger transport services and Ergon Energy receives community service payments to support regional electricity retail pricing structures. PNFCs collectively earned after tax profits of $1.64 billion in 2013–14.

Their current profitability and recent past performance means PNFCs have been, and remain, financially sustainable in the short to medium term. The longer term financial sustainability of CS Energy, Seqwater and Stadiums Queensland is less certain. Figure 4F contains a summary of the sustainability measures applied to each of the PNFC sectors.

Figure 4F
Sustainability measures by PNFC sector

Measures	Energy	Water	Ports	Rail
Operating ratio	Operating sustainably, except for CS Energy	Operating sustainably, except for Seqwater	Operating sustainably	Operating sustainably
Capital replenishment ratio	Operating sustainably	Operating sustainably	Operating sustainably	Downward trend
Debt to revenue ratio	Operating sustainably	Operating sustainably, except for Seqwater	Operating sustainably	Operating sustainably

Source: Queensland Audit Office

Generally energy, rail and port sectors are operating sustainably, except CS Energy which made losses after tax in each of the last five years. The state's new generation rolling stock public private partnership arrangement and Moreton Bay Rail project will help replenish the state's rail assets and offset the downward trend in Queensland Rail's capital replenishment ratio.

Seqwater is less sustainable as it charges less in bulk water prices in south-east Queensland than the cost to supply water. Prices charged are expected to rise to meet the costs of supplying water over the next ten years. Seqwater is also carrying significant debt related to manufactured water assets and the south-east Queensland water grid.

5 Budgetary reporting

In brief

Background

The Queensland Government produces a state budget annually, with forward estimates compiled on a rolling five-year basis. A robust budgeting process is fundamental to providing Parliament and other parties such as ratings agencies and the community with an accurate picture of the financial outlook for the General Government Sector (GGS), including the government's prioritised policy initiatives. The accuracy of budget forecasts can be assessed against results subsequently reported in the Audited Consolidated Financial Statements—Government of Queensland (state government financial statements).

Public corporations are integral to the finances of the GGS. They provide essential public infrastructure; contribute revenue to the GGS in the form of dividends, income tax equivalents and interest; and are the vehicle through which certain GGS expenses such as community service obligations are distributed. In addition, public financial corporations are responsible for managing significant long term financial assets and liabilities held by the GGS.

The state budget incorporates public non-financial corporations (PNFCs) in two ways: as revenue and expenses for the GGS and with performance expectations measured on a sector basis.

Key findings

- Over the past five financial years, annual state budgets have provided a reasonable forecast of the total revenues, expenses, assets and liabilities of the GGS for each financial year.
- The actual performance of PNFCs is consistent with each budget of the last five years, except for 2010–11 where a number of material commercial businesses were sold.
- In some years, factors which the state government could not reasonably anticipate have resulted in estimates differing significantly from the final result at a net operating balance and/or net asset level.
- In 2014–15, each department will compare individual budgets to actual performance in its financial statements. This will increase the focus on each department’s performance to budget, increasing budget reliability and reducing the risk of errors in financial statement reporting.

5.1 Background

The Queensland Government produces a state budget annually. The budget is prepared on a rolling five-year basis and details expected financial transactions and performance measures for government departments. Actual performance compared to budget reflects the robustness of the budget process and the accuracy of predictive models.

The introduction of Australian Accounting Standard AASB 1055 *Budgetary Reporting* in 2014–15 will enhance the rigour of the existing process as each department will prepare a note to the financial statements comparing its individual budget to actual performance.

The state established public corporations to improve its overall economic performance, increasing efficiency and effectiveness through operating commercial businesses. Public corporations include electricity generation, transmission, distribution and retail businesses; rail and port infrastructure; bulk water; and financial corporations.

Public corporations are self-sustaining entities independent of government support. They usually have their own revenue sources and manage their own assets and expenditure, although there is often a regulatory pricing regime in place. The state owns the entities which provide returns to the state through dividends and taxes.

The state budget includes public corporations providing revenue to and expenditure from the general government sector (GGS) and monitors their performance through key ratio reporting.

At 30 June 2014, the non-financial assets of the public corporations are valued at $59.6 billion (19.5 per cent of total state assets) with $31.3 billion of borrowings (32.5 per cent of total state borrowings).

5.2 Conclusions

Over the past five financial years, the annual state budgets have provided a reasonably accurate forecast of the total revenues, expenses, assets and liabilities of the GGS when compared to actual results reported in the Audited Consolidated Financial Statements—Government of Queensland (state government financial statements).

Some areas have varied materially from budget, due to factors such as Commonwealth payment of large grant advances late in the financial year; natural disasters; late adjustments to non-current asset opening balances; delays in capital projects; and the challenges of estimating future changes in fair values for non-current assets and superannuation liabilities. These factors have contributed to a difference of up to $24.5 billion between the state's actual net worth and budgeted results and a difference of up to $4.4 billion between the actual net operating balance and budgeted results.

While most of the factors have been beyond the state's fiscal control, the state should focus on those factors its decision making influences, such as completing capital projects.

5.3 Future changes to the budget process

Currently, the Mid-Year Fiscal and Economic Review, the following year's budget and the state government financial statements include a note to the accounts detailing the performance and position of the state, compared to the estimates included in the budget, to assess the accuracy of the state budget on a whole of government basis.

From 2014–15, each department will also prepare a note to the financial statements, comparing its individual budget to actual performance as well as the budgets the department reports in its Service Delivery Statement (SDS).

Reporting of budget to actual in state and individual departments' financial statements will enhance the accuracy and reliability of the budget process; reflect circumstances which are beyond the fiscal control of the state; and enhance the accountability of information contained in financial statements. Machinery of government changes affect the financial statements of departments and original budgets; any future changes of this nature will require attention to ensure the accuracy of the reported values.

5.4 Budget variances

The state government financial statements include a disclosure that compares final actual operating statement, balance sheet and cash flow statement results for the financial year against initial state budget estimates for the GGS. The statements explain reasons for major differences between final actual results and budget estimates.

We assessed the accuracy of the GGS budget process over the past five years against the results subsequently reported in the state government financial statements.

5.4.1 Revenue

Grants have been the primary contributor to budget variances for revenue over the past five years as shown in Figure 5A.

Figure 5A
Variances between budgeted and actual results—revenue from transactions

	2009–10 Variance	2010–11 Variance	2011–12 Variance	2012–13 Variance	2013–14 Variance
Grants revenue ($ m)	1 470	1 400	2 391	-303	1 640
Grants revenue (%)	7.8	7.4	11.8	-1.6	8.2
Other revenue ($ m)	1 067	-50	397	-176	417
Other revenue (%)	5.1	-0.2	1.6	-0.8	1.6

Source: Consolidated Financial Statements of the Government of Queensland for financial years 2009–10 to 2013–14

There have been two main drivers of the budget variances for grants revenue: Commonwealth grants and goods and services tax (GST) revenue.

Commonwealth grant revenues post-state budget

The Australian Government sometimes pays Natural Disaster Relief and Recovery Arrangements (NDRRA) grants in advance, acquitted at a later date against actual expenses. It has been difficult for the state to forecast the timing and amount of these grant advances in the original budget each year. Grants exceeded budget by $2.1 billion in 2010–11, $1.8 billion in 2011–12, and $1.5 billion in 2013–14. Under Australian Accounting Standard AASB 1004 *Contributions*, not for profit entities must recognise as revenue such non-reciprocal grants on receipt rather than as the related expenses are incurred, which can be over several years. The uncertainty and irregular nature of Commonwealth payments result in uncertainty of actual results to budget.

Commonwealth approval of grant funding for road projects after the state budget has been published has also led to significant variances; for example, road funding exceeded the original budget by $0.5 billion in 2009–10 and $1.1 billion in 2011–12.

Complexity of estimating GST revenue

The state experienced budget variances of $0.5 billion (five per cent) in GST revenue for three consecutive years from 2009–10 to 2011–12. Consumption levels determine the amount of GST raised nationally and Queensland's share. In 2009–10, revenue was higher than expected as the global financial crisis affected consumption less than anticipated. GST revenue was lower than forecast in 2010–11 and 2011–12, but the variance between actual and budget for GST revenue was less than $200 million in 2012–13 and 2013–14.

5.4.2 Expenses

Figure 5B allocates budget variances in expenses from transactions over the past five years between 'grants' and 'other'. We adjusted the 2013–14 variance to recognise a $3.6 billion reclassification from grant expenses to other expenses and to compare years consistently.

Figure 5B
Variances between budgeted and actual results—expenses from transactions

	2009–10 Variance	2010–11 Variance	2011–12 Variance	2012–13 Variance	2013–14 Variance
Grants expenses ($ m)	645	763	-501	-1 090	-1 348
Grants expenses (%)	7.1%	7.5%	-4.4%	-9.3%	-16.6%
Other expenses ($ m)	-7	358	-537	-1 299	-973
Other expenses (%)	-0.0%	1.1%	-1.6%	-3.8%	-2.8%

Source: Queensland Audit Office

In percentage terms, the material variances in Figure 5B relate to grant payments to local governments for natural disaster recovery.

Variability of natural disaster recovery grant payments to local governments

The state has found it challenging to forecast the cost and timing of NDRRA grants payable to local governments in recent years. NDRRA grants to local governments were over budget by $0.4 billion in 2010–11 and under budget by $0.4 billion in 2011–12, by $0.9 billion in 2012–13 and by $0.8 billion in 2013–14. Excess expenditure in 2010–11 was due to the significant damage caused by flooding and cyclone events between November 2010 and February 2011 that required immediate emergent works. Expenditure below budget in subsequent years was due to delays completing and acquitting road reconstruction works sometimes due to cyclones or flooding in consecutive years.

While the effects of future natural disasters are difficult to forecast, budget variances relating to past disasters should be lower in 2014–15 as much of the recovery works for the most severe past natural disasters had to be completed by 30 June 2014.

5.4.3 Assets

Other than in 2010–11 when there was a one-off variance relating to receivables from QTC, material budget differences for assets in recent years have been isolated to property, plant and equipment and investments in public sector entities, as demonstrated in Figure 5C.

Figure 5C
Variances between budgeted and actual results—assets

	2009–10 Variance	2010–11 Variance	2011–12 Variance	2012–13 Variance	2013–14 Variance
Property, plant and equipment ($ m)	18 677	-11 579	-7 308	2 208	11 666
Property, plant and equipment (%)	12.6%	-6.4%	-4.0%	1.2%	-6.3%
Investments in public sector entities ($ m)	3 730	-6 480	2 617	5 341	4 226
Investments in public sector entities (%)	23.8%	-26.3%	13.8%	31.5%	19.0%
Other ($ m)	357	4 361	229	204	-94
Other (%)	0.6%	15.1%	0.5%	0.4%	-0.2%

Source: Consolidated Financial Statements of the Government of Queensland for financial years 2009–10 to 2013–14

There were three key factors causing the variances in property, plant and equipment and investments in public sector entities relating to opening balances, capital expenditure and future asset revaluations

Changes to opening balances

Budgeted opening balances for assets can differ from amounts signed off in the audited financial statements, due to changes identified between the budget release in June and finalisation of audited financial statements in August.

The property, plant and equipment budget was 12.6 per cent higher than forecast in 2009–10 because the opening balance for land under roads in the budget was $25.4 billion lower than the final audited value. Land under roads was first recognised as at 30 June 2009 in accordance with changes to Australian accounting standards.

Further examples of this issue occurred in 2010–11 and 2011–12 where the original budget for property, plant and equipment was based on opening balances which differed from the values in the audited financial statements by $6.9 billion and $2.9 billion respectively.

Scheduling changes for capital expenditure

In some instances, capital projects have not been completed within projected time frames. Project delays have caused purchases of non-financial assets to be below budget by $0.7 billion or 8.9 per cent in 2012–13 and $0.8 billion or 11.3 per cent in 2013–14.

This below-budget capital expenditure and changes to opening balances for property, plant and equipment affects depreciation expense. Audited depreciation and amortisation expense has been less than forecast in the original budget by between $0.1 billion and $0.3 billion in each of the last five financial years.

Uncertainty of future asset revaluation movements

Agencies have experienced difficulty forecasting asset revaluations 12 months into the future. The difference between budget and actual for revaluations recorded against equity was $10.8 billion in 2009–10, $5.8 billion in 2010–11, $10.4 billion in 2011–12, $8.1 billion in 2012–13 and $8.6 billion in 2013–14. Each GGS entity must provide an estimate of revaluations for the land, buildings, infrastructure, major plant and equipment and heritage and cultural assets it owns. Revaluations of physical assets controlled by PNFCs and financial assets owned by PFCs can materially affect the value of GGS investments.

Budgeting for revaluation movements involves many inputs that are difficult to estimate—changes in land values, building construction costs, interest rates and share market indexes.

5.4.4 Liabilities

Figure 5D allocates budget variances for liabilities over the past five years between 'borrowings' and 'other'.

Figure 5D
Variances between budgeted and actual results—liabilities

	2009–10 Variance	2010–11 Variance	2011–12 Variance	2012–13 Variance	2013–14 Variance
Borrowings ($ m)	-2 859	1 839	-3 671	-3 437	-5 795
Borrowings (%)	-15.2%	7.9%	-11.1%	-8.3%	-12.3%
Other ($ m)	1 112	1 805	5 577	1 271	-3 340
Other (%)	3.3%	4.5%	14.0%	3.6%	-10.5%

Source: Consolidated Financial Statements of the Government of Queensland for financial years 2009–10 to 2013–14

The variances for other liabilities were material in 2011–12 and 2013–14, due to changes in discount rates on superannuation liabilities.

Effects of operating and capital variances on borrowings

Borrowings have been below budget in four of the last five years. In these years, net cash inflows from revenues, expenses and capital purchases were higher than anticipated, meaning fewer new borrowings were required than originally forecast. Although borrowings have regularly been under budget, we note they have increased each year, from $15.9 billion in 2009–10 to $41.4 billion in 2013–14.

Borrowings were above the projected level in 2010–11 because the state drew down $2.2 billion post budget to repay Queensland Motorways Limited debt and transfer it to the long term assets operations Queensland Treasury Corporation controls.

Volatility of discount rates for superannuation liabilities

Superannuation liabilities have differed materially from budget in years where discount rates have moved significantly. The liability in 2011–12 was $4.9 billion or 18.9 per cent above the original budget, primarily because the actual year-end discount rate of 3.2 per cent was significantly different to the 5.3 per cent rate used for the budget.

Such movements in discount rates are difficult to predict and the effects are at least partially offset by movements in the investment at Queensland Treasury Corporation, which holds the assets set aside to fund the superannuation liabilities.

5.5 Budget process for public corporations

The board of each public corporation must approve an annual budget. Public corporations that are government owned corporations must include a corporate plan that is submitted to the shareholding Minister/s for agreement.

Public corporations influence GGS forecasts of revenue relating to dividends, income tax equivalents, interest and outflows for interest expense and community service obligations. Public corporations forecast these revenues and expenses to relevant departments each year to assist their budget process.

The Australian Loan Council has agreed a Uniform Presentation Framework so government financial information is comparable across states and territories. As this framework requires, state budget papers include consolidated projections for public non-financial corporations, but not for public financial corporations, nor thus the total state sector position.

5.6 Comparing budget and actuals for PNFCs

As PNFCs are significant to the GGS results we have compared forecasts and actuals over the last five years to assess the reliability of PNFC budgets. These are illustrated in Figure 5E.

Figure 5E
Comparison between PNFC budget and actual results

	2009–10 Variance $ m	2010–11 Variance $ m	2011–12 Variance $ m	2012–13 Variance $ m	2013–14 Variance $ m
Operating statement					
Total revenue from transactions	-743	1 794	-130	-381	27
	-6.6%	13.7%	-1.3%	-3.4%	0.2%
Total expenses from transactions	-649	1 741	379	1	249
	-6.0%	13.6%	3.9%	0.0%	2.4%
Balance sheet					
Total assets	-1 031	18 528	855	-2 070	-2 556
	-1.5%	23.8%	1.4%	-3.4%	-4.1%
Total liabilities	2 289	11 245	128	607	226
	4.6%	22.0%	0.3%	1.4%	0.5%

Source: State Budget Papers and Reports on State Finances of the Queensland Government

The actual performance compared to budget is reasonably accurate except for 2010–11 where the differences exceeded 10 per cent. A number of material commercial businesses were sold in that year, decreasing materially the total PNFC revenues, expenses, assets and liabilities. Although the 2010–11 budget papers acknowledged an intention to sell these businesses, the original 2010—11 budget included only the sale of Forestry Plantations Queensland as the sale process had not progressed sufficiently.

Appendices

Appendix A—Comments

In accordance with section 64 of the *Auditor-General Act 2009*, a copy of this report was provided to Queensland Treasury and Trade with a request for comment.

Responsibility for the accuracy, fairness and balance of the comments rests with the head of these agencies.

Comments received from Under Treasurer, Queensland Treasury and Trade

Queensland Government

Queensland Treasury and Trade

Our Reference: TRY-08533

-5 DEC 2014

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

Dear ~~Mr Greaves~~ Andrew

Thank you for your letter of 4 November 2014, and revised draft on your audit of the 2013-14 State Government Financial Statements.

The Results of Audit: Queensland state government financial statements, which follows the tabling of the 2013-14 Report on State Finances, provides QAO analysis and commentary on a number of complex issues. I appreciate the opportunity that my officers have been provided to comment on the report and clarify a number of matters.

The report discusses the size of the future cash flow commitments of the government through PPPs. In terms of context, I would note that these payments are undiscounted and spread over contracts up to 32 years and reiterate, that as mentioned in your report, the state enters a PPP on the basis that the arrangement will deliver better value for money outcomes.

As we have noted in the responses to your previous reports to Parliament in 2012 and 2013 in relation to financial sustainability, the role of governments is to select a small number of appropriate financial performance measures to drive decision making consistent with policy settings and for public reporting purposes. The Queensland Government has four key measures for this purpose and publishes these in its Budget, Mid-Year Fiscal and Economic Review and Report on State Finances. As you are aware, the Government's measures were informed by the considerable work undertaken by the Commission of Audit on the strategies required to improve the State's finances.

The Government publishes a full suite of financial statements at these three intervals, allowing interested parties the opportunity to calculate the State's financial sustainability using their own set of preferred metrics.

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Comments received from Under Treasurer, Queensland Treasury and Trade

- 2 -

The measures you have selected remain different from both the Government's fiscal principles and the measures used by ratings agencies. In our view, it would be preferable to use a consistent set of measures of the State's financial performance. We do acknowledge that the QAO has replaced its previous net financial liability to revenue ratio measure with gross borrowings to operating revenue.

I would like to acknowledge the cooperation of our respective officers in the completion of your audit.

Thank you again for the opportunity to comment on the report.

Yours sincerely

Mark Gray

Mark Gray
Under Treasurer

Appendix B—General government sector

Entities in the general government sector comprise:

- Departments of government:
  - Department of Aboriginal and Torres Strait Islander and Multicultural Affairs
  - Department of Agriculture, Fisheries and Forestry
  - Department of Communities, Child Safety and Disability Services
  - Department of Education, Training and Employment
  - Department of Energy and Water Supply
  - Department of Environment and Heritage Protection
  - Department of Housing and Public Works
  - Department of Justice and Attorney-General
  - Department of Local Government, Community Recovery and Resilience
  - Department of National Parks, Recreation, Sport and Racing
  - Department of Natural Resources and Mines
  - Department of the Premier and Cabinet
  - Department of Science, Information Technology, Innovation and the Arts
  - Department of State Development, Infrastructure and Planning
  - Department of Tourism, Major Events, Small Business and the Commonwealth Games
  - Department of Transport and Main Roads
  - Public Safety Business Agency (renamed from Department of Community Safety on 1 November 2013)
  - Queensland Fire and Emergency Services (established 1 November 2013)
  - Queensland Health
  - Queensland Police Service
  - Queensland Treasury and Trade.
- Other general government entities:
  - Anti Discrimination Commission
  - Australian Agricultural College Corporation
  - Board of the Queensland Museum
  - City North Infrastructure Pty Ltd
  - Commission for Children and Young People and Child Guardian (ceased 30 June 2014)
  - Crime and Misconduct Commission (renamed Crime and Corruption Commission from 1 July 2014)
  - Electoral Commission of Queensland
  - Gold Coast 2018 Commonwealth Games Corporation
  - Gold Coast Institute of TAFE (transferred to Education, Training and Employment on 1 July 2013)
  - Gold Coast Waterways Authority
  - Health Quality and Complaints Commission (ceased 30 June 2014)
  - Hospital and Health Services:
    - Cairns and Hinterland
    - Cape York (amalgamated with Torres Strait—Northern Peninsula to form Torres and Cape Hospital and Health Service from 1 July 2014)
    - Central Queensland
    - Central West
    - Children's Health Queensland
    - Darling Downs
    - Gold Coast
    - Mackay
    - Metro North
    - Metro South

    - North West
    - South West
    - Sunshine Coast
    - Townsville
    - West Moreton
    - Wide Bay
- Legal Aid Queensland
- Legislative Assembly
- Library Board of Queensland
- Motor Accident Insurance Commission
- Nominal Defendant
- Office of the Governor
- Office of the Health Ombudsman (established 17 February 2014)
- Office of the Information Commissioner
- Office of the Ombudsman
- Prostitution Licensing Authority
- Public Service Commission
- Queensland Art Gallery Board of Trustees
- Queensland Audit Office
- Queensland Building and Construction Commission (established 1 December 2013)
- Queensland Building Services Authority (ceased 30 November 2013)
- Queensland Mental Health Commission (established 1 July 2013)
- Queensland Performing Arts Trust
- Queensland Reconstruction Authority
- QRAA
- Queensland Studies Authority
- Residential Tenancies Authority
- South Bank Corporation
- Southbank Institute of Technology (transferred to Education, Training and Employment on 1 July 2013)
- The Council of the Queensland Institute of Medical Research
- The Public Trustee of Queensland
- Tourism and Events Queensland
- Trade and Investment Queensland (commenced 1 February 2014)
- Workers' Compensation Regulatory Authority (QComp) (ceased 29 October 2013).

Appendix C—Public corporations

Public non-financial corporations comprise:

- CS Energy Ltd
- Energex Ltd
- Ergon Energy Corporation Limited
- Far North Queensland Ports Corporation Limited
- Gladstone Area Water Board
- Gladstone Ports Corporation Limited
- Mount Isa Water Board
- North Queensland Bulk Ports Corporation Limited
- Port of Townsville Limited
- Powerlink Queensland
- Queensland Bulk Water Supply Authority
- Queensland Rail
- Queensland Treasury Holdings Pty Ltd
- Stadiums Queensland
- Stanwell Corporation Limited
- SunWater Limited
- The Trustees of Parklands Gold Coast (ceased 30 September 2013).

Public financial corporations comprise:

- QIC Limited
- Queensland Treasury Corporation
- WorkCover Queensland.

Appendix D—Financial sustainability indicators

Figure D1 explains ratios we used to assess financial sustainability in this report.

Figure D1
Financial sustainability indicators

Indicator	Description	Formula	Interpretation
Operating ratio	Capacity to meet recurrent operating expenditure from recurrent operating revenue	Net operating balance divided into total operating revenue Expressed as a percentage	A negative ratio indicates a net operating deficit and the larger the negative percentage, the worse the result. Net operating deficits cannot be sustained in the long term. A positive percentage indicates surplus revenue is available to support the funding of capital expenditure.
Net operating cash flow ratio	Capacity to self-finance non-financial asset acquisitions from operations rather than sources such as borrowings or asset sales	Net cash flows from operations (excludes depreciation) divided into net purchases of non-financial assets (as reported in the cash flow statement) Expressed as a percentage	A negative ratio indicates the state has insufficient operating cash receipts to fund its total operating cash payments and any of its non-financial assets purchases (mainly property, plant and equipment). A positive ratio indicates the extent to which non-financial asset purchases are funded by net cash flows from operations.
Capital replenishment ratio	Comparison of the rate of net spending on non-financial assets with depreciation	Net purchases of non-financial assets divided into depreciation expense Expressed as a number	A ratio greater than one means the state is replacing its property, plant and equipment asset base at a rate faster than it is being depreciated.
Debt to revenue ratio	Capacity of the state to repay debt and interest	Debt divided into total operating revenues Expressed as a percentage	This ratio indicates the extent to which operating revenues can cover the state's debt. The higher the ratio, the lower the capacity of the state to repay debt and interest.

Source: Queensland Audit Office

Auditor-General Reports to Parliament

Reports tabled in 2014–15

Number	Title	Date tabled in Legislative Assembly
1.	Results of audit: Internal control systems 2013–14	July 2014
2.	Hospital infrastructure projects	October 2014
3.	Emergency department performance reporting	October 2014
4.	Results of audit: State public sector entities for 2013–14	November 2014
5.	Results of audit: Hospital and Health Service entities 2013–14	November 2014
6.	Results of audit: Public non-financial corporations	November 2014
7.	Results of audit: Queensland state government financial statements 2013–14	December 2014

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