



TRANSPORT AND RESOURCES COMMITTEE

Members present:

Mr SR King MP—Chair
Mr LL Millar MP
Mr BW Head MP
Mr JR Martin MP
Mr LA Walker MP
Mr TJ Watts MP

Staff present:

Dr J Rutherford—Committee Secretary
Mr Z Dadic—Assistant Committee Secretary

PUBLIC BRIEFING—CONSIDERATION OF AUDITOR-GENERAL REPORT 8: 2022-23— *ENERGY 2022*

TRANSCRIPT OF PROCEEDINGS

Monday, 13 March 2023

Brisbane

MONDAY, 13 MARCH 2023

The committee met at 9.00 am.

CHAIR: Good morning. I declare open this public briefing for the committee's consideration of the Queensland Audit Office report No. 8 of 2022-23, *Energy 2022*. My name is Shane King, the member for Kurwongbah and chair of the committee. I would like to respectfully acknowledge the traditional custodians of the land on which we meet today and pay our respects to elders past and present. We are very fortunate to live in a country with two of the oldest continuing cultures in Aboriginal and Torres Strait Islander people, whose lands, winds and waters we all share. Other committee members with me here today are Lachlan Millar MP, the member for Gregory, who is our deputy chair; Bryson Head MP, the member for Callide; James Martin MP, the member for Stretton; Les Walker MP, the member for Mundingburra; and Trevor Watts MP, the member for Toowoomba North.

The Queensland Audit Office tabled its report No. 8 of 2022-23, *Energy 2022*, on 9 December 2022. On 23 February 2023 the report was referred to the Transport and Resources Committee to consider as part of its responsibilities. We thank the Queensland Audit Office for attending today to provide a briefing on the report.

The committee's proceedings are proceedings of the Queensland parliament and are subject to the standing rules and orders of the parliament. As parliamentary proceedings, under the standing orders any person may be excluded from the hearing at the discretion of the chair or by order of the committee. Only the committee and invited witnesses may participate in the proceedings. Witnesses are not required to give evidence under oath or affirmation, but I remind witnesses that intentionally misleading the committee is a serious offence. You have previously been provided with a copy of instructions to witnesses, so we will take those as being read. I also remind members of the public that they may be excluded from the briefing at the discretion of the committee.

These proceedings are being recorded and broadcast live on the parliament's website. Media may be present and are subject to the committee's media rules and the chair's direction at all times. You may be filmed or photographed during the proceedings and images may also appear on the parliament's website or social media pages. I ask that responses to questions taken on notice today be provided to the committee by 4 pm on Thursday, 23 March 2023.

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

LUWINGA, Mr Martin, Director, Queensland Audit Office

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

CHAIR: I officially welcome representatives from the Queensland Audit Office. Thank you all for your attendance here today. We will start with a short opening statement, after which we will have some questions.

Mr Worrall: We had to make a late substitution for Irshaad Asim. He actually had three train cancellations and that is why he is not here. Thanks for the opportunity to brief the committee on *Energy 2022*. This report summarises the results of our financial audits of the six state government owned energy entities being CleanCo, CS Energy, Stanwell, Powerlink and Energy Queensland, which also includes its subsidiary Ergon Energy Queensland. These entities generate, transmit and distribute Queensland's electricity, while Ergon Energy is the Queensland electricity retailer for most customers in regional Queensland. We found that the financial statements of all entities in the energy sector are reliable and comply with relevant laws and standards. We issued unmodified opinions for all entities. All entities met their legislative deadline of 31 August despite the ongoing challenges presented by COVID and the volatility in the energy market.

As part of our annual audit process, we assess whether the internal controls entities use to prepare their financial statements are effective and we report any weaknesses to management for action. While we were able to rely on the entities' internal controls, we continued to identify weakness in their information systems. Weaknesses mainly relate to user access to systems and the upgrade of information systems. Given how much entities rely on their information systems and the increasing

threats to cybersecurity, they need to continue to strengthen their security. In November 2021 CS Energy was subject to a cyber attack that disabled its corporate network. CS Energy enacted its business continuity plan and successfully restored its corporate network. Its power stations were not impacted and continued to safely generate and dispatch electricity. As a result, the incident did not have a material impact on the financial performance of the business. We recommend that energy entities continue to emphasise the importance of strong security practices over their information systems to protect against fraud or error, cyber attacks and significant reputational damage. This was the same recommendation in our 2021 energy report.

In 2022 profits decreased by \$147 million on the previous year, largely due to losses incurred by generators. The generators enter into forward contracts that lock in a fixed price for the electricity that they will sell. A rise in wholesale electricity prices above the fixed prices at the reporting date resulted in losses to those contracts because they are selling at a rate less than what the market rate is at that point in time. In 2022 Queensland recorded the highest increase in the average wholesale electricity prices at \$162 per megawatt hour across the national electricity market regions. It was \$62 in 2021. The increase was due to higher volatility in the second half of the year because of high demand and reduced supply. High international prices for gas and coal impacted on the domestic market. Outages in coal-fired power stations impacted on supply. Upgrades to the Queensland-New South Wales interconnector caused transmission line outages and the state experienced extreme weather events, so in some ways a perfect storm.

Total returns to the state government amounted to \$214 million, which was a decrease of \$647 million, or 75 per cent, from the previous year. This is mainly due to decreased profits and the policy for energy entities to retain the dividends that supply critical infrastructure and grow their business. Total returns to customers in rebates, concessions and payments were \$1.1 billion, which was up \$39 million from the previous year. The increases primarily related to community service obligation payments of \$71 million. The state government made these to Energy Queensland to subsidise the higher cost of providing electricity to regional Queensland.

As the sector diversifies energy sources, entities face challenges in balancing unpredictable supply of renewable energy such as solar and wind with delivering stable, reliable and affordable energy. The Queensland government released a \$62 billion Energy and Jobs Plan in September 2022. It targets 70 per cent renewable energy by 2032, a 50 per cent reduction in emissions from 2005 levels by 2030 and gradual conversion of all state owned coal-fired generators to clean energy hubs by 2035. Entities will need to consider the impact of current market conditions on the budgets and timing of these projects.

I encourage you to look at our interactive energy dashboard, which allows you to explore information on energy entities and compare across the regions. The committee may benefit in hearing from the entities themselves on their progress in implementing our recommendations. We are happy to take questions.

CHAIR: Thank you. You mentioned that the foreign commodity prices had an impact, along with a generator failure. I am just wondering if there has been any long-term modelling done on what the market would do with less reliance on fossil fuels in the long term, knowing that overseas prices can affect those commodity prices here, hence the power.

Mr Worrall: You would probably need to direct that to either the department or maybe some of those generators. We would have touched on that when we did the performance audit on transition to renewables where we basically said that it has to be a balancing act as traditional sources of energy are winding down and replaced by renewables.

CHAIR: It was more the impacts that commodities can have, whereas solar and everything else—the renewables—do not have those foreign impacts.

Mr MILLAR: Thank you, Brendan, for coming in again. I always value your contribution and your reports. They are very important to us. I want to go to figure 3B with the national energy market. We have gone from the lowest in the national energy market—\$53 per megawatt—to \$162 per megawatt. You also mentioned that some of the factors may be the international coal price, but is it not the case that the electricity generators here in Queensland have long-term locked-in contracts?

Mr Worrall: They do have long-term future sale contracts for selling electricity to distributor-retailers, and that has contributed to the loss because they locked in a price and when they came to settle those contracts the market was actually a lot higher, so they were basically selling their electricity at a loss in that situation. That impacts on their financial statements, so those losses are brought to account because their future contract prices are less than the market. That was one of the main contributors—not the only one, but it was one of the significant contributors.

Mr MILLAR: Given that we are a coal-rich state and these contracts have been locked in for a long time—and obviously with the volatility in Ukraine and overseas markets—I would have thought, and please correct me, that we would have been able to deliver coal to these generators much more cheaply than relying on the international market.

Mr Worrall: It is still a market that they are operating in, so they are still selling to distributors and the contract prices they have entered into were actually less than the market price, so they took losses on those contracts. That is what is represented in their financial results for the generators.

Mr WATTS: We have locked-in contracts for supply but the coal that is being burnt to generate the energy is owned by Queensland, so I am trying to understand how the international price of coal affects the generation price when the coal is owned by Queensland. We are not buying it on the international market.

Mr Worrall: No, but they are still operating in a market so there would be other competitors in the market.

Mr WATTS: So the profit then would be in the coal extraction?

Mr Worrall: Maybe Martin can explain this better than I can. What has really happened is that the generators have suffered a loss on those contracts and the distributors have probably benefited.

Mr WATTS: I understand the electricity side of it. What I am trying to work out is: whether coal is \$100 or \$400, if we own the coalmine as Queenslanders, the profit is made there at the point the energy companies bought it from it, in which case we own the coalmine. I do not see how the international price for coal affects the extraction costs for Queensland to supply coal to its own generators.

Mr Luwanga: I think there were other factors which affected their supply of coal in Queensland. There were issues affecting the flooding of some of their mines, which most of the generators were relying on, which pushed the supply and demand to be out of balance which caused the prices to go up. On top of the international demand for Queensland coal, the local demand basically pushed the prices up.

Mr WATTS: In terms of those same mines that are government owned that are supplying the coal to the electricity generator, what I do not get is why the international price of coal affects the Queensland generation extraction costs in a mine that we own.

Mr Worrall: It is also a reporting issue. Those contracts have to be accounted for at fair value at reporting date, so if they entered into a contract to sell it at a future date of \$100 but at the reporting date they could have sold it for \$150 then they have to recognise an unrealised loss of \$50.

Mr WATTS: But that is a paper loss, yes; it is not an actual loss?

Mr Worrall: It is a theoretical loss up until they actually realise that loss, but it is also represented in their financial results.

Mr WATTS: Sorry, Chair, I just need to get this clear in my head.

CHAIR: I will give you a little bit more leeway. We have some questions on this side, but keep going. I understand what you are—

Mr WATTS: I am just trying to get it clear in my head. They made a paper loss because they have had to recognise the international price, but how do they actually realise that loss? If Queensland owns the mine, we have dug the coal up. We have supplied it to the generator. Surely the only cost is the extraction cost. The international price does not affect the price of extraction in Queensland and delivery to the Queensland generator.

Mr Worrall: I will just say again that, in terms of their reporting obligations, they have to value that contract at fair value at 30 June 2022. At 30 June 2022 they were out of the money because the market was higher than the contract amount, so that is an unrealised loss at that point of time. When they actually deliver on those contracts they will then have to bring to account whatever the realised profit or loss is. That situation could change potentially, depending on what the market does.

Mr WATTS: Is there a future profit coming from the coal extraction? Is that what you are saying?

Mr Worrall: I am not saying that. It still depends on what the market is doing. Any realised position, once they settle on that contract, still has to be at fair value, and fair value is the market rate, so it is being dictated by what the market is doing.

CHAIR: I might let you formulate another question. We will go to the member for Stretton.

Mr MARTIN: I have a question in relation to cybersecurity, which you have mentioned in your report. Are you able to expand on what led to the cyber attack on CS Energy? Are you aware of any increases in cyber attacks on these assets, the impacts they have had and how CS Energy was able to respond?

Mr Worrall: I might just start on that and then defer to Martin. Cyber attacks are rife. Since this one we have seen major entities like Optus be subject to this. I think it is fair to say that all entities are at risk—big entities, small entities, public sector, private sector. Everybody is at risk. That is why we have been calling this out as the No. 1 risk facing state entities probably as long as I have been Auditor-General.

There was an attack on CS Energy back in November 2021. Martin can give you the details, but I think it started from a phishing exercise, which is sort of a dodgy email. Somebody within CS Energy has probably opened it up or clicked on a link within that email, and then that has created a vulnerability. Then typically once that happens, these people doing these sorts of things will then exploit that vulnerability. It might be easy to exploit or they might have to bide their time over a series of weeks or months—sometimes even a year—to keep garnering further movements through the system as they identify other weaknesses. I will hand to Martin, who can give you a bit more detail.

Mr Luwanga: As Brendan mentioned, the cyber incident was through phishing. Someone has clicked on whatever email link was sent and they managed to go into the system. Management was able to detect it quickly and isolate the incident and shut down all of the systems, which basically resulted in no major losses for the entity.

CHAIR: Thanks for that. I am still being affected by the Optus one at home—nothing to do with here. My wife cannot email anyone, which is frustrating.

Mr WALKER: In relation to coal prices, the question was asked about when there is a fluctuation in price and coal is supplied by the state to the generator. For taxation and accounting purposes, when that price goes up and it is sold at a different price, that gap has to be accounted for somewhere.

Mr Worrall: That is exactly right. I am not talking about taxation here; I am just talking about financial reporting. If there is a difference between the contract price and fair value, which is dictated by the market, then even though that contract has not settled at the reporting date—in this case, it is 30 June 2022—the entity has to bring to account any unrealised profit or loss on that contract, and that is what has happened with the generators. At balance date they have had an unrealised loss because of the future contracts. They found themselves out of the money on those and they have brought to account an unrealised loss. When they actually settle on those contracts at a future date, the settlement will be based on the fair value at the date of settlement.

Mr WALKER: On page 10 of your report you identify that energy dividends are down. Will you please advise the committee what these are, where they come from and where they go? Would the recipient of these moneys be different if our energy system was privately owned?

Mr Worrall: Those dividends are really generated by the operating results of the entities that we are talking about here. You can only really pay dividends from profits, so if profits are down then likely the dividends are going to be down. There was definitely a reduction in dividends. Those dividends are paid to the shareholding ministers, ultimately to the Consolidated Fund.

Mr WALKER: Would the recipient of these moneys be different if our energy system was privately owned?

Mr Worrall: They would be, because the ownership would be private, not public. With public ownership they are paid back into the Consolidated Fund on behalf of the community. If it was private ownership, they would be paid to those private investors.

CHAIR: That is why I was asking about confusion over the international market affecting our price of coal here when we are less reliant on that and whether there has been any modelling done. As you said, we will take that to another entity and just see.

Mr MILLAR: I am going back to figure 3B. With Queensland's electricity price the highest in the country at \$162 per megawatt—New South Wales is \$132 per megawatt, South Australia is \$105 and Victoria \$91—did you find out from those other states why they have a lower megawatt price?

Mr Worrall: As I think I said in my opening statement, a variety of factors have resulted in that. I am happy to go over them again.

Mr MILLAR: I guess what I am trying to say is: did they negotiate a better wholesale coal price or coal price than Queensland? Is that part of it?

Mr Worrall: I think some of it is to do with supply, and some of those reasons I gave were because supply was interrupted. I think Martin mentioned that some of the mines were affected, but the interconnector between Queensland and New South Wales was down for maintenance, from what I understand, whereas if it was not the case they might have been able to source some supply from New South Wales at a cheaper rate. There was the outage at Callide C. I think there was also some planned maintenance with one of the other generators. We also had a bit of an unseasonal, cooler winter and I think we had a lot of rain in there somewhere as well. As I said, there was in some ways a bit of a perfect storm.

CHAIR: Were transmission costs purely generation costs or transmission costs? The reason I am going there is because of the size of the network in Queensland versus New South Wales and Victoria to deliver power to people's front door. The other networks are privatised as well, but with the transmission costs obviously that has to weigh into things.

Mr Worrall: We are just talking about the wholesale price here. Transmission cost is the cost of delivering electricity, and that is also regulated in terms of how much revenue they can derive.

Mr HEAD: With regard to coal supply contracts, how many coal supply contracts at our state owned power generators have been renewed in the last 2½ years?

Mr Worrall: I cannot answer that off the top of my head, but you could ask the entities that. I would expect they are entering into multiple contracts at different times of the year.

Mr HEAD: My understanding is that these contracts are generally very long term, so if they are five- or 10-year contracts it is unlikely that the majority of those were renewed in the last couple of years since coal prices have been high.

Mr Luwanga: As the Auditor-General mentioned, I think we cannot stipulate how many contracts have been renewed. In terms of the way prices operate, they basically lock in prices, and those prices fluctuate depending on what the market dictates. At this stage, because we are not aware of which contract has been renewed, I think we would not be able to answer the question in terms of how much better.

Mr WATTS: Martin, we have locked in long-term contracts for the supply of coal but they are reflective of a fair market price. In terms of long-term contracts for the supply of electricity, why do they not protect themselves in the same way for price fluctuations? It seems that one is locked and one flows, and that does not seem to make sense to me.

Mr Luwanga: In terms of the supply of electricity to customers, if you look at the way prices have worked, generators made losses during the same period while retailers have made profits. In terms of the way derivatives operate, it would basically have the opposite effect. Coal prices went up, but because the retailer locked in some prices the various distributor retail companies which retail the price have made profits. If you look at one of the tables you will see the retail companies have made profits.

Mr WATTS: I understand that, but coal generators—and this is the nub of what I am trying to get at—have long-term contracts to purchase coal, but you are saying that is influenced because the nature of the contract means they still have to look at international prices, even though they have a long-term contract for supply. Yet when they supply electricity they have a fixed-price contract that does not reflect market volatility. It seems they have signed one contract that reflects market volatility and one contract that does not reflect market volatility, and therefore they have been caught.

Mr Worrall: In the scenario you are talking about there is only one contract. I will just come back to what I said earlier. They enter into a contract to supply electricity for \$100 in a future period post 30 June 2022. At 30 June 2022 the market is \$150, so reporting standards say they need to recognise an unrealised loss at 30 June 2022 of \$50 on that contract. Fast-forward. Let's say that contract is settling on 1 July 2024, for argument's sake, and they entered into it to supply for \$100. When they supply that electricity at \$120, let's say, they would realise a \$20 gain on that contract at that point in time. It is still the one contract. Until the settlement of that contract, reporting standards require them to fair-value it at the reporting date.

Mr WATTS: Sorry, I am just a dumb old publican so I am missing something here. You are talking about the electricity supply contract. I am talking about the coal they are buying to generate the electricity. It appears to me from what you have said that the coal we are buying is reflective of the international volatility in the coal supply market, because even though you have a fixed-term contract—that is how the contract is written—they have not written that into electricity supply. There are two contracts here: one is buying coal; one is selling the electricity. But we own the coal, so what—

CHAIR: Sorry, we are just about out of time, so this will be the last answer. Time has beat us again.

Mr Worrall: I would expect in that scenario that they have two derivative arrangements: one is on the supply of electricity and one on the sourcing of the coal. That is the whole purpose of derivatives: to try to mitigate your risk when there are fluctuations between the two.

Mr Luwinga: Company management monitors all of those on a periodical basis in terms of the risk management of what contract. Because of all the factors which were mentioned, I think that created a perfect storm where the prices went up, but management are always looking at their risk management. I do not know if that makes sense.

Mr Worrall: I think you would benefit from hearing from some of the generators themselves about how they manage those sorts of things.

CHAIR: I think we will get some other bodies in here. Thank you very much for that. Time has beaten us. That concludes this briefing. I would like to thank you all for your participation today. You will be provided with a copy of the transcript when it is available and a copy will be published on the committee's webpage. I declare this public briefing closed.

The committee adjourned at 9.30 am.