STATE DEVELOPMENT, NATURAL RESOURCES AND AGRICULTURAL INDUSTRY DEVELOPMENT COMMITTEE

Members present:

Mr CG Whiting MP (Chair)
Mr DJ Batt MP
Mr JE Madden MP
Mr BA Mickelberg MP
Ms JC Pugh MP
Mr PT Weir MP

Staff present:

Dr J Dewar (Committee Secretary)
Ms N Mitchenson (Assistant Committee Secretary)

PUBLIC HEARING—CONSIDERATION OF AUDITOR-GENERAL'S REPORTS NOS 8 AND 9: RESULTS OF THE FINANCIAL AUDITS OF THE QUEENSLAND GOVERNMENT'S WATER AND ENERGY ENTITIES FOR THE 2017-18 FINANCIAL YEAR

TRANSCRIPT OF PROCEEDINGS

MONDAY, 25 FEBRUARY 2019

Brisbane

MONDAY, 25 FEBRUARY 2019

The committee met at 10.03 am.

CHAIR: Good morning. I declare open this public hearing for the committee's consideration of Auditor-General's reports Nos 8 and 9, the results of the financial audits of the Queensland government's water and energy entities for the 2017-18 financial year. The Committee of the Legislative Assembly referred both reports to the State Development, Natural Resources and Agricultural Industry Development Committee for our consideration.

Thank you for your attendance here today. My name is Chris Whiting. I am the chair of the committee and the member for Bancroft. The other committee members with me here today are Mr Pat Weir, the deputy chair and member for Condamine; Mr David Batt, the member for Bundaberg; Mr Jim Madden, the member for Ipswich West; Mr Brent Mickelberg, the member for Buderim; and Ms Jess Pugh, the member for Mount Ommaney.

The committee's proceedings are proceedings of the Queensland parliament and are subject to the standing rules and orders of the parliament. Witnesses should be guided by schedules 3 and 8 of the standing orders and note that their responsibility is to provide factual and technical background to government legislation and administration.

The proceedings are being recorded by Hansard and witnesses will be provided with a copy of the transcript. To assist with clarity, could you please identify yourself when you first speak and speak clearly and at a reasonable pace? All those present today should note that it is possible you might be filmed or photographed during the proceedings by the media, and images may also appear on the parliament's website or social media pages. The media rules endorsed by the committee are available from committee staff if required. I ask everyone to turn their mobile phones off or to silent mode. I ask that if witnesses take a question on notice today they provide the information to the committee by 10 am on Monday, 4 March 2019. We will begin our hearing today with Auditor-General's report to parliament No. 9 of 2018-19 titled *Energy: 2017-18 results of financial audits*.

OLIVE, Mr Damon, Sector Director, Energy and Natural Resources, Queensland Audit Office

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

CHAIR: I welcome Mr Worrall and Mr Olive from the Queensland Audit Office. I invite you to make an opening statement, after which committee members may have some questions for you.

Mr Worrall: Thank you for the opportunity to brief the committee on report No. 9 of 2018-19 titled *Energy: 2017-18 results of financial audits*. Each year the QAO audits the financial statements of the state's public sector entities. Our audits assure those entities and the users of their financial statements that their information can be relied upon. This report summarises the results of our financial audits of the state government energy entities. These included the four state owned energy companies—Stanwell Corporation Ltd; CS Energy Ltd; Queensland Electricity Transmission Corporation, trading as Powerlink; and Energy Queensland Ltd—and 30 subsidiaries including Ergon Energy Queensland Pty Ltd.

We issued unmodified audit opinions for the financial statements of each of the entities, with all audits completed within the 31 August legislative deadline. We also considered the regulatory information notices of Energex Ltd and Ergon Energy Corporation Ltd provided to the Australian Energy Regulator, the AER. While there were no significant issues impacting on the audit opinions issued on the financial reports of these entities, the timeliness and quality of financial statements in 2017-18 across the sector is lower than the previous year. During the year, CS Energy and Stanwell had complex accounting issues that were not resolved prior to year end. This resulted in their respective ratings for timeliness and quality being lower this year.

Similar to the previous year, we have reported on key audit matters in our independent audit reports for all energy entities. Key audit matters are those areas which in our professional judgement pose a higher risk of material misstatement to the financial statements. These matters mostly reflect those areas requiring significant judgement and estimation, with three of the six matters reported covering the valuation of property, plant and equipment.

The overall sector performance and position is analysed in the report, adding up the results from each of the individual companies. The key analysis showed that profits for the energy sector were $1.7 billion, a decrease of nine per cent from last year. This was mostly due to reduced profits in transmission and distribution which were collectively down $256 million in that year resulting from lower determinations from the Australian Energy Regulator. In contrast, the combined profits of generators have increased by $86 million or 14 per cent compared to the previous year. This was due to several factors including increased wholesale and retail electricity sales and increased income from coal revenue sharing arrangements. Returns to the state government, which consist of dividends and income tax equivalents, amounted to $2.3 billion—a decrease of $40 million from the previous year. This was primarily due to the reduced profits from the sector. The dividend policy of the energy entities remains the same as the previous year.

The energy sector recorded expenses of $9 billion, an increase of two per cent over last year. This was largely due to an increase in generation fuel and coal costs of $139 million; increased network charges and electricity purchases of $79 million; and depreciation, amortisation and impairment of $47 million. Net assets, which is assets less liabilities, increased by $422 million—an increase of six per cent from last year. Although total assets decreased by $290 million, there was a large decrease in total liabilities of $711 million primarily due to $242 million in loan repayments to QTC by CS Energy, $292 million in Solar Bonus Scheme payments by EQL and a decrease in the value of electricity financial instruments.

The energy sector holds $22.9 billion in borrowings—a one per cent decrease from 2016-17—and $7.5 billion in equity. The debt to equity ratio for the sector of 76 per cent is consistent with 2016-17 and continues to be within industry benchmarks. As part of the audit process we assessed internal controls of each of the entities. Where we identified controls that we can rely on, we tested whether they were operating throughout the period. We concluded that the control environment was suitably designed and implemented for all energy entities. In 2017-18 we identified eight control deficiencies of a low to moderate risk. These are not high risk but are matters which should be resolved to ensure a good quality control environment. These deficiencies mostly related to general information technology controls relating to things such as user access, system capability and system changes. These issues are being addressed by management. We are now happy to answer questions the committee may have of the report.

CHAIR: I will start off, bearing in mind that an audit office report provides comment on financial statements, not on electricity policy. I am very aware of that. One of the things you talked about was the debt to equity ratio of 76 per cent. I am very interested to know how that compares to other state sectors throughout Australia. Do they have a similar debt to equity ratio? You said that it was in the ballpark.

Mr Worrall: When the sector was provided with more debt, I am aware that a benchmarking exercise was done at that point in time. I think we were just talking about that, but I think that goes back at least three to four years since that was done. The ratio at the moment is consistent with previous years and is still within those benchmarks in terms of debt to equity. I do not know if you have more to add specifically, Damon?

Mr Olive: Queensland has public ownership of electricity entities, has a different mix of assets to the other states, with a lot of other states having their electricity assets in private ownership. Regardless of the ownership, that debt to equity ratio adopted in Queensland is still relatively consistent with what we see in those entities.

CHAIR: So private or public across Australia this is consistent with the debt to equity ratios?

Mr Olive: To the best of my knowledge, yes.

Mr WEIR: I note that you made comment regarding the growth in solar and the impact that is going to have. Could you run me through what that impact will be? How significant will that impact be?

Mr Olive: Maybe I can touch briefly on the sector and what that might transpire to. We audit the retrospective financial results of the energy entities. We are not forecasting experts, but there is likely to be several impacts of a move to a greater level of renewable energy in the sector in the future. Some of the longer term impacts may be on a reduced need for the coal-fired generation fleet which Queensland currently possesses. As those assets are eventually retired, as they approach retirement the future value of those assets would likely be reduced.

The renewable energy market creates some operational challenges for the market operators in balancing the supply, but it also will have an impact on those wholesale electricity prices. Wholesale prices do have an impact for the generation fleet due to the way in which they are carried on the balance sheets of the generation entities. They are carried at a cost but they are assessed annually to make sure that their cost does not exceed the amount for which the entity would be expected to recover that cost over the duration of using those assets. From our perspective they are some of the potential impacts of a change in the renewable composition in the future on existing entities.

Mr Worrall: The other thing I would add in the context of whole home solar is that there is likely also to be reduced transmission activity given that people can generate it from their home and if they are consuming it or consuming a lot of it then there is less need to draw down their electricity through the grid, so transmission providers may potentially also have a diminishing asset base over a period of time.

Mr WEIR: With regard to that debt to equity that we were talking about earlier in the chair's question, is that going to have a significant impact on that?

Mr Worrall: I think it is probably something that will need to be managed going forward because if they seek to maintain a similar percentage as we currently have—around 75 per cent or 76 per cent—then they will need to stage manage that, so as their asset values are going down they will need to work out how they are going to retire some of that debt so that those percentages do not change dramatically. That is how I would see that that is what they would need to do.

Mr MADDEN: Welcome, gentlemen. I am very glad to see you here today. I was very interested to read pages 16 to 18 of your report where you mention the Powering Queensland Plan that reaffirms the government's commitment to 50 per cent renewable energy by 2030. I was also very pleased to see that you mentioned a new system—a reverse auction of up to 400 megawatts of renewable energy capacity where private entities submit bids for renewable energy projects that the state government will provide support for. I just wondered if you could explain that and if you could maybe give some examples of some industry projects that have accessed that reverse auction system.

Mr Olive: I am happy to take that one. At the time of drafting the report the auction and the potential projects that were being considered under that option I believe were still subject to cabinet deliberation, so that project is in its quite early stages at this stage and I do not have detailed knowledge of which projects are the likely projects to be successful under that arrangement.

Mr MADDEN: Would it be suitable to take that one on notice?

Mr Olive: Potentially I could, but I wonder whether that might be more a question for perhaps the Department of Natural Resources, Mines and Energy in which energy policy sits which would be considering and recommending to government those suitable projects.

Mr MADDEN: You mentioned that CleanCo has now come on board and it is expected to deliver 1,000 megawatts of renewable energy capacity. In the market of energy production in Queensland, what does 1,000 megawatts of energy represent?

Mr Olive: Turning back, there is a summary page in the report—and I am just looking for the page reference, page 7—and I think it talks there about the state's generation capacity of 8,615 megawatts, so I guess that could give you context in terms of that 1,000 megawatts.

Mr MADDEN: I very much appreciate that. Thanks, Mr Olive.

Mr Worrall: In those similar pages that you were referring to in February 2018 there was a peak megawatts of 9,840 in the month of February 2018, so that is potentially 10 per cent or a little bit more than 10 per cent.

Mr MADDEN: Thanks very much, gentlemen.

Mr BATT: You mentioned in your opening statement about timeliness and quality of financial statements from the previous year and issues with CS Energy and Stanwell. They had some complex accounting issues which brought in the control deficiencies. Are you satisfied now how they have reported on those or are not reporting on those? Is that the only reason why you mentioned that they were the only two businesses?

Mr Worrall: There are probably two issues there, and I will start and Damon can jump in. In relation to the financial statements, with regard to the complex accounting issues that required resolution, I am assuming that would have been around valuations. They probably were not as proactive in starting that process early enough and that delayed them providing us with a decent draft of financial statements at the start of the audit process. Obviously we were able to get to a position and issue an unmodified opinion, so they were able to sort those things out during that audit process and so there are no residual issues in relation to that side of it. The control deficiencies are more in relation to their systems of internal control and I think they were more in relation to controls around IT systems, if I am right.

Mr Olive: Yes, that is correct. In terms of the control deficiencies, they were more related to people having the right level of user access to systems to be able to perform their functions but not for that access to be too open so as to potentially exceed the sorts of functions they should be delivering. In relation to the complex accounting issues, I think the report talks briefly at CS Energy. One of them was in relation to the Alinta joint venture and the underlying accounting for that and there was another one to do with what was called an offtake agreement with the Kennedy Energy Park. These ultimately were derivative financial instruments which are quite complex and require complex financial models to value. At Stanwell it was again related, as Brendan said, to an asset valuation. There were three issues there, but one was primarily around the Swanbank E power station and the discounted cash flow modelling associated with that.

Mr Worrall: Just coming back to the internal control issues, because I think you asked whether or not they are resolved, at the end of the audit management we are working through those. We had rated them maybe up to a medium risk, so we would anticipate that they are issues that they would have either resolved now or are close to resolving.

Mr BATT: For those risks, do you go back and review those to make sure that they are resolved?

Mr Worrall: We certainly do. Ideally their audit committee should put them on a register and the audit committee should hold management to account for resolving those in terms of time frame and agreed action and our role is to satisfy ourselves that they have been resolved. Even though management might say they are resolved or their internal audit might say they are resolved, we will make our own determination and we will provide that feedback back to the audit committee that we are satisfied that they can come off the issues risk.

Mr BATT: Thank you.

Ms PUGH: Thanks so much for coming to appear before the committee today. My question is around renewable energy. Obviously renewable energy adds a new dimension to the overall power plan as it were, so I am just interested to hear what opportunities and challenges you think it presents in terms of the audit that you have done. I am just leaving it really broad so you can answer that question however you like.

Mr Worrall: I think there are probably going to be some challenges because we are likely to see some new products on the market. We had that question about the reverse auction and that is a potential other new product, so they may require some other expertise to audit those transactions but maybe there are valuation issues in relation to those. Also, a new entity has been established, CleanCo. They are probably two that immediately spring to mind. As per that previous discussion, as the proportion of renewables increases that has some other impacts on some of the existing infrastructure in terms of their usage and their valuations, whether it be generators or transmission lines as well. I do not know if you have anything to add.

Mr Olive: Other than to say that in terms of valuing and doing models to assist with valuation of assets at the moment obviously future electricity prices is a key input to that and at the moment, federally at least, the lack of clarity about energy policy has made some of those future forecast prices difficult which then has an impact around the valuation of assets. I suppose as energy policy becomes firmer and the market more established, the likelihood is that there will be more stability in forecast energy prices in the wholesale level.

Mr MICKELBERG: Under the CleanCo proposal, I understand existing renewable assets are going to be transferred out of CS Energy and Stanwell into CleanCo. How much does that equate to at the moment in terms of generation?

Mr Olive: In terms of the megawatt hours?

Mr MICKELBERG: Yes, in terms of megawatt hours.

Mr Olive: Just off the top of my head, there are 385 megawatts from Swanbank E which will transfer; Wivenhoe I believe is in the vicinity of 500 megawatts, but I might have to just defer to confirm; and I think there are some smaller contributions from some of the others such as Koombooloomba and Barron Gorge as the hydroplants further north. If I can just take that one on notice, I will endeavour to answer it before the end of the session just to close out the contributions from those other assets.

Mr MICKELBERG: No dramas. As a follow-up, you mentioned earlier, Mr Olive, that one of the concerns or considerations going forward is the fact that this mix of renewables and coal generation assets may affect the valuations of the coal generation assets. Given that we are transferring the renewables into a separate entity and leaving two entities that will only have coal generation assets in them, does that affect the financial stability of CS Energy and Stanwell over the longer term?

Mr Olive: From our perspective we would normally look at the results at 30 June and then the forecast position over the next 12 months, so in terms of forming a conclusion on the financial report we are really looking 12 months ahead. In terms of our report, we have identified, as you describe, those as longer term impacts on the industry. There certainly is a longer term potential for an impact around the coal-fired generation fleet, and it is something that is reassessed from our perspective every year as to what those future forecasts look like and what might need to change in terms of the expected use of those assets. Both of the energy generators relying on coal-fired generation are looking to diversify to some extent in terms of moving into retail markets. CS Energy with the Alinta joint venture has moved into domestic retailing and I guess Stanwell continues to operate a relatively large retail customer base more at business and corporate customer sales. Both of those have resulted in increased retail sales for the generators this year.

Mr MICKELBERG: Would a more diversified generation base, as presumably exists now within CS Energy and Stanwell, result in greater financial stability over the longer term?

Mr Olive: It is probably more of a policy decision, I think, than one for us to assess what that impact might be. As I said, we are typically looking 12 months in advance and auditing is very much a historical account of what has transpired year in and year out.

Mr MICKELBERG: Presumably in order to make the assessment with respect to the long-term risk of that factor you considered that in your audit?

Mr Olive: Of course and I suppose at this stage given the results at 30 June we were looking at future forecasts and what they would look like on expected revenue streams for those generation assets and were satisfied at both entities based on the market evidence available about the future need for those assets and the price that they would receive with the values at 30 June 2018.

CHAIR: I have two quick questions. Obviously the amount of electricity we send over the border to New South Wales has affected the business case and the profitability of these generators. Did you want to talk more about how much that has pumped up the bottom line of our generators?

Mr Olive: In terms of the amount that we distribute to New South Wales via the respective interconnectors?

CHAIR: Yes.

Mr Olive: Other than to comment that the flow via the interconnector is, on average, probably 99 per cent north to south rather than the other way, I do not have much in the way of detail to hand as to what that transpires to in a financial sense.

CHAIR: Thank you.

Mr WEIR: Regional Queenslanders pay a higher cost for their electricity, particularly in the agricultural sector where there is a lot of irrigation and pumping. I know people who are turning off their electricity pumps and going back to diesel. Did you identify anything that could help the situation in regional Queensland cost wise in the audit?

Mr Worrall: There is a community service obligation that the state provides to those distributors to equalise electricity prices in regional Queensland. I have the number here. It is quite a substantial amount of money.

CHAIR: I think in the paper it is $493 million.

Mr Worrall: Yes. The purpose of that is to equalise electricity prices for regional Queenslanders to put them on a level playing field.

Mr Olive: That is correct. It is to remove any additional cost that they might otherwise be levied as a consequence of the tyranny of distance in terms of the distribution and transmission lines to reach some of those communities. Obviously, some of the further and more remote communities have their own isolated generation fleet—in places such as Birdsville, for example. Those assets are assets managed and operated by Energy Queensland to provide electricity in those more regional and remote areas. In terms of the cost, as the Auditor-General explained, the state subsidises any additional cost that rural and remote communities would otherwise pay to help cover the costs of those additional network costs.

CHAIR: Thank you. The time allocated for this session has expired. If there are any questions on notice, we can note those at 11 o'clock.

STEMMETT, Mr Vaughan, Sector Director, Water and Infrastructure, Queensland Audit Office

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

CHAIR: The committee will now consider the Auditor-General's report No. 8, which is the results of financial audits of water entities in 2017-18. I now invite someone to make an opening statement after which we shall have questions for you.

Mr Worrall: Thank you again for the opportunity to brief the committee on report No. 8 *Water: 2017-18 results of financial audits.* This report summarises the results of the six main state and local government owned water entities. These include the Queensland Bulk Water Supply Authority, trading as Seqwater; SunWater Ltd; the Gladstone Area Water Board; the Mount Isa Water Board; the Central SEQ Distributor-Retailer Authority, trading as Queensland Urban Utilities; and the Northern SEQ Distributor-Retailer Authority, trading as Unity Water. Smaller water boards and local governments provide water services in designated areas and to their ratepayers respectively and are outside the scope of this report.

We issued unmodified opinions on all financial statements this year within the statutory deadline of 31 August. Water entities generally had effective year-end close processes, producing timely, high-quality financial reports. Asset valuations is a significant component of financial statement preparation for water entities. Five of the six entities demonstrated continued emphasis on improving the quality and timeliness of asset valuations. All water entities, other than the Mount Isa Water Board, ensured that their asset valuations were completed early along with proforma financial statements being provided at or before the agreed milestone dates. Mount Isa Water Board experienced delays in completing asset valuation processes, which had flow-on effects on the timeliness and quality of its financial statements.

Although all water entities met their statutory deadline, we continue to encourage them to consider bringing forward audit committee, or its equivalent, endorsement and board approval of their financial statements in 2018-19. This will assist in ensuring the effective resolution of potential issues that may happen between year end and the signing of the financial report.

This year was the second year that we included key audit matters in our independent audit reports for Seqwater and SunWater. Key audit matters are those areas that, in our judgement, pose a higher risk of material misstatement to the financial statements. These matters mostly reflect those areas requiring significant judgement and estimation. For both Seqwater and SunWater, the key audit matters covered the valuation of property, plant and equipment and the estimation of useful lives to calculate the depreciation expense for the period.

The overall sector performance and position is analysed in the report, which adds up the results from each of the individual entities and state bodies. Our key analysis showed that, for the third consecutive year, the overall water sector delivered operating profits, with profits decreasing by six per cent to $346.8 million on the previous year of $368 million. This was attributed to a slowdown in development growth in South-East Queensland since 2015-16 and the end of the Queensland Urban Utilities' and Brisbane City Council's student accommodation developments stimulus program. This also affected the resulting developer contributions for urban household infrastructure received by distributor-retailers. However, Seqwater continues to make an operating loss, largely reflecting the historical underrecovery of the cost of water and the past acquisition of highly geared businesses, including climate-resilient manufactured water assets.

Returns to the state government have increased in the 2017-18 year to $47.8 million from $8 million in the previous year. SunWater declared dividends of $39.7 million in the current year, with prior year profits of $36 million being retained to contribute to future dam improvements projects. Due to operating losses, Seqwater continues to make no dividend payments to the state.

The returns made by the distributor-retailers, Queensland Urban Utilities and Unity Water, to their participating local governments amounted to $166.5 million for 2017-18, down $35.2 million from the previous year as a result of decreased profits. The water sector reported $3.3 billion of revenue, which is an increase of one per cent from the previous year. Increased demand from customers, distributor-retailers and local governments has increased the demand for water from bulk water suppliers. Price increases for all entities have also driven increases in revenue despite the notable decrease in developer contributions of $61 million and community service obligation revenue of $800,000.

The water sector recorded expenses of $2.8 billion, which is an increase of one per cent from the previous year. Each of the entities has worked towards maintaining and containing expense through cost-reduction strategies. Financial costs are the most significant expense for the water sector and they have continued to decrease, reducing by $32.8 million from the previous year in line with interest rates and the continued interest repayments by Seqwater. Seqwater incurred 72 per cent of total finance costs for the sector as a result of the entity's higher geared financial position.

The water sector reported $23.3 billion of total assets, which is an increase of three per cent from the prior year. The major component contributing to this increase were additions of $580 million, revaluations of $444 million and donated assets of $170 million. Donated assets included $90.3 million of water and sewerage infrastructure covering the areas of Brisbane, Ipswich, the Scenic Rim, Lockyer Valley and the Somerset. These increases were offset by depreciation and impairment of $569 million and disposals and transfers of $52.5 million. The most significant contribution in revaluations was the $419 million revaluation movement in Seqwater infrastructure assets. Demand forecasts were the main factor for this movement.

The water sector entities borrowings remained steady at $13.6 billion, which is a less than one per cent increase from the previous year. Of the borrowings amount, Seqwater holds $9.4 billion, which continues to be guaranteed annually by the state government. Seqwater has commenced paying interest costs for all of its debt rather than capitalising these costs, which in the past had increased the debt. I think last year was the first time they started paying interest costs.

As part of the audit process, we assessed internal controls for each entity. This year, we noted an increased effort in the sector to resolve prior year deficiencies. All deficiencies identified in the previous year have now been resolved and that includes two significant deficiencies that were noted in SunWater. This year, we did not identify any new significant internal control deficiencies in the sector. However, three low to moderate risk deficiencies were identified.

In terms of major changes and restructures, the state government legislated the Water (Local Management Arrangements) Amendment Act 2017 to facilitate the future implementation of local management arrangements for SunWater's eight channel irrigation schemes. The arrangements investigate the potential transfer of distribution schemes, such as channels, pipes and drains, out of public ownership to irrigator ownership. It does not consider bulk water supply assets, such as dams. Four of the channel irrigation schemes—St George, Theodore, Emerald and Eton—have either completed transferring to or are commencing agreeing terms to transfer to local management arrangements at no cost to the recipients of the assets. Of the remaining four schemes, two of the schemes—Burdekin and Mareeba—have submitted revised business proposals with the remaining two schemes, Bundaberg and Lower Mary, withdrawing from the transfer process and will, therefore, continue to be owned and managed by SunWater. We are happy to take questions.

CHAIR: Thank you very much. I am looking at the participation returns to local governments from these entities. Page 4 outlines that $166 million goes back to local governments for their participation. Can I get a breakdown of that? Does that also include tax equivalents? I note in some areas there can be a third tranche of payments for the financial borrowings that were used to purchase these assets in the first place in some cases. Has that captured all the money that goes back to councils from their water businesses?

Mr Stemmett: During the period the state received $47.8 million in dividend payments, $166.5 million was in participation returns and $187.6 million was in tax equivalents from the sector. We need to add the tax equivalents to that participation return to get the full amount that was paid.

CHAIR: Okay. That is $166 million in participation and $188 million in tax equivalents also to local governments.

Mr Stemmett: Yes.

CHAIR: That is quite—

Mr Stemmett: SunWater is included in that as well.

CHAIR: Is that what happened in the last financial year—the $188 million in tax equivalents?

Mr Stemmett: Yes.

CHAIR: That is returned to the local governments as well? It does not go to the state?

Mr Stemmett: Yes.

CHAIR: I just wanted to clarify that.

Mr WEIR: I notice that there is a significant increase in dam improvement programs from $902 million to $1.3 billion. Could you explain that increase in cost? Were any of these projects that are underway forecast in the $900 million originally?

Mr Stemmett: As at 30 June, SunWater estimated the future cost of its dam improvement to be $1.3 billion, which is an increase, obviously, from last year of $900 million. Future projects include the Burdekin Dam wall raising and hydro-electric power station and the Paradise and Fairbairn dams spillway improvements. These projects will have a significant influence on SunWater's results going forward. Some of those have already commenced in the current year.

We take these into account when looking at the asset base of the entities in terms of the cash flow forecasts. We use that to estimate whether the assets are recoverable. We certainly look at that going forward.

Mr WEIR: Have business cases been done on all of these?

Mr Stemmett: Not necessarily all of those, but the Burdekin Falls Dam wall raising and the spillway improvements, yes.

Mr WEIR: How many are we still waiting for business cases to be done on them?

Mr Stemmett: I would have to take that on notice.

Mr MADDEN: Thank you very much for coming in today. Following on from that question Mr Stemmett, about the raising of the dam wall at the Burdekin Dam, is that what was referred to as the second stage of the Burdekin Dam?

Mr Stemmett: I believe so.

Mr MADDEN: For many, many decades we have referred to the Burdekin Dam as only having delivered the first stage. This raising of the dam wall is a significant improvement to the dam, so is that is what referred to as the second stage?

Mr Stemmett: I believe so.

Mr MADDEN: It is really this question I wanted to ask: what percentage increase does that give to the capacity of the Burdekin Dam?

Mr Stemmett: That is something that we would not necessarily know as part of the financial statement audit.

Mr MADDEN: I have another question related to a different issue: what did you find to be the key improvements since the last financial year with respect to the water entities' financial reports and processes?

Mr Stemmett: Certainly on internal controls there was significant improvement. The one entity that brought it all down was Mount Isa Water Board and that was purely due to management not being timely with regard to presentation and delivery of their asset valuation. In terms of internal controls it was a very good improvement.

Mr BATT: I have a question along similar lines to what we just talked about in relation to improvements. In this year the dividend for SunWater is $39.7 million. Last year they did not declare any dividends because they retained the money due to future improvements. Yet we have now an extra $400 million going towards future improvements for SunWater. Do we know why SunWater has declared dividends and are not holding back money for the next 10 years or whatever it is to pay towards these improvements?

Mr Stemmett: Last year SunWater was directed to hold back dividends and use that money for improvement projects. This year they were told to declare dividends. In addition, government would be providing another $100 million for future improvement projects in terms of Burdekin and the like. That would explain the increase in movement, but in terms of additional funding I guess that would be—

Mr BATT: A decision of government?

Mr Stemmett: Yes.

Mr BATT: When you say that they were told to hold back the money and then this time declare a dividend, it is advised by government to do that?

Mr Stemmett: Yes.

Mr Worrall: That would have been by the shareholder ministers.

Ms PUGH: I note in the report that you have said that profits for the water sector have decreased marginally because South-East Queensland development growth has slowed. You also referred to the student accommodation development stimulus program having ended. Is that to do with the housing slow down? Has there been an impact that you have noticed? Do you think that trend is replicated nation wide?

Mr Stemmett: Yes, that is due to the slowing in the economy and because of that slowing that has actually reduced the developer contributions that are paid to the participating entities, QUU and Unity. Yes, there has been a slowing in the economy which has impacted on that.

Ms PUGH: Is that throughout Australia? That is what I am getting at. Is it hard for you to comment on the rest of the country?

Mr Stemmett: It is certainly for Queensland, yes.

Mr Worrall: Because there has been less development there is less developer contributions going to the water entities to cover local water infrastructure to support those developments.

Mr MICKELBERG: My question is in relation to Seqwater. I note that Seqwater made an operating loss which was largely reflective of underrecovery across the water, which my question does not relate to, but the operating loss also reflects the past acquisition of highly geared businesses. I take it we are talking about the manufactured water assets there, which I understand are carried on the books at $3 billion, give or take, and have about $2.8 billion worth of debt associated with them. I note the trigger points were included in your report. What would the cost be, when those trigger points are reached, to ramp up to meet their requirements under the various different triggers?

Mr Stemmett: Those costs would be determined by Seqwater. As auditors we generally look at the past 12-month period. Looking forward it is at this stage an unknown other than the maintenance costs that are currently incurred for those two separate assets. Right now they are going through their costings in terms of how much those assets would likely cost in terms of operating, but it all depends on which percentage they actually meet. At 70 per cent it is just an additional communication exercise to the public; at 60 per cent those assets actually do turn on. The costings of those will then be determined and we will focus on that at the next 12-month audit.

Mr MICKELBERG: So I am clear, Seqwater are carrying assets on the books worth $3 billion and they have not conducted modelling with respect to what it would cost to turn them on?

Mr Stemmett: They would have.

Mr MICKELBERG: You did not analyse that as part of the audit?

Mr Stemmett: We have, but it is not something that is really set down in terms of what those costs would likely be. There are a number of factors that are actually taken into account: the gravity of the drought, whether it rains again et cetera, et cetera. In terms of those numbers, it is not something that I can tell you.

Mr MICKELBERG: Just so we are clear, we have clear trigger points at which they have to perform a certain course of action if it reaches 60 per cent, 20 per cent, et cetera and so forth. Seqwater has modelled what the costs would be to implement those actions as required; yes or no?

Mr Stemmett: I believe so, yes.

CHAIR: You have asked about those trigger points. From what I can understand they are modelled on different scenarios.

Mr Stemmett: Yes, there would be a range of scenarios that go into those models. There is not a number that I can tell you.

Mr MICKELBERG: But is there a range?

Mr Stemmett: Yes. I don't know what that range is right now.

Mr MICKELBERG: Presumably, if we are talking about the financial viability of an entity and we are talking about a considerable asset carrying 93 per cent of the asset value in debt, surely whether or not that asset is going to be utilised and the cost to utilise that asset would be an important part of any audit.

Mr Stemmett: Yes, it would be. Some of that is included in the current pricing forecast which has come out through the QCA. Their next determination occurs 1 July 2021. Going forward though, any additional costs that would be incurred by the use of those assets would then likely be taken into account in the next forward pricing. It is difficult now to assign a price in terms of how much it would cost to turn those on, because it has been assessed through the current pricing in terms of their price path up to now.

CHAIR: We are looking at a range of scenarios where these would kick in. Would that be better put to the department because we are looking at how they would have calculated that?

Mr MICKELBERG: No, I am actually interested in the financial impact of these departmental decisions or government decisions. Just so I am clear, the bulk water price path currently accounts for the cost to keep the assets as they sit now in care and maintenance and one of them I think is in hot standby; is that correct?

Mr Stemmett: Yes.

Mr MICKELBERG: But the bulk water price path does not account for the costs to utilise those assets if they were required. That would be an additional cost.

Mr Stemmett: It would, but it goes up incrementally over a number of years. It takes into account a number of different factors in terms of probability of those assets being turned on.

Mr MICKELBERG: If those assets were to be turned on, the bulk water price path would have to increase above what it currently is?

Mr Stemmett: Potentially, yes, and that would be done at the next price reset.

CHAIR: Which is 2021.

Mr MICKELBERG: After they are utilised?

Mr Stemmett: Yes.

CHAIR: Member for Buderim, the question comes down to how those different scenarios act out and what kicks in in 2021. Perhaps it would be something we could explore through the department.

Mr MICKELBERG: It strikes me that we have a $3 billion asset there that we actually do not know what it will cost to utilise.

CHAIR: We have talked about going out to this asset and reviewing it. It is a massive asset in terms of what we have. If we want get a bit more on the financial costs we need a briefing on the asset itself. I think these guys have answered the best they can. More information could come from the water sector. We only have a few minutes left. I talked about the tax equivalents coming in and the participation returns. You may want to take this one on notice: have you identified as auditors any further streams of revenue or income to councils outside of the participation returns and tax equivalents that they get from their water businesses or assets?

Mr Worrall: Do you mean revenue streams still from water?

CHAIR: Yes. It may be that councils carry some financial instruments paying for these assets and they are compensated for owning those financial models that fund these particular assets. Could we identify if there are any further revenue streams that flow to councils from water businesses besides these two streams we have talked about? Is that something you can take on notice?

Mr Worrall: We can take it on notice.

CHAIR: If there is none, that is fine.

Mr WEIR: My question is in relation to Luggage Point. It says here it is capable of producing 23 megalitres per day. Is that water being sold? What is happening with that water? Is it providing a return? That is set out on page 25 of the report down the bottom.

Mr Worrall: I actually think it is on maintenance mode. A small part of Luggage Point remains operational as part of care and maintenance mode. I think that is what it can produce but I do not think it is producing that at the moment.

Mr MICKELBERG: It has water going around to keep it from not falling apart.

Mr WEIR: Remains operational as part of the care and maintenance mode.

Mr Worrall: Yes.

CHAIR: Where does that water go that is being produced? Is it going into the system or are they pumping it out to sea?

Mr WEIR: Water is a very valuable resource at the moment. I was wondering whether it was delivering a return.

Mr Stemmett: I think they use that to keep the operation working.

Mr WEIR: That is what it is capable of, it is not producing it.

Mr Stemmett: Yes, I think so.

Mr WEIR: We do not know how much it did produce.

CHAIR: Deputy Chair, may I suggest we need to ask this from those water entities themselves. Clearly they are capable of producing that but we do not know if they are and, if they are, where it is going. Perhaps we need to discuss these questions with the department.

Mr MADDEN: You mentioned previously developer contributions with regard to the profit of our water assets. Can you explain the role of developer contributions and how they play a role in the operating profits of water entities?

Mr Stemmett: With the downturn in the economy that we have seen recently there is a lot less building development occurring. These entities, being QUU and Unitywater, receive developer contributions in the form of either cash or donated assets. That obviously is revenue for those agencies. When the economy goes the opposite way and goes in decline that all tapers off. That has obviously effected the reduction in those revenue streams for those entities.

Mr MADDEN: Are developer contributions a significant percentage of their income stream?

Mr Stemmett: They are, yes.

Mr MADDEN: Could you put a figure on it generally? Is it 20 per cent, 10 per cent or is it less?

Mr Stemmett: I would have to take that on notice.

Mr MADDEN: That is fine.

Mr MICKELBERG: Can I ask a follow-up? Do the developer contributions adequately cover the cost of the additional infrastructure that is required as a consequence of development? Is there a gap that needs to be met?

Mr Worrall: There should not be.

Mr Stemmett: There should not be.

Mr Worrall: They should be covering the costs. There should not be a gap, otherwise that gap will fall back on the water entities.

Mr MICKELBERG: Is that issue with respect to developer contributions just a timing mismatch?

Mr Worrall: No, I think it is just a decrease in activity. Because there is a decrease in activity—there are less developments—there are less assets or cash being given to the water entities—less revenue. Less revenue is going to translate to less profits unless they can manage their costs downwards accordingly and I think in the report their costs did not decrease as much as their revenue so that is why they have less profits.

Mr BATT: In relation to dam improvement, with the Dam Improvement Program going up from $900 billion to $1.3 billion, does that then affect the pricing to customers of their water from those entities? Does SunWater have to put the pricing of water to their customers up because of the extra capital costs in the Dam Improvement Program?

Mr Stemmett: The pricing that SunWater receives is obviously set by the state. Their next pricing reset will occur shortly. They will obviously take a look at all that and factor that into account.

Mr BATT: It is whatever is decided but it could be because of that. Everything has to be taken into consideration?

Mr Stemmett: Yes.

CHAIR: The time allocated for the session has expired. We have some questions on notice. In terms of energy, Mr Olive, there was a question about the financial contribution in relation to assets which are to be transferred to CleanCo. Do you have any information on that or do you want to take that on notice?

Mr Olive: In terms of the megawatt hours contribution of assets to CleanCo, it is in excess of 1100 megawatt hours in terms of total generation capacity. The actual breakdown of asset values is probably not something that is reported on an individual level in the financial reports of any of the entities, so that might be a better question for Stanwell Corporation and CS as being the entities relinquishing those low-emission or no-emission assets.

CHAIR: Should we chase it up with those particular assets?

Mr MICKELBERG: Yes, thank you.

CHAIR: We have two questions on notice on water. One question on notice was how many business cases are to be finalised in the Dam Improvement Program and any other streams of revenue or income to councils from their water businesses outside of participation returns and tax equivalents. We would appreciate the answers to those questions on notice to be provided by 10 am on Monday, 4 March 2019. That concludes this hearing. On behalf of the committee I would like to thank the Auditor-General and officers from the Queensland Audit Office for their attendance today. Thank you to our Hansard reporters. A transcript of these proceedings will be available on the committee's parliamentary website in due course. Thank you to our secretariat. I declare this public meeting closed.

The committee adjourned at 11.03 am.