



STATE DEVELOPMENT, NATURAL RESOURCES AND AGRICULTURAL INDUSTRY DEVELOPMENT COMMITTEE

Members present:

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

Staff present:

Dr J Dewar (Committee Secretary)
Ms R Duncan (Assistant Committee Secretary)

**PUBLIC BRIEFING—CONSIDERATION OF THE
AUDITOR-GENERAL'S REPORT NO. 4 OF 2019-20,
*WATER: 2018-19 RESULTS OF FINANCIAL
AUDITS*, AND AUDITOR-GENERAL'S REPORT
NO. 6 OF 2019-20, *ENERGY: 2018-19 RESULTS OF
FINANCIAL AUDITS***

TRANSCRIPT OF PROCEEDINGS

MONDAY, 17 FEBRUARY 2020

Brisbane

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The committee met at 9.45 am.

CHAIR: Good morning. I declare open this public briefing for the committee's consideration of Auditor-General's report No. 4 of 2019-20, *Water: 2018-19 results of financial audits*, and Auditor-General's report No. 6 of 2019-20, *Energy: 2018-19 results of financial audits*. The Committee of the Legislative Assembly referred both reports to the State Development, Natural Resources and Agricultural Industry Development Committee for consideration. I would like to acknowledge the traditional owners of the land on which we meet today. Thank you for your attendance here today. My name is Chris Whiting, I am the member for Bancroft and chair of the committee. The other committee members here today are: Mr Pat Weir, deputy chair and the member for Condamine; Mr David Batt, the member for Bundaberg; Mr Brent Mickelberg, the member for Buderim; and Ms Jess Pugh, the member for Mount Ommaney. Mr Don Brown, the member for Capalaba, is substituting for Jim Madden, the member for Ipswich West.

The committee's proceedings are proceedings of the Queensland parliament and are subject to the standing rules and orders of the parliament. They are being recorded by Hansard and broadcast live on the parliament's website. Media may be present and will be subject to the chair's direction at all times. The media rules endorsed by the committee are available from committee staff if required. Those present today should note it is possible that you may be filmed or photographed during the proceedings and images may appear on the parliament's website or social media pages. I ask everyone to turn their mobile phones off or to silent mode. We will begin our briefing now with Auditor-General's report No. 4 of 2019-20, *Water: 2018-19 results of financial audits*. I now welcome the Auditor-General and officers from the Queensland Audit Office.

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

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

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

Mr Worrall: Thank you for the opportunity to brief the committee on report No. 4 of 2019-20, *Water: 2018-19 results of financial audits*. Each year the QAO audits the financial statements of the state's public sector entities. This report summarises the results of five state and local government owned water entities. These include Queensland Bulk Water Supply Authority, trading as Seqwater; Sunwater Ltd; Central SEQ Distributor-Retailer Authority, trading as Queensland Urban Utilities; Northern SEQ Distributor-Retailer Authority, trading as Unitywater; and the Mount Isa Water Board. We issue unmodified audit opinions on the financial statements of these entities within the statutory deadline of 31 August 2019, meaning the financial reports are reliable and comply with the relevant laws and reporting standards. A sixth water entity, the Gladstone Area Water Board, did not meet its legislative time frame as it did not have directors in place at the time the financial statements were due to be signed. We subsequently issued an unmodified opinion on their financial statements on 13 November 2019. Smaller water boards, known as category 2 boards, and local governments also provide water services in designated areas and to their ratepayers respectively. These entities are outside the scope of this report.

As part of the audit process we assessed whether the systems and processes that the entities use to prepare their financial statements are reliable. Overall, to the extent that we tested them we found that the internal controls the water entities have in place to ensure reliable financial reporting are generally effective, but there is room for improvement. We made 22 recommendations to support further improvement in controls and processes. Areas for improvement include strengthening controls on information systems, and reporting revenue and assets received from developers in a more timely way.

Targeted frauds continue across all public sector entities. There was a successful fraud in a water entity where the employee's bank account details were changed as a result of a phishing email. Management has now strengthened controls over changes to employees' bank accounts. The sector is continuing its efforts to ensure asset valuations are accurate and timely, and we encourage these

processes to continue. We provided an action point to ensure that financial statements reflect the impact of extreme weather events on the measurement of transactions and balances. The overall performance and position is analysed in the report which adds up the results from each of the individual companies and statutory bodies.

Our key analysis showed that profits from the sector were \$402.8 million, which is an increase of \$64.6 million from the 2017-18 year. This was mostly due to urban bulk water prices moving closer to cost-recovery levels, which has led to higher operational revenue. Four of the five water entities achieved operating profits in 2018-19. Combined shareholder returns to state and local governments were \$244.1 million, which was an increase of \$36.7 million over 2017-18. Shareholder returns as a percentage of profits have remained stable year on year. Total assets for the sector were \$22.8 billion, which is an increase of \$241.8 million from 2017-18. This increase was mainly due to increased investment in infrastructure and assets by distributor-retailers. Total liabilities for the sector remain steady at \$15 billion, which is an increase of one per cent over 2017-18. We are happy to take questions around the report.

CHAIR: When we have done these in the past, one of the things we focused on is control mechanisms, and that was one of the outstanding things we saw in this report. There has been some work done in these organisations on their control mechanisms once your office brought it to their attention. It is interesting to see that there is still work to be done in some of those areas, information technology and preventing fraud, even though it is a very rare occurrence. Once you have said to those entities, 'You still have to improve your control mechanisms,' are we seeing enough work being done to implement those control mechanisms?

Mr Worrall: I think the water entities are quite responsive to the improvements that we recommend. You are quite right: a number of the deficiencies do relate to information systems controls, and that is an ongoing concern for me as the Auditor-General because that is a theme in a number of sectors that does make these entities more vulnerable to fraud. Phishing email fraud is a type of cybersecurity fraud. What is concerning about that fraud is that that fraud has been kicking around now since even before I started in this role 2½ years ago. It initially started in local government as a vendor fraud. A number of local governments were impacted, a number of state entities have been impacted, and in more recent times over the last 12 to 18 months that has sort of morphed into a payroll fraud as well where they are getting the personal bank account details of an employee changed to a fraudulent bank account. The way it is happening is similar to the vendor fraud and the money is being paid not to the employee's bank account but to somebody else. That is a concern. That message does not seem to be getting through, not only to this sector but to all sectors, because even as recently as this year there has been another potential fraud like that. I think this one might be a vendor fraud in local government, so it is still happening even though we have been publicising it since before I came into the role.

CHAIR: It is good they have been responsive. Is there a timetable or a certain aim that we want to get to in terms of having sufficient training and sufficient awareness? Is there a timetable that you might have in mind, or is there any other way that we can emphasise to these bodies the importance of these mechanisms?

Mr Worrall: In the first instance we are reliant on the entity's audit committees to hold management to account around deficiencies and significant deficiencies that we are finding. We would report those in our management letters and closing reports. They would go into those reports with an agreed timetable for remedy, and then our expectation is that those audit committees would then hold management to account and that they actually remedied those in a set time. The audit committee may also have a view around whether the agreed time is soon enough, and they may override management's wishes on that path. In terms of training, if there are ongoing issues within particular organisations then my expectation would be that management and the audit committee would identify those and assist those people to be skilled up if that was required.

Mr Stemmett: Based on the results of the sector in terms of control deficiencies that we have seen, certainly we do indicate agreed time lines for them to remedy going forward. Of all the control deficiencies that we have noted in the past, the majority of those have been resolved in quite quick time frames. It is one of those where the audit committee then needs to hold management to account to fix those. The key one was rectified very quickly. They had the processes and procedures in place to make sure that did not happen again.

Mr WEIR: As I am a regional member, you will not be surprised if I turn to irrigation. I notice there is a paragraph in here where you say—

Sunwater's community service obligation for irrigation decreased by 31.3 per cent and 14.9 per cent in 2018-19 and 2017-18, respectively, due to prices moving closer to cost recovery and schemes transferring to Local Management Arrangements.

Can you explain that to me a little more?

Mr Stemmett: It has to do with their irrigation pricing, which is coming up for reset as well. Not all of their pricing actually covers their operating costs in terms of what they charge on to irrigators. They are obviously subsidised by those CSOs they receive. It is a function of the operating cycle of that agency as well. Their next reset is meant to take place from 1 July 2020 to 30 June 2024. During that period they will then reset and look at how those prices do recover costs, which means that there will be fewer CSOs that are imparted onto those agencies.

Mr WEIR: That has not been the traditional model?

Mr Stemmett: It has.

Mr WEIR: We are increasingly hearing about the cost of water to irrigators. They are citing it as a factor and saying it is too expensive for them to use. I was up in North Queensland, in the Proserpine and Mackay area. There is plenty of water up there but they say the cost of water is so expensive. How do we get around that?

Mr Stemmett: That will come through the next pricing reset that is done through state government and recommended by the QCA. They will look at a range of scenarios and alternatives.

Mr WEIR: That alters from region to region?

Mr Stemmett: I think so, yes.

Ms PUGH: I zeroed in on the water security part of the report. At the bottom of page 2 it states—

Seqwater included a probability weighting for drought (likelihood of drought occurrence) as an assumption in its asset valuation ...

You talked about how you encourage all entities to assess the impact of extreme weather events on their balance sheets. Can you just expand a bit on why that is important? Obviously it is a really tricky thing to do. We have just had a fantastic downpour and I think our dam levels in total have gone up about 10 per cent, which is great, but it is very tricky. I would really appreciate your insight there.

Mr Stemmett: Seqwater modelled a different model for drought scenarios. Severe water restrictions potentially coming in will increase operational costs. It will potentially increase prices. We are then asking agencies, whilst they are modelling those potential increases further into the future, to look at what that means for the agencies themselves in terms of the valuation of those assets, to assess what it does for things like pricing and then assess potential increases on that. It is taking into account the major scenarios and disclosing those in the financial statements so that readers are aware of the impact of significant drought.

Mr BATT: The Gladstone Area Water Board was granted an extension to the time frames for finalising its annual report. Three new directors, including a new chair, were appointed on 22 August which was all around the time this was happening. Is that a normal process that was happening? Is there a reason there were three new board members and they could not get to doing this at the right time?

Mr Stemmett: At the time of finalisation of the accounts we were notified of that, so it certainly was not a normal process. Obviously based on that, we could not finalise those financial statements due to the lack of directors. An extension was granted on 10 September by the Minister for Natural Resources to get their annual report sorted and finalised. We subsequently came in and certified the accounts by the end of November. It is not a normal process, but that process did occur.

Mr BATT: You were not aware of why that occurred? Was it a case of, 'This has occurred and we need more time'?

Mr Stemmett: Yes.

Mr Worrall: Was it a timing issue in relation to the directors' terms?

Mr Stemmett: Yes and no.

Mr BATT: It was not a normal director end-of-term matter, by the sound of it?

Mr Stemmett: There was, and I think there was another that rotated off.

Mr BATT: At the same time?

Mr Stemmett: Yes.

Mr BROWN: My understanding of the Western Corridor Recycled Water Scheme is that it is treated twice; is that correct?

Mr Stemmett: Yes.

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Mr BROWN: Is there a capability after the treatment in the advanced treatment plant to go to the home or does it have to go back through Wivenhoe and then get treated again? Are there cost savings?

Mr Stemmett: I believe it has been set up for that function—to go straight back into Wivenhoe so it gets treated again through the normal process.

Mr BROWN: I take you to the tables for the different local government areas. Is Redland City Council a separate entity that you do not audit because it is too small?

Mr Flemming: Redland, Gold Coast and Logan used to be part of a water entity called Allconnex, which disbanded in 2013. Each of those councils run their own water businesses now. Anything coming out of those councils will feature in our local government reports to parliament as opposed to our water reports. There are different timings. They are not an entity in their own right; they are part of the council's normal business process.

Mr BROWN: When you do that review into local government, is water included in the report?

Mr Flemming: Not specifically the water aspect, because it is just one part of the much bigger council operation.

Mr Worrall: In their financial statements you would be able to see the revenue and expenses in relation to the water service delivery for that council.

Mr Flemming: It is probably timing for this as well, because local governments have a 31 October financial reporting deadline, as opposed to these entities that have a 31 August deadline. It is timing of information availability as well.

Mr MICKELBERG: My question is in relation to the Western Corridor Recycled Water Scheme. We inspected it a couple of months ago and it became evident that each of the parts of the scheme were effectively constructed to different specs. Different providers constructed each of those areas. For example, Luggage Point was constructed with one design by one provider; other areas were constructed by other providers. Does the Audit Office consider benchmarking with respect to maintenance costs with other recycled water schemes across the world?

Mr Stemmett: Yes and no. That is a tricky question. As part of our audit, we assess the results of the entities' financial statements and costs relating to that specific project. The western corridor project has been in care and maintenance since 2015. There are different components of that asset that have, as you say, different assets and pumping stations and the like. It is something that we could do in terms of assessing how it is benchmarked. In terms of the financial statement results for the agency incurred, we look at the pure maintenance costs for that asset specifically at a point in time.

Mr MICKELBERG: I see in the report that the maintenance and operating costs went up by about 29 per cent.

Mr Stemmett: Yes.

Mr MICKELBERG: Is that reflective of increased utilisation of that asset? I understand, for example, they were running it to pump into one of the PR stations. Is that the reason for that cost, or is that as a consequence of ageing across that network?

Mr Stemmett: It is increased operational usage.

CHAIR: One of the matters I found interesting was that in your introduction you identified the lack of clear national policies for an orderly transition. Can you specify what you mean about the lack of clear national policies?

Mr Worrall: Is that in relation to water?

CHAIR: Sorry, I have the wrong one. I jumped the gun.

Mr WEIR: My question is in regard to the recycled water scheme. During our visit to Luggage Point we were told that it would take two years before they are fully operational and have it to a standard. I would have thought maintenance would have it ready to be at full production basically at the flick of a switch.

Mr Worrall: That would be my understanding with the term 'care and maintenance'.

Mr Stemmett: That is only one component of that entire scheme, though. There is a series of different advanced water treatment plants that are connected to that set of infrastructure. Based on my understanding, it would take anywhere from 24 months to get it up and running. In spite of the Brisbane

mere fact that that large infrastructure gets turned on, they still need to go through a range of water testing to make sure it is actually fit for purpose in terms of drinking. That takes into account that time period as well. It is not purely just switching on an asset and running it.

Mr Worrall: Is it the case that all assets in that network have to be switched on?

Mr Stemmett: For western corridor, yes.

Mr MICKELBERG: Returning to the Western Corridor Recycled Water Scheme, are you able to split out the pumping costs associated with moving water right through the network back up to Wivenhoe as opposed to pumping directly into the water grid?

Mr Stemmett: That is not something that we generally look at as part of the audit. I am sure management would have that. Yes, it makes it hard because it is not fully operational. There is that limit of how much information we get to see on that.

Mr MICKELBERG: Presumably, in terms of the drought costs that you talk about being incorporated, they would have considered that pumping cost in order to factor for drought costs?

Mr Stemmett: Yes. That would have been at a point in time. The model would then reflect future cash flows associated with that discounted back.

Mr MICKELBERG: Understood. Can you explain how the competitive neutrality fee works with Sunwater in practicalities? There is a shade over \$2.3 million there to ensure that state government entities are not competing with the private sector. Who is getting that money? How does it work in actuality?

Mr Stemmett: As you say, that is the basis for that arrangement. Due to the nature of the extent of dollar values, we have not necessarily looked at that in detail, but it has been set up for that factor.

Mr MICKELBERG: Will those funds, though, be going to the private sector? It is obviously an irrigation or a water supply grid. I am not sure who we are competing with there.

Mr Stemmett: I would not be able to tell you at this stage.

Mr Worrall: Is that in relation to their debt?

Mr Stemmett: I am not sure.

Mr MICKELBERG: Did you say 'in relation to their debt'?

Mr Worrall: Quite often competitive neutrality fees are in relation to debt borrowings from QTC where they receive a more attractive borrowing rate than what they would get in the market. To bring them to a competitive level with an external provider, they do not get the discounted rate; they pay the market rate.

Mr MICKELBERG: That could potentially be flowing to QTC?

Mr Worrall: To Treasury, I would have thought. I do not think it would go to QTC in that instance.

Mr MICKELBERG: If it was flowing to Treasury, would that be included in the shareholder returns?

Mr Stemmett: No, it would not.

Mr MICKELBERG: So it is an additional amount?

Mr Stemmett: Yes.

Mr Worrall: Just looking at table G1 at appendix G, which is page 34, you can see that there was a competitive neutrality fee of \$2.2 million, which is what you are talking about, paid by Sunwater. I am assuming that has probably gone to Treasury.

CHAIR: We talked earlier about the cost-recovery model. We have noted here that, for example, Seqwater continues to make an operating loss. In terms of cost recovery, can you portray the path of what has been done and where we might go in the future?

Mr Worrall: I will start and Vaughan can jump in. They have been on this cost-recovery pathway for a number of years. They have a regulated price which is set by the regulator. Essentially, that price is increasing over time. They are approaching a point where they will generate a profit. A lot of that has to do with debt that they took on to do with the South-East Queensland Water Grid, including the desalination plant. They have a lot of debt on their books to pay for those assets which has not really made them competitive. Over time, their pricing is increasing and they will turn to a profit situation.

Mr Stemmett: Their regulatory pricing resets on 1 July 2021. Going forward, every time after that they will look at ways to ensure their revenue covers their cost base. Seqwater's intention is to pay back their water grid manager debt by 2028. The pricing scenario that currently sits there obviously assists with that intention. As things move in terms of drought and things become more expensive in terms of operational costs and the like, that will need to be factored into the next reset period again for prices because things will start moving in term of how expensive water becomes.

Mr BATT: I wish to return to the Western Corridor Recycled Water Scheme. It is of interest to us as we have been there and had a look through it only in the last six months or so. From what the member of Buderim said, there was a 29 per cent increase in costs in the last 12 months from the year before, amounting to \$13.8 million. I notice there is only the one industrial customer. I think it is a power station.

CHAIR: One of the Stanwells.

Mr BATT: Some 1,700 megalitres of water was pumped there. If that is the only amount that has been used for the money coming in, is that like a CSO again? That is, whatever the cost is over the top of whatever they receive from that customer would come back in a CSO to cover the costs or the loss? How does that work? I assume Stanwell is not paying \$13.8 million to cover running costs to make 1,700 megalitres of water.

Mr Stemmett: Yes, I think that is in addition to everything else they are doing in terms of general operations and to keep it in a state of readiness. It is not purely just for the supply of that water.

Mr BATT: We keep talking about CSOs and recovering costs. Will the difference come through as a CSO or is that just a loss?

Mr Worrall: Probably not, because they need to run the plant like that anyway to make sure it is ready if they need to put it on. In a way, the water they are supplying as part of that exercise is almost a by-product of that. Therefore, it would not be a CSO and it would not be appropriate for the entity receiving the water to pay that price because that is probably not a commercial price anyway. They would need to turn the plant on anyway and, in doing that, they generate some water. That is how I see it.

Mr BATT: Under 'Actions for entities' on page 2, you encourage entities to explore a controls monitoring solution to bring in real-time data on key financial processes. That is to help prevent people phishing and so on. Are any of the five or six you have looked at doing that at the moment?

Mr Stemmett: Yes, they are. It is a point of concern for them, so that is part of what we recommended during the audit. We have taken that further to say, 'This is a recommendation now for all entities and agencies.'

Mr BROWN: Locally the LNP is campaigning to overrule an SEQ decision about water infrastructure and dam improvements to the Leslie Harrison Dam which Seqwater has said would cost an extra \$18 million. With political style campaigns like that, when the QCA comes to decision-making, how would that extra infrastructure money be recovered by Seqwater? How would the QCA decide how to recover that infrastructure cost?

CHAIR: Member for Capalaba, you are asking for an opinion on policy.

Mr BROWN: It is a simple question: how are extra dam improvement infrastructure costs recovered by these water entities?

CHAIR: You are rephrasing the question asking how that extra infrastructure is covered by the entities? I will allow that.

Mr Stemmett: Additional debt.

Mr BROWN: How is that additional debt paid for?

Mr Stemmett: It continues until they reach a point where they can recover the operating costs based on the revenue that they earn.

Mr BROWN: Where does their revenue stream comes from?

Mr Stemmett: It is set through QCA pricing.

Mr BROWN: Paid by the water user; is that correct?

Mr Stemmett: Yes. That is why the next reset will become very important.

Mr Worrall: The regulator would need to take into account the entity's operating environment in terms of debt, revenue it can generate, growth of customer base—a whole lot of financial metrics.

Mr WEIR: Are the costs of water included in the proposals for Rookwood Weir and the Granite Belt? We have a figure of \$352.5 million as the proposed cost of Rookwood Weir. Is there any proposal of what the cost recovery will be or what the price of that water will be?

Mr Stemmett: I do not believe so. That is purely for the cost of construction of the asset.

Mr WEIR: There are no figures on what will be charged for that water?

Mr Stemmett: Not at this stage, no. We purely look at what those costs are, based on the business cases that are presented.

Mr WEIR: The business case does not have a cost-recovery model.

Mr Stemmett: They would, but the financial statements would reflect the capital costs incurred to build that asset as opposed to factoring in what it would cost to charge for water.

Mr MICKELBERG: My question is in relation to depreciation for the desal plant and the Western Corridor Recycled Water Scheme. Do either of them have a time frame that depreciation is worked out for useful life? If so—I presume they do—what is that time frame?

Mr Stemmett: It would be covered through the overall valuation of the infrastructure assets. There is specific depreciation for each one of those specific assets. I cannot tell you what that is now. It would be covered through that valuation process, where we look at future revenue attached versus operating costs.

Mr MICKELBERG: You use a discounted cash flow model?

Mr Stemmett: Yes.

Mr MICKELBERG: I understand the concept behind that. Using the desal plant as an example, if it is considered to be a pivotal part of the grid, arguably it has to be replaced at some point as well. It is not only about the discounted cash flow but also about the fact that it provides a capability that has to exist in the grid.

Mr Stemmett: Yes.

Mr MICKELBERG: That is one system. The desal plant is probably an easier example than the Western Corridor Recycled Water Scheme. Do you have the time frame for that system for useful life?

Mr Worrall: The entire system?

Mr MICKELBERG: You cannot separate out one of the buildings; it flows through all of them, so I assume it has the same useful life as a structure complete.

Mr Worrall: We would have the level of detail around the desal plant in terms of useful life on the engagement file. It is probably also broken down into key components of that asset, because some assets within that entire facility may have a longer useful life than others. That is what we would expect management to do and the accounting standards would say they would need to reassess that on an annual basis. As it turns out, Vaughan and I were down to do a tour of the desal plant last Thursday. That had been in our diaries for a few months, but it ended up being cancelled because of the weather. They said it was too hazardous to go there. However, that is how they would do it. With a big asset there would be different major components which would have different useful lives, and management would be depreciating those components based on their useful life. Again, they would be reassessing that on an annual basis.

Mr MICKELBERG: Do you get that information? Do you get that the membranes have a useful life of X, pipes have a useful life of Y and then obviously it is reported in the financial statements as an aggregate cost?

Mr Worrall: Yes, that is exactly right, because those useful lives drive the rate of depreciation.

Mr MICKELBERG: Is there any benchmarking that you look at with respect to operating costs for irrigation and dam schemes? Is there a rule of thumb that we consider best practice for operating costs as a percentage of production or anything like that?

Mr Stemmett: Not specifically as part of the audit. That is something that management would be doing. We would look purely at the circumstances that have occurred in that financial period in terms of how much cash, grants or money each agency has received for a specific project and how they have treated that in terms of capitalised versus expensed. What you have just asked is potentially more of an operational type benchmarking exercise.

Mr MICKELBERG: When you are looking at management controls, do you look at the appropriateness of controls—not only financial risks but also operational management at a higher level?

Mr Worrall: We do. The auditing standards tell us that we need to make an assessment of entity level controls, which could be both financial and operational, as you say. One of the ways we would do that is inspect their risk registers. You would expect organisations to have strategic risk registers and operational risk registers. We then do a sense check to not only ascertain whether they contain the risks we would expect for that sort business but also to understand the process for managing those risks besides just putting them in a register. In terms of benchmarking, that is probably something the regulator is also interested in, in setting those price pathways. I would expect that they would be interested in benchmarking, that they are not giving price pathways to entities that are performing at a level a lot less than industry benchmarks.

Mr MICKELBERG: So we are not subsidising inefficiency?

Mr Worrall: Yes, that is what I would expect.

Ms PUGH: Going back to the drought response triggers, at figure 3F you have the diagram listing out the trigger points and response. At 70 per cent we have 'Increase general water efficiency messaging' and at 50 per cent we are quite actively targeting the 140 litres per person per day water restriction. Were you able to delve into the costs associated with those kinds of marketing and messaging programs for SEQ or any of the water bodies? There would obviously be some kind of cost associated. It is probably less than the cost of making the water. Is that something you were able to cover or did it fall outside the scope of your timing because of the levels of water?

Mr Stemmett: There are definitely additional costs once you get to those trigger points—more so on the 60 per cent. Those additional costs have come through in terms of operating costs within the agencies. As we get further down the track in terms of reaching the further stringent thresholds, it will become more costly. That is captured through Seqwater preparing different modelling in terms of what drought does for the asset base in terms of the valuation of their assets. Certainly there are increased costs that have come through, yes.

Mr BATT: Infrastructure challenges are listed in the report. There is another part on future challenges and emerging risks et cetera. It says that Sunwater's dam improvement programs are likely to impact financial performance and cash flows. There are those challenges that are known—we have talked about some of the pipelines, dams and so on—but there are also unknowns such as Paradise Dam. How does that work for funding into the future? If we discover in the next 12 months that Paradise is \$100 million or \$700 million to fix, is that amount borrowed and it comes back to the users to cover the costs of borrowing the money? How does that work?

Mr Worrall: That is potentially one option. At the end of the day, those investment decisions are probably decisions for the entities and government. You are right: if there are borrowings involved then the money has to be paid back some way. The only other thing I would say is that the regulator would have a role in there as well in setting pathways.

CHAIR: There being no further questions, we will move to the next report.

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

OLIVE, Mr Damon, Assistant Auditor-General, Queensland Audit Office

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

CHAIR: The committee will now consider Auditor-General's report No. 6 of 2019-20, *Energy: 2018-19 results of financial audits*. I invite you to make an opening statement, after which we will have some questions.

Mr Worrall: Thank you for being able to brief the committee on report No. 6 in relation to the 2018-19 results of the financial audits of the energy sector. This report summarises the results of our financial audits of the state government energy entities. These include the five state government owned energy companies—Stanwell Corporation Ltd; CS Energy Ltd; Queensland Electricity Transmission Corporation, which trades at Powerlink; Energy Queensland Ltd; and CleanCo Queensland Ltd—and 30 subsidiaries which include Ergon Energy Pty Ltd. We issued unmodified opinions for the financial statements of each of these entities, with all audits being complete by 31 August, being the statutory deadline. We also considered the regulatory information notices of Engelex Ltd and Ergon Energy Corporation Ltd provided to the Australian Energy Regulator.

The overall sector performance and position is analysed in the report, adding up the results from each of the individual entities. Energy entities have solid financial positions and are investing in their assets to ensure they can deliver a stable and reliable supply of electricity within the national wholesale electricity market. For 2018-19, Queensland continued to have the lowest wholesale electricity prices, which influences the prices consumers pay.

Key analysis showed profits for the sector were \$1.67 billion, which was a decrease of two per cent from the prior year. This was mostly due to reduced profits in transmission and distribution, which were down \$53.3 million in the year under review, resulting from lower determinations from the Australian Energy Regulator. In contrast, the combined profits of generators have increased \$173.4 million, or 24 per cent, compared to the previous year. This was due to increased income from activities other than generating electricity such as rebates from coal export sales. The total value of assets from the sector increased by \$579.5 million, or one per cent, mainly due to an increase in investment in these assets. In 2018-19 the sector spent \$2 billion in capital expenditure. This includes overhaul of power stations, upgrading and replacement of supply system assets, and investment in information systems. The sector continues to invest more on new and replacement assets than it is consuming each year.

Returns to the state, which consist of dividends and income tax equivalents, amounted to \$2.2 billion, which was a decrease of \$175 million from the prior year. This was primarily due to reduced profits from the sector. The dividend policy of the energy entities remains the same as in the previous year. The state government gave back \$1.07 billion to consumers in the form of rebates and subsidies. This included funding to support the additional cost of supplying electricity in regional Queensland.

As part of the audit process, we assessed internal controls for each of the entities. Where we identified controls that we plan to 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. Although we did not identify any significant or high-risk control deficiencies, we noted an increase in control deficiencies throughout the sector. We made 12 recommendations to the entities to strengthen their controls, most relating to information systems. Management undertook significant work to resolve outstanding issues from the prior year and is working to resolve any new deficiencies we identified in that current year. We are happy to take questions on that report.

CHAIR: Thank you very much, Mr Worrall. I have already given you my first question! Tell us about what you have identified as clear lack of national policies.

Mr Worrall: Matters have played out in the media for quite a number of years. We are reporting on the entities within the state, but we are trying to say that the state cannot and does not operate in full isolation of the national system. That is what we are trying to reflect.

Mr Olive: In addition, as Brendan highlighted, Queensland operates as part of the National Electricity Market, which is the eastern seaboard states including Tasmania and South Australia. Not having a national policy to try to overarch each of the state based strategies and policies around energy does potentially have an impact in terms of pricing and competition. Investment in energy is a long-term and expensive investment, so it can have an impact for investment decisions for the private sector.

CHAIR: It is not something traditionally you have talked about. Obviously we do not talk about policy, but we have identified that there is a lack of a national framework which will impact investment decisions, as you said. It is of enough significance to fall into your remit of what you need to look at; is that correct?

Mr Olive: It is consistent with a comment we made in the report in the prior year. In the 2016-17 year there was the National Energy Guarantee, which did provide an overall strategy and framework for industry participants in the energy sector.

Mr WEIR: My question is around the networks. You are saying that network tariffs have declined. At the back of your report you talk about the growth in solar projects. On the back page you say that there are 34 large-scale projects in the current financial year. They all need to be connected to the grid. You also state there are 13 gigawatts of solar projects being proposed in Queensland by privately owned companies. There must be a lot of work to come onto the network to have all those connected. Who is covering that cost? Are the entities that are building these projects doing that?

Mr Olive: In the main, I would suggest that that would be part of a private sector business case to arrange for connection of their energy infrastructure to the remainder of the network. Government owned corporations such as Energy Queensland and Powerlink would be involved in physically making some of those connections and would potentially be contracted to make those connections to the network.

Mr WEIR: Yes, because 13 gigawatts would indicate there are a lot of projects to be constructed in the future.

Mr Olive: Absolutely.

Mr WEIR: Are the 34 large-scale projects that you talk about all connected to the grid?

Mr Olive: They would be proposed to be connected to the grid, yes.

Mr WEIR: They are not all connected as yet?

Mr Olive: Not at the time of producing the report, no.

Mr WEIR: Do you know how many would be?

Mr Olive: I am sorry, I do not have an update. I would suggest probably the department of natural resources would be best placed to answer that in the current state.

Ms PUGH: I do not know where to start. I get so excited about this. This is great. You stole my first question, Chair. On the back page, right before the appendices, you touch on individual households. My colleague the member for Condamine has talked about large-scale solar. There are also a lot of individual households with their small-scale solar. We know that that is a really considerable source of power. I understand that if you add them all together it is a considerable source. What impact has that had on pricing, demand and all of those sorts of things in the electricity market?

Mr Olive: We highlighted in one of the graphs in the report the penetration of rooftop solar in terms of changing the demand pattern on a 24-hour cycle. On page 22, figure 3J shows that over the last three years there has been a noticeable change in the demand for electricity in Queensland over a 24-hour window. In that period during daylight hours, as you can see there, the demand is reducing; the evening peak is increasing. That creates a challenge for the energy network to respond from that lower base during the middle of the day to meet the peak demand in the evening.

Mr Worrall: Given that there is no solar happening in the evening.

Mr BATT: The report shows that a net profit of \$1.7 billion was posted, allowing the sector to return \$2.2 billion to the state, comprising \$1.5 billion in dividends and \$713 million in taxes. The state government then gives back \$1.07 billion in rebates and subsidies. Basically, half of that is going back. In terms of the rebates and subsidies that we talk about helping people in the regions et cetera, that money is coming from the consumers in the first place? Is that how that works?

Mr Olive: That would be the intent in terms of the sector. In a true sense, the profits from energy GOCs are passed back to the shareholding ministers. Yes, there were rebates for energy consumers. The community service obligation was around \$460 million to help meet the cost in regional Queensland. There were other schemes to help, with concession rebates. There was the \$50 rebate across the state as well as part of some of the other schemes in terms of returning funds to the consumers in Queensland.

Mr BATT: Are those CSOs similar to the water scheme? In the last three years that figure has dropped to be at \$462 million presently. Two years ago it was at \$600 million. It reduced to \$493 million and then to \$462 million. In regard to water, there are less CSOs now because they are bringing that closer to their own profit. Is that similar in this circumstance?

Mr Olive: Correct. The QCA operates in energy in the same way that it operates in water in establishing tariffs for regional Queensland, where Ergon Energy supplies the electricity. There have been some increases in those tariffs which is moving the profitability of Energy Queensland closer to the cost. That community service obligation then supplements the difference of the true cost of providing those services to regional Queensland.

Mr BROWN: As a substitute committee member, I have not had a chance to go through it. Is there any breakdown in the report of the revenue stream we receive from the interconnector down into New South Wales and southern states? Is that a growing revenue stream?

Mr Olive: The amount of revenue generated from the interconnector would not be separately identified. I have a couple of statistics that show that in 2018-19 around 4,400 gigawatts of energy were exported south over the connector. The Australian Energy Market Operator reported in its quarterly report that the flow of electricity was almost entirely southerly in its direction.

Mr BROWN: Is that trend growing? Are we going to export more power to southern states in the coming years?

Mr Olive: That would be a symptom of demand and supply. In New South Wales, the forecast closure of Liddell is probably an indicator that there could be more electricity flowing south to help meet the demand requirements in New South Wales.

Mr MICKELBERG: I have a question with respect to Stanwell's coal resource, Kunioon. I note the report states —

As Stanwell does not expect to realise the estimated value of this resource through future use or sale, it recorded an impairment loss of \$105.3 million ...

Is that a consequence of the closure of Tarong? Presumably they were anticipating a longer operating time frame, hence why they invested in that resource; is that correct?

Mr Olive: It probably is more a question for Stanwell in terms of the underlying mechanics behind decision-making. Ultimately, the future fuel resource for Tarong will be obtained from the existing Meandu Mine. The Kunioon resource was a reserve fuel supply for the Tarong operation. There has been a decision for Stanwell to no longer require that because they believe the fuel resource is sufficient at the Meandu Mine.

Mr MICKELBERG: They have taken a decision to write off \$105 million worth of assets when the alternative is that they could sell that asset and realise \$105 million. Presumably that is why they are carrying \$105 million on their books?

CHAIR: I think you are going into policy there.

Mr MICKELBERG: Is it a matter of government policy? Is that the reason they have chosen to take that course of action?

CHAIR: I am going to rule that out of order. Do you have another question?

Mr MICKELBERG: I have plenty more, thank you, Chair. Let's talk about CleanCo. The government has a policy to establish CleanCo. Your report talks about renewables replacing coal as the main energy source by 2050 and the transfer of all the renewable assets from Stanwell and CS across to CleanCo, along with some gas assets as well.

Mr Olive: That is correct, to Swanbank E.

Mr MICKELBERG: We have talked about the progressive retirement of the coal-fired power stations. Does the fact that we are going to see a shift to renewables and the transferring of all the renewable assets into one entity expose CS and Stanwell from a strategic risk perspective with respect to their sustainable income stream?

Mr Worrall: That is an observation that is reasonable to make. I think over time those risks could increase if they do not diversify their income base. We mentioned that the generators have increased revenue from non-traditional sources. If they do not do that, that will restrict their financial performance because they will have this asset which has a limited life and no new revenue sources.

Mr MICKELBERG: What are those non-traditional sources you talk about?

Mr Worrall: I think they have been selling electricity directly to some large corporates.

Mr Olive: Yes, that is correct. Certainly they would contract directly with large customers over a certain capacity threshold for the provision of electricity. In the report we also say that CS Energy has entered a joint venture with Alinta Energy to enter the residential electricity market. Another point is—and this is a matter for the GOCs and the government—that they do negotiate on their shareholder

mandate in terms of what activities any of those entities can participate in. I suppose that is a function of the government owned corporation environment. A change in that shareholder mandate could see them participating in areas of the market they do not currently participate in.

Mr MICKELBERG: What you are talking about as a conceivable course of action would be that a future government or the current government mandates or provides scope for CS Energy and Stanwell to invest in renewables which then mitigates that risk. Is that what you are referring to?

CHAIR: I am going to rule that question out of order. You are going into government policy. You have had a few questions, member for Buderim. I am going to go to the member for—

Mr MICKELBERG: You do not like that line of questioning, Chair? Is it too close to home?

CHAIR: Member for Buderim, you get a fairly good crack at questions. You have done pretty well today, so I would just caution you about the line you are taking.

Ms PUGH: You talked about Alinta Energy, and I should declare at the outset that I am a very happy Alinta customer. I think their marketing strategy is brilliant. They sponsor the cricket team. When you are watching the cricket and it is hot, it makes you think about turning on the air conditioning and it makes you think about your power bill. It is genius.

You have identified that the CS Energy retail joint venture with Alinta Energy is growing year on year. From my observation they have undertaken a pretty good marketing campaign. They are very visible in shopping centres and things like that. The report says that in the last financial year we had about 97,000 customers in South-East Queensland. Can you explain how Alinta has contributed to the increase in retail revenue in that financial year?

Mr Olive: Probably not in a detailed way, other than to say that obviously another retail participant in the market to increase competition has certainly added to the competitive tension in the market and offered residential customers in South-East Queensland another opportunity.

Mr WEIR: I will return to the 13 gigawatts of solar projects proposed by privately owned companies in Queensland. You have only named privately owned companies. Do you have a number of proposed solar by government corporations in that time frame?

Mr Olive: There were none noted because we were not aware of any government owned projects.

Mr WEIR: Your report states—

The forecast decline of coal and the growth in renewable energy is likely to impact on the government-owned generators' ability to maintain high levels of profitability ...

which the member for Buderim alluded to. Was there any modelling done on that or what the impact to the government would be as those generators close down and we go to such a large percentage of privately owned solar?

Mr Olive: That would probably be more a matter for the Department of Natural Resources, Mines and Energy from an overall state perspective. Obviously, in our audits we look at those coal-fired plants and their remaining useful lives and the revenue cash flows they are expected to generate over that life, and we make an assessment as to whether the values that are carried in the books of the respective energy entities do not exceed the cost to operate.

Mr WEIR: That value, I would imagine, would be declining at a fairly rapid rate.

Mr Worrall: That is the risk. If the future revenue streams start to decline then that is going to impact on asset valuations; you are quite right.

CHAIR: Report No. 4 talked about internal control mechanisms and it is mentioned in this report also. There is nothing we could really identify there, but once again you have identified that perhaps in information technologies there are some control mechanisms that could be improved. How different are those control mechanisms between water and energy? It seems to be consistent. They are two different bodies but there must be some similarities. Are there potential vulnerabilities?

Mr Olive: In the way that we assess information systems controls, we would look at those as the environment changes at the entity and we would also look at those probably at a different level of technology. We would not look at all levels of technology every year. Some of what we are seeing are new issues arising from looking at different aspects of information technology. We are seeing issues being resolved from one year to the next but highlighting slightly different vulnerabilities. Some of the things that we often see are around security and having the right person with the right level of access within a system, having that access removed when the person is no longer with the organisation or performing that role, and also things around passwords. Password complexity is another fairly common theme across information system security deficiencies.

Mr Worrall: Some of those themes were canvassed in the report last year on cybersecurity where it spoke about superuser access and passwords not being sophisticated enough.

CHAIR: That must be common across all government entities and bodies, the constant emphasis on maintaining password integrity and emphasising to all users the need to—

Mr Worrall: The theory now is to not have eight-character passwords that you change every six weeks. The theory is that users will have the same lettering and just add numbers onto it or something like that. Now they are saying go to a minimum 16 characters, I think it is, and have phrases or sayings which are a lot more complex. You still use a combination of letters and numbers and other characters, but you actually have a phrase so it is easier for users to remember but very difficult for it to be cracked. That cybersecurity report highlighted that people are still using passwords quite commonly like 'password' and instead of 'S-S' they use '5-5'. All of those basic passwords are still in use, and we were able to glean that as part of the report across those three entities we looked at. There are still definitely issues with password security. That is why they are saying we should go to longer ones, change them less frequently and make it a phrase that is easy to remember.

CHAIR: In terms of identified risks, we are certainly seeing more robust resistance or capability against incursions from all over the world into these networks. We are building better capacity and better resilience; would that be correct?

Mr Worrall: The cybersecurity report looked at three entities. We did what was called 'red teaming', where we tried to access the crown jewels of information for each of those entities, and that varied. This was in a controlled environment over a short period of time. We did it in such a way that we did not contravene any laws. We behaved within the law. The method we used for each entity was to choose their weakest spot, and in all three of those entities we were able to access the crown jewels. It was in different ways for each entity, but we were able to access them. State actors—organised crime—are actually taking a lot longer. They might spend 12 or 18 months working their way through, and they are not necessarily going to abide by the law either. I guess what we are saying is that there are vulnerabilities there in terms of cybersecurity threats.

Mr BATT: On pages 21 and 22 you have figures 3H and 3I, which show that 80 per cent of the electricity came from coal in 2018-19 and that is expected to drop to 37 per cent in 2039-40 by closing Callide B, Gladstone, Tarong, Kogan Creek and eventually Stanwell. Electricity from solar is expected to grow to 46 per cent in the next 20 years. We can see from both of those charts that we are losing government owned power stations to privatisation of the electricity market in the next 20 years, at least 50 per cent of it through solar.

Mr Worrall: I think the challenge for industry is that the transition is orderly as coal-fired power stations are decommissioned, that there are sufficient other electricity sources to replace them.

Mr BATT: For the night-time as well, I suppose.

Mr Worrall: That is right, and for the night-time as well—or, if it is wind powered, that the wind is not blowing and that sort of thing. I think we are trying to highlight that that is a challenge. As Damon said earlier, I think the other challenge is that the pattern of consumption is changing. There is not as much peak consumption in the day as there is in the night-time. I think the other observation we make in the report is that at the moment we have large pieces of infrastructure in different places around the state, whereas over time we are going to end up with a lot more smaller pieces of infrastructure coming into the network, and that may also pose challenges. The look and feel of the network is definitely going to change, and I guess we are just trying to highlight that there are probably challenges in there for the players around some of that as well.

Mr BATT: And that that generation will come from private enterprise rather than from government in the future.

CHAIR: Where are you going with that question?

Mr Worrall: I guess potentially in terms of those 34 solar farms that we highlight in the report—

Mr BATT: I am not going anywhere with this, Chair. It has already been explained that there are no government owned solar farms. They are all privately owned solar farms. In the next 20 years it is going to be nearly half the market, but it is all going to be privately owned generation coming into it rather than the government owned generation that we currently have, and we have to deal with that.

Mr Olive: I would just comment that some of the government owned corporations may well have what they call power purchase agreements. They may actually contract to purchase some or all of the energy being produced by some of the renewables participants in the market and then they would sort of control the trading rights to the output from those entities. They may not own the infrastructure, but they own the rights to trade the energy that is produced by those.

Mr BATT: Is that current practice, or are you saying it may happen in the future?

Mr Olive: CS Energy already has what is called an IPPA to trade the rights from the Gladstone coal-fired station. There is the R400 project that is being assessed by CleanCo at the moment to determine a suitable project they would potentially take the right to trade the energy from, and at the moment the Solar 150 arrangement at the state level gives the state the ability to trade the rights from four privately owned solar farms.

CHAIR: Member for Bundaberg, we have not explored the role of CleanCo with all of these generators and that is outside the remit of what we are talking about, so be careful with the language you use.

Ms PUGH: In your chapter summary you say that electricity generated from coal is likely to decrease and you talk about renewable energy generation such as solar and wind. One thing we have not talked about much is the role of batteries. A lot of people would probably say that the technology is not quite as far advanced compared to solar. If we are talking down the track, can you shed any light on the role of batteries in the energy market?

Mr Olive: There are probably a number of people better placed to comment on that, other than to say that Energy Queensland does actually have a small-scale battery trial running in Townsville at the moment. I think that battery is in the vicinity of four megawatts perhaps, as opposed to the 100-megawatt battery in Hornsdale, so it is small relatively. Obviously, some of the private proponents are looking at introducing battery technology, but I probably cannot shed too much more light on it.

Chair, can I correct something that I said earlier. I think I suggested under Solar 150 that we had the trading rights for that. That was probably not correctly described. It is more that the state has agreed contractual arrangements to purchase the electricity from those.

Mr Worrall: The other wildcard in relation to batteries might be if battery prices come down and the technology advances, and then people actually store the solar power that is currently being generated on their rooftops—

Ms PUGH: That is exactly right, yes.

Mr Worrall:—that potentially has another impact on grids where there is a high amount of solar going in, because suddenly that power is not going into the grid; it is just being stored at home for that consumption. How many years away that is I do not know, but already I think Tesla markets domestic batteries in this country. I think they are very expensive.

Ms PUGH: They are, yes.

Mr Worrall: I do not think they necessarily store a lot at the moment, but you would assume that over time that is going to change as well.

Ms PUGH: Absolutely, because 10 or 20 years ago when my parents were getting solar installed it was a bit of a luxury item. Now it is much more affordable and I expect that batteries will go the same way with the private market. It will be interesting, when we have solar on people's rooftops and then batteries in their homes, how much will be kept in-house, as it were.

Mr MICKELBERG: My question is with respect to your comments on page 23 around the reliability and sustainability of the network. In the last paragraph you state—

Without adequate investment, the networks may not be able to withstand fluctuations in demand caused by extreme weather conditions.

What are we talking about with respect to 'adequate investment'? What is the investment that you are referring to there?

Mr Olive: I suppose it is about trying to maintain a reliable and secure supply of electricity. Obviously, climatic events can physically damage and interfere with the assets, requiring maintenance or replacement. Like severe weather events in terms of heat, obviously they are key drivers in increasing demand and the reason behind seeing peak demand. I think it is about the third or fourth year in a row that the peak demand on any one day has increased year on year. I guess those are some of the impacts that we are seeing in the network in terms of being able provide electricity.

Mr MICKELBERG: Is the intent of that sentence to capture both of those aspects—the physical and environmental impact associated with a storm or a cyclone and also heat, for example—creating an increase in demand? Was that the intent when you were articulating that sentence?

Mr Worrall: The context of that sentence is really around the changing nature of the network, given that there are renewables coming on, coal powered going off over time, potentially home batteries being commonplace in 10 years time—who knows? It is saying that the nature of the network is going to change, which is going to potentially require different strategies to be able to accommodate significant weather events. If there is no sun for a long period and we are 50 per cent solar dependent, that will have a huge impact. That is really just trying to point out those things.

Mr MICKELBERG: Did your office model any of those scenarios? Did you consider what that quantum would look like?

Mr Worrall: No.

CHAIR: Just for clarification on the extreme weather conditions, that follows on from the sentence before where you talk about changing climate patterns. Is that the context of those extreme weather conditions you have mentioned here?

Mr Worrall: It is also the context of the technology impacting on the electricity network as we know it, as the mix of power sources changes over time. The response to a severe weather event may need to be different to what it is currently.

Mr Olive: To add to that, that sentence says, 'also affects', so it is a continuation of some of the description in the preceding paragraphs, which talk about changes in the network, the nature of more dispersed energy, even the two-way flow on the network of electricity from rooftop solar that is not used in the household being exported back into the network. As there is more rooftop solar, there is a greater capacity or a greater need for more capacity for two-way flow on the network, which really was not designed in its original state for managing a two-way flow. They are all complexities that go into the cost of maintaining the network.

Mr MICKELBERG: Without that additional investment, we can expect issues with respect to reliability in the network; is that a fair comment?

Mr Olive: That is correct.

Ms PUGH: In your report you have commented that Queensland has the lowest wholesale prices. For those of us playing along at home, can you explain what that means for Queenslanders paying their power bills at the end of the day?

Mr Olive: The wholesale price is different in each state, as we comment. The wholesale price is set on a basis of demand—the required energy need and what is generated and provided by the generating entities. They bid their generation into the pool. It is that bidding that, as they increase the bids and the demand grows, actually sets the wholesale price. That is the price that is set for each five minutes; that is not the price that retail customers pay. However, a lower wholesale price over a longer period would influence the price that energy is bought from the market by a retailer and then provided to residential customers.

Mr WEIR: My question is around the unregulated revenue that you mentioned earlier. Your report states 'the Australian Energy Regulator issues a determination that caps the amount of regulated revenue distribution', with the unregulated amount increased by \$25.9 million during the year. Can you explain that cap? Would that not be an opportunity? We say that these entities will start to lose, basically, their base. Would there not be an opportunity for them to cap further into that unregulated market?

Mr Olive: Absolutely. Certainly that would be a strategy that energy entities would be looking to take up and pursue opportunities in the unregulated revenue sector. Bidding for work to connect private solar farms would be an example of an unregulated revenue source for an entity like a Powerlink or an Energy Queensland.

Mr WEIR: Who regulates that?

Mr Worrall: The Australian Energy Regulator.

Mr Olive: Yes, the Australian Energy Regulator dictates prices for the existing transmission for Powerlink and distribution for energy in Queensland, which is Ergon and Energex. More commercial projects like connecting a private solar farm, for example, would be an unregulated revenue source.

Ms PUGH: Turning to page 18 and figure 3F, we have returns to consumers. I think the member for Bundaberg has already touched on those. These provide financial assistance to low-income households, pensioners, seniors and other eligible customers in the form of rebates. There was a large increase from 2016-17 and that also included the solar energy plans. In spite of there being a reasonable return to customers in that space, we are still in a healthy financial position—despite providing significant rebates to a pretty large cross-section of Queenslanders; would that be correct to say?

Mr Olive: That would be a fairly accurate statement, based on the financial results of the entities this year. As we said, profit was down marginally over the last year in transmission and distribution, but certainly there were increases in generation.

Mr BATT: We have spoken about increases in generation. In figure 3A, page 13, you discuss profits trending down for the sector except in generation but that generators are not making money from generation; that is what we are getting as well. They are getting it from coal export sales and gains from contracts. Without that 40-odd per cent, if they did not have that other income stream, would generators be making a profit currently?

Mr Olive: Would they be making a profit? I would suggest that they would probably still be making a profit, but obviously a much skinnier profit than they are carrying at the moment, for sure.

CHAIR: That is also dealt with on page 1, where it says that sector finances are steady.

Ms PUGH: I have a question about the Solar Bonus Scheme, page 18. We introduced the Solar Bonus Scheme in 2008, when solar obviously was a lot more expensive, as an incentive for Queenslanders to install rooftop solar systems. There has been a huge uptake, certainly in South-East Queensland where I live. The scheme pays eligible participants and the cost of the scheme is being funded by the network tariff. In 2017 we removed that cost from network tariffs for the three years ending in 2020 by providing grant funding to Energy Queensland. Can you expand a bit on what that means for the scheme going forward?

Mr Olive: 2020 will be the last year of the Solar Bonus Scheme. Effectively, that will continue to run for another eight years to 2028 in terms of the higher tariff for customers on those original contracts. At the end of 2020 that funding to Energy Queensland, which removes that cost from consumers' bills, if you like, will run out. A decision will need to be made as to whether that funding would continue beyond that period.

Mr BATT: I should mention, now that we have brought that up, a declaration of interest or conflict: I am on that solar scheme. I want that put on the record.

CHAIR: That is good. Are you doing well out of it?

Mr BATT: The same as everybody else.

CHAIR: Is the government looking after you enough, member for Bundaberg? That is good to see. Is anyone else on the Solar Bonus Scheme?

Ms PUGH: I have solar on my rooftop.

CHAIR: Do you get a bonus?

Ms PUGH: Like a feed-in tariff?

CHAIR: Yes.

Ms PUGH: I will double-check with my provider as to how much that is.

CHAIR: No, that should be fine. We have noted a potential there. Are there any more questions before we finish up?

Mr MICKELBERG: My question is with respect to valuations and how you account for the closure of the power station. There are a fair few variables between now and 2028 when it is planned that Callide B will close. Presuming you use a discounted cash-flow model, does that fall off a cliff for Callide B in 2028 because revenues will cease or do you assume, in that model, that they will take different management decisions that will create an additional revenue stream?

CHAIR: It is a long way in the future, but that is mentioned in this report. This is in relation to the financial audit for the last financial year?

Mr MICKELBERG: Correct, yes. How does your valuation methodology take account of the fact that a specific asset is going to close at a given point in time?

Mr Olive: As you said, if the asset is forecast to close, management would continue to review and update its assumptions and decision-making around those things. If all things are held equal and Callide would continue to be forecast for closing in that period of time, which is what CS Energy has advised AEMO, obviously that would not generate cash flows beyond the 2027-28 financial year. Obviously the remaining generation portfolio for CS Energy would continue to derive cash flows. As we approach that period we would need to consider what adjustments would need to be made to the valuation of the asset in the books of CS Energy because the forecast revenues might result in that asset value being written down to a lower amount.

Mr MICKELBERG: Can you clarify your last statement? As we approach the closure point, the forecast revenues might determine that you need to—I just did not understand what your point was there.

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Mr Olive: The way in which a discount cash flow model works is you would use that to assess whether your current value that you have recorded in your books for the asset is supported by that model. If the period of cash flows gets shorter, that would result in your value being reduced.

Mr MICKELBERG: Understood. If it was to get longer, similarly, it would result in your valuation increasing?

Mr Olive: Potentially, yes.

Mr Worrall: As I said earlier, they would need to reassess the useful life on an annual basis and reassess the valuation on an annual basis. Our expectation would be that that model is being updated on an annual basis as they become more informed. You would expect at some point in time that the final cash flow from Callide B is actually the scrap value of the plant once the revenue stream is finished.

CHAIR: The time for questions has now expired.

Mr Olive: Can I just clarify something? Because they carry the assets at cost, it would not actually be written up, but while their discounted cash flow model is higher it continues to support the value of the asset in the books of the generators.

CHAIR: The time allocated for the session has now expired. We do not have any questions on notice. That concludes this briefing. On behalf of the committee I would like to thank the Auditor-General and officers from the Queensland Audit Office for their attendance today. A transcript of these proceedings will be on the committee's parliamentary web page in due course. Thank you to the secretariat and Hansard. I declare this public briefing closed.

The committee adjourned at 11.17 am.