

Results of audit: Water sector entities 2012–13

Report to Parliament 7 : 2013–14



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November 2013

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

Dear Madam Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled
Results of audit: Water sector entities 2012–13.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Andrew Greaves', is written over a light grey rectangular background.

Andrew Greaves
Auditor-General

Contents

Summary	1
Recommendation	3
Reference to comments	3
1. Report context	5
1.1 South-east Queensland	5
1.2 Outside south-east Queensland	9
1.3 Role of the Queensland Competition Authority	12
1.4 Regulatory framework	14
1.5 Audit responsibilities	15
1.6 Report structure	16
2. Results of audits	17
2.1 Background	18
2.2 Summary of results	18
2.3 Timeliness and quality of draft financial statements	19
3. Financial performance, position and sustainability	23
3.1 Background	24
3.2 Conclusions	24
3.3 Financial performance and position	25
3.4 Financial sustainability	29
3.5 Recommendation	33
Appendices	35
Appendix A—Comments	37
Appendix B—Financial sustainability measures	39
Appendix C—Controlled entities for which audit opinions will not be issued	40
Appendix D—Controlled and dissolved water entities’ audit results	41
Appendix E—Bulk water price path	43

Summary

In Queensland, water is used primarily by households, agriculture and industry.

In south-east Queensland, the Queensland Bulk Water Supply Authority (trading as Seqwater) sells raw and manufactured treated drinking and recycled bulk water. Its major customers are the Central SEQ Distributor-Retailer Authority, trading as Queensland Urban Utilities (QUU); the Northern SEQ Distributor-Retailer Authority, trading as Unitywater; and three local governments – Gold Coast, Logan and Redland City Councils. It is these entities that provide the infrastructure to distribute water to their customers.

Outside south-east Queensland, the makeup of the water supply chain is somewhat different. Ownership of public sector surface water storage infrastructure (i.e. dams) is shared between SunWater Limited (SunWater), local government councils and other entities. It is only SunWater and Water Boards that operate as stand alone water suppliers owned by the state.

Figure A
Stand alone public sector water entities that operate in Queensland

Entity	Purpose
South-east Queensland (SEQ)	
Seqwater	Sells bulk water within SEQ
QUU Unitywater	Source bulk water from Seqwater and sells it on through their water distribution infrastructure
Outside SEQ	
SunWater	Owns and operates the infrastructure which stores and supplies water to irrigators, industrial customers and local government councils
Gladstone Area Water Board (GAWB)	Sources and sells water to the Gladstone Regional Council, industry and other customers in and around the greater Gladstone region
Mount Isa Water Board (MIWB)	Sources and sells water to the Mount Isa City Council and two private sector entities
Category two water boards	Smaller water boards that source and sell water primarily to irrigators in designated areas throughout the state; as at 30 June 2013, there were 35 category two water boards

Source: QAO

The financial statements for all public sector entities are required to be audited each year and an independent audit opinion expressed thereon. The audit opinion adds credibility to the financial information presented. An unqualified audit opinion means that a reader can rely on the correctness of information within the financial statements. The results of these financial audits are required to be reported to the Parliament annually.

This report contains the results from our financial audits of the six state and local government owned entities whose primary business activity is to supply water. It also summarises the factors impacting on their financial performance, position and sustainability. The results from our financial audits of category two water boards and local government councils are outside the scope of this report.

Results of audits

Unmodified audit opinions were issued this year for all six stand alone water entities.

The factors last year that led to emphasis of matter paragraphs being included in the audit opinions for Seqwater, QUU and Unitywater no longer existed in 2012–13. The reasons for this are explained below:

- an emphasis of matter paragraph was included with the audit opinion of Seqwater last year to draw the readers' attention to the restructure of the south-east Queensland bulk water entities and uncertainty regarding the future regulatory price that Seqwater could charge for its bulk water
- emphasis of matter paragraphs were included with the audit opinions of QUU and Unitywater last year because of the uncertainty regarding the future price that could be charged for retail water and sewerage.

The financial statements of all six entities were timely and of good quality. MIWB was however unable to finalise its audit by the legislated deadline because additional time was needed to finalise the valuation of its assets.

Financial performance, position and sustainability

When forming an audit opinion on the financial statements of an entity, an assessment is undertaken over its ability to continue to operate as a going concern. In this regard, an assessment is made of its financial performance and position; including its ability to pay its ongoing expenses, replace and grow its assets, and pay its debts as and when they fall due. Taken together, these factors are key indicators of an entity's financial sustainability.

Five of the six water entities achieved operating profits in 2012–13, with Seqwater the exception. The financial position of QUU and Unitywater has been stronger than that of the other four entities since commencement of their operations three years ago. All six entities are replacing and/or growing their infrastructure asset base faster than these assets are being depreciated. All six entities are able to pay their ongoing operational expenses and loans as and when they fall due.

Overall these entities are financially sustainable, but for Seqwater, its future sustainability is predicated on achieving the indicative prices in the ministerial approved price path. Figure B summarises the factors impacting on Seqwater's financial performance, position and sustainability.

Figure B
Financial performance, position and sustainability of Seqwater

Factors impacting on financial performance, position and sustainability	
Financial performance (operating result)	Its operating results continue to be adversely affected because the price it can charge for supplying bulk water is less than the cost of production. Its performance is also affected by interest payments on its loans and depreciation expenses on its bulk water supply assets.
Financial position (net assets)	Its financial position is adversely affected by debt relating to the construction of the state's manufactured water assets. Further debts of \$1.8 billion were inherited from the SEQ Water Grid Manager; the result of bulk water prices being less than the cost of supplying bulk water in the past.
Financial sustainability	Based on the indicative prices approved to date, the price for bulk water is expected to increase by between 22.5 and 118.6 per cent over the next five years, depending on an end user's location in south-east Queensland.

Source: QAO

A framework which requires entities in the water sector to assess their financial performance, position and sustainability against short, medium and long term targets does not presently exist. Entities currently have their own financial performance and position measurement frameworks which they use and report to their own boards and executive management. The indicators used by these entities differ.

The Department of Energy and Water Supply (DEWS) is currently developing a performance reporting framework for which entities will be requested to report against. To date, entities have been consulted on the suite of indicators against which that they will be requested to report.

Recommendation

- 1. It is recommended that the Department of Energy and Water Supply's (DEWS) performance reporting framework include the measures of financial sustainability used in this report for Seqwater, SunWater, QUU, Unitywater, GAWB and MIWB. It is further recommended that DEWS encourage these six entities to self-report against these measures of financial sustainability whilst the performance reporting framework is being developed.**

Reference to comments

In accordance with section 64 of the *Auditor-General Act 2009*, a copy of this report was provided to the Premier; the Treasurer and Minister for Trade; the Minister for Energy and Water Supply; Queensland Competition Authority; Gold Coast City Council; Logan City Council; and Redland City Council.

This report was provided to the Director-General—Department of Energy and Water Supply; Director General—Department of the Premier and Cabinet; the Under Treasurer; and the heads of Seqwater, SunWater, QUU, Unitywater, GAWB and MIWB with the option of providing a response.

The agencies' views have been considered and are represented to the extent relevant and warranted in preparing this report.

The full comments received are included in Appendix A of this report.

1 Report context

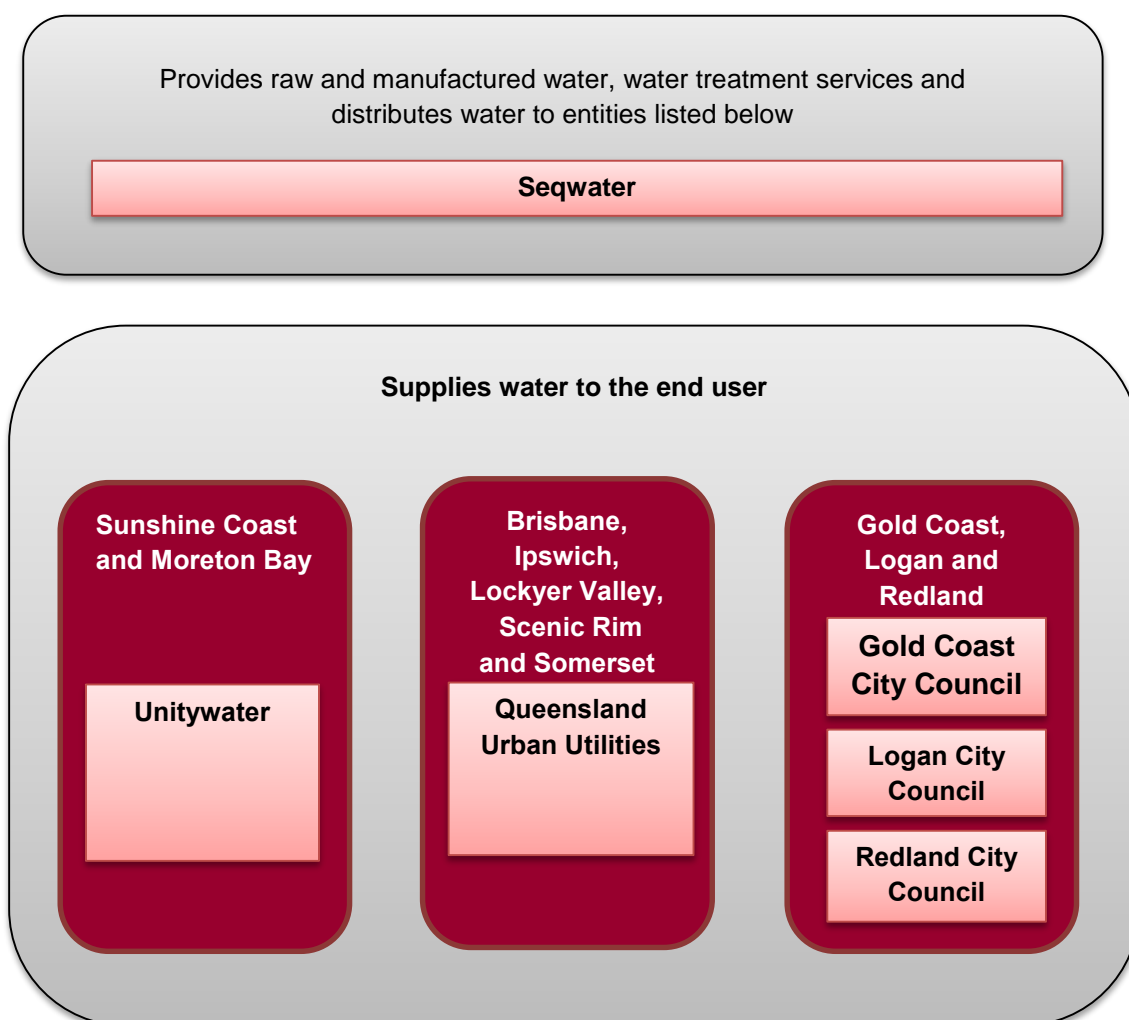
In Queensland, water is used primarily by households, agriculture and in the mining, electricity generation, tourism and manufacturing industries.

Direction and oversight of the water sector in Queensland is primarily provided through the Department of Energy and Water Supply (DEWS). A number of other government departments also have a strategic role in managing the supply of water throughout the state.

1.1 South-east Queensland

Within south-east Queensland, the Queensland Bulk Water Supply Authority (trading as Seqwater) sells and distributes bulk water to entities as described in Figure 1A using rules established under the Bulk Water Supply Code and Bulk Water Supply Agreements. Seqwater also owns the infrastructure assets to manufacture, store, distribute and treat the water that it sells.

Figure 1A
Water supply chain in south-east Queensland



Source: QAO

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

QUU and Unitywater are known as distributor-retailers for the purposes of the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009*. To a lesser extent, Seqwater also supplies water directly to Stanwell Corporation Limited (Stanwell), Toowoomba Regional Council and irrigators; but water sales to these entities accounted for less than five per cent of its revenue from bulk water sales during 2012–13.

Figure 1B summarises the major restructures to the water sector entities in south-east Queensland since 1 July 2010.

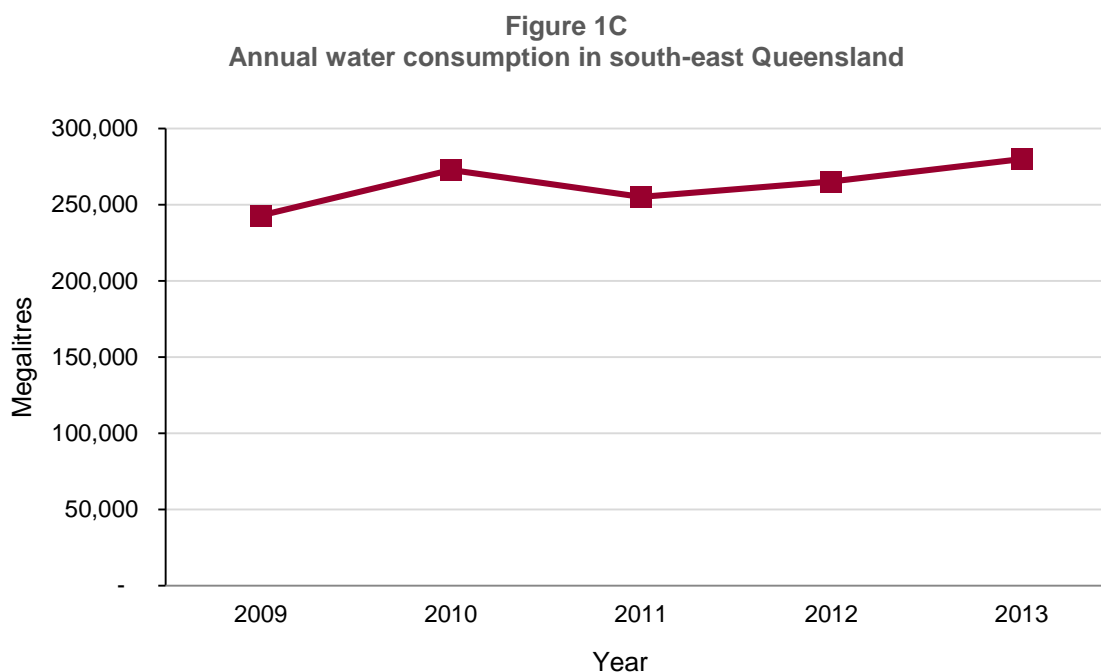
Figure 1B
Major restructures to south-east Queensland water entities

Date	Description	Enabling legislation
1 July 2010	QUU, Unitywater and the Southern SEQ Distributor-Retailer Authority (trading as AllConnex) were established to manage the water distribution and sewerage treatment responsibilities of 10 local government councils.	<i>South-East Queensland Water (Distribution and Retail Restructuring) Act 2009</i>
1 July 2011	WaterSecure, the legal owner of manufactured water assets, was amalgamated with Seqwater.	South East Queensland Water (Restructuring) Regulation 2011 made under the <i>South-East Queensland Water (Restructuring) Act 2007</i>
1 July 2012	AllConnex disbands transferring functions back to Gold Coast, Logan and Redland city councils.	<i>South-East Queensland Water (Distribution and Retail Restructure) Act 2009</i>
1 January 2013	Transfer of operations from Linkwater and SEQ Water Grid Manager into Seqwater.	South-East Queensland Water (Restructuring) and Other Legislation Amendment Regulation (No.1) 2012
1 January 2013	Queensland Water Commission disbands and transfers functions to DEWS, Department of Natural Resources and Mines, and Seqwater.	<i>South-East Queensland Water (Restructuring) and Other Legislation Amendment Act 2012</i>

Source: QAO

1.1.1 Water consumption

Annual water consumption in south-east Queensland, as measured by water supplied from Seqwater owned infrastructure, has remained comparatively stable over the past five years. Over this period, water consumption has ranged from around 243 000 megalitres in 2008–09 to 280 000 megalitres in 2012–13. There has however been a small upward trend over the last three years as illustrated by Figure 1C.



Source: Seqwater and QAO

The completion of the Gold Coast desalination plant at a cost of \$1.2 billion and three new advanced water recycling facilities at a cost of \$2.6 billion added the potential to supply over 130 000 megalitres of additional water to the south-east Queensland water grid each year if operated at full capacity.

1.1.2 Price of water in south-east Queensland

A water consumer's bill is typically made up of the following components as shown in Figure 1D.

Figure 1D
Components of a water bill

Component	Description
Bulk water charges	This is based on water usage and is what Seqwater charges QUU, Unitywater and local government councils. This is based on a price path recommended by DEWS and approved by the government.
Access charges	This is a fixed charge and is what QUU, Unitywater and local government councils charge customers for access to the distribution network that delivers water to end users.
Usage charges	This is based on water usage and is what QUU, Unitywater and local government councils charge customers for actual usage of water.

Note: Sewerage access charges also form part of a typical water bill, but are outside the scope of this report.

Source: QAO

The final price of water charged to an end user depends on a number of factors. Along with bulk water charges which are passed through to the end user; QUU, Unitywater and local governments (Gold Coast, Logan and Redland City Councils) typically add a fixed access charge and variable usage charge to an end user's water bill.

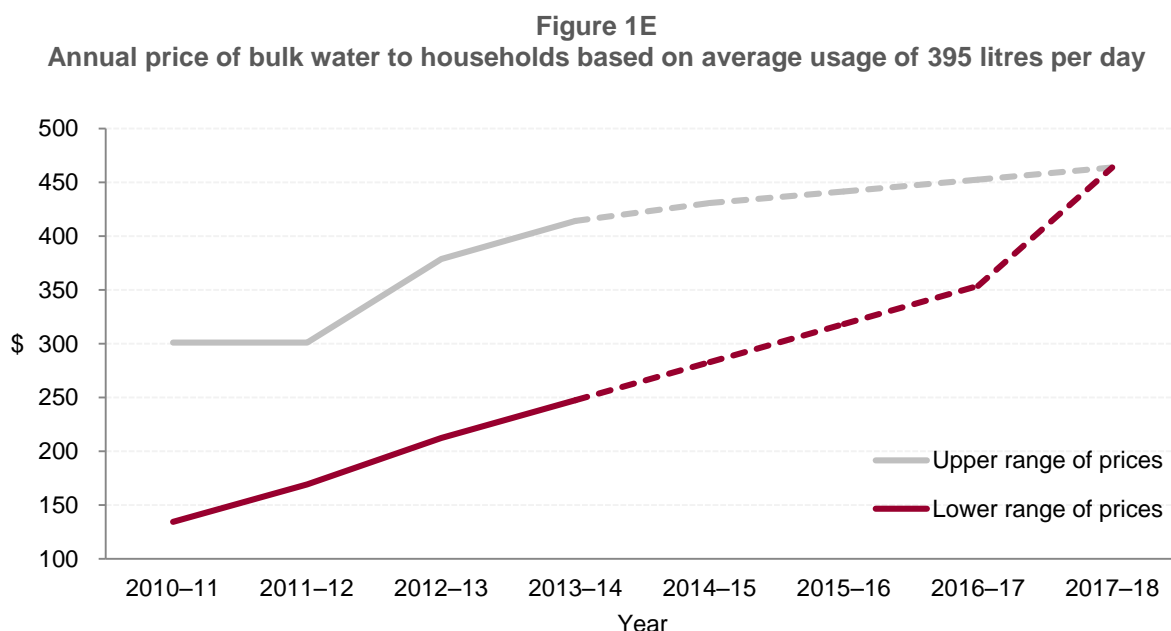
Access and usage charges generally depend on a user's location and whether they are a household or other customer. Usage charges typically increase once a user reaches a certain threshold of usage over a certain period. Depending on the customer's location, the increase in usage charges can be quite significant. Such pricing policies have the objective of discouraging excess water usage.

Water is also purchased directly from Seqwater by irrigators and by Stanwell to supply its power stations. In 2012–13, irrigators paid an average of \$27.90 per megalitre under a price path approved by the government. Stanwell paid an average of \$207.92 per megalitre under pricing arrangements determined with Seqwater.

Bulk water prices

Bulk water charges comprise around 32 to 51 per cent of a typical household's annual water bill, based on an average usage of 395 litres per day. The amount charged depends on where a user is located, but within this location it is the same for residential, commercial and industrial customers. The bulk water component of a user's water bill may be up to 78.5 per cent higher than someone else in another local government council in south-east Queensland in 2012–13.

The indicative price for bulk water has been set at \$3 217 per megalitre by 2017–18, with the aim of achieving a single price for bulk water in south-east Queensland. Figure 1E shows actual and forecasted upper and lower range of bulk water prices that a residential household in SEQ will pay in a year. This is based on an average usage of 395 litres per day. Assuming that indicative prices do not change, the bulk water component of a user's water bill will increase by between 22.5 and 118.6 per cent over the next five years depending on where the user is located. Appendix E provides a detailed breakdown of bulk water prices by local government council area.



Source: QAO

The past and prospective increases to bulk water charges are part of a planned approach to phase in bulk water price rises so the costs of infrastructure, including those costs associated with the recent large scale investments in the south-east Queensland bulk water supply system are recovered. Investments in the south-east Queensland water supply system include the construction of the Gold Coast desalination plant and three advanced water recycling plants.

The phasing in of bulk water price rises has meant that up to now, the price charged for bulk water has been significantly less than the cost of supplying it. This has contributed to debts of \$1.8 billion accumulating in the financial statements of the former SEQ Water Grid Manager, which were then transferred to Seqwater on 1 January 2013.

1.2 Outside south-east Queensland

Outside south-east Queensland, the makeup of the water supply chain is somewhat different with ownership of public sector surface water storage infrastructure, irrigation channels, and major pipelines to distribution points shared between SunWater, local government councils, water boards and other entities. Figure 1F summarises the makeup of the water supply chain.

Figure 1F
Water supply chain outside of south-east Queensland: major entities with bulk water assets

Entity	Dams and / or large weirs	Other assets
SunWater	19	Distribution
GAWB	1	Distribution and treatment
MIWB	0	Distribution and treatment
DEWS	19	Distribution
Dumaresq–Barwon Border Rivers Commission	1	—
Local governments		
Cairns Regional Council	1	Distribution, treatment and reticulation
Fraser Coast Regional Council (Wide Bay Water)	5	Distribution, treatment and reticulation
Townsville City Council	2	Distribution, treatment and reticulation
Rockhampton Regional Council	3	Distribution, treatment and reticulation
Toowoomba Regional Council	3	Distribution, treatment and reticulation
Tablelands Regional Council	2	Distribution, treatment and reticulation

Source: QAO and Commission of Audit, 2013

SunWater provides much of the bulk water infrastructure which supplies water to irrigators and industrial customers. SunWater does not own all the rights to sell water contained in its dams and other infrastructure. Instead, other public and private sector entities purchase and sell water allocation entitlements between each other. This effectively means that the risk of drought and other water shortages is retained by the holder of the water allocation entitlement.

In comparison to south-east Queensland, drinking water provided to urban customers is primarily sourced and treated from local government owned infrastructure. There are currently two types of water boards which provide a combination of bulk water, distribution and treatment services to water users in Queensland. Category one water boards—the Gladstone Area Water Board (GAWB) and Mount Isa Water Board (MIWB)—are larger ‘for profit’ statutory bodies. Category two water boards are smaller not for profit statutory bodies.

Bulk water is stored mainly in dams and weirs. A weir is a smaller version of a dam. Distribution assets are those assets which distribute water to major distribution points. Treatment assets make the water drinkable and useable for households. Reticulation assets are used for distributing water to end users.

Apart from the entities shown in Figure 1F, 62 other local government councils outside south-east Queensland provide a combination of water distribution, treatment and reticulation services to their ratepayers. Another 35 category two water boards provide reticulation and related services mainly for irrigation purposes. Private sector companies also own bulk water storage, distribution, treatment and reticulation infrastructure.

1.2.1 Local management arrangements and changes to SunWater

The Commission of Audit’s final report made four recommendations in relation to regional bulk water. All four recommendations were accepted by the government in its response to the Commission of Audit’s final report which was made publicly available on 30 April 2013. The first two recommendations affect the current operations of SunWater with the last two recommendations affecting the future operations of SunWater.

The first recommendation involved moving SunWater’s eight irrigation channel schemes to local management arrangements. This will lead to the transfer of water distribution assets (with a historical cost of \$930 million) and the operational responsibilities for those assets to privately owned companies and/or cooperatives. An interim board has been established for each of the eight irrigation channel schemes. These interim boards will initially undertake the due diligence over their respective schemes and describe how the schemes could be managed by irrigator owned entities in a business proposal. At this stage, the government is expected to make a final decision on proceeding with local management arrangements by the middle of 2014.

These eight irrigation channels supply water to around 30 per cent of the 500 000 hectares of irrigated land in Queensland. These schemes range in size from approximately 45 000 hectares around the Burdekin Haughton water supply scheme to approximately 3 000 hectares in and around Theodore. These schemes consist of water distribution assets such as channels, pipes and pump stations. They do not include bulk water supply assets such as major dams.

The second recommendation was to offer SunWater’s dedicated water supply infrastructure servicing commercial and industrial clients for private ownership and/or private operation, depending on the solution which provides the best value for money outcome for the government.

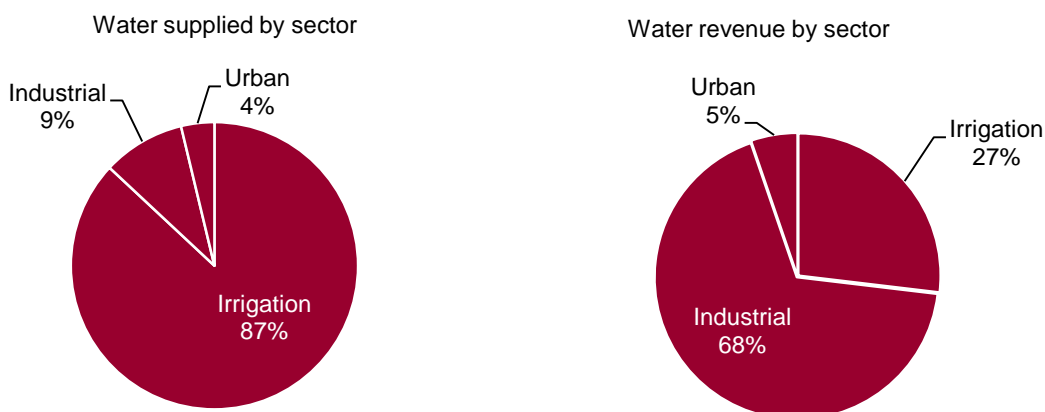
Since the government’s acceptance of the Commission of Audit recommendation, SunWater has commenced work to restructure its organisation in preparation for expected changes. Queensland Treasury and Trade has also established a project team to scope the work necessary to implement this Commission of Audit recommendation.

The third recommendation accepted by the government recommends that SunWater remain as a government-owned corporation with a residual function to retain ownership and management of existing bulk water assets in regional Queensland. The final recommendation accepted by the government recommends that future bulk water storage facilities be developed by the private sector, unless there are compelling public good or market failure reasons not to do so.

1.2.2 Price and consumption of water outside south-east Queensland

Outside south-east Queensland, SunWater owns and manages bulk water infrastructure which supplies water to urban, irrigation and industrial customers. In 2012–13, irrigators consumed around 87 per cent of water and contributed 27 per cent of SunWater's revenue from water charges. Industrial customers (such as mining companies) consumed around nine per cent of water and contributed 68 per cent of SunWater's revenue from water charges as can be seen in Figure 1G.

Figure 1G
Water supply and revenue from water charges



Source: SunWater

Irrigation customers

Prices charged to irrigators by SunWater are regulated by a five-year price path. The current price path commenced on 1 July 2012 and ends on 30 June 2017. Prices depend on factors which include the water supply scheme that an irrigator is part of. In 2012–13, SunWater received almost \$9 million in community service obligation (CSO) payments from the state in recognition of the current rural water pricing policies which determine how much irrigators are charged.

Urban customers

SunWater's revenue from water charges to urban customers are typically households and other businesses that purchase their water from local government councils. Each council agrees their prices with SunWater individually.

Local government councils also source much of their water from infrastructure not owned by SunWater (such as council-owned dams). This is a key reason why water deliveries to urban customers represent only five per cent of SunWater's revenue from water charges in 2012–13.

Industrial customers

In 2012–13, industrial customers contributed 68 per cent of SunWater's revenue from water sales. Industrial customers are not subject to a price path. SunWater's industrial customers are mainly mining companies that operate throughout regional areas of the state. Each customer agrees its prices with SunWater individually.

1.3 Role of the Queensland Competition Authority

The Queensland Competition Authority (QCA) has in the past, been directed to recommend prices paid by irrigators to Seqwater and SunWater. The QCA has also previously reviewed the pricing practices of the GAWB. Within south-east Queensland, it is currently undertaking a price monitoring review over retail water prices charged to end users. It is also developing a long term regulatory framework for retail water prices in south-east Queensland.

Figure 1H summarises the more recent reviews that the QCA has been directed to undertake by the Treasurer and Minister for Trade (Treasurer), and the Attorney-General and Minister for Justice (Attorney-General).

Figure 1H
Reviews by the QCA

Entities	Description of review	Date final report due or provided
SunWater	<ul style="list-style-type: none"> Recommend bulk water irrigation prices to apply to SunWater water supply schemes from 1 July 2012 to 30 June 2017. The government has since accepted all the QCA's recommendations. 	30 April 2012
Seqwater	<ul style="list-style-type: none"> Recommend bulk water irrigation prices to selected Seqwater water supply schemes from 1 July 2013 to 30 June 2017. The government has since accepted all the QCA's recommendations subject to selected recommendations being referred to the Minister of Natural Resources and Mines for further detailed consideration concerning implementation. 	30 April 2013
QUU Unitywater	<ul style="list-style-type: none"> Price monitoring review over expected water charges to end users in south-east Queensland for 2013–14 and 2014–15. 	31 March 2014
Gold Coast, Logan and Redland City Councils	<ul style="list-style-type: none"> Investigate and develop a long term regulatory framework (and pricing principles) for monopoly distribution, retail water and sewerage activities to apply from 1 July 2015. 	30 September 2014
GAWB	<ul style="list-style-type: none"> Recommend pricing principles to apply from 1 July 2010 to 30 June 2015. The government has since accepted all the QCA's recommendations. 	30 June 2010

Source: QCA

1.3.1 SunWater

The QCA finalised its report recommending irrigation prices and tariff structures to apply across 22 water supply schemes and eight distribution service systems from 1 July 2012 to 30 June 2017. These recommendations were accepted by the Treasurer and the Attorney-General on 30 June 2012. The price path as recommended by the QCA applies from 1 July 2012 to 30 June 2017.

Irrigation prices for a water supply scheme include the costs of water storage, associated infrastructure and services necessary to supply water to end users. The eight distribution service systems relate to the infrastructure that the government is proposing to move to local management arrangements. Each distribution service system includes a network of subsystems, pump stations and related infrastructure that supply water to properties for irrigation purposes across eight different geographical areas.

1.3.2 Seqwater

The QCA finalised its report recommending irrigation prices to apply across seven water supply schemes in south-east Queensland from 1 July 2013 to 30 June 2017. At the date of this report, the Treasurer and the Attorney-General have since accepted all the QCA's recommendations, subject to selected recommendations being referred to the Minister of Natural Resources and Mines for further detailed consideration concerning implementation.

Irrigation prices, for selected irrigation water supply schemes between 1 July 2006 and 30 June 2011 were approved by the government on the basis of SunWater's recommendations, prior to the transfer of these schemes to Seqwater on 1 July 2008.

In accordance with a Directive from the Responsible Ministers (Minister for Energy and Water Supply, and Treasurer and Minister for Trade), 2010–11 prices under the price path were extended to 2011–12 and 2012–13 after applying the Consumer Price Index for all seven water supply schemes in south-east Queensland.

1.3.3 QUU, Unitywater and local government councils

The majority of the QCA's work on the water sector in south-east Queensland is currently focused on the retail water and wastewater activities of QUU, Unitywater, Gold Coast City Council, Logan City Council and Redland City Council.

The QCA is currently undertaking a price monitoring review over water charges to end users in south-east Queensland for 2013–14 and 2014–15. A final report is expected on 31 March 2014. Part of this price monitoring review will involve comparing water and sewerage revenues earned by these entities against a maximum allowable revenue (MAR) model. MAR is a mathematical formula that sets the maximum allowable revenue that an entity should earn based on its expenses.

The QCA is also working on a long term regulatory framework and pricing principles for the five entities. A final report is due on 30 September 2014 with the regulatory framework to apply from 1 July 2015.

1.3.4 GAWB

The bulk water storage, delivery and treatment services undertaken by GAWB have been declared to be government monopoly business activities. Since 2000, the QCA has undertaken reviews and made recommendation affecting the prices that can be charged by the GAWB. The final report from the most recent review was issued on 30 June 2010. This report made recommendations that will affect the pricing principles of the GAWB from 1 July 2010 to 30 June 2015.

1.4 Regulatory framework

1.4.1 *Water Act 2000 (Water Act) requirements*

The Water Act and subordinate legislation outline the requirements for water security, management of water supply and management of demand. The Water Act is supported by the Water Regulation 2000 and water resource plans. Water resource plans allocate and regulate water entitlements in defined areas. These plans typically also include rules aimed at meeting objectives around the availability of water, sustainability of the water source, future requirements and reversing degradation.

In south-east Queensland, a Bulk Water Supply Code came into effect on 1 January 2013. The Bulk Water Supply Code replaces the previous market rules around the sharing of water allocations between entities in south-east Queensland.

There is also other legislation impacting on the water sector in Queensland. These include the *Water Supply (Safety and Reliability) Act 2008*, the *Environmental Protection Act 1994* and the *Sustainable Planning Act 2009*.

1.4.2 *Statutory bodies*

Seqwater, QUU, Unitywater and water boards are statutory bodies for the purposes of the *Financial Accountability Act 2009* (FAA). Unless exempt, these entities must comply with the requirements of the FAA, the Financial Accountability Regulation 2009 and the Financial and Performance and Management Standard 2009 (FPMS). They must have regard to the Financial Accountability Handbook and other requirements issued by Queensland Treasury and Trade such as the Non-Current Asset Policies for the Queensland Public Sector.

Section 45(3) of the FPMS requires that entities must have their financial statements prepared and audited no later than 31 August each year. Entities can seek an exemption from this deadline but are required to seek the approval of the Treasurer.

QUU and Unitywater are exempt from the resource management provisions of the *Financial Accountability Act 2009* as per section 15(2) of the *South-East Queensland (Distribution and Retail Restructuring) Act 2009*.

1.4.3 *Government owned corporations*

SunWater is a public company and government owned corporation. SunWater is required to comply with the requirements of both the *Government Owned Corporations Act 1993* (GOC Act) and the *Corporations Act 2001*.

The GOC Act sets out specific governance and other requirements such as the payment of dividends and the production of a Statement of Corporate Intent. SunWater's financial statements are required to be prepared in accordance with the *Corporations Act 2001* and subordinate legislation each year.

Under s.45(3) of the Government Owned Corporation Regulation 2004, SunWater is required to have the audit of its financial statements finalised by 31 August, unless a Ministerial exemption has been obtained.

1.5 Audit responsibilities

Section 40 of the *Auditor-General Act 2009* requires the Auditor-General to audit the annual financial statements of all public sector entities and prepare an auditor's report about the financial statements.

The auditor's report, which includes the audit opinion, provides assurance about the reliability of the financial reports, including compliance with legislative requirements with regards to the establishment and keeping of accounts. In accordance with Australian Auditing Standards, one or more of the following audit opinion types as outlined in Figure 11 is issued.

Figure 11
Audit opinions

Opinion	Description
Unmodified	An unmodified opinion is issued where the financial statements comply with relevant accounting standards and prescribed requirements.
Qualified	A qualified opinion is issued when the financial statements as a whole comply with relevant accounting standards and legislative requirements, with the exceptions noted in the opinion.
Adverse	An adverse opinion is issued when the financial statements as a whole do not comply with relevant accounting standards and legislative requirements.
Disclaimer	A disclaimer of opinion is issued when the auditor is unable to express an opinion as to whether the financial statements comply with relevant accounting standards and legislative requirements.

Source: QAO

An emphasis of matter paragraph may be included with the audit opinion to highlight an issue which the auditor believes the users of the financial statements need to be aware of. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.

The *Auditor-General Act 2009* outlines requirements relating to the return of the financial statements and auditor's report at the conclusion of each audit. Issues identified during the audit along with recommendations for improvement are reported to those charged with governance.

Figure 1J sets out the requirements for the return of the certified financial statements and auditor's report. It also sets out requirements for reporting audit findings.

Figure 1J
Financial statements, auditor's report and report on audit findings

Entity type	Return of certified financial statements and auditor's report	Recipient of the report on audit findings
Department	<ul style="list-style-type: none"> • Accountable officer • Minister • Treasurer 	<ul style="list-style-type: none"> • Accountable officer
Statutory body	<ul style="list-style-type: none"> • Chief Executive Officer • Chairperson • Minister 	<ul style="list-style-type: none"> • Chief Executive Officer • Chairperson • Person responsible for financial administration
Government owned corporation	<ul style="list-style-type: none"> • Chief Executive Officer • Chairperson • Minister • Treasurer 	<ul style="list-style-type: none"> • Chief Executive Officer • Chairperson • Person responsible for financial administration

Source: Auditor-General Act 2009

The *Auditor-General Act 2009* also requires that the Auditor-General report to Parliament on each financial audit conducted. The report must state whether the audit has been completed and the financial statements audited. It must also include details of significant deficiencies where financial management functions were not performed properly along with any actions taken to improve deficiencies reported in previous reports.

1.6 Report structure

This report focuses on issues specific to six stand alone water entities, being Seqwater, SunWater, QUU, Unitywater, GAWB and MIWB. The results of audits of DEWS, category two water authorities and local government councils are discussed in other reports to Parliament.

The report is structured as follows:

- Chapter 2 discusses results of the audits for six entities including the timeliness and quality of draft financial statements provided.
- Chapter 3 contains an analysis of the financial performance and position of the six entities, trends and issues impacting on financial sustainability and how well positioned these entities are to meet their future financial obligations.
- Appendix A contains responses received.
- Appendix B provides explanations of financial sustainability measures.
- Appendix C details the controlled entities for which audit opinions will not be issued in 2012–13.
- Appendix D summarises the results of audits for controlled and dissolved water entities.
- Appendix E provides an outline of bulk water prices and indicative prices that will be charged to ratepayers and customers of QUU, Unitywater, Gold Coast City Council, Logan City Council and Redland City Council.

2 Results of audits

In brief

Background

The audited financial statements for statutory bodies and government owned corporations must be included in their annual reports. During our audit of financial statements we identify significant financial reporting and other audit issues. The usefulness of financial statements depends on the quality of the information contained in them and the time it takes to produce them.

Conclusions

The financial statements of Queensland Bulk Water Supply Authority (trading as Seqwater); SunWater Limited (SunWater); Central SEQ Distributor-Retailer Authority, trading as Queensland Urban Utilities (QUU); Northern SEQ Distributor-Retailer Authority, trading as Unitywater; and Gladstone Area Water Board (GAWB) were timely and of good quality. The Mount Isa Water Board's (MIWB) financial statements were of a sound quality; however, the audit could not be completed within the legislative deadline.

The low number of management and audit identified adjustments and disclosure changes between the first and final audited version of the financial statements reflects good financial reporting processes.

Key findings

- Unqualified audit opinions were issued for the six entities. Emphasis of matter paragraphs included with last year's audit opinions have been removed.
- The audit of the financial statements for five of the six entities was completed by the legislative deadline of 31 August 2013. MIWB did not complete its audit by the statutory deadline as additional time was required to finalise the valuation of its assets for the purposes of its financial statements.
- The financial statements provided for audit were of good quality. This is reflected in the small number of material account balance adjustments. The number of disclosure enhancements and errors identified differed significantly between entities. This was mainly because some entities wanted to improve the quality of their financial statements and not because of poor financial reporting practices.
- There were \$521 million in account balance adjustments to Seqwater's draft 2012–13 financial statements. These adjustments relate to the timing by which cash flows were discounted and the calculation of future cash flows.

2.1 Background

This chapter reports on the results of our audit of:

- Queensland Bulk Water Supply Authority, trading as Seqwater
- Central SEQ Distributor-Retailer Authority, trading as Queensland Urban Utilities (QUU)
- Gladstone Area Water Board (GAWB)
- Mount Isa Water Board (MIWB)
- Northern SEQ Distributor-Retailer Authority, trading as Unitywater
- SunWater Limited (SunWater).

These entities have 30 June balance dates.

Both Seqwater and SunWater have non-trading and/or non-reporting subsidiaries where an audit opinion was not required to be issued. A listing of these entities has been included in Appendix C.

There were four entities that amalgamated their assets, liabilities and functions into Seqwater on 1 January 2013. The results of our audit of these entities and of the Australian Water Recycling Centre of Excellence Ltd are included in Appendix D.

2.2 Summary of results

Figure 2A
2012–13 audit opinions issued

Audit	Included in State Govt financial statements	Financial statements signed	Opinion issued	Certified by deadline	Opinion
<i>Government owned corporation</i>					
SunWater	✓	28.08.2013	30.08.2013	✓	Unmodified
<i>Statutory bodies</i>					
Seqwater	✓	27.08.2013	30.08.2013	✓	Unmodified
GAWB	✓	29.08.2013	30.08.2013	✓	Unmodified
MIWB	✓	04.09.2013	05.09.2013	✘	Unmodified
QUU	✘	26.08.2013	28.08.2013	✓	Unmodified
Unitywater	✘	26.08.2013	30.08.2013	✓	Unmodified

Source: QAO

2.2.1 Audit opinions

Unmodified audit opinions were issued on all six entities' financial statements. An unmodified audit opinion is issued when the financial statements comply with relevant accounting standards and legislative requirements relating to the establishment and keeping of accounts. Audit opinions are issued to provide readers with assurance that the financial statements are reliable and present a true and fair view.

2.2.2 Emphasis of matter removal

An emphasis of matter paragraph may be included with the audit opinion to highlight an issue which the auditor believes the users of the financial statements need to be aware of. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.

Seqwater

The emphasis of matter paragraph included with last year's audit opinion was removed in 2012–13. Future bulk water prices have a significant impact on the fair value of property, plant and equipment (PPE), and intangible assets as they affect the underlying cash flows and assumptions used to value such assets. The announcement of the five-year bulk water price path effective on 1 July 2013 in south-east Queensland provided greater certainty around forecasted future cash flows used for asset valuation purposes.

Any changes to the future regulatory price of bulk water would impact on future cash flows of Seqwater and the fair value of its PPE and intangible assets. The need to include an emphasis of matter paragraph with the audit opinion of Seqwater will be reassessed each year.

QUU and Unitywater

An emphasis of matter paragraph was included in the audit opinions accompanying the financial statements of QUU and Unitywater since these entities were established in 2009–10.

In 2011–12, the emphasis of matter paragraph was included because the price path for retail water and sewerage charges post 30 June 2013 in south-east Queensland had not been determined. This led to significant uncertainty around the appropriateness of assumptions used to value PPE and intangible assets.

The *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009* has since been amended to remove the requirement for participating councils to develop and publish final price paths for water and sewerage charges by 1 March 2013 for the period 1 July 2013 to 30 June 2019. This effectively provides QUU and Unitywater the right to determine their pricing policies.

The Queensland Competition Authority (QCA) is currently investigating and developing a long term regulatory framework (and pricing principles) for monopoly distribution, retail water and sewerage activities to apply from 1 July 2015. The QCA is also performing a price monitoring review of expected water charges to end users in south-east Queensland for 2013–14 and 2014–15. The results of these reviews may have an impact on the future of water prices to consumers. The inclusion of emphasis of matter paragraphs with the audit opinions of QUU and Unitywater will need to be reassessed each year.

2.3 Timeliness and quality of draft financial statements

2.3.1 Timeliness

To enhance accountability for the use of public monies, entities should prepare and publish their financial statements as soon as possible after the end of the financial year. The later the financial statements are produced and published after their balance date, the less useful they are for stakeholders and for informing decision making.

Government owned corporations and statutory bodies are required to have their financial statements prepared and audited no later than 31 August each year. Exemptions can be granted but only by approval from the Treasurer for statutory bodies. No exemptions were requested in 2012–13.

Dates for which draft financial statements are provided for audit are agreed to by each entity. This is usually through a formal client strategy document which is communicated to the entity at the start of the audit and formalised with a subsequent letter to the entity closer to the end of the audit.

The financial statements for five of the six entities were certified by management and audit by the 31 August 2013 legislative deadline. These entities also provided draft financial statements for audit by their agreed milestones. MIWB's financial statements were not certified by the legislative deadline of 31 August because additional work was needed to finalise the valuation of its property, plant and equipment.

2.3.2 Quality and accuracy

The quality of the draft financial statements and supporting work papers provided was satisfactory. Some disclosure changes and material account balance adjustments were required to the draft financial statements provided for audit.

Differences adjusted to the draft financial statements

Five of the six entities did not require any material management or audit initiated adjustments to their draft financial statements. Material adjustments were made to the draft financial statements of Seqwater.

Figure 2B summarises the adjustments made to Seqwater's draft financial statements that resulted in increases to the assets and equity of Seqwater by \$521.7 million at 30 June 2013.

Figure 2B
Material adjustments

Component(s) affected	Amount of adjustment	Underlying cause of difference
Property, plant and equipment Asset revaluation surplus	\$104.2 million	Amortisation expense relating to unearned grant revenue was removed from the discounted cash flows used to recognise PPE at fair value.
Property, plant and equipment Asset revaluation surplus	\$417.5 million	Annual cash flow forecasts used to recognise PPE at fair value were previously discounted in the valuation model based on end of year discount rates (i.e. there is an implied assumption that all of the cash flows for a year will occur at the end of the year). Market convention is to apply mid-year discount rates (i.e. assumes that cash flows will occur relatively evenly throughout the year).

Source: QAO

Disclosure enhancements

The majority of disclosure changes made to the draft financial statements provided to audit resulted in enhancements aimed at improving the overall understandability and quality of the financial statements.

Common disclosure issues identified across the entities were:

- Changes to disclosure requirements as a result of new accounting standards were not always adequately considered. For example, the Statements of Profit or Loss and Other Comprehensive Income of some entities were not always updated to reflect the requirements of Australian Accounting Standard AASB 2011–9 *Amendments to Australian Accounting Standards — Presentation of items of Other Comprehensive Income*.
- The effect of accounting standards applying in future financial reporting periods was not always adequately considered. Australian Accounting Standards impacting on entities in future reporting periods include AASB 13 — *Fair Value Measurement* and AASB 119 — *Employee benefits*.
- Useful lives of non-current assets were not always representative of the asset's future economic benefits to the entity.
- Significant accounting policy disclosures were not always relevant to the entity's transactions.

3 Financial performance, position and sustainability

In brief

Background

We assess each entity's ability to continue as a going concern when forming an audit opinion on its financial statements. In this regard, we make an overall assessment of financial sustainability. Measures of financial sustainability include the entity's financial performance and position over time; and its future ability to pay its operational costs, replace and grow its assets, and pay its debts when they fall due.

Conclusions

All six entities of focus within this chapter are financially sustainable and were assessed as being able to pay their debts and ongoing operating expenses as and when they fell due at 30 June 2013. These entities have also been replacing and/or growing their asset base faster than they were depreciating it. The financial sustainability of the Queensland Bulk Water Supply Authority (trading as Seqwater) is however predicated on achieving the indicative prices in the ministerial approved price path.

Key findings

- SunWater Limited's (SunWater) financial performance has been affected by natural disasters and the announcement of regulated prices that SunWater can charge their irrigation customers.
- Mount Isa Water Board has the highest revenues relative to its operational expenses in four of the last five years. The sustainability of future operations is however impacted by its dependence on two key private sector customers.
- Gladstone Area Water Board (GAWB) and SunWater replaced and increased their asset bases faster than they were being depreciated over the last two years. This is primarily due to the construction of new water supply assets on Curtis Island by the GAWB and new commercial pipeline infrastructure by SunWater.
- Queensland Bulk Water Supply Authority's (trading as Seqwater) debt was almost 12 times that of its revenue at 30 June 2013. Seqwater's debt is guaranteed by the state; but it will rely significantly on the proposed future increases to the price of bulk water to address its current adverse operating performance and financial position.

Recommendation

1. **It is recommended that the Department of Energy and Water Supply's (DEWS) performance reporting framework include the measures of financial sustainability used in this report for Seqwater, SunWater, QUU, Unitywater, GAWB and MIWB. It is further recommended that DEWS encourage these six entities to self-report against these measures of financial sustainability whilst the performance reporting framework is being developed.**

3.1 Background

When forming an audit opinion on the financial statements we are required to assess each entity's ability to continue and operate as a going concern. In this regard, an assessment is made over an entity's future financial sustainability.

Financial sustainability can be measured in a number of ways. Measures of future financial sustainability can be derived from examining trends in an entity's past and current financial performance and position. Specific measures computed from this information include an entity's operating, investing and debt ratios.

Operating ratios indicate the extent to which operating revenues cover operating expenses. Typically entities target a positive ratio, so they can generate surplus funds to invest in new assets, rather than borrow for such investments. Investing ratios measure the extent to which an entity is replacing and growing its asset base by relating net capital expenditure to depreciation. Debt ratios indicate the ability of an entity to pay their debts and interest charges while maintaining their assets and community services.

At the time of this report, the Department of Energy and Water Supply (DEWS) was finalising a performance reporting framework. Public sector entities that constitute the water sector in Queensland currently have varying methods of evaluating their own financial performance, position and sustainability.

3.2 Conclusions

This chapter reports on our assessment of the financial sustainability of the Queensland Bulk Water Supply Authority, trading as Seqwater; SunWater Limited (SunWater); Gladstone Area Water Board (GAWB), Mount Isa Water Board (MIWB); and the two distributor-retailers (Central SEQ Distributor-Retailer Authority, trading as Queensland Urban Utilities (QUU) and the Northern SEQ Distributor-Retailer Authority, trading as Unitywater).

Overall, all six standalone public sector water entities are financially sustainable and were assessed as being able to pay their debts and ongoing operating expenses as and when they fell due at 30 June 2013. These entities have also been replacing and/or growing their asset base faster than they were depreciating it. The continuing financial sustainability of Seqwater is however predicated on a number of factors.

Seqwater's debt is guaranteed by the state. Interest rates and other factors can however impact on the future operating ratios of Seqwater if it is required to spend more on loan and interest payments over an extended period of time. The indicative price of bulk water has been forecasted to increase. These price increases are expected to improve the future operating ratios of Seqwater. Distributor-retailer pricing policies encouraging efficient water usage can, however, impact on the operating ratios of Seqwater if consumers use less water.

The operating and debt ratios of the two distributor-retailers, SunWater, GAWB, and MIWB were generally strong in 2012–13. Factors that have and will continue to impact on the future operating and debt sustainability of these entities include natural disasters and changes to the regulatory framework. These factors affect the prices that entities can subsequently charge. The MIWB has also been highly dependent on two private sector entities for the majority of its revenue.

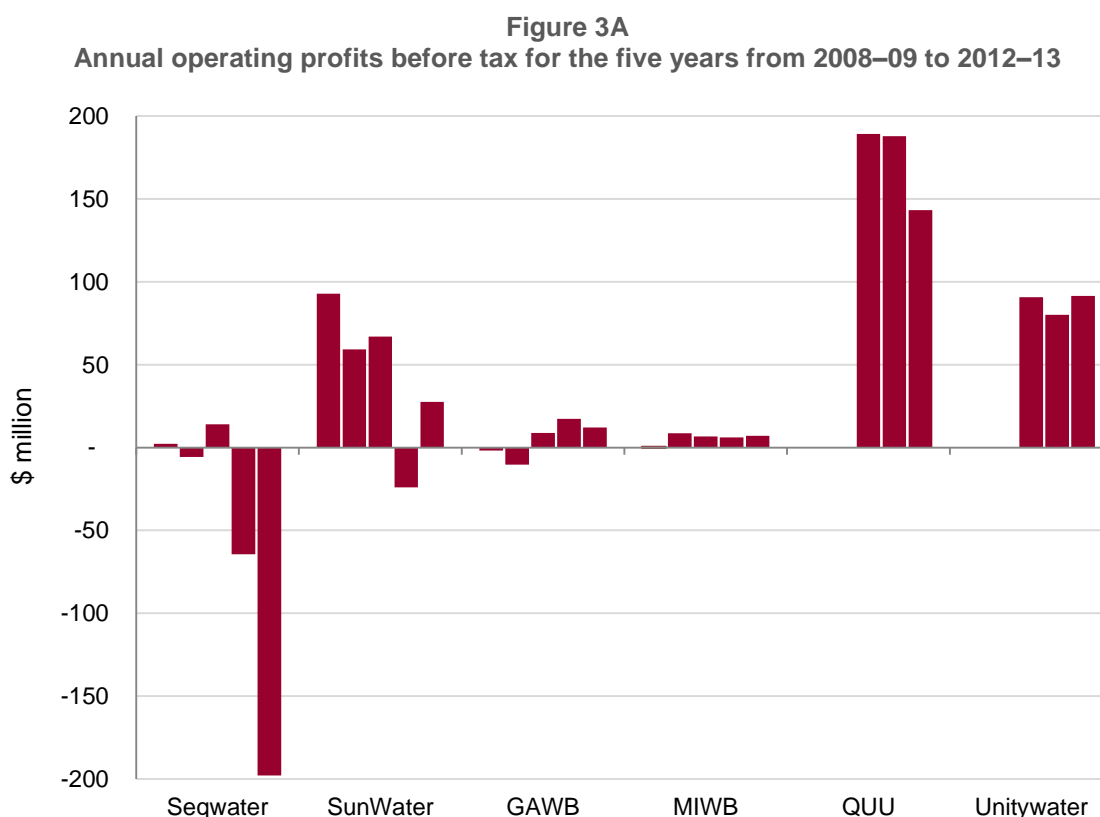
All six entities have replaced and grown their asset bases faster than existing assets have depreciated. In Seqwater’s case, large increases to the asset base in 2008–09 and 2009–10 were largely related to the construction of stage three of the Hinze Dam. For other entities, increases in recent years are mainly due to new infrastructure such as the water supply assets on Curtis Island and commercial pipelines transporting water.

3.3 Financial performance and position

3.3.1 Financial performance

Figure 3A shows that the operating profits before tax for the six entities have differed significantly from each other over the past five years. Operating profits before tax is calculated as revenue less expenditure but does not include the effects of other comprehensive income or income tax payments. In most cases, other comprehensive income represents increases in asset values. QUU and Unitywater are required to pay income tax under the Local Government Tax Equivalent Regime (LGTER). Seqwater, SunWater, GAWB and MIWB are required to pay income tax under the National Tax Equivalent Regime (NTER). LGTER and NTER require entities to account for income tax in accordance with relevant taxation laws.

QUU and Unitywater have made the highest pre-tax profits since they commenced operations three years ago. Both Seqwater and SunWater have experienced periods of profits followed by periods of losses over the past five years. Seqwater’s recent results largely reflect its acquisition of loss-making businesses. Both GAWB and MIWB have achieved profits of between \$6 million and \$18 million per year before tax over the last three years.



Notes: QUU and Unitywater commenced operations from 2010–11; Seqwater acquired significant loss-making businesses during the period

Source: QAO

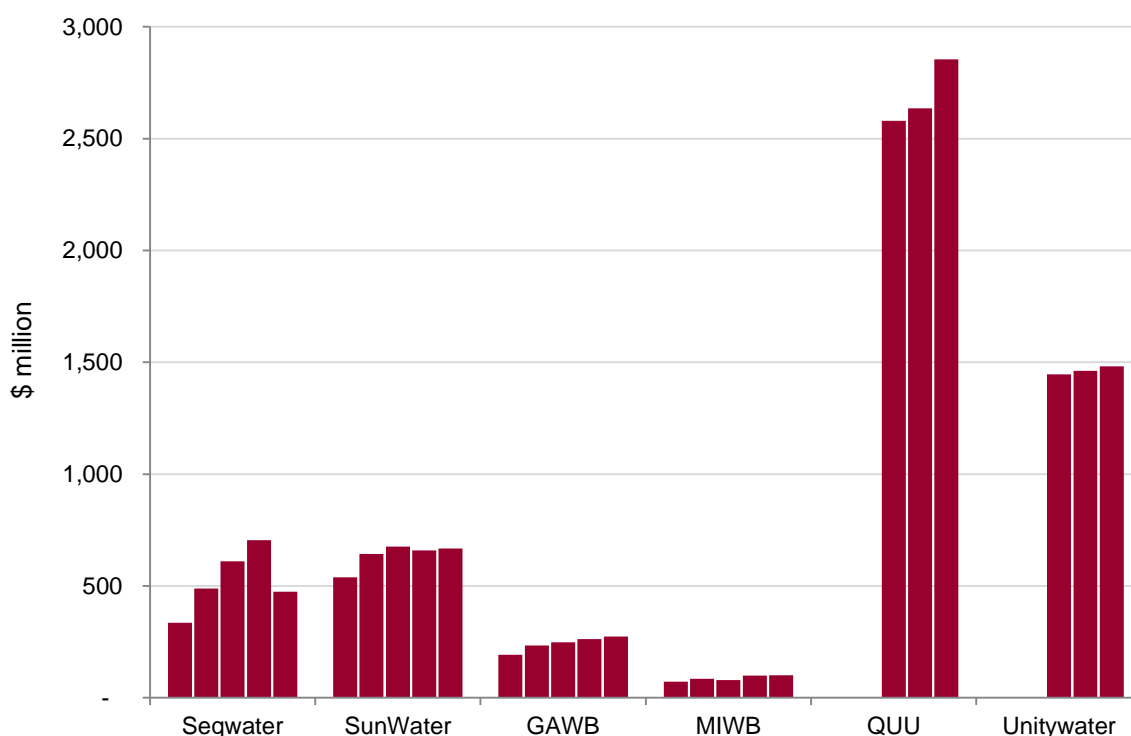
3.3.2 Financial position

Figure 3B shows that the financial position of the six entities, as measured by their net assets, also differed significantly from each other. Net assets are calculated as total assets less total liabilities.

The financial position of Seqwater continues to be affected by the debt it holds. The distributor-retailers continue to have the strongest financial position since the commencement of operations three years ago, with combined net assets of \$4.3 billion at 30 June 2013.

Unlike the other water entities which use fair value measurement, the infrastructure assets of SunWater are recorded at cost or deemed cost. As a result, its net asset position is lower than it otherwise would be if its assets were recorded at their higher fair values.

Figure 3B
Financial position measured by net assets for the five years from 2008–09 to 2012–13



Note: QUU and Unitywater commenced operations from 2010–11

Source: QAO

3.3.3 Seqwater

Over the last two years, Seqwater's financial performance and position has been affected by its acquisition of WaterSecure on 1 July 2011; parts of the Queensland Water Commission on 31 December 2012; and of Linkwater and the SEQ Water Grid Manager on 1 January 2013.

Figure 3C shows how material acquisitions have affected Seqwater's financial performance and position over the last two years.

Figure 3C
Effect of material amalgamations on Seqwater's performance and position

Amalgamation	Date occurred	Impact on performance	Impact on position
Amalgamation with WaterSecure	01.07.2011	Contributed to increases in depreciation and interest expense of \$293 million in 2011–12.	Contributed to the increase in net assets of \$153 million at 30 June 2012.
Amalgamation with the SEQ Water Grid Manager and Linkwater	01.01.2013	Contributed to increases in depreciation and interest expense of \$161 million in 2012–13.	Contributed to the decrease in net assets of \$232 million at 30 June 2013.

Note: Parts of the Queensland Water Commission were also amalgamated with Seqwater in 2012–13. This did not have a material effect in changing the financial performance and position of Seqwater and was therefore not included within Figure 3C.

Source: QAO

Seqwater's financial performance has and will continue to be affected by \$9.2 billion in borrowings to:

- partly fund the cost of constructing the manufactured water assets – the Gold Coast desalination plant and the three advanced water recycling plants
- cover past losses incurred because bulk water was sold to distributor-retailers and local government councils at a price which was less than the cost of supplying such water.

The ongoing depreciation expense associated with the construction of \$3.8 billion in manufactured water assets has been a continuing factor impacting on Seqwater's profitability.

The government has since approved a new bulk water price path which regulates the price Seqwater can sell bulk water to distributor-retailers, Gold Coast City Council, Logan City Council and Redland City Council. The approved bulk water price path, indicative only after 1 July 2015, will see prices incrementally increase by between 22.5 and 118.6 per cent depending on a customer's location between 1 July 2013 and 1 July 2017.

3.3.4 SunWater

In comparison to Seqwater, SunWater's financial position has remained relatively stable over the last five years. The composition of SunWater's revenue from water charges is different from that of Seqwater's revenue. Unlike Seqwater, SunWater is able to negotiate and charge its own prices with non-irrigation customers for the supply and transportation of water.

The prior year operating loss of \$24 million was because of a write down of \$95.9 million primarily to the value of its irrigation assets. The value of these assets was written down because prices which irrigators will pay SunWater for the use of its assets up until 30 June 2017 was lower than SunWater initially expected.

The profit before tax of \$27.5 million for the 2012–13 financial year, lower than historic levels, was impacted by flood repairs resulting in further asset write downs to SunWater's assets of \$12.8 million.

3.3.5 Distributor-retailers

QUU and Unitywater have recorded strong operating profits and financial positions since their commencement of operations three years ago.

On 1 July 2010, both distributor-retailers became responsible for the delivery of water and waste water services to customers within their local government areas. These distributor-retailers have typically achieved larger operating profits relative to Seqwater as they have purchased bulk water from Seqwater at prices which were below the cost of providing such services.

Distributor-retailers also pass through the full cost of bulk water charges to the end user and are not responsible for the interest payments and depreciation expense from ownership of the state's manufactured water supply assets.

3.3.6 Category one water authorities

GAWB and MIWB have recorded operating profits before tax over the last three years.

GAWB

GAWB's water price reflects the pricing principle recommendations made by the Queensland Competition Authority (QCA) and subsequently accepted by the relevant Ministers at the 2002, 2005 and 2010 Price Reviews. This regulatory process is aimed at ensuring that GAWB's water prices reflect expenditure and other commitments necessary to supply customers.

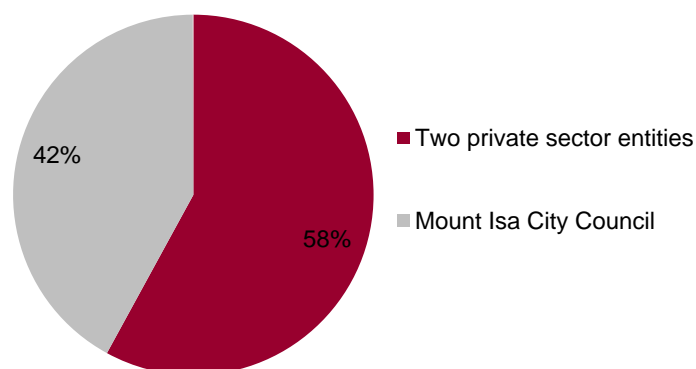
The latest pricing review took effect from 1 July 2010. The recommendations of the QCA were accepted in December 2010 by the government. This resulted in a reassessment of prices and operating profits before tax of \$8.8 million in 2010–11, \$17.2 million in 2011–12, and \$12 million in 2012–13, following losses in 2008–09 and 2009–10.

Operating profits before tax in 2012–13 decreased from the previous year due to increases in depreciation expense of more than \$2 million. Increases in depreciation related to the construction and subsequent depreciation of temporary water supply assets on Curtis Island that were funded by private operators who required water in advance of more permanent infrastructure.

MIWB

Unlike GAWB, MIWB has not been subject to any price monitoring by the QCA and was about one third the size of GAWB in terms of net assets as at 30 June 2013. As shown in Figure 3D, financial performance is largely influenced by two private sector entities. Together these entities contribute to more than half of MIWB's revenue from water sales.

Figure 3D
Breakup of MIWB's revenue by customer (%)



Source: QAO

MIWB has consistently achieved operating profits before tax of between \$6.1 and \$8.7 million in four of the last five years. Unlike the other five water entities, MIWB values its assets using depreciated replacement cost. This means that the fair value of its assets is not as affected by the levels of future income. MIWB's assets have steadily increased in value from \$87 million at 30 June 2009 to \$114 million at 30 June 2013.

3.4 Financial sustainability

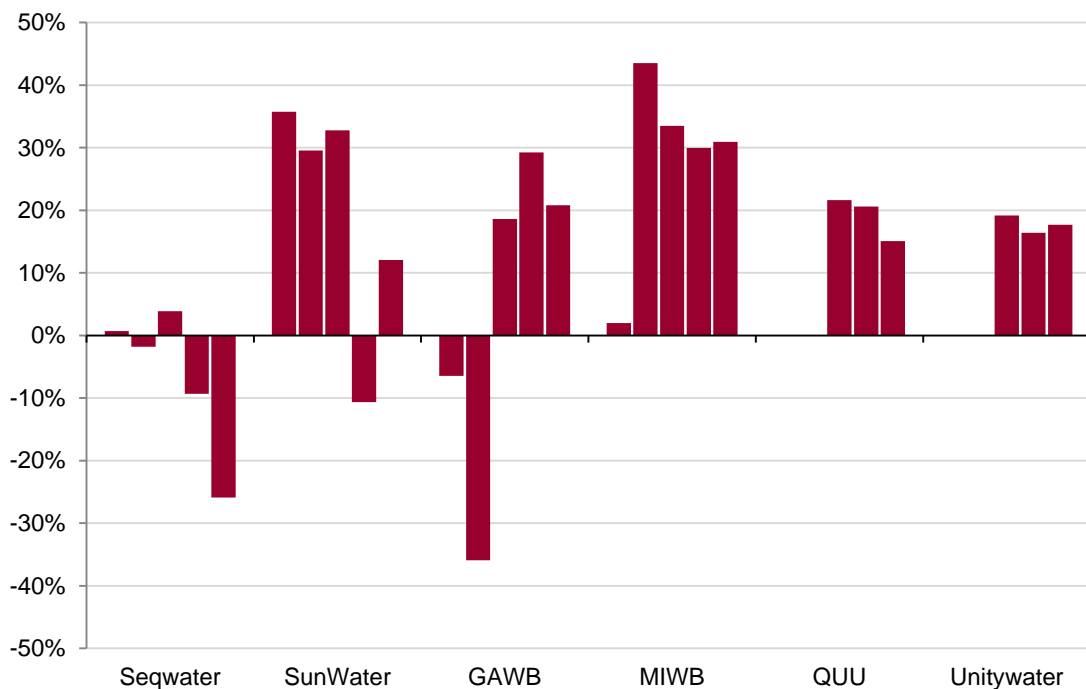
Financial sustainability can be measured in a number of ways. Figures 3E to 3G summarise the results of three indicators of financial sustainability using the information reported in the financial statements. Further information about each of the financial sustainability indicators used in this report can be found in Appendix B.

Entities within the water sector supply chain in Queensland have varying methods and use different indicators to monitor and evaluate their financial sustainability. The existence of a single common reporting framework which encourages entities to use common measures of financial sustainability is currently being progressed by DEWS. It is intended that this framework will also encourage reporting by water sector entities not currently administered by DEWS (e.g. QUU and Unitywater).

3.4.1 Operating ratio

This ratio is the operating profit before tax expressed as a proportion of total revenue. It should be positive over the medium to long term for the entity to remain financially sustainable. Ongoing negative ratios indicate net losses, which mean insufficient revenue is being generated to fund operating and future capital expenditure. This in turn leads to the depletion of cash reserves and/or increased borrowings; and potentially compromises the ability of an entity to invest in new assets and/or maintain its service levels.

Figure 3E
Operating ratios for the five years from 2008–09 to 2012–13



Source: QAO

Unlike measures of absolute financial performance (Figure 3A), comparisons of operating ratios allow readers to understand better the financial performance of entities relative to their size.

The operating ratios of Seqwater and SunWater have contrasted significantly in four of the last five years. Results for Seqwater indicate that operating revenues are not covering operating expenses in 2011–12 and 2012–13. This is in part due to the acquisition of highly leveraged entities such as WaterSecure on 1 July 2011 and the SEQ Water Grid Manager on 1 January 2013. SunWater's negative operating ratio in 2011–12 was primarily the result of write downs to the value of its irrigation assets.

The apparently strong financial performance of the distributor-retailers shown in Figure 3A is not as prominent when comparing operating results to total revenues. They have relatively smaller margins than the other entities in part because they have maximum allowable revenue benchmarks which are used to calculate how much revenue they can earn.

GAWB's results have varied significantly in the last five years. Improved results in 2010–11 were as a result of the government's acceptance of new pricing arrangements from 1 July 2010 to 30 June 2015, as recommended by the QCA. The losses incurred in 2009–10 were influenced by a \$6.3 million write down to the value of intangible assets connected with the construction of the lower Fitzroy Weirs and Gladstone to Fitzroy pipeline.

Risk to future operating ratios

- The government approved a five-year bulk water price path that regulates the price Seqwater can charge distributor-retailers and three local government councils in south-east Queensland. This price path commences on 1 July 2013 and is only indicative after 30 June 2015. Any decisions with regards to the future price path will have an impact on the future operating ratios of Seqwater.
- Distributor-retailer water pricing policies encouraging efficient water usage can also impact on the future operating ratios of Seqwater if water users consume less water. This is because of the high fixed costs of servicing the state's loans.
- The QCA is currently carrying out a price monitoring review over prices charged by distributor-retailers. It is also investigating and developing a long term regulatory framework (and pricing principles) for monopoly distribution, retail water and sewerage activities to apply from 1 July 2015. The outcome of these QCA reviews may influence future prices and therefore impact on the future operating ratios of the two distributor-retailers.
- The operating ratios of GAWB have improved as a result of the 1 July 2010 to 30 June 2015 price path. The announcement of a future price path beyond 30 June 2015 will have an impact on the future operating ratios of GAWB.
- MIWB depends significantly on two private sector customers to provide over 50 per cent of its revenue each year. The loss of one or both customers would have a significant impact on the MIWB's future operating ratios.

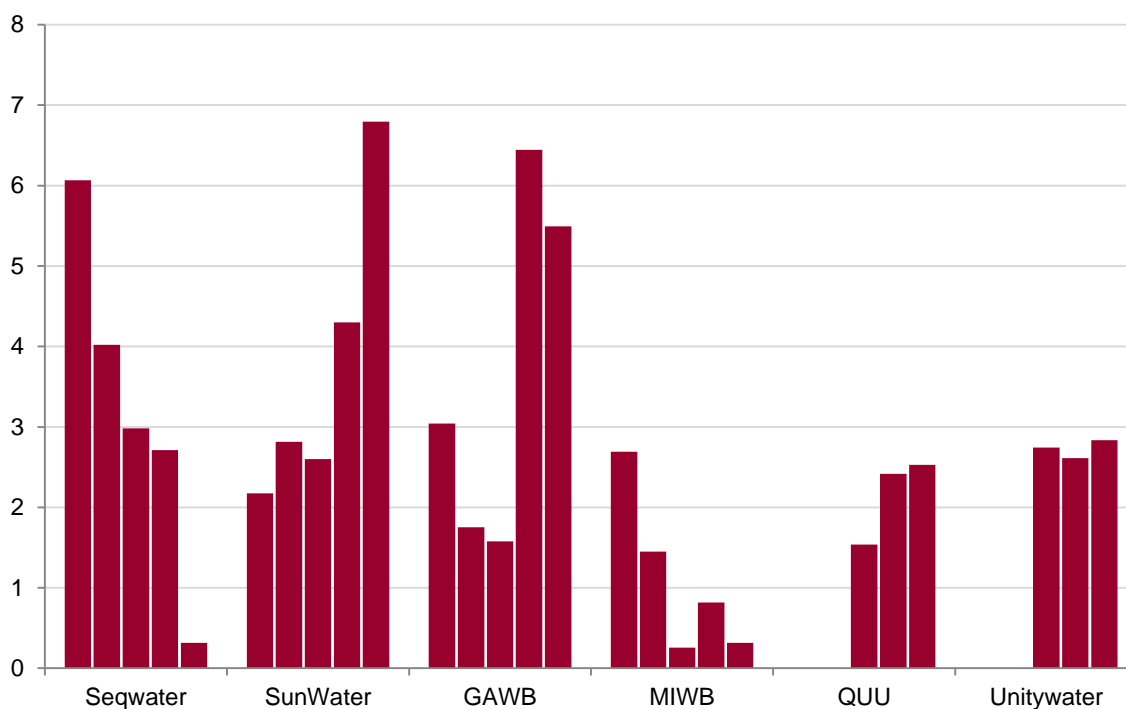
3.4.2 Capital replenishment ratio

The capital replenishment ratio compares the annual net expenditure on non-current assets to annual depreciation. An average ratio below one, over time, indicates that assets are being built or replaced below the rate that the non-current asset base is being depreciated.

The results from the capital replenishment ratio analysis in Figure 3F indicate that the stock of non-current assets is presently being added to or replaced faster than exiting assets are being depreciated.

The large increases in Seqwater’s asset base relate to the construction of stage three of the Hinze Dam between 2008–09 and 2010–11. The completion of the Lake Manchester Dam Spillway upgrade near Ipswich also contributed to Seqwater’s asset base in 2008–09. As would be expected, the capital replenishment ratio of Seqwater has declined since the end of the 2001 to 2009 drought in south-east Queensland, completion of upgrades to the Hinze Dam and completion of the manufactured water assets that were transferred from WaterSecure on 1 July 2011.

Figure 3F
Investing ratios (capital replenishment) for the five years from 2008–09 to 2012–13



Source: QAO

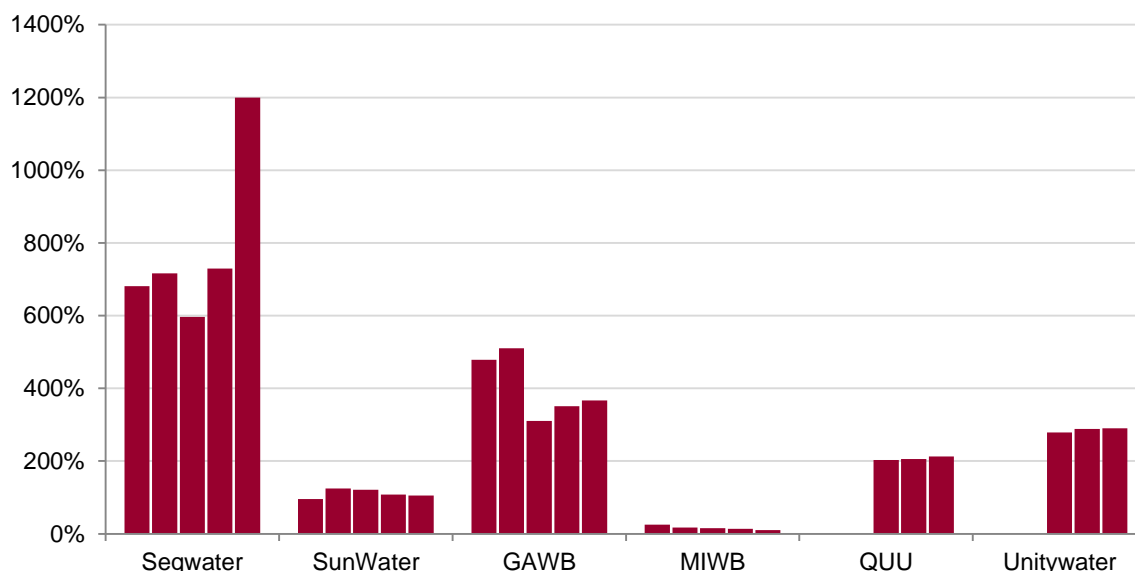
Risks to future capital replenishment ratios

- The results of a capital replenishment analysis for GAWB indicate it has increased and/or replaced its asset base at a rate of 5 to 6 times depreciation in the last two years. These rates of growth can be attributed to factors such as the completion of water supply assets at Curtis Island. The capital replenishment rates in future years will depend on the outcome of any new infrastructure developments.
- Residents in south-east Queensland (and other parts of Queensland) experienced a drought from 2001 until 2009. The end of the drought resulted in increasing levels of stored water in excess of water usage in south-east Queensland. Combined with the potential to further increase water supply to the south-east Queensland water grid through the state’s manufactured water assets, these factors will mean that Seqwater is unlikely to significantly increase its bulk water asset supply base unless there are significant changes in water consumption and existing water supply.
- The January 2013 flood event and other natural disasters have resulted in a number of enhancements to infrastructure held by SunWater. Additionally, the construction of pipelines has contributed to net expenditure on non-current assets being six times that of depreciation in 2012–13. The impact of further natural disasters will continue to have an impact on capital replenishment rates.

3.4.3 Debt to revenue ratio

The debt to revenue ratio assesses an entity's ability to pay the principal and interest on borrowings when they fall due from the funds generated through the entity's operations. Debt for the purposes of this ratio is borrowings and does not include other liabilities such as trade creditors.

Figure 3G
Debt to revenue ratios for the five years from 2008–09 to 2012–13



Source: QAO

The loans of Seqwater, GAWB, MIWB and Unitywater with QTC are all secured by a shareholder guarantee. This means that the risk of entities not paying the principal and interest on their loans with QTC is held by the shareholding councils for Unitywater and the state for the other three entities. The loans of SunWater and QUU are not secured by a shareholder guarantee.

Over the past five years, Seqwater has and remains the most highly leveraged of the six entities as shown in Figure 3G. Loans for the remaining entities at 30 June 2013 were between 0.10 and 3.66 times that of revenue. Seqwater's loans increased from \$5 billion at 30 June 2012 to \$9.2 billion at 30 June 2013 when it took over responsibility for \$4 billion in loans from the former SEQ Water Grid Manager and Linkwater on 1 January 2013.

GAWB's debt to revenue position improved in the years following the announcement of the 2010–2015 price path. GAWB has the second highest debt to revenue ratio because of loans taken out to fund new water supply infrastructure assets in and around the Gladstone region.

The distributor-retailers' debt has been trending at between two to three times revenue since they commenced operations in 2010–11. At 30 June 2013, 74 per cent of QUU's loans and 79 per cent of Unitywater's loans were provided by its shareholding councils. The remaining loans were provided by the Queensland Treasury Corporation (QTC). A key difference between the two distributor-retailers is that Unitywater has a deed of guarantee from its shareholding councils guaranteeing its loans with QTC. This means that Unitywater pays less in interest payments than it otherwise would if such a guarantee was not in effect.

Risks to future debt ratios

- Loans across the six entities totalled \$13.1 billion at 30 June 2013. Seqwater accounted for \$9.2 billion of the \$13.1 billion in loans. The majority of these loans have variable interest rates. Notwithstanding a shareholder guarantee over payment of loans for four of the six entities, the risk of interest rate movements can have a significant impact on interest payments and therefore the ability of highly leveraged entities to pay other ongoing operational expenses. In the case of Seqwater, arrangements are in place which allows the entity to actively manage their interest payments by alternating the duration of its loans.
- The price of bulk water has, in the past, been lower than the cost of supplying bulk water after including the effects of depreciation and interest payments. This difference resulted in \$1.8 billion (30 June 2009: \$296.1 million) in loans being transferred to Seqwater when it acquired the SEQ Water Grid Manager on 1 January 2013. The difference between the cost and price of bulk water adds to the overall loans and therefore cost of providing bulk water to users in south-east Queensland. Any future decisions about bulk water prices will impact on the future debt to revenue ratios of Seqwater.

A framework which requires entities within the water sector to assess their financial performance, position and sustainability against short, medium and long term targets does not currently exist.

Entities have their own financial performance and position measurement frameworks which they use and report to their own board and executive management. The indicators used by these entities tend to differ. The DEWS is working on a performance reporting framework against which entities will be requested to report. To date, entities have been consulted on the suite of indicators that they will be requested to report against. The DEWS is currently finalising the indicators that would be included in such a framework.

3.5 Recommendation

1. **It is recommended that the Department of Energy and Water Supply's (DEWS) performance reporting framework include the measures of financial sustainability used in this report for Seqwater, SunWater, QUU, Unitywater, GAWB and MIWB. It is further recommended that DEWS encourage these six entities to self-report against these measures of financial sustainability whilst the performance reporting framework is being developed.**

Appendices

Appendix A—Comments	37
Appendix B—Financial sustainability measures	39
Appendix C—Controlled entities for which audit opinions will not be issued	40
Appendix D—Controlled and dissolved water entities' audit results	41
Appendix E—Bulk water price path.....	43

Appendix A—Comments

Auditor-General Act 2009 (Section 64)—Comments received

Introduction

In accordance with section 64 of the *Auditor-General Act 2009* a copy of this report was provided to the Minister for Energy and Water Supply, Director-General—Department of Energy and Water Supply and Under Treasurer.

The Director General – Department of the Premier and Cabinet and the heads of the Queensland Bulk Water Supply Authority (trading as Seqwater), SunWater Limited, Central SEQ Distributor-Retailer Authority (trading as Queensland Urban Utilities), Northern SEQ Distributor-Retailer Authority (trading as Unitywater), Gladstone Area Water Board and Mount Isa Water Board were also provided with a copy of this report with the option of providing a response.

Copies of the report were also provided to the Premier, Treasurer and Minister for Trade,, Queensland Competition Authority, Gold Coast City Council, Logan City Council and Redland City Council for their information.

Responsibility for the accuracy, fairness and balance of the comments rests with the head of these agencies. All comments received within 21 days are included in this Appendix.

Comment(s) received

Response provided by the Chairperson, Gladstone Area Water Board on 6 November 2013



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Reply please quote ref: 266319

6 November 2013

Mr A.M. Greaves
Auditor-General
PO Box 15396
City East BRISBANE QLD 4002



Dear Mr Greaves

Results of Audit: Water Sector Financial Statements 2012/13

We refer to the draft report on the water sector financial statements for 2012/13 that has been provided to us for comment.

GAWB appreciates the opportunity to provide comment on the report and acknowledges the positive engagement that it has had with QAO officers in the development of the report (including receipt of a further draft report on 5 November).

For completeness, I provide the following comment that has been also provided to QAO officers:

- In relation to the operating ratios included at Figure 3E (page 28) and commentary (page 29), we believe the report would benefit from additional wording explaining that the impairment of the intangible asset, which consisted of GAWB's preparatory costs for the Gladstone to Fitzroy Pipeline and Lower Fitzroy River Infrastructure projects, resulted from the QCA recommendation that some of the preparatory costs should not be recovered in customer prices until such time as the infrastructure is constructed.

Please do not hesitate to contact me if you require any further information or wish to discuss this matter.

Yours sincerely

Mary Boydell
Chairperson

Appendix B—Financial sustainability measures

Ratios used to assess financial sustainability of the six entities discussed in this report are explained in Figure B1.

Figure B1
Financial sustainability measures

Measure	Formula	Description	Target range
Operating ratio	Net operating result before tax divided by total operating revenue Expressed as a percentage	Indicates the extent to which operational revenues raised cover operational expenses	Needs to be developed by individual entities and reported against at regular intervals
	A negative result indicates an operating loss. The larger the negative percentage the worse the result. Operating losses cannot be sustained in the long term. A positive percentage indicates that surplus revenue is available to support the funding of capital expenditure, or to be held in reserve to offset past or expected future operating losses.		
Capital replenishment ratio	Purchases of non-current assets divided by depreciation expense Expressed as a number	Comparison of the rate of net spending on assets with depreciation	Needs to be developed by individual entities and reported against at regular intervals
	A ratio greater than one means that an entity is replacing and/or growing its property, plant and equipment and intangible asset base at a rate faster than it is being depreciated and amortised.		
Debt to revenue ratio	Total loans and borrowings divided by total operating revenue Expressed as a percentage or number	Indicates the extent to which its operating revenues (including grants and subsidies) can cover an entity's loans and other borrowings	Needs to be developed by individual entities and reported against at regular intervals
	Entities with a high debt to revenue percentage or number are generally most at risk of not being able to pay the principal and interest on borrowings as and when they fall due. For entities with a shareholder guarantee, a high debt to revenue ratio can impact an entity's ability to pay other operational expenses.		

Source: QAO

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

Figure C1
Government controlled entities for which no opinion will be issued for 2012–13

Entity	Parent entity	Reason
Western Corridor Recycled Water Pty Ltd	Queensland Bulk Water Supply Authority (trading as Seqwater)	Non-trading / Dormant
South East Queensland (Gold Coast) Desalination Company Pty Ltd	Queensland Bulk Water Supply Authority (trading as Seqwater)	Non-trading / Dormant
North West Queensland Water Pipeline Pty Ltd	SunWater Limited	Non-reporting
Eungella Water Pipeline Pty Ltd	SunWater Limited	Non-reporting
Burnett Water Pty Ltd	SunWater Limited	Non-reporting

Source: QAO

Appendix D—Controlled and dissolved water entities' audit results

Figure D1 (shown on next page) summarises the results from our audit of entities that are either controlled or were amalgamated into Seqwater in 2012–13.

The assets, liabilities and functions of Linkwater, the SEQ Water Grid Manager and the South East Queensland Bulk Water Company Limited were transferred to Seqwater on 1 January 2013. The assets, liabilities, and functions of the Queensland Water Commission were transferred to the Department of Energy and Water Supply, the Department of Natural Resources and Mines, the Department of Housing and Public Works, and the Queensland Bulk Water Supply Authority (trading as Seqwater) on 31 December 2013. The Australian Water Recycling Centre of Excellence Ltd (AWRCE) was a controlled entity of Seqwater at 30 June 2013.

All five entities were issued with an unmodified audit opinion in 2012–13. Except for AWRCE, entities were issued with an unmodified audit opinion that included an emphasis of matter paragraph to reflect the dissolution of the entity or the Board's intention to dissolve the entity. The financial statements of these entities were certified by management and audited within their legislated deadlines.

There were no material management or audit initiated account balance adjustments from the first version to the final set of the draft financial statements provided for audit. Disclosures in draft financial statements provided were generally satisfactory. However changes were required to the disclosures of the four dissolving entities. These disclosure changes relate mainly to the circumstances surrounding the dissolution of these entities.

Figure D1
2012–13 opinion, financial statement quality, performance, position and status

Entity	Status at 30 June 2013	Audit opinion	Included in State Govt financial statements	Financial statements signed	Opinion issued	Certified by deadline	Quality of statements provided for audit	Financial performance \$ million	Financial position \$ million
Queensland Bulk Water Transport Authority (trading as Linkwater)	Dissolved	Unmodified	✓	11.04.2013	18.04.2013	✓	Satisfactory	(0.02)	0
SEQ Water Grid Manager	Dissolved	Unmodified	✓	27.03.2013	02.04.2013	✓	Satisfactory	(0.26)	0
Queensland Water Commission	Dissolved	Unmodified	✘	03.05.2013	07.05.2013	✓	Satisfactory	0	0
South East Queensland Bulk Water Company Limited	Pending deregistration	Unmodified	✘	25.10.2013	25.10.2013	✓	Satisfactory	(1.17)	0
Australian Water Recycling Centre of Excellence Ltd	Controlled by Seqwater	Unmodified	✘	27.09.2013	27.09.2013	✓	Satisfactory	3.19	14.5

Source: QAO

Appendix E—Bulk water price path

Figure E1 summarises the price of bulk water in 2012–13 and the price that will be charged to ratepayers and customers of local government council owned water businesses and distributor-retailers till the end of 2014–15. Bulk water prices from 2015–16 are indicative only at this stage.

Figure E1
Bulk water price path

Council	2012–13	2013–14	2014–15	2015–16	2016–17	2017–18	Increase per megalitre by dollar	Increase per megalitre by per cent
Brisbane City	\$2 057	\$2 302	\$2 547	\$2 792	\$3 037	\$3 217	\$1 160	56.39%
Gold Coast City	\$2 225	\$2 470	\$2 715	\$2 960	\$3 139	\$3 217	\$992	44.58%
Ipswich City	\$1 993	\$2 238	\$2 483	\$2 728	\$2 973	\$3 217	\$1 224	61.41%
Lockyer Valley Regional	\$2 250	\$2 495	\$2 740	\$2 985	\$3 139	\$3 217	\$967	42.98%
Logan City	\$2 383	\$2 628	\$2 873	\$3 062	\$3 139	\$3 217	\$834	35.00%
Moreton Bay Regional	\$2 192	\$2 437	\$2 682	\$2 927	\$3 139	\$3 217	\$1 025	46.76%
Redland City	\$1 472	\$1 717	\$1 962	\$2 207	\$2 452	\$3 217	\$1 745	118.55%
Scenic Rim Regional	\$2 357	\$2 602	\$2 847	\$3 062	\$3 139	\$3 217	\$860	36.49%
Somerset Regional	\$2 627	\$2 872	\$2 988	\$3 062	\$3 139	\$3 217	\$590	22.46%
Sunshine Coast Regional	\$1 610	\$1 855	\$2 100	\$2 345	\$2 590	\$3 217	\$1 607	99.81%

Source: Department of Energy and Water Supply and QAO

Auditor-General Reports to Parliament

Tabled in 2013–14

Report number	Title of report	Date tabled in Legislative Assembly
1	Right of private practice in Queensland public hospitals	July 2013
2	Supply of specialist subject teachers in secondary schools	October 2013
3	Follow up - Acquisition and public access to the Museum, Art Gallery and Library collections	October 2013
4	Follow up - Management of offenders subject to supervision in the community	October 2013
5	Traffic management systems	November 2013
6	Results of audit: Internal control systems	November 2013
7	Results of audit: Water sector entities 2012–13	November 2013

Reports to Parliament are available at www.qao.qld.gov.au