

# Results of audit: Energy sector entities 2012–13

Report to Parliament 9 : 2013–14



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Queensland Audit Office

Location Level 14, 53 Albert Street, Brisbane Qld 4000

PO Box 15396, City East Qld 4002

Telephone (07) 3149 6000

Email [qao@qao.qld.gov.au](mailto:qao@qao.qld.gov.au)

Online [www.qao.qld.gov.au](http://www.qao.qld.gov.au)

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December 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: Energy 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

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# Summary

The electricity industry faces a number of significant issues. With customer bills rising more than 80 per cent on average over the last five years, there has been a significant level of industry review in the last 12 months in an effort to reform the industry and address government and community concerns.

The Queensland energy sector is made up of a number of state and privately owned generators, one state owned transmitter, two state owned distributors, one state owned retailer and a number of privately owned retailers. They operate in a regulated, national energy market.

High voltage transmission networks transport electricity from the generators to distribution networks. Lower voltage distribution networks then transport electricity to residential, commercial and industrial customers.

The predominant generators are the state owned Stanwell Corporation Limited (Stanwell) and CS Energy Limited (CS Energy).

The state owned Queensland Electricity Transmission Corporation Limited (trading as Powerlink) is responsible for transferring power around Queensland. The two state owned distributors are Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy). For the purposes of this report, we refer to Powerlink, Energex and Ergon Energy as network businesses. Unlike the two generators, these three state owned businesses do not have any direct competition from private sector operators in the regulated networks.

By nature, the generator and network businesses are different. Generator revenues streams are driven by market forces and network revenue is determined in five-year periods by the Australian Energy Regulator (AER), making revenue streams more predictable for network businesses.

The state owned bodies are designated as government owned corporations (GOCs). The purpose of establishing GOCs is to provide services to the community on a commercial basis, with the direct intention of making commercial returns that government can redistribute to meet other government objectives.

The financial statements of all public sector entities, including GOCs, 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 annually to Parliament.

This report contains the results from our financial audits of the five GOCs and their three controlled reporting entities, whose primary business activity is to supply electricity. It also summarises the factors affecting their financial performance, position and sustainability.

## Results of audits

Unmodified audit opinions were issued this year for all five GOCs and the three controlled entities that prepare financial statements.

The financial statements of all eight were timely and of good quality. The quality of draft financial statement preparation and checking by management was effective and minimised the amount of changes required to draft statements before they could be certified.

## Significant financial reporting issues

In forming our audit opinion, we identified a number of issues that required careful consideration of their appropriate accounting treatment and presentation. The most significant of these are drawn to the attention of the users of the financial statements, so they understand better the financial results for the year:

- Significant restructure in the current year prompted redundancy costs of \$93.36 million across the sector, with provisioning of \$39.64 million recognised at 30 June for redundancies confirmed in 2013 for employees who will leave after this date.
- Carbon pricing had a significant effect on the total revenue and expenditure of generators, with the introduction of the scheme from 1 July 2012. Stanwell Corporation Limited and CS Energy Limited incurred \$600 million in related expenditure during the year and \$159 million in associated liabilities at 30 June 2013. Generators sought to recover 80 to 85 per cent of this in revenue sales.
- Generators had previously booked significant asset impairments in 2010–11, primarily due to the effect of the carbon pricing scheme on the net worth of core generation assets. Should the carbon pricing scheme be removed, generators will need to assess whether there are grounds to reverse these asset impairments in the context of other market conditions.
- Stanwell disposed of its interest in the Tri-Star gas exploration joint venture, resulting in a pre-tax gain of \$2.5 million, after impairment losses in the previous year totalling \$10.1 million. Stanwell also exited its Icon Energy Limited interest in coal seam gas post-balance date, writing off the remainder of its exploration and evaluation asset of \$8.4 million at year-end.
- Powerlink sold its investment in the South Australian company, Electranet Pty Ltd, resulting in a pre-tax gain of \$348.7 million. The after-tax proceeds from this divestment flowed back to the state government in the form of a dividend.
- Powerlink, Energex and Ergon collectively recognised \$947.1 million in receivables as under-recovery of revenues at 30 June 2013. Regulated revenue entitlements not recovered through pricing in the period, during which the entities become entitled to that revenue and proposed pass-through costs, were carried as regulated revenue receivables and recovered in future periods within guidelines established by the AER. Conversely, over-recoveries of regulated revenue entitlements were carried as liabilities and returned to customers within those guidelines.
- Solar tariff rebates (partially included in under-recovery of revenue) were significant during 2012–13 for the distribution businesses, with \$242.3 million attributed to these rebates appearing in the accounts as revenue and associated expenditure line items.

## Financial performance, position and sustainability

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

The five GOCs generated a combined net profit before tax (NPBT) and other comprehensive income of \$1.7 billion, compared to \$1.2 billion in 2011–12. With CS Energy the exception, the GOCs achieved operating profits in 2012–13.

Since their restructure in 2010–11, the operating results of the two generators have been significantly influenced by the carbon pricing scheme and by decreases in electricity demand.

CS Energy reported losses over the past three years and had previously projected future losses until 2014–15. Although it has plans in place to turn the business around, a return to profitability is now not forecast until 2015–16. In contrast, Stanwell has a coal revenue agreement in relation to a coal mine which significantly contributes to its ongoing profitability.

CS Energy reviewed its operating structures, with a significant focus on operational efficiency improvements and cost rationalisation during 2012–13. This resulted in it being able to minimise its overall loss in the current year. Access to undrawn debt facilities with Queensland Treasury Corporation (QTC) and the continued support of the Queensland Government is key to maintaining its solvency.

Improvements in NPBT for network businesses were largely driven by higher revenue on regulated assets and decreased expenditure associated with business improvement processes. Dividends paid to shareholding Ministers totalled \$1.03 billion (\$0.62 billion in 2011–12); however, community service obligation payments totalling \$0.63 billion (\$0.41 billion in 2011–12) were paid into Energex and the retail arm of Ergon Energy to support the provision of the state's uniform tariff policy and non-commercial operations.

The GOCs held combined net assets of \$10.93 billion at 30 June 2013, compared to \$10.37 billion at 30 June 2012. As at 30 June 2013, GOCs held combined total property, plant and equipment (PPE) of \$31.3 billion and total borrowings of \$16.75 billion. Post 2010–11, the PPE and borrowings of the two generators remained steady. Over the last five years, network business PPE has increased by \$8.75 billion (45 per cent) and borrowings have increased by \$4.75 billion (43 per cent). The increase in borrowings is mainly to fund significant capital works being undertaken on the electricity network.

All entities achieved financial results which indicate that they are sustainable in the short term. The longer term sustainability of generators depends critically on their ability to reduce future operating and capital costs and constrain their future debt levels. Sustainability of networks depends on their ability to anticipate and address forecast demand adequately, to adapt to revised forecasts and to align the delivery of planned expenditure programs to meet customer requirements within the regulatory framework.

GOCs currently have their own financial performance and position measurement frameworks which they use and report to their own boards and shareholding Ministers. The indicators used by these entities tend to differ. The Department of Energy and Water Supply and Queensland Treasury and Trade are using a performance reporting framework against which entities report.

## Recommendations

- 1. It is recommended that the Department of Energy and Water Supply (DEWS) and Queensland Treasury and Trade (QTT) include the indicators of financial sustainability used in this report in their performance reporting framework.**

## 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 Director-General of the Department of the Premier and Cabinet, the Under Treasurer, Queensland Treasury and Trade and the Minister for Energy and Water Supply for information.

This report was provided to the Director-General of the Department of Energy and Water Supply and the heads of Stanwell Corporation Limited, CS Energy Limited, Powerlink, Energex Limited and Ergon Energy Corporation Limited with a request for comments.

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

Full comments or a fair summary of the comments received are included in Appendix A of this report.



# 1 Context

## 1.1 Introduction

In Queensland, five government owned corporations (GOCs) are involved in generating, transmitting and distributing electricity.

**Figure 1A**  
Roles of public sector energy entities

Generation	Transmission	Distribution
Stanwell	Powerlink	Energex
CS Energy		Ergon Energy*

Note: The Ergon Energy consolidated group includes Ergon Energy Queensland Pty Ltd which provides retail services in regional Queensland.

Source: Queensland Audit Office

Across the state, a combination of government owned electricity generators and privately owned electricity generators contribute to the east coast national electricity market (NEM). The predominant generators are the state owned Stanwell Corporation Limited (Stanwell) and CS Energy Limited (CS Energy).

Once electricity has been generated and sold in the NEM, Queensland Electricity Transmission Corporation Limited (trading as Powerlink) is responsible for transferring power around Queensland between the high voltage supply networks of the generators and the lower voltage networks of Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy) and some direct connect high voltage customers. For the purposes of this report, Powerlink, Energex and Ergon Energy are referred to as network businesses. These three state owned entities do not have any competition from private sector operators for their regulated networks.

The main interface between the electricity and gas industries and their customers, such as households and businesses, are the energy retailers. In Queensland, these retailers are privately owned, except for Ergon Energy which services regional Queensland. Retailers buy electricity and gas in the wholesale markets, package it with transportation services and sell it to customers. Some large customers may opt to participate directly in the NEM wholesale market and manage their own contracts with the generators and network service providers. Where generators supply customers in the NEM, they do so as retailers.

An overview of the regulatory authorities and market participants is provided in Appendix B.

## 1.2 Electricity supply and demand

### 1.2.1 Changes in demand

In recent years, the network businesses in Queensland have invested to meet expected growth in peak demand as well as meeting required reliability and security standards. The industry was experiencing continued increases in demand each year, with the expectation that demand would continue to rise, for which the network would need to prepare itself. This forecast demand has not eventuated.

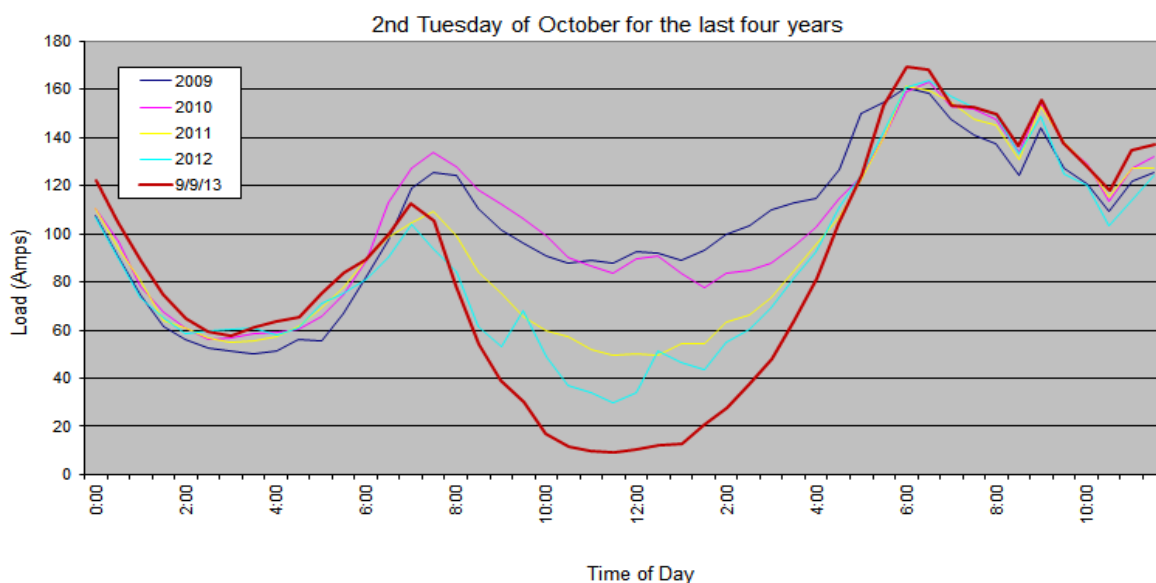
A significant and unprecedented slow-down in demand has occurred, leading to a net difference in actual demand compared to forecast demand.

Although the take up of rooftop solar photovoltaic (PV) has been a significant contributor to reduced demand, smart energy appliances and light fittings, together with a general change in consumer behavior (including just turning the power off), has also led to unexpected changes in the level of demand. Increases in air conditioner installations, which initially were expected to increase demand, have been countered by milder summers, further reducing actual demand by consumers. Forecasting is now not only taking into account changes in population and weather, but also the economic rationale of customer behaviour.

Figure 1B shows how the shape of electricity demand on an individual section of the Energex network with very high levels of solar PV installations has changed over the last few years. Although it appears solar panels are taking some load off the demand level during the middle of the day, they are not reducing the 'peaks' in daily demand.

Currently, network prices for domestic customers are largely based on the volume of energy consumed and do not reflect the cost drivers of building a network which is designed to meet peak energy demand but has significant periods of underuse.

**Figure 1B**  
Impact of solar PV on daily demand



Source: Energex—Presentation given to the All Energy Conference, Melbourne, October 2013.

Peak demand usually occurs in the early morning and early evening when customers are getting ready for work and when they arrive home, prepare dinner, watch television and turn on heaters and air conditioners, computers and washing appliances. These are times when solar panels are not generating power for a household's own consumption and therefore do not contribute significantly to addressing peak demand issues.

Distribution businesses are looking at ways to understand demand better by analysing the power consumption of households before and after solar panels installation. Distributors also want to encourage customers to change their patterns of consumption through 'time of use' tariffs in an aim to reduce the 'peakiness' of power demand. This is because a lower level of network assets can provide reliable supply if power consumption is spread to take out the peaks in demand.

## 1.2.2 Effect on pricing

Increased revenue allowances for the current regulatory period and lower consumption than forecast have led to increased pricing to customers. The revenue allowance is determined with reference to the forecast cost of energy delivery (capital and operating cost) and a return on assets. Return on assets comprises the largest component of the revenue allowance. The forecast asset base increased for the current regulatory determination due to anticipated increases in demand and compliance with security and reliability standards.

Variations in actual expenditure do not increase allowed revenue but could impact allowed revenue for the next regulatory determination period. This could occur through an adjustment to the opening regulated asset base for the next period.

## 1.2.3 Oversupply of generation capacity

With oversupply of the market, generators are not operating at capacity. In some cases, they are putting units into storage to reduce costs of operations and achieve commercial outcomes. Two ongoing issues for GOC generators are industry growth and vertically integrated players.

### Industry growth

The Department of Energy and Water Supply (DEWS) noted that, since 2008, Queensland has experienced unprecedented growth with the development of the coal seam gas to liquefied natural gas export industry and the fact that the overwhelming majority of Australia's current '2P' (proven and probable) reserves are found in Queensland—more than 93 per cent. Coal seam gas is estimated to account for about 20 per cent of the state's electricity generation.

The number of gas projects in Queensland will increase gas infrastructure and supply in the near future. Although the market is divided between export and domestic consumption, the increase in supply is likely to affect domestic NEM pricing.

State owned generators may experience price and overall demand effects where gas-fired generators increase production during peak demand periods. Further effects arise where liquefied natural gas trains, heading for export, increase their demand for electricity if the electricity is sourced from the NEM. Changes in domestic gas prices, driven by changes in export prices, may also influence the price of electricity during peak demand periods.

### Vertically integrated players

State owned generators are competing with privately owned plant which vertically integrate both the generation and retail aspects of the supply chain—they are commonly known as 'gentailers'.

When demand peaks, private gas-fired generators ramp up electricity supply to meet increased demand. This is good news for consumers as demand is met and further competition exists on pricing; however, for coal-fired generators, this increased competition during peak demand erodes their annual revenue and makes the overall business less viable. Although state owned businesses have gas-fired generators, they do not have access to the efficiencies obtained by vertically integrating separate parts of the supply chain.

## 1.3 Costs of networks

The capital spending imperative of the transmission and distribution system has emerged over the last ten years and is a function of:

- pressures on the demand side
- reliability and service standards
- end of life replacement of ageing assets with current technology.

These influences can create a bias towards building a bigger, stronger, newer version of the existing distribution network. They tend not to encourage options to build a smarter, leaner network. Consequently, businesses have sought substantial capital spending at each occasion of determining regulatory revenue and, once spent, the cost of those assets is locked into prices—typically for between ten and 50 years.

Networks continue to implement control measures to ensure that expenditure is prudent, efficient and ultimately results in better pricing outcomes for consumers. Networks have also reduced capital works during the current regulatory period as a result of reduced demand. This is resulting in networks spending less on capital expenditure than allowed by the Australian Energy Regulator (AER) in its regulatory determinations.

## 1.3.1 Asset investment

### Developments in solar technology

As customers use electricity they have generated themselves and avoid paying the full retail price, they reduce their contribution toward meeting the aggregate cost of providing network services. However, solar PV generation does not reduce the cost of the network as peak demand remains constant and the full capacity of the network is still required during these peak periods.

Over or under investment in poles and wires can occur when industry planning does not predict accurately how demand and new technology will develop over time. Voltage management of electricity needs to travel up and down wires as a result of solar energy coming into the grid. This is a new issue for distributors because the old networks did not cater for this prior to the introduction of solar technology.

With customers becoming smarter on how they take advantage of green energy, including the development and use of battery storage and wind technology in the future, the focus moves to how electricity GOCs are going to prepare themselves for this changing electricity generation landscape.

This is a core focus for GOCs and they will need to continue to monitor the likely effects that solar technology will have on demand and infrastructure management. This includes how they will change their business and the level of assets they hold and maintain long term and how networks may or may not benefit from increased use of regional green energy generation.

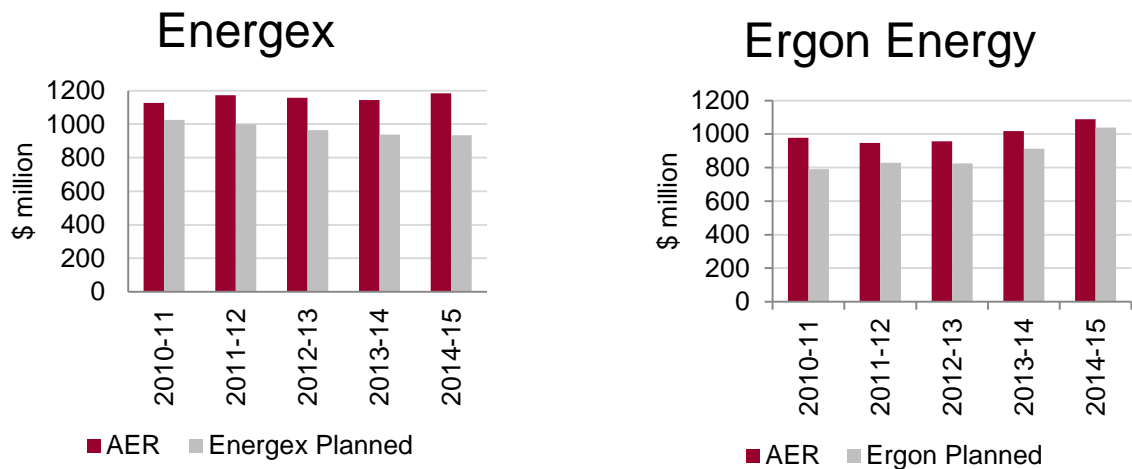
### Extent of planned capital expenditure (capex) compared to AER determination

As part of determining the revenue requirements of network businesses, the AER assesses the level of capital expenditure to be spent during that period. This is done as capital expenditure forms part of the asset base on which businesses seek a return in future periods.

Over the past five years, the gap between demand and supply has continued to widen; however, the level of investment in infrastructure has remained significant.

As part of the recognition that demand levels have changed and there are pressures to reduce pricing. As shown in Figure 1C, distribution businesses have reduced their capital expenditure budgets beneath allowances made in AER current pricing determinations.

**Figure 1C**  
Distribution forecast capital expenditure compared to AER approved capital expenditure



Source: Queensland Audit Office, *Energex and Ergon Energy Network Management Plans (2012–13 to 2016–17)*

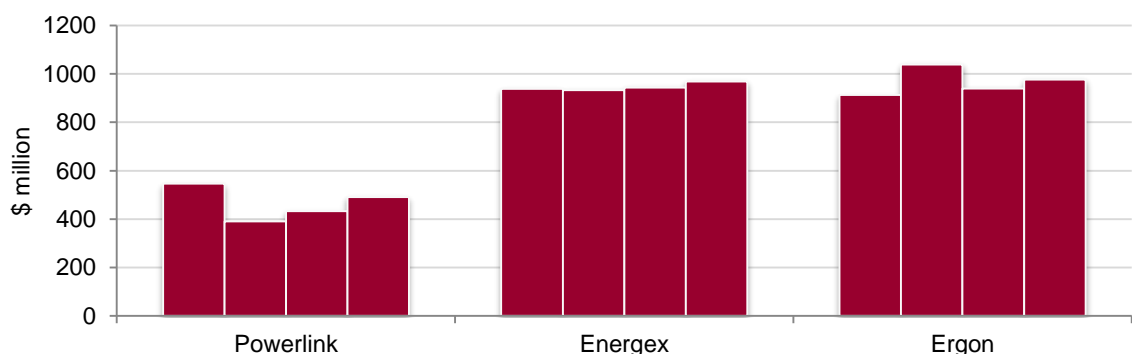
Over the next two years, distribution businesses are forecasting 14 per cent less planned capital expenditure compared to the spend approved by the AER in the current revenue determinations. The changes in 2013–14 and 2014–15 evidence the change in demand modelling that each business is undertaking.

### Funding capital expenditure

Part of the ongoing challenge is how to fund networks to ensure efficiency in maintenance and address peak demand requirements. Generators have forecast a total \$1.04 billion to be spent on assets over the next four years. Network businesses have forecast a total \$10.2 billion to be spent on assets over the same period.

The timing and planned level of investment for networks over the next four years is illustrated in Figure 1D.

**Figure 1D**  
Network planned capital investment 2013–14 to 2016–17



Note: Powerlink figures include regulated capital expenditure only. Energex and Ergon Energy figures are for both regulated and non-regulated capital expenditure

Source: *Powerlink substitute capital expenditure allowance included in Table 5.1 of the Powerlink final decision regulatory determination for the 2012–13 to 2016–17, Energex and Ergon Energy Network Management Plans (2012–13 to 2016–17)*

## 1.3.2 Geographic location

Powerlink transports electricity from generators to the distribution networks of Energex in the south-east corner and to Ergon Energy in the rest of the state. As noted in many reports, the major contributors to price are the poles and wires component of the electricity supply chain. The further away customers are from the sources of electricity (being the coal power stations and gas plants), the more costly it is to transport power to these customers.

The most expensive networks in Queensland are the regional ones. Ergon Energy's electricity distribution network has approximately 150 000 kilometres of power lines servicing around 700 000 customers in 97 per cent of Queensland. Around 70 per cent of the network's power lines are considered rural, with very low customer density. They also own and operate 33 stand alone power stations, with local distribution networks, to supply communities isolated from the main electricity grid in western Queensland, the Gulf of Carpentaria, Cape York, various Torres Strait islands and Palm Island.

In comparison, Energex's distribution network spans approximately 25 000 square kilometres, including the high growth regions of Brisbane, the Gold Coast and the Sunshine Coast and provides distribution services to more than 1.3 million residential, commercial and industrial customers.

## 1.3.3 Reliability and customer service standards

The industry has a number of standards which it is required to apply. They include general reliability standards established by the Australian Energy Market Commission (AEMC) to ensure safety, security and reliability of the national electricity system itself and state government reliability standards. The obligation to meet these standards contributes to the overall costs of networks.

NEM reliability standards are established by the AEMC Reliability Panel. The AEMC Reliability Panel imposes a number of reliability standards that the generation and bulk supply part of the electricity supply chain must follow in conducting their businesses. A power system demonstrates reliability by providing enough capacity to generate and transport electricity to meet all consumer demand.

The Queensland Electricity Industry Code (the Code) sets out the state government Minimum Service Standards (MSS) and Guaranteed Service Levels (GSL) for distribution networks. The MSS are a set of network reliability limits that establish minimum levels of network performance for the duration and frequency of outages on the electricity distribution networks. The GSL are a means of providing some financial recognition to customers who have received poor reliability or have been otherwise inconvenienced by the distributor.

Powerlink's network is planned and operated to meet transmission reliability standards set out in the National Energy Rules, *Queensland's Electricity Act 1994* and Powerlink's Transmission Authority.

Customer service standards require the AER to have regard to the quality, reliability and security of supply in setting the efficient costs that can be recovered by the regulated annual revenue requirements for Energex, Ergon Energy and Powerlink. This, in turn, forms the basis of setting network charges.

The use of these reliability and service standards can put upward pressure on maintenance and capital expenditure, which is reinforced by incentive payments for exceeding the standards; however, there are also penalties for not achieving these standards.

## 1.4 Industry reform

There have been a number of reviews conducted over the last 12 months aimed at addressing the rising cost of electricity. The reviews at the state and national levels have included:

- Queensland Commission of Audit
- AEMC transmission frameworks review (April 2013)
- Queensland Interdepartmental Committee review (June 2013)
- National Productivity Commission review (June 2013)
- national policy reform—white paper (Standing Council on Energy and Resources, Council of Australian Governments) (December 2012)
- AEMC transmission and distribution network reliability frameworks review (current)

Together, these reviews have recommended a number of changes to generator and network service provider operations. Greater pressure will be put on network service provider businesses to justify new infrastructure and improve operations. The challenge will be to maintain existing assets efficiently and use advances in technology effectively.

The Queensland Government is currently considering all recommendations of industry reviews conducted over the past 12 months in developing the 30-year electricity strategy.

## 1.5 Financial reporting framework

The Queensland energy GOCs are established under the *Corporations Act 2001* and are subject to regulation and oversight by the Australian Securities and Investments Commission (ASIC).

They apply the Australian accounting standards as 'for profit' entities. They are required also to comply with the *Government Owned Corporations Act 1993* (GOC Act) and the *Government Owned Corporations Regulation 2004* (GOC Regulation). The commercial monitoring division of Queensland Treasury and Trade (formerly the Office of Government Owned Corporations (OGOC)) also issues a number of policies and guidelines which are applicable to GOCs.

As public sector entities, they are required to comply with the *Financial Accountability Act 2009* and *Financial Management Performance Standard 2009*, but only to the extent that it is prescribed in the GOC Act (s.118) and the GOC Regulation (Part 5). Under s.45(3) of the GOC Regulation, GOCs are required to have an audit of their financial statements finalised by 31 August each year.

The government owned energy sector comprises 37 entities—five GOCs and 32 entities that they control, including one jointly controlled between Energex and Ergon Energy.

Figure 1E summarises the number of reporting entities, categorised by corporation type.

**Figure 1E**  
**Energy sector reporting entities**

Industry	Type of entity	2010–11	2011–12	2012–13
<b>Generator</b>	GOC	3	2	2
	Entities they control	21	20	20
<b>Transmitter</b>	GOC	1	1	1
	Entities they control	2	2	2
<b>Distributor</b>	GOC	2	2	2
	Entities they control	10	10	10
<b>Total</b>		<b>39</b>	<b>37</b>	<b>37</b>

Note: Energy sector entities within each category are shown in Figure 2A and Appendix C.

Source: Queensland Audit Office

All GOCs except for Ergon Energy have entered into 'deed of cross guarantee' arrangements within their consolidated groups. By entering into these deeds, the wholly owned subsidiaries within those groups are relieved of the requirement to prepare individual financial reports under the ASIC class order 98/1418. Instead, the GOC parent entity prepares a single consolidated financial report.

Consequently, only eight of the 37 energy sector entities prepare financial statements. Each controlled entity which prepares financial statements uses the same 31 August deadline as its GOC parent to enable the consolidated report to be certified.

### 1.5.1 Other reporting requirements

In addition to 30 June financial statements and whole-of-government reporting, generator and distribution, GOCs submit financial reports to ASIC as part of maintaining their Australian financial services licences. The AER also requires the preparation of Regulatory Information Notice accounts for Energex, Ergon Energy and Powerlink, whose revenues it regulates.

## 1.6 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, including those of government owned entities and their controlled entities, and to prepare an auditor's report.

The auditor's report, which includes the audit opinion, provides assurance about the reliability of the financial reports, including compliance with legislative requirements. In accordance with Australian Auditing Standards, one or more of the audit opinion types outlined in Figure 1F is issued.



**Figure 1F**  
**Audit opinions**

Opinion	Description
Unmodified	An unmodified opinion is issued where the financial statements comply with relevant accounting standards and prescribed requirements.
Qualification	A qualification is issued when the financial statements as a whole comply with relevant accounting standards and legislative requirements, but with particular exceptions.
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: Queensland Audit Office

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

The *Auditor-General Act 2009* requires that, after the audit opinion has been issued, a copy of the certified statements and the auditor's report must be provided to the chief executive officer of the entity as well as the appropriate Minister.

The Act also requires the Auditor-General to prepare a report to Parliament on each audit conducted. The report must state whether or not 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 adequately or properly and any actions taken to improve deficiencies reported in previous reports.

## 1.7 Report structure

The report is structured as followed:

- Chapter 2 discusses the results of the audits for the eight reporting entities, including the timeliness and quality of their draft financial statements and any significant reporting issues identified.
- Chapter 3 analyses the financial performance and position of the five parent entities over the last five years, trends and issues affecting their financial sustainability and their position to meet their future financial obligations.
- Appendix A contains responses received.
- Appendix B contains information on regulators, market participants and retail pricing.
- Appendix C contains a listing of energy sector entities for which audit opinions will not be issued in 2012–13.



## 2 Results of audits

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### In brief

#### **Background**

The audited financial statements for energy sector government owned corporations (GOCs) must be included in their annual reports. During our audit of these statements, we identify significant financial reporting risks and issues. The usefulness of financial reports depends on the quality of the information contained in them and the time it takes to produce them.

#### **Conclusions**

The financial statements of all electricity GOCs and their controlled entities were timely and of good quality.

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

#### **Key findings**

- Unqualified audit opinions were issued for all five GOCs and three controlled reporting entities within the statutory deadline of 31 August 2013.
- Hard close and early shell financial statement processes significantly assist in smoothing the year-end process. No material changes were made to the draft financial statements. Minor changes were made that related mostly to reclassifications between line items and increased policy disclosure to enhance understandability.
- Significant transactions included redundancy payments across the industry, carbon pricing, accounting for under-recovery of revenue and solar tariff rebates.
- Disposal of investments occurred in both the Powerlink and Stanwell consolidated groups.
- CS Energy continued to forecast net operating losses until 2015–16; however, the entity has provided analysis showing that it can continue to operate as a going concern.
- Changes in federal government and industry reform may have a significant effect on the valuation of GOC assets in 2013–14 and beyond.

## 2.1 Background

The Queensland energy sector comprises five GOCs; one jointly controlled entity established to provide information and communications technology services to the electricity distributors; 31 controlled entities; and a further seven joint venture interests audited by private sector firms. In addition, CS Energy controls one foreign based entity which is not within the mandate of the Auditor-General. This entity is audited by an overseas private sector firm. All entities have a 30 June balance date.

Each entity should establish financial management systems that identify and manage financial risks, including risks for reliable and timely reporting. The performance of financial management systems must be reviewed regularly.

Effective financial systems can produce timely and reliable financial information for management, directors and users of electricity services. An efficient system will integrate internal management reporting with external accountability reporting.

## 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 corporations and controlled entities</i>					
Stanwell Corporation Limited	Yes	22.08.2013	22.08.2013	✓	Unmodified
CS Energy Limited	Yes	29.08.2013	30.08.2013	✓	Unmodified
Queensland Electricity Transmission Corporation Limited (Powerlink)	Yes	30.08.2013	30.08.2013	✓	Unmodified
Energex Limited	Yes	26.08.2013	27.08.2013	✓	Unmodified
Ergon Energy Corporation Limited	Yes	29.08.2013	30.08.2013	✓	Unmodified
• Ergon Energy Queensland Pty Ltd	Yes	28.08.2013	30.08.2013	✓	Unmodified
• Ergon Energy Telecommunications Pty Ltd	Yes	28.08.2013	30.08.2013	✓	Unmodified
<i>Jointly controlled entities</i>					
SPARQ Solutions Pty Ltd	No	09.08.2013	09.08.2013	✓	Unmodified

Source: Queensland Audit Office

## 2.3 Audit opinions

Unmodified audit opinions were issued for all five government owned corporations (GOCs) and the three reporting entities they control. This is consistent with the prior year, confirming that financial statements have been prepared according to the requirements of legislation and relevant accounting standards.

An unmodified audit opinion has been issued for the financial component of the Energex 2012–13 Regulatory Information Notice (RIN). An opinion on Ergon Energy's 2012–13 RIN is yet to be provided. The work required for these audits is conducted after the financial statement audits and certified by December of each year. The RINs financial reports for 2011–12 were unmodified.

## 2.4 Timeliness and quality of draft statements

### 2.4.1 Timeliness

To enhance accountability in the use of public monies, entities should prepare and publish their financial information 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 informed decision making.

GOCs and statutory bodies are required to have their financial statements prepared and audited no later than 31 August each year.

Each entity agrees the date by which draft financial statements are provided for audit. 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.

All eight audit opinions issued for 2012–13 financial statements were issued by the 31 August 2013 legislative deadline. All controlled entity opinions were issued prior to the certification of group consolidated financial statements.

### 2.4.2 Quality and accuracy

#### Financial statement process

The standard process for electricity GOCs is to have shell financial statements agreed by external audit and the audit and risk management committees each year. This practice provides early detection of qualitative errors prior to 30 June, reduces the workload of entities at year-end and allows an appropriate length of time to consider disclosure issues in a methodical and timely manner.

Adjustments to year-end disclosure may still occur where financial results require further explanation. Errors reported in financial data will also be raised with management. Material errors require correction so that an unqualified audit opinion can be issued. The entity itself may also change its draft financial statements after submitting them to audit, if their quality assurance procedures subsequently identify that reported information is incorrect or incomplete, or to enhance readability of the financial statements.

Overall, there are two types of adjustments:

- financial statement adjustments—changes to the amounts being reported
- disclosure adjustments—changes to the commentary or financial note disclosure within the financial statements.

For the purposes of this report, material disclosure adjustments are defined as those which have been made since the first draft financial statements, including new notes added since the first draft and major changes to existing note disclosures.

### Material financial statement adjustments

Quality assurance processes have been fairly well bedded down after a year of restructuring businesses. As a result, no material changes were made to the draft financial statements. Changes that were made related mostly to reclassifications between line items to enhance readability of the statements and did not have an effect on the net operating result or net assets disclosed.

### Disclosure adjustments

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.

## 2.5 Significant audit and reporting issues

There were a number of significant audit and financial reporting issues across the electricity GOCs during the year.

### 2.5.1 Going concern status

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

Report 5 for 2012–13 Results of audit: State public sector entities for 2011–12 detailed the ongoing issue of CS Energy Limited's financial sustainability. CS Energy Limited reported losses over the past three years (2011–12: \$51.5 million, 2010–11: \$614.6 million, 2009–10: \$47.6 million) and had projected future losses until 2014–15 which affected its ongoing sustainability. Notably a significant portion of the 2010–11 loss was attributed to asset write-downs with the introduction of the carbon pricing scheme and the restructure of the generator businesses.

CS Energy again reviewed its operating structure in 2012–13 with a significant focus on operational efficiency improvements and cost rationalisation. The generator had a net loss of \$47.8 million in 2012–13 and continued to forecast losses up until 2014–15, with the first year of return to net profit occurring in 2015–16. An onerous contract continues for the Gladstone Interconnection and Power Pooling Agreement. Operations are also affected by continuing coal supply constraints at Callide.

In preparing its 2012–13 financial statements, CS Energy performed a going concern assessment at 30 June 2013 which took into consideration:

- the actual historical and projected future losses of the company based on May 2013 statement of corporate intent and corporate plan numbers, updated with the 30 June 2013 financial results and the cash flow forecast known deviations
- access to available facilities with Queensland Treasury Corporation (QTC) and confirmations from QTC that debt would not be called on in the next 12 months
- cash flow sensitivity analysis incorporating the Ergon Energy load and a Callide coal supply scenario based on adjusted high and low case gross margin sensitivities, given these are the most variable items in the financial forecasts.

CS Energy made adequate disclosure in the financial statements for the year ended 30 June 2013 regarding the directors' assessment of going concern and a positive liquidity ratio demonstrated the ability of the company to meet short term debt.

CS Energy continued to report key criteria to the board of directors and shareholding Ministers through monthly performance reports. These reports monitor the going concern assumption, solvency and overall sustainability of the company. QTC continues to monitor the GOC.

Overall going concern depends on its ongoing access to undrawn debt facilities with QTC and continued support of the government.

## 2.5.2 Significant transactions

### Redundancy payments

As part of the drive to make the electricity sector more cost efficient, the GOC entities undertook a program of restructures to reduce staff numbers employed by each entity.

In total, \$133 million was recognised in the 2012–13 financial statements, including \$93.36 million paid as redundancy costs in 2012–13 across the five entities as shown in Figure 2C.

Figure 2C  
2012–13 redundancies

Entity	Total redundancy cost \$ m	Total number of redundancies	Redundancies provision at 30 June 2013 \$ m
Stanwell Corporation Limited	20.5	123	22.39
CS Energy Limited	6.3	35	0
Powerlink	0.96	2	0.85
Energex	38.6	406	12.4
Ergon Energy	27.0	321	4.0
<b>Total</b>	<b>93.36</b>	<b>887</b>	<b>39.64</b>

Note: Redundancy provisions at 30 June 2013 have not been included in the total redundancy cost. Total number of redundancies represents those employees who were made redundant in 2012–13.

Source: Queensland Audit Office

At 30 June 2013, the entities had made provisions totalling \$39.64 million for further redundancies in 2013–14.

### Carbon pricing scheme impacts

Under the terms of the *Clean Energy Act 2011* which commenced 1 July 2012, Stanwell and CS Energy incurred a carbon emissions expense for the first time in 2012–13. Expenditure is required to be recognised in the statement of comprehensive income in the reporting period in which the carbon is emitted.

Generators endeavour to pass on 80 to 85 per cent of their carbon costs to minimise the effect on their bottom lines. Given the high carbon intensity of coal-fired generators, they are unable to recover 100 per cent of their carbon costs through the pool and contract market. Carbon costs for 2012–13 totalled \$600 million, with a 30 June 2013 liability of \$159 million as shown in Figure 2D.

**Figure 2D**  
Carbon expenditure and liability—Stanwell and CS Energy

Entity	Carbon expense 2012–13 \$ m	Carbon liability 30 June 2013 \$ m
CS Energy	244.8	71.1
Stanwell	355.2	87.9
<b>Total</b>	<b>600.0</b>	<b>159.0</b>

Source: Queensland Audit Office

### Revenue recognition and accounting for over/under-recovery of revenues

An amount is recognised in the income statement, statement of comprehensive income and the balance sheet for the over-recovery or under-recovery of revenue. In most cases a net under-recovery is recognised.

The transmission and distribution businesses account for revenue under a revenue cap which the Australian Energy Regulator (AER) determines. Over-recovery and under-recovery of revenues are adjusted via pricing mechanisms in subsequent financial years.

Regulated revenue entitlements, not recovered through pricing in the period during which the entities become entitled to that revenue and proposed pass-through costs, are carried as regulated revenue receivables and recovered in future periods within guidelines established by the AER.

Over-recoveries of regulated revenue entitlements are carried as liabilities and returned to customers within those guidelines.

As shown in Figure 2E, there has been a significant increase in the under-recovery of revenue for the distribution businesses in 2012–13.

**Figure 2E**  
Total revenue under-recoveries receivables—Transmission and Distribution GOCs

Entity	30 June 2012 \$ m	30 June 2013 \$ m
Powerlink	28.3	13.1
Energex	233.0	557.0
Ergon Energy	251.0	377.0
<b>Total</b>	<b>512.3</b>	<b>947.1</b>

Source: Queensland Audit Office

The key drivers for increased under-recoveries this year are:

- the ongoing effect of underestimating payments and corresponding revenue under the government's solar panel rebate scheme for distributors
- the estimated consumption when setting tariffs for 2012–13 exceeding actual consumption during the year
- the effect of prior year under-recoveries yet to be recovered.



They are only recognised if they are able to be recovered in future periods as set out in the AER approved pricing proposals. The recoverability of these receivables is based on the assumptions that:

- distributors will continue to seek to recover the maximum allowable revenue to which they are entitled
- they will be compensated for any government intervention on proposed price rises arising from political pressures to control electricity prices
- the recoverability of prior period amounts evidences the ongoing collectability of the 30 June 2013 balances.

### Solar tariff rebates

On 25 June 2012, the state government announced changes to the Solar Bonus Scheme whereby the 44 cent feed-in tariff was reduced to eight cents for all applications received after 9 July 2012.

For applications received by 9 July 2012, installations had to be completed by 30 June 2013 to retain the 44 cent feed-in tariff. This announcement led to a significant increase in the number of installations during the year as more customers lodged solar photovoltaic (solar PV) applications and completed installations to take advantage of the higher feed-in tariff.

Figure 2F shows the amount of solar PV cost paid out to customers by Energex and Ergon Energy over the past two years.

**Figure 2F**  
Amount of solar PV for pass through to customers

Entity	Customers with solar panels connected to the grid		Electricity sold back to grid		Amount of solar PV paid out to customers	
	Number of households		MWh		\$ m	
	2012	2013	2012	2013	2012	2013
Energex	148 311	222 257	168 056	389 625	73.9	167.1
Ergon Energy	46 018	78 709	63 183	171 588	27.8	75.2
<b>Total</b>	<b>194 329</b>	<b>300 966</b>	<b>231 239</b>	<b>561 213</b>	<b>101.7</b>	<b>242.3</b>

Source: *Energex 2012–13 Directors report, Queensland Audit Office*

In 2013, there were 561 213 MWh (2012: 231 239 MWh) of electricity fed into the grid at a total cost of \$242.3 million (2012: \$101.7 million) in feed-in tariff payments under the requirements of the Queensland Government Solar Bonus Scheme.

As these costs are included in determining the regulated revenue received by distributors, the net effect over subsequent years on their operating profit after tax is zero.

### Sale and reduction in investments held

On 18 December 2012, Powerlink sold its investment in Electranet Pty Ltd, an electricity transmission entity located in South Australia. The investment held by Harold Street Holdings Pty Ltd (a wholly owned subsidiary of Powerlink) resulted in a pre-tax gain of \$348.7 million. The after tax proceeds from the divestment were returned to the consolidated entity's shareholders by way of an interim dividend.

Stanwell disposed of its interest in the Tri-Star joint venture in January 2013, resulting in a pre-tax gain of \$2.5 million after recognising prior year impairment losses totalling \$10.1 million. The venture covered the gas exploration and development of the ATP 606P and ATP 927P sites in the Surat Basin. The disposed assets included a one per cent interest in the joint venture which had a carrying amount of \$24.6 million and accumulated exploration and evaluation expenditure of \$1.2 million.

Stanwell also exited its contractual interest in coal seam gas resources ATP 626P in the Surat Basin with Icon Energy Limited on 2 July 2013, due to unfavourable results in drilling. Stanwell took capitalised exploration and evaluation expenditure of \$8.4 million (2011–12: \$4.0 million) to the statement of comprehensive income as an impairment expense to write off the remaining asset at 30 June 2013. The deed of termination and release has resulted in Stanwell avoiding the requirement to fund the full \$16.1 million and removed all future obligations and limited exposure to existing claims.

## 2.6 Future financial reporting issues

### 2.6.1 Valuation of assets—generators

Generators booked a significant level of impairment in 2010–11, primarily due to the effect of carbon on the net worth of core generation assets. Over the past two years, impairment testing has been conducted to identify if assets are stated in excess of net cashflows and to assess whether there are any indicators that impairment booked in prior years can be reversed.

In 2012–13, CS Energy and Stanwell conducted a full impairment review to identify whether they needed to either book further impairment or reverse impairment previously booked. Neither generator identified reasons to reverse prior year impairment. This was primarily due to the uncertainty of the political environment at 30 June 2013, leading up to the federal election, as to whether carbon legislation may change after the federal election and the effect that international carbon prices would have on the market.

Now that the elected government may remove the carbon pricing scheme, generators will need to assess whether there are grounds to reverse the asset impairment that was booked in 2010–11 to the extent allowed by accounting standards.

### 2.6.2 Valuation of assets—transmission and distribution

The valuation of assets is determined using a discounted cash flow approach. Variables in these valuations include the forecasted regulated asset base, discount rates, expected revenue, forecasted operating costs and estimated residual values. With significant uncertainties in the energy sector around demand and the effect it will have on future income streams, the valuation of assets will need to be revisited to ensure property, plant and equipment balances are materially close to fair value at reporting dates.

### 2.6.3 Industry reform

The government announced that it has agreed in principle to the establishment of a holding company over Energex and Ergon Energy and the potential reallocation of the lines of business between the distributors to achieve greater efficiencies. The effect on the financial statements will be assessed as plans for restructure are developed and implemented.

# 3 Financial performance, position and sustainability

## In brief

### Background

We assess each entity's ability to continue as a going concern when forming our 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; its future ability to pay its operational costs; replace and grow its assets; and pay its debts when they fall due.

### Conclusions

All entities are sustainable in the short term. The longer term sustainability of generators depends critically on their ability to reduce future operating and capital costs and constrain their future debt levels. Sustainability of networks depends on their ability to anticipate and address forecast demand adequately, to adapt to revised forecasts and to align the delivery of planned expenditure programs to meet customer requirements within the regulatory framework.

### Key findings

- Combined net profit before tax (NPBT) of the five government owned corporations (GOCs) was \$1.7 billion (2011–12: \$1.2 billion). At 30 June 2013, the five GOCs held \$10.94 billion in net assets (2011–12: \$10.37 billion).
- Dividends paid to shareholding Ministers totalled \$1.03 billion (2011–12: \$0.63 billion); however, community service obligation payments totalling \$0.63 billion (2011–12: \$0.41 billion) were paid out to Energex and the retail arm of Ergon Energy to support the provision of the state's uniform tariff policy and non-commercial operations.
- Operating sustainability ratios are marginally above zero, except for CS Energy which continued to be in a negative position but improving. Although cash flows decreased over the five-year period, all GOCs continue to operate as going concerns.
- Investing sustainability ratios indicate assets were generally being built or refurbished faster than they were being depreciated. They were primarily funded through debt.
- Debt sustainability ratios in the light of capital structures used indicate that GOCs were continuing to meet their debt obligations. GOCs need to ensure capital structures continue to support long term sustainability.

### Recommendations summary

1. **It is recommended that the Department of Energy and Water Supply (DEWS) and Queensland Treasury and Trade (QTT) include the indicators of financial sustainability used in this report in their performance reporting framework.**

## 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, we assess its future short and longer term 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.

To be financially sustainable in the short term, energy sector government owned corporations (GOCs) must have the capacity to meet current and future obligations as they fall due. In the longer term, they should be able to absorb foreseeable financial risks without substantially reducing their operating costs or significantly increasing the price they charge for their services.

The Department of Energy and Water Supply (DEWS) is the overarching department providing policy to the energy sector. Queensland Treasury and Trade (QTT) also monitors GOC performance.

Energy GOCs all have different ways of evaluating their own financial performance, position and sustainability. Each year, the GOCs agree statements of corporate intent and five-year corporate plans with their shareholding Ministers. These documents contain a suite of key financial and operational performance indicators and budget financial statements which are reported against, monthly and quarterly, to shareholding Ministers. DEWS and QTT are using a performance reporting framework against which GOCs report.

## 3.2 Conclusions

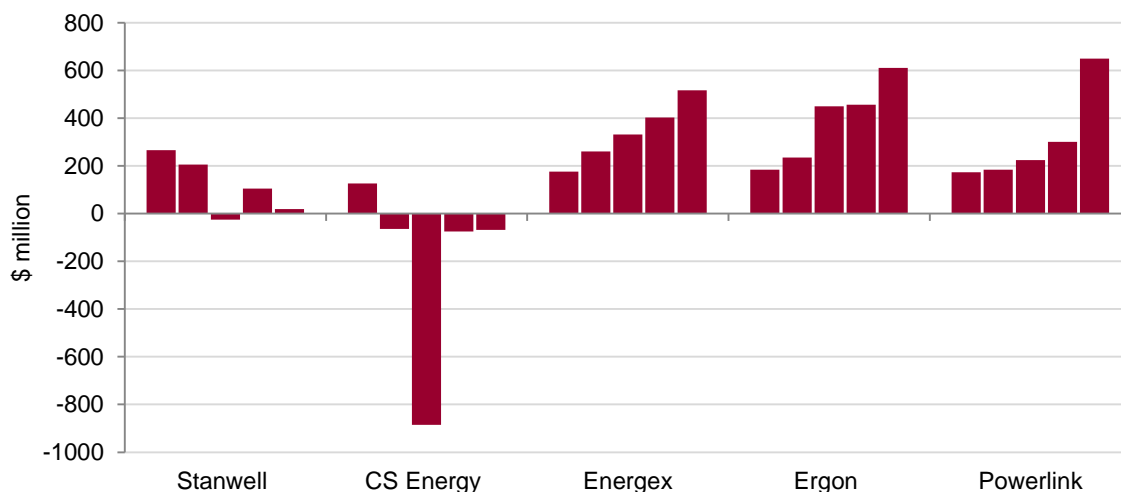
Energy sector entities achieved financial results which indicate that they are sustainable in the short term. The longer term sustainability of generators depends critically on their ability to reduce future operating and capital costs and constrain their future debt levels. Sustainability of networks depends on their ability to anticipate and address forecast demand adequately, to adapt to revised forecasts and to align the delivery of planned expenditure programs to meet customer requirements within the regulatory framework.

## 3.3 Financial performance

Figure 3A shows the consolidated net profits before tax (NPBT) for each GOC since 2008–09. Net profit before tax is calculated as revenue less expenditure but does not include the effects of other comprehensive income or National Tax Equivalent Regime (NTER) payments.

In most cases, other comprehensive income represents increases in asset values, adjustments for actuarial gains and losses on defined benefit plans and changes in the value of cash flow hedges at balance date. The GOCs are part of the NTER and are required to account for income tax in accordance with relevant taxation laws.

**Figure 3A**  
**Net profit before tax 2008–09 to 2012–13**



Source: Queensland Audit Office

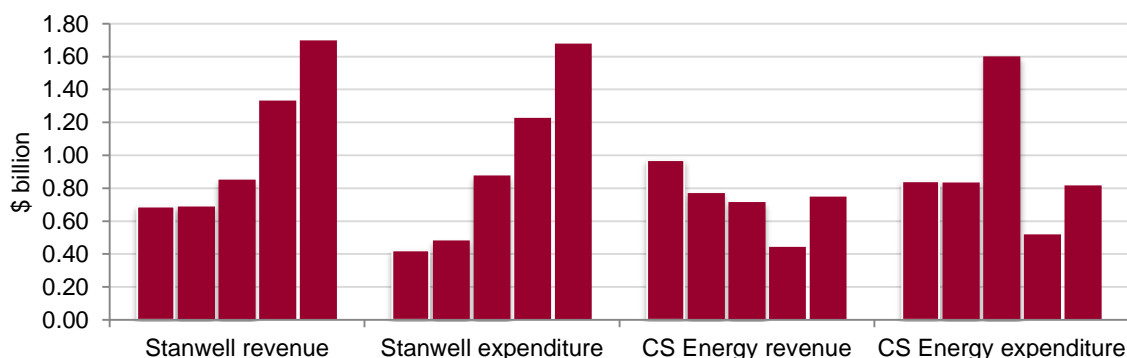
In 2012–13, a total \$1.7 billion (\$1.2 billion in 2011–12) NPBT was generated by the GOCs. The 2010–11 loss for CS Energy was attributed to asset write-downs with the introduction of the carbon pricing scheme and the restructure of the generator businesses. Net profit before tax has steadily increased over the past five years for the network businesses. Increases in regulated revenue have been the main drivers for network business improved results. A revenue reset for Energex and Ergon Energy in 2010–11 contributed significantly to this outcome. For Powerlink, the sale of Electranet Pty Ltd and revenue reset in 2012–13 flowed through to affect the net profit before tax.

Total revenues for the state owned electricity businesses increased by over \$1.7 billion to \$9.1 billion for 2012–13 (\$7.4 billion in 2011–12). Total expenditure also increased by \$1.1 billion to \$7.3 billion during 2012–13 (\$6.2 billion in 2011–12); however, all GOCs have undertaken significant restructure and business improvement programs in the current year to reduce expenditure.

### 3.3.1 Generators

Figure 3B shows the changes in generator revenue and expenditure across the past five years.

**Figure 3B**  
**Generator revenue and expenditure 2008-09 to 2012-13**



Source: Queensland Audit Office

Large movements in the 2010–11 year occurred during the generator restructure period. After the restructure, CS Energy and Stanwell were very different in terms of staffing, level of debt and make-up of the portfolios they hold which decreases the comparability of their businesses pre- and post-restructure. Our analysis therefore applies to the 2011–12 and 2012–13 years only.

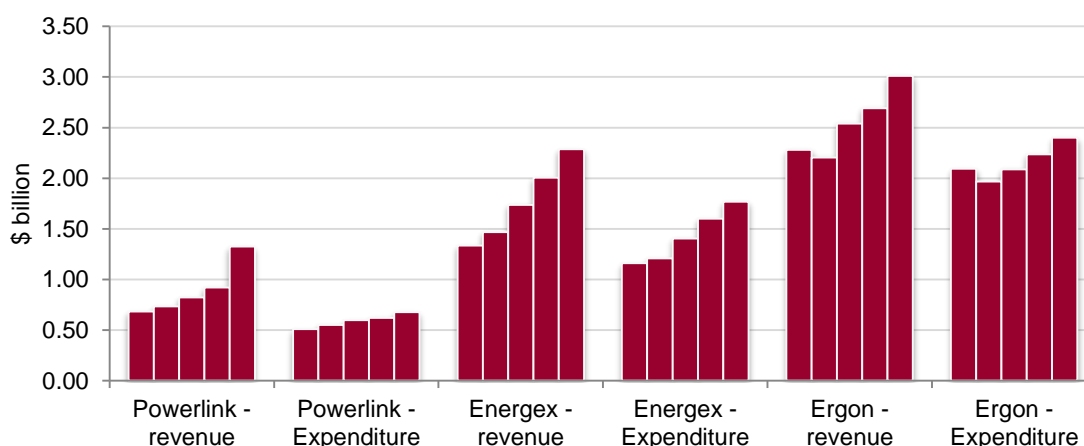
Post-restructure generator revenues from continuing operations increased by \$634 million (35 per cent) and expenditures increased by \$714 million (40 per cent). The cost increases were largely attributable to carbon pricing—a carbon emissions expense of \$600 million was incurred for the first time in 2012–13—but this cost is also largely recovered in revenues.

In general, less demand due to lower than average summer temperatures reduced profitability. Stanwell had reduced coal revenue rebates compared to 2011–12, while both entities had redundancy payments and provisions expenditure. CS Energy incurred unbudgeted expenditure of \$7.7 million, predominantly associated with restructuring costs and a fire at Wivenhoe on 18 September 2012.

### 3.3.2 Networks

Figure 3C shows the changes in network revenue and operational expenditure across the past five years.

**Figure 3C**  
Network revenue and expenditure 2008–09 to 2012–13



Source: Queensland Audit Office

Total revenues across the network businesses have increased over the past five years from \$4.30 billion to \$6.62 billion in 2012–13 (53.9 per cent).

Powerlink's notable increase in revenues in 2012–13 was due primarily to its divestment of its 41.1 per cent share in Electranet, resulting in a pre-tax gain of \$348.7 million.

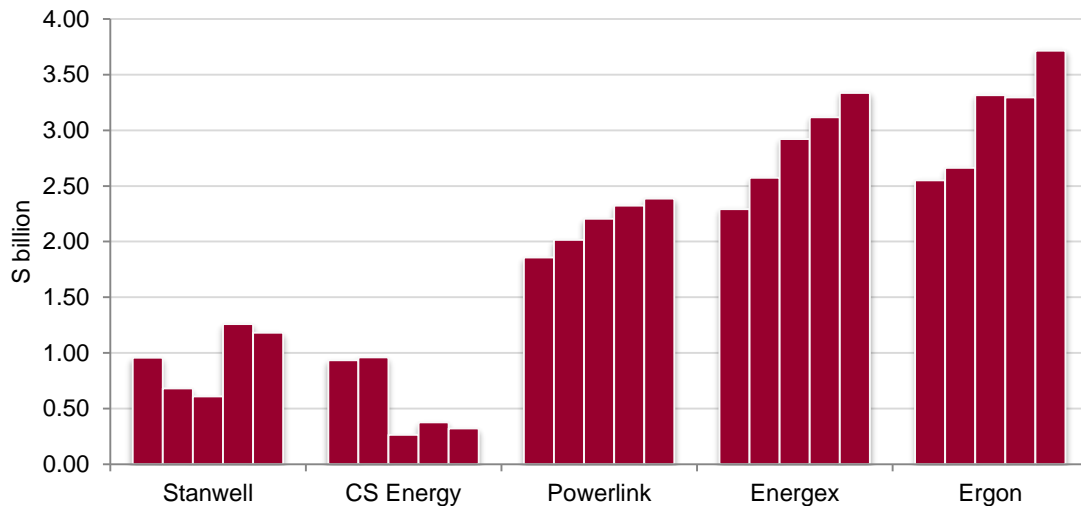
For Energex and Ergon Energy, increases in revenue and expenditure over the last couple of years were in part attributable to increases in the solar tariff rebate. Community service obligation (CSO) revenue has climbed since 2009–10 to \$594.2 million in 2012–13 for Ergon Energy—an increase of \$344 million (237 per cent), highlighting the increased cost of operations for the retail arm of Ergon Energy. Energex also obtained a CSO revenue of \$35.8 million in 2012–13 for the first time over this five-year period. Included in revenue for all three network businesses are under-recoveries which represent revenue to be recovered in future periods.

Expenditure across the network businesses increased over the past five years from \$3.76 billion to \$4.84 billion in 2012–13 (28.7 per cent). Steady increases in employee costs for Ergon Energy and Powerlink, and depreciation expenditure across all network businesses as new assets came on line over the last five years have been significant contributors. Finance costs have also risen as increased borrowings occurred to fund new asset projects. Efficiency and reform programs in recent years were introduced by network businesses to address rising costs.

### 3.4 Financial position

Net assets increased significantly, by \$2.35 billion (27 per cent), since 2008–09. Net assets are calculated as total assets less total liabilities. Figure 3D illustrates the value of net assets held by the five GOCs.

Figure 3D  
Net assets 2008–09 to 2012–13



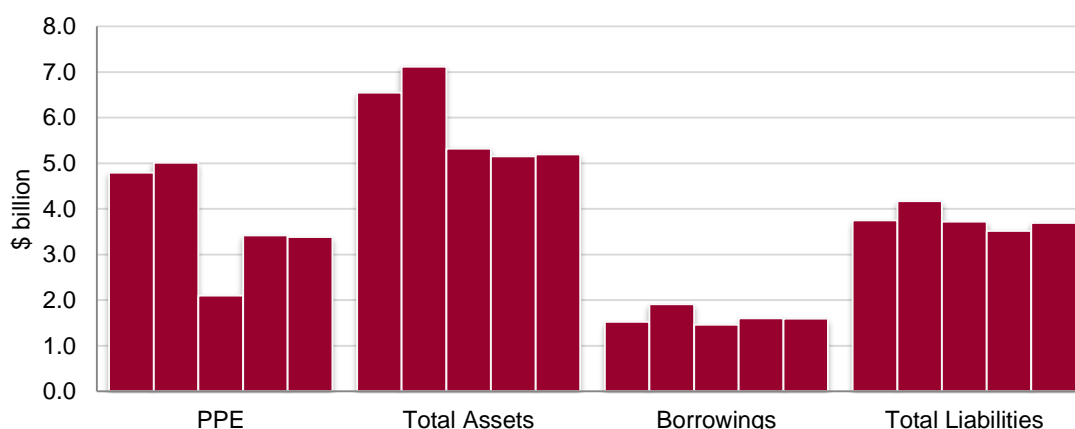
Source: Queensland Audit Office

Changes in total assets and liabilities over the five-year period have been driven by movements in property, plant and equipment and borrowings.

#### 3.4.1 Generation

Figure 3E shows the progression of key balances across a five-year period for the public sector owned generators in Queensland. The balances to 2010–11 include Tarong Energy Limited. With the generator restructure occurring 1 July 2011, property, plant and equipment and Queensland Treasury Corporation (QTC) borrowings have now decreased over the total five-year period, in line with overall decreases in total assets and liabilities. Significant decreases in assets occurred in 2010–11, due to the impairment of property, plant and equipment after the carbon pricing scheme was announced.

**Figure 3E**  
**Generation businesses combined 2008–09 to 2012–13**



Source: Queensland Audit Office

Post-restructure net assets for both generators remained fairly constant. Slight decreases were attributable to reductions in capital project expenditure in accordance with expectations of shareholding Ministers. This was offset by increases in cash holdings with generators holding 25 per cent of their 2012–13 carbon expenditure at 30 June 2013 for payment in February 2014.

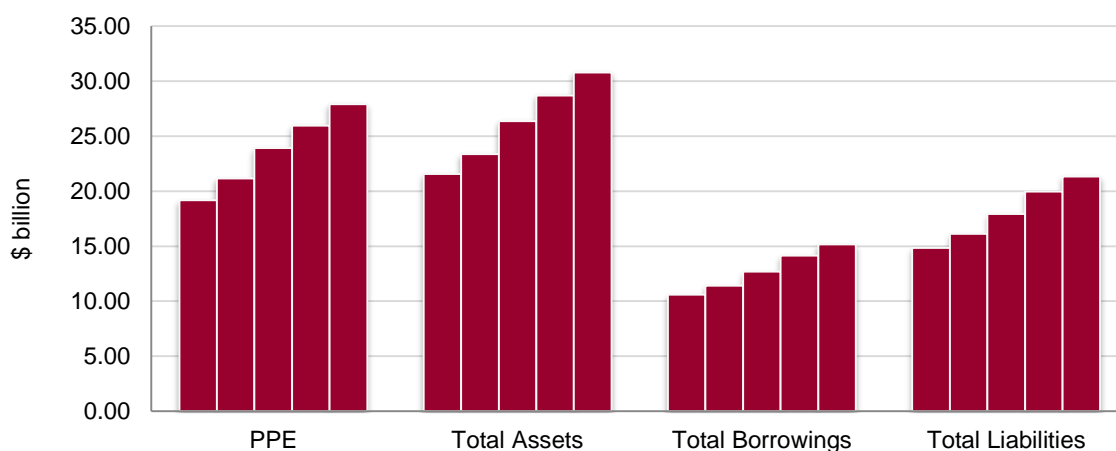
The generators enter into derivative hedging contracts to manage their exposure to electricity prices. The net derivative value of both generators at 30 June 2013 changed to a net liability position of \$177.7 million, compared with 30 June 2012 when a net derivative asset position of \$62.8 million was recognised. The significant change in this position was due to the price volatility in the contract markets for electricity, foreign exchange and other commodities and the constant change in the actual products being valued, as old deals terminated and new deals were traded. Whether individual deals are classified as assets or liabilities will depend on whether the market prices have risen or fallen since the individual deals were traded; their value and classification can swing accordingly from asset to liability and back with each monthly valuation as the market's forward curve prices change.

### 3.4.2 Networks

Figure 3F shows the progression of key balances across a five-year period for the three state owned network businesses in Queensland.



**Figure 3F**  
**Network businesses combined—changes in balances**  
**over five years from 2008–09 to 2012–13**



Source: Queensland Audit Office

Overall property, plant and equipment assets increased by \$8.75 billion (45 per cent) and QTC borrowings increased by \$4.75 billion (43 per cent).

In 2012–13, Powerlink invested \$558 million in assets with a further \$166.3 million booked as revaluation increments. Its borrowings increased by a net of \$300 million and were used to fund capital projects.

Energex increased its assets by \$910 million. Revaluation increments of \$137.5 million were also recognised in 2012–13. An increase in long term borrowings, with drawdowns of \$536.2 million, also had a significant effect on the level of liabilities held at 30 June 2013.

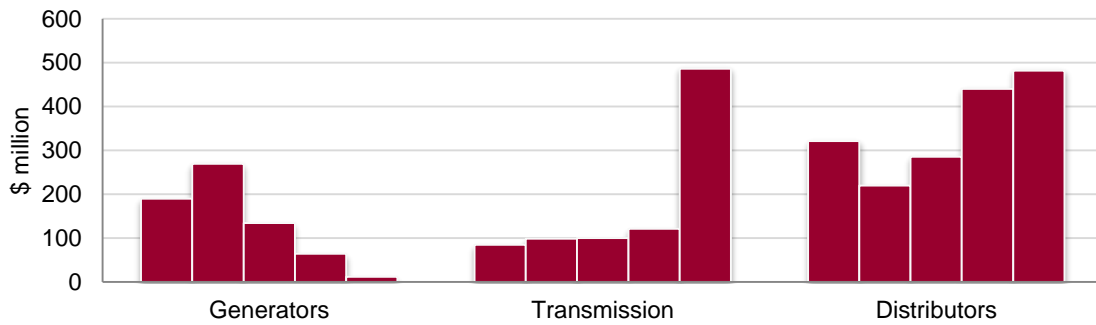
Ergon Energy property, plant and equipment increased by \$793 million in 2012–13 with additions of \$819 million and revaluation increments of \$393 million. Borrowings increased by \$187 million with drawdowns of \$528 million offset by repayments of \$365 million.

## 3.5 Flows to and from government

### 3.5.1 Dividends

The energy GOCs usually pay 80 per cent of their net profit after tax as a dividend to government. In 2012–13, GOCs paid \$1.03 billion to government as dividends, with Powerlink returning 90 per cent of its profit after tax in the current year. Figure 3G highlights the amount paid out as dividends over the last five years for each part of the supply chain.

Figure 3G  
Dividends paid 2008-09 to 2012-13



Source: Queensland Audit Office

### 3.5.2 Community service obligations

Due to the size of the network that the retail arm of Ergon Energy operates in regional Queensland, operational and capital expenditures exceeded what can reasonably be expected to be recovered from customers. As a result, CSO payments from government form the second major portion of the consolidated group's revenue. The CSO deed is valid until June 2014. A replacement deed to apply post-June 2014 is under development.

### 3.5.3 Competitive neutrality fees

The purpose of establishing GOCs is to provide services to the community on a commercial basis, with the direct intention of making commercial returns that government can redistribute to meet other government objectives.

To ensure a level playing field is obtained in the commercial environment, the government imposes competitive neutrality fees. Figure 3H shows the upward trend in the competitive neutrality fees charged to GOCs over the past five years in relation to their borrowings from QTC.

Figure 3H  
Amount of competitive neutrality fees charged to GOCs over the past five years

Entity	2008-09 \$ m	2009-10 \$ m	2010-11 \$ m	2011-12 \$ m	2012-13 \$ m
Stanwell	1.90	3.49	4.55	17.50	15.35
CS Energy	7.27	3.55	12.66	14.56	15.22
Powerlink	10.63	6.86	5.48	5.75	36.65
Energex	17.68	11.97	36.20	42.02	47.14
Ergon Energy	16.52	12.49	44.87	49.44	53.30
<b>Total</b>	<b>54.00</b>	<b>38.36</b>	<b>103.76</b>	<b>129.27</b>	<b>167.66</b>

Source: Queensland Audit Office

These fees remove the advantages that GOCs obtain from being owned by the public sector. An example of this is where GOCs borrow monies from QTC at a rate which is comparatively lower than rates which could be obtained by similar private sector entities in the private market.

## 3.6 Financial sustainability

Financial sustainability can be measured in a number of ways. We developed three key indicators of financial sustainability using the information reported in the financial statements.

### 3.6.1 Operating sustainability

#### Operating surplus ratio

The current operating surplus is a short term indicator of an entity's ability to continue as a going concern. Over an extended period, the average operating surplus ratio needs to be positive if the entity is to remain financially sustainable over the medium to long term.

Persistent negative ratios indicate continuing net losses, which mean insufficient revenue is being generated to fund operating and future capital expenditure. This in turn leads to depletion of cash reserves or requires increased borrowings; and potentially compromises the ability of an entity to invest in new assets and maintain their service levels.

Figure 3I  
Operating sustainability ratios for five years to 2012–13

Ratio	Entity	2008–09	2009–10	2010–11	2011–12	2012–13	Five year average
<b>Operating surplus ratio</b> Indicates the extent to which operational revenues raised cover operational expenses. = Net operating result divided by total operating revenue.	Stanwell	0.28	0.22	(0.01)	0.06	0.01	<b>0.11</b>
	CS Energy	0.10	(0.06)	(0.86)	(0.12)	(0.06)	<b>(0.20)</b>
	Powerlink	0.18	0.18	0.19	0.22	0.34	<b>0.22</b>
	Energex	0.10	0.13	0.14	0.14	0.16	<b>0.13</b>
	Ergon Energy	0.06	0.08	0.13	0.12	0.14	<b>0.11</b>

Note: Net operating result represents Net Profit After Tax

Source: Queensland Audit Office

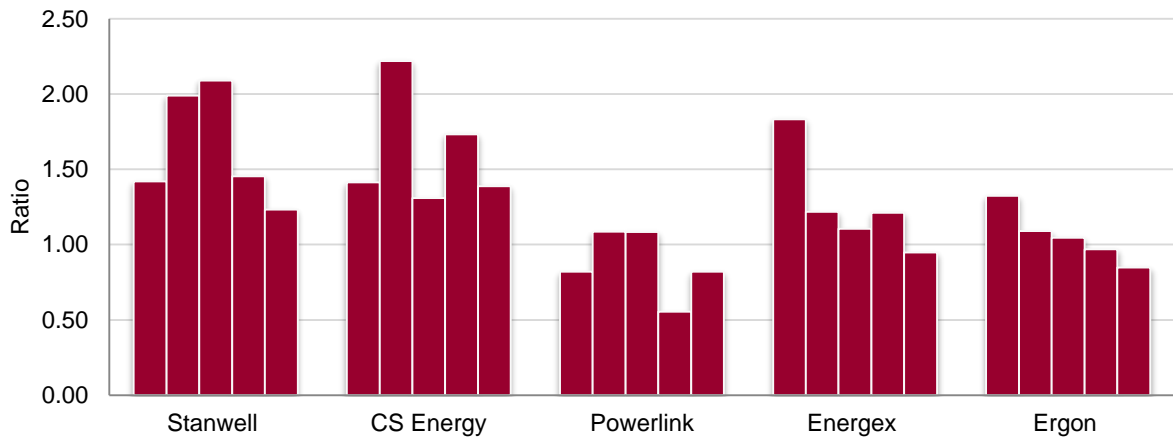
Unlike measures of absolute financial performance (as illustrated in Figure 3A), comparisons of operating ratios allow readers to understand better the relative financial performance of entities of different sizes.

Except for CS Energy, the five-year average results for this ratio are above zero. The operating surplus ratios of both generators were negative in 2010–11, with CS Energy having a negative ratio over the past four years. CS Energy has experienced declining revenues since 2008–09, with a drop of \$526.3 million (54 per cent) between 2008–09 and 2011–12 figures. In contrast, Stanwell has a coal revenue agreement in relation to a coal mine which significantly contributes to its ongoing profitability.

#### Liquidity ratio

The liquidity or current ratio is the relationship between current assets and current liabilities. A ratio of greater than 1.5 is considered favourable, but a ratio of more than one still indicates a low risk of not being able to fund current obligations. The higher the ratio, the more liquid a company is.

Figure 3J  
Liquidity ratio 2008–09 to 2012–13



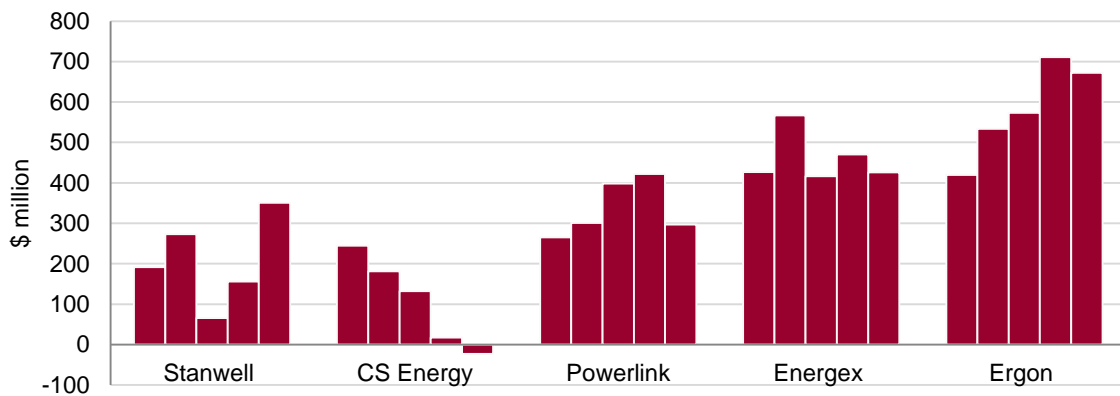
Source: Queensland Audit Office

Over the past five years, each electricity GOC has experienced lower liquidity ratios; however, the generators have been the stronger performers in this area until recently. Powerlink, Energex and Ergon Energy have remained around a ratio of 1.0. A lower liquidity ratio for network businesses is reflective of the regulated environments in which they operate that can allow revenue cashflows to be more predictable in managing their working capital.

### Net operating cash flows

Looking further at the GOC net operating cash flows, it can be seen that, historically, both distributors have shown fairly strong net cash flows which are rising. Powerlink also improved its net cash flows and were near parallel with Energex in 2011–12. CS Energy, in particular, continues to worsen in its position.

Figure 3K  
Operating cash flow 2008–09 to 2012–13



Source: Queensland Audit Office

The government provided an ongoing commitment to ensure the energy businesses achieve increased efficiencies, better capital management and operational cost savings. This process started in September 2012 when shareholding Ministers wrote to each energy business, outlining their expectation for financial and non-financial performance in 2012–13 and beyond, emphasising the need to focus on cost and performance efficiencies. This was monitored monthly in reports to shareholding Ministers, coupled with higher levels of scrutiny on revision of annual statements of corporate intent and corporate planning documents submitted by each business.

## Risks to future operating sustainability

- **Coal revenue sharing agreement**—In refocusing the energy businesses, the Commission of Audit recommended the divestment of non-core businesses, including the coal export revenues of Stanwell. The businesses are continuing to evaluate these proposals, based on their commercial merits and are looking at avenues by which they can monetise coal assets. Had Stanwell operated without its coal revenue sharing agreement revenue in 2012–13, it would have recorded a net loss before tax of \$140.2 million (2012: \$103.3 million), compared to the current year profit before tax of \$18.6 million (2012: \$105.5 million). Consequently, no dividend would have been paid to government in either year, compared to the \$11.7 million declared to be paid to the government in 2012–13 (2012: \$63.9 million).
- **Cold storage of generator units**—Over the last 12 months, Stanwell has put into cold storage two of its Tarong units, to respond to issues of market oversupply. The reintroduction of these units into the market will depend on increases in demand. The units continue to incur depreciation and a certain level of overheads to maintain the units in a serviceable condition for when they do come back into use.
- **Profitability of core generation assets**—Generators are continuing to focus on commerciality of core generation assets. Discussion on the viability of CS Energy is detailed in Chapter 2. Improvement in gross margins for both CS Energy and Stanwell will be required in order to remain competitive in the supply market.
- **Revenue under-recoveries**—At 30 June 2013, net regulated revenue under-recoveries of \$947.1 million were recorded in the network businesses. These businesses rely on being able to recover this revenue in future periods under approved pricing proposals. Should this revenue not be recoverable, this would have a significant effect on operating ratios.

## 3.6.2 Investing sustainability

Investing sustainability is an indicator of an entity's ability to fund asset renewal and replacement.

In comparison to generators who value assets at cost, network businesses value their assets at fair value. Although both categories of the sector assess for impairment using discounted cash flows, the basis used by generators will result in assets being valued at a lower amount where the discounted cash flow amount is higher than the asset cost recorded in the financial statements.

For network businesses at fair value, the discounted cash flow is the value recorded in the financial statements. Except cases where an impairment below asset cost occurs, generators are recording their assets below what they would have otherwise been recording if they had used a fair value approach.

In this section, the capital replacement and growth ratio has been used as the primary indicator for investing sustainability.

### Capital replacement and growth ratio

The capital replacement and growth ratio compares the annual net expenditure on non-current assets (predominantly property, plant and equipment) to the annual depreciation charge. 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.

**Figure 3L**  
**Capital replacement and growth**

Ratio	Entity	2008–09	2009–10	2010–11	2011–12	2012–13	Five year average
<b>Capital replacement and growth ratio (times)</b>	Stanwell	1.07	0.90	0.88	1.22	1.05	<b>1.02</b>
	CS Energy	1.31	0.72	1.08	1.49	0.79	<b>1.08</b>
Net rate of replacement of non-financial assets = Net purchases of non-current assets divided by depreciation expense	Powerlink	4.01	2.39	2.00	2.97	2.36	<b>2.75</b>
	Energex	3.47	4.00	3.21	2.85	2.49	<b>3.20</b>
	Ergon Energy	3.05	2.68	2.61	2.32	2.11	<b>2.55</b>

Source: Queensland Audit Office

Analysis of this ratio shows that all GOCs are above one over a five-year average; however, the generation companies are not spending money on new assets at the same rate as network companies.

Capital cost requirements of network businesses depend on network demand, condition of the assets and reliability standards. The regulatory framework is aimed at ensuring an efficient capital expenditure allowance is being provided through regulatory determinations.

### Risks to future investing sustainability

The network businesses continued to increase their asset bases over the past five years. Businesses are now reforecasting demand patterns; however, investing sustainability will still be largely dependent on the ability to source funds for the replacement and growth of further assets.

### 3.6.3 Debt sustainability

Debt sustainability means entities can pay their debts when they fall due from the funds they generate from their operations, including meeting their obligations to repay principal and interest on their borrowings. The ratio of debt to operating revenue is an indicator of the capacity of an entity to do this. Debt for the purposes of this ratio is borrowings and does not include other liabilities such as trade creditors.

**Figure 3M**  
**Debt sustainability—ability to repay debt**

Ratio	Entity	2008–09	2009–10	2010–11	2011–12	2012–13	Five year average
<b>Debt to revenue ratio (times)</b>	Stanwell	0.37	0.93	0.75	0.58	0.45	<b>0.62</b>
	CS Energy	0.85	1.07	1.15	1.86	1.10	<b>1.21</b>
Capacity to repay debt and interest	Powerlink	4.45	4.55	4.33	4.18	3.13	<b>4.13</b>
	Energex	2.88	2.79	2.75	2.73	2.63	<b>2.75</b>
= Interest bearing liabilities divided by total operating revenues	Ergon Energy	1.63	1.81	1.71	1.79	1.66	<b>1.72</b>

Source: Queensland Audit Office

In total, the GOCs had \$16.75 billion in long term borrowings at 30 June 2013 against operating revenues of \$9.1 billion. Ratios highlight that, although CS Energy and Stanwell hold similar levels of debt at 30 June 2013, Stanwell has more revenue to service this level of debt. In line with shareholding Minister expectations, reduced generator debt is likely to assist long term sustainability.

The debt to revenue ratio for Powerlink is higher than that of the distributors as distributor revenue includes charges which are passed on from Powerlink and an overall higher level of revenue.

By nature, the generator and network businesses are different. Generator revenues streams are driven by market forces and network revenue is regulated in five-year periods by the AER, making revenue streams more predictable for network businesses. As a consequence, different capital structures are used by the GOCs to operate their businesses.

Network GOCs' capital structures contain debt which are below the AER benchmark debt levels (as applied in the guidance related to determinations of the regulated rate of return) that approximately 60 percent of the regulated asset base is assumed to be funded by debt. This reflects the way the businesses are operated in that the costs of assets are spread across the life of those assets.

Recovery of debt costs occurs through the regulated return on assets as set in the revenue determinations by the AER.

All entities except CS Energy and Energex underwent debt optimisation in the current year to take advantage of low interest rates. CS Energy has plans to refinance its debt in 2013–14. Energex is maintaining its current debt funding in advance of a final refinancing strategy to be determined in 2013–14.

### Risks to future debt sustainability

GOCs will need to ensure capital structures continue to support long term sustainability.

## 3.7 Recommendations

1. It is recommended that the Department of Energy and Water Supply (DEWS) and Queensland Treasury and Trade (QTT) include the indicators of financial sustainability used in this report in their performance reporting framework.



# Appendices

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# 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 Premier, the Treasurer and Minister for Trade, the Director-General of the Department of the Premier and Cabinet, the Under Treasurer, Queensland Treasury and Trade and the Minister for Energy and Water Supply for information.

This report was provided to the Director-General of the Department of Energy and Water Supply and the heads of Stanwell Corporation Limited, CS Energy Limited, Powerlink, Energex Limited and Ergon Energy Corporation Limited with a request for comments.

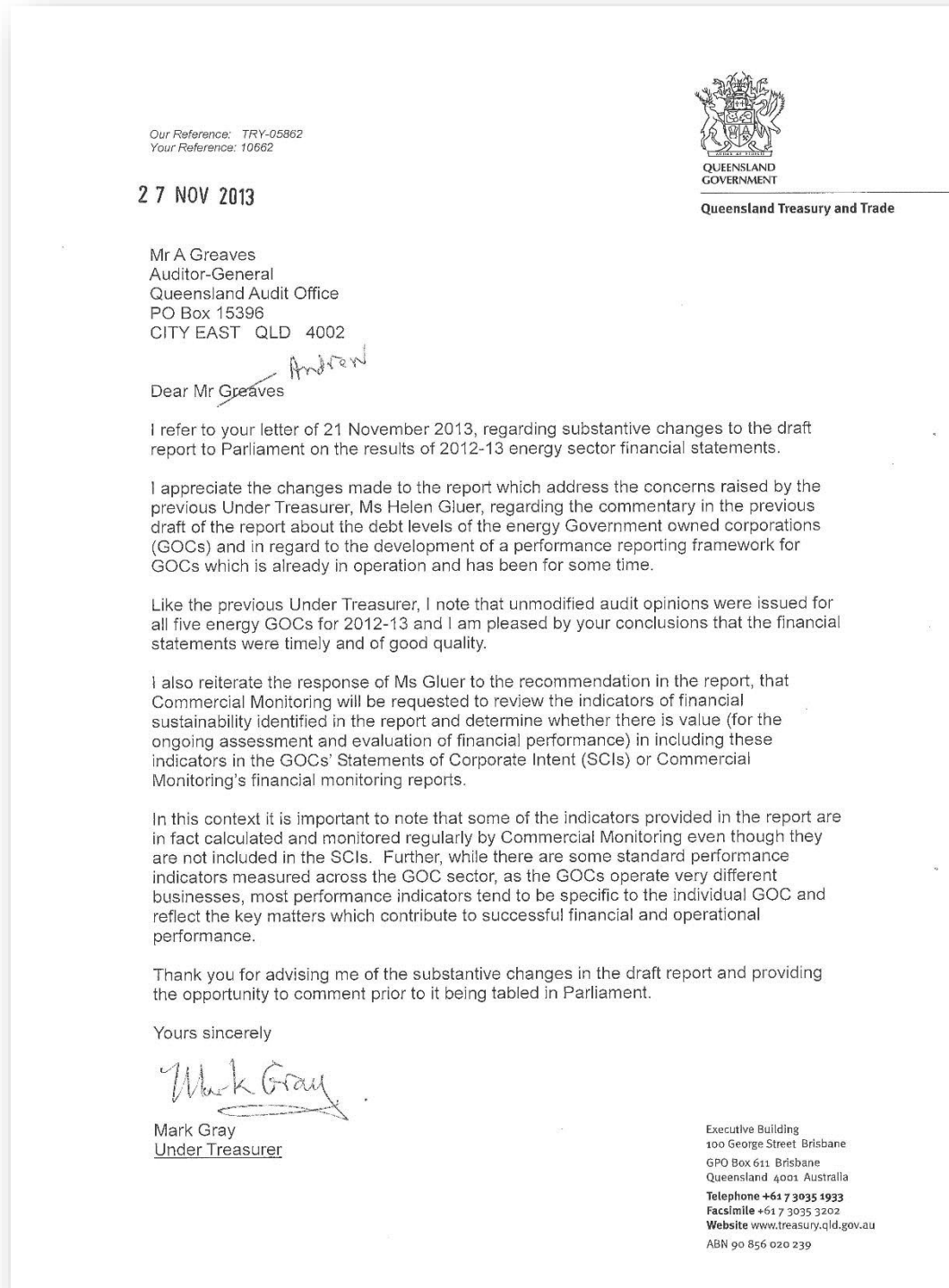
Their views have been considered and are represented to the extent relevant and warranted in preparing this report.

Full comments or a fair summary of the comments received are included in Appendix A of this report.

Responses provided by the Chief Executive, Powerlink and the Director-General, Department of Energy and Water Supply on 14 November 2013 have been addressed in finalising this report. No further comments have been provided for inclusion in Appendix A of this report.


## Comments received

Response provided by the Under Treasurer, Queensland Treasury and Trade on 27 November 2013.



## Comments received

Response provided by the Chairman, CS Energy on 14 November 2013.



Ref: B/D/13/34393

14 November 2013

Attention: Andrew Greaves  
Auditor-General  
Queensland Audit Office  
PO Box 15396  
City East, Queensland, 4002

RECEIVED  
22 NOV 2013  
QUEENSLAND  
AUDIT  
OFFICE

Dear Mr Greaves

**CS ENERGY LIMITED RESPONSE TO THE RESULTS OF AUDIT: ENERGY  
SECTOR FINANCIAL STATEMENTS 2012-13**

Thank you for the opportunity to provide comments on the Queensland Audit Office's (QAO's) report to Parliament on the results of the 2012-13 energy sector financial statements which is scheduled to be tabled in November 2013.

At the outset it should be noted there has been a significant change to the composition of the state-owned generators following the Generator Restructure which took place on 1 July 2011, therefore impacting on the comparability of performance of these businesses pre and post restructure. In particular, following the restructure, CS Energy's financial results include the impact of the onerous contract for the Gladstone Interconnection and Power Pooling Agreement (IPPA), a change in the generation asset portfolio composition and an unsustainable debt position. In addition, CS Energy booked a significant level of impairment in 2010-11 primarily due to the impact of the carbon price on the value of its generation assets that resulted in the large negative results and ratios for that year when compared with the other years included in the analysis.

A reader of the report should exercise caution when considering the ratios used to compare the financial sustainability of energy sector entities, as the operational and capital structures of the generators are significantly different to the network businesses. Therefore, applying a standard set of performance indicators to these entities is not practical and may skew any comparison. In addition, when comparing ratios between the two generators, in order to enhance comparability, the revenue from Stanwell's coal revenue sharing arrangements should be identified or eliminated from the ratios to enable a comparison of the core generation businesses' financial performance.

CS Energy has raised concerns with some of the analysis provided by the financial sustainability ratios used in the report, primarily in relation to the operating sustainability ratio and debt sustainability ratios.

<input checked="" type="checkbox"/> <b>Brisbane Office</b> PO Box 2227 Fortitude Valley BC Qld 4006 Phone 07 3854 7777 Fax 07 3854 7300	<input type="checkbox"/> <b>Callide Power Station</b> PO Box 302 Biloela Qld 4715 Phone 07 4992 9329 Fax 07 4992 9328	<input type="checkbox"/> <b>Kogan Creek Power Station</b> PO Box 41 Brigalow Qld 4412 Phone 07 4665 2500 Fax 07 4665 2599	<input type="checkbox"/> <b>Wivenhoe Power Station</b> PO Box 38 Fernvale Qld 4306 Phone 07 5427 1100 Fax 07 5426 7800
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CS Energy Ltd ABN 54 078 848 745 [www.csenergy.com.au](http://www.csenergy.com.au)

## Comments received

Response provided by the Chairman, CS Energy on 14 November 2013.

- 2 -

The operating sustainability ratio, based on Net Profit after Tax (NPAT) divided by total operating revenue, is not a good indicator of operating performance as it includes sunk capital expenditure (non-cash depreciation and amortisation), non-cash mark to market hedge book adjustments, interest and other financing costs, and non routine and restructuring costs. The ratio is more reflective of the company's capital structure and, in CS Energy's case, has been impacted by past capital investment decisions, non cash accounting adjustments (such as asset impairments), an inappropriate capital structure, and current restructuring underway to reform the organisation into a sustainable and economically viable organisation.

The debt sustainability ratio measures interest bearing liabilities relative to total operating revenues. It is questionable whether the absolute level of revenue is a useful indicator of debt carrying capacity, especially for a generator, as it does not take into account relative operating margins. Notwithstanding the above, it is acknowledged that CS Energy has an unsustainable level of debt and CS Energy is committed to working with Queensland Treasury Corporation (QTC) to review options for reducing the debt level going forward.

In the past year CS Energy has embarked on a reform agenda with a significant focus on operational efficiency improvements and cost rationalisation which resulted in an improvement in operational earnings, before non-routine items, of \$51.6 million in 2012-13. CS Energy's earnings continue to be impacted by events that are beyond its control, such as a challenging electricity market, losses above the onerous contract provision on the Gladstone IPPA transferred to CS Energy as part of the Generator Restructure, as well as continuing coal supply constraints at Callide.

CS Energy is committed to rebuilding its business into a commercially viable and sustainable business and to pursue a strategic direction that delivers greater value to its shareholders.

Yours sincerely



Ross Rolfe  
Chairman

Enquiries: Ole Elsaesser  
Chief Financial Officer  
Telephone (07) 3854 7425

## Comments received

Response provided by the Chairman, Energex on 28 November 2013.

28 November 2013

Mr Andrew Greaves  
Auditor-General  
Queensland Audit Office  
Level 14, 53 Albert Street  
BRISBANE QLD 4000



Dear Mr Greaves

**Response to results of audit: Energy sector financial statements 2012-13**

Office of the  
Chairman

I refer to your latest correspondence regarding the Energy Sector Report dated 21 November 2013.

### Formal Commentary

For Energex, business sustainability is all about consistent delivery of safe, reliable and cost effective service outcomes to our customers in South East Queensland, balanced with commercial returns for its shareholders, the Queensland Government. Since the change in Government in 2012, Energex has made significant progress in this regard through efficiency improvements, prudent capital management and efficient pricing mechanisms.

In the context outlined above, the Energy Sector Report does not adequately address the full range of long term sustainability issues for Energex. Energex considers a key component of future sustainability to be the introduction of pricing mechanisms that will create more equitable, understandable and predictable pricing outcomes for customers.

The report makes only brief mention of the current disparity between the basis of energy recovery (predominantly energy volumes) and the main driver of capital investment (energy demand) in section 1.1.1 of the report. We wish to emphasise the need for an appropriate response to this issue through the development and application of tariff structures that enable more equitable and cost reflective pricing. Introducing pricing which is more cost reflective will influence customer behaviour to improve network utilisation, reduce the need for new investment in the network, and reduce the volatility and unpredictability inherent in a mechanism based on volumes.

If you have any questions in relation the comments included in this response, please contact Energex CEO Mr Terry Effeny (07 3664 4572) in the first instance.

Yours sincerely

A handwritten signature in black ink, appearing to read "Shane L. Stone".

The Honourable Shane L. Stone AC PGDK QC  
Chairman  
Energex Limited



Energex  
26 Reddacliff Street  
Newstead Qld 4006  
GPO Box 1461  
Brisbane Qld 4001  
Telephone (07) 3664 4330  
Facsimile (07) 3664 9808  
energex.com.au

Energex Limited  
ABN 40 078 849 055

## Comments received

Response provided by the Chief Executive, Ergon Energy on 14 November 2013.

*We appreciate the commentary in the report that acknowledges the timeliness, quality and accuracy of Ergon Energy's financial statements, which were certified by the deadline with an unmodified audit opinion and did not require any material quantitative or qualitative disclosures changes as a result of the audit. We generally accept the content of the report and the recommendation made to the Department of Water and Energy Supply. We have however included some minor comments regarding the Financial Sustainability section of the report which we believe provides further clarification of comments made in the report.*

### *Section 3.6.1*

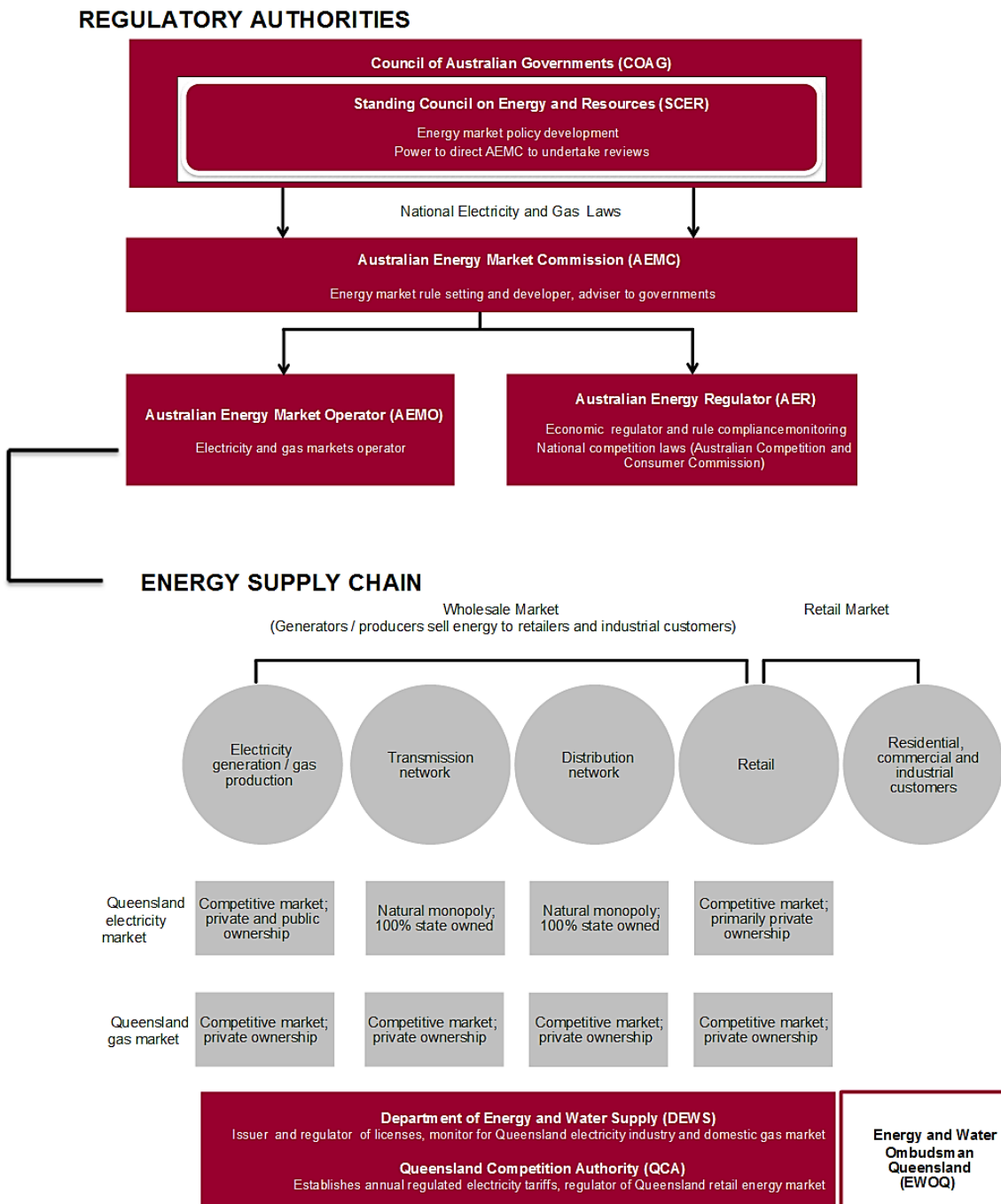
*The way the Liquidity ratio analysis is presented implies that Ergon Energy is at risk of not being able to fund its current obligations. This is not the case. Ergon Energy's liquidity ratio is affected by accounting standard requirements which require it to disclose certain obligations as current liabilities, even though Ergon Energy either does not have an obligation to settle the amounts within 12 months or does not expect to settle the amounts within 12 months. Ergon Energy's directors are satisfied that Ergon Energy can fund its current obligations.*

# Appendix B—Regulatory authorities and market participants

Queensland's electricity and gas industries have multiple members that can be classified into two groups—regulatory authorities and market participants. Queensland's electricity industry is partially privatised, whereas its gas industry is fully privatised.

An overview of the Queensland's market and regulatory framework is provided in Figure B1.

**Figure B1**  
Overview of regulatory authorities and market participants



Source: Queensland Audit Office



## National regulatory authorities

The Council of Australian Governments (COAG) is an intergovernmental forum whose role is to promote policy reforms that are of national significance or which need coordinated action by all Australian governments (source: COAG). COAG's Standing Council on Energy and Resources (SCER) is responsible for pursuing priority issues of national significance in the energy and resources sectors and progressing key reform elements (source: COAG).

Deregulation of the energy industry has led to the creation of competitive energy supply markets. The COAG Australian Energy Market Agreement (30 June 2004) introduced a national scheme for energy legislation and regulation. Electricity cannot be stored economically and this has given rise to an electricity trading market, the National Electricity Market (NEM). The NEM is a wholesale, spot trade market operated by the Australian Energy Market Operator (AEMO) in line with national electricity law and national electricity rules. The *Electricity—National Scheme (Queensland) Act 1997* provides for Queensland's participation in the NEM and application of national electricity law. The gas wholesale spot trade market in Victoria and short term trading markets in Sydney, Adelaide and Brisbane are managed by AEMO under national gas law and national gas rules. Application of national gas law in Queensland is due to the *National Gas (Queensland) Act 2008*. AEMO also operates the gas retail market.

The Australian Energy Market Commission (AEMC) is the rule maker and developer for Australian energy markets. As a national independent body, the AEMC makes and amends the detailed rules for the NEM and elements of natural gas markets. To further support the development of these markets, the AEMC also provides strategic and operational advice to the SCER.

Sitting alongside AEMO is the Australian Energy Regulator (AER). The AER is the energy markets regulator and sets the prices charged for using energy networks (electricity poles and wires and gas pipelines) to transport energy to customers; monitors AEMO-operated electricity and gas markets to ensure suppliers comply with the legislation and rules set by the AEMC; and takes enforcement action where necessary. The AER is responsible for the economic regulation of pipelines in all states and territories, excluding Western Australia. The AER also assists the Australian Competition and Consumer Commission (ACCC) with energy-related issues arising under the *Competition and Consumer Act 2010*, including enforcement, mergers and authorisations. The Australian Competition Tribunal performs reviews of the AER's decisions (upon application) and limited merit reviews of economic regulatory decisions.

Other national legislation which has an effect on the Queensland electricity sector include:

- *Australian Securities and Investments Commission Act 2001*
- Australian Financial Services Licence requirements
- Environmental Protection Agency legislation.
- *Renewable Energy (Electricity) Act 2000*
- *Renewable Energy (Electricity) (Charge) Act 2000*
- *National Greenhouse and Energy Reporting (NGER) Act 2007*
- *Clean Energy Act 2011*.

## State regulatory authorities

All Queensland electricity market participants are required to comply with the *Electricity Act 1994* (Electricity Act) and the Electricity Regulation 2006 (Electricity Regulation). All gas market participants involved in the supply and sale of reticulated natural gas are to comply with the *Gas Supply Act 2003* (Gas Supply Act) and the Gas Supply Regulation 2007 (Gas Regulation).

Under the Electricity Act and the Gas Supply Act, the regulator is the Director-General, Department of Energy and Water Supply (DEWS). The regulator issues authorities (licences) for generation, transmission, distribution and retail activities in Queensland's electricity industry and for distribution and retail of natural gas in Queensland. Annually, all authority holders are required to provide an annual report that enables the regulator to assess the licence holder's compliance with its statutory obligations and to determine its continued suitability to hold a licence.

DEWS regulates and monitors policy and legislation affecting Queensland's electricity industry and Queensland's domestic gas market (being the supply chain process from gas entry into distribution pipelines to supply to customers) that are outside the national energy regime.

Commencing 1 July 2012, the AER became responsible for regulation of the retail energy market under COAG's National Energy Customer Framework for the states and territories that adopted the Framework. The Queensland Government has conditionally agreed to adopt the Framework in early to mid-2014 after it considers options to deliver protections for customers outside south-east Queensland. The state is responsible for regulation of the Queensland retail energy market until that time. The Queensland Competition Authority administers this function.

Individual states and territories remain responsible for control of the energy prices. In Queensland, the Queensland Competition Authority determines regulated electricity prices but gas is unregulated.

The Energy and Water Ombudsman Queensland (EWOQ) provides residential and small business energy customers with an independent and just way of resolving disputes with their energy entities.

## Electricity industry market participants

The electricity supply chain comprises four distinct but interconnected participants—electricity generation, transmission, distribution and retail.

The Queensland generation sector has a mixture of government owned electricity generators and privately owned electricity generators that contribute to the east coast NEM. The NEM sells electricity through a competitive, national, wholesale, spot trade market where supply and demand in five-minute intervals determine prices. Its main customers are energy retailers that buy electricity for resale to business and household customers.

The transmission and distribution sectors are natural monopolies. High voltage transmission networks transport electricity from the generators to distribution networks. Lower voltage distribution networks transport electricity to residential, commercial and industrial customers. These network assets are mainly owned and operated by Queensland GOCs. A small area near Goondiwindi is supplied by the New South Wales GOC distributor, Essential Energy.

Full retail contestability commenced in Queensland's electricity and gas markets in July 2007. This allowed all Queensland customers the right to choose their energy retailer. Predominantly, the electricity retail sector is privately owned, with the state government limited to one retailer and negotiated retail contracts between government owned generators and large commercial and industrial customers. Electricity prices are currently regulated but there is intention to remove electricity price regulation by 1 July 2015.

Specific information on Queensland owned electricity market participants is included in Chapter 1 of this report.

## Natural gas industry market participants

The gas supply chain is comprised of four distinct but interconnected participants—gas production, transmission, distribution and retail.

The gas is extracted from gas fields and coal seams and processed to remove impurities and produce natural gas. The producers sell the gas to wholesalers or retailers (both retail and wholesale gas markets are operated by the AEMO) that are responsible for the distribution to their customers.

A network of high pressure transmission pipes transports bulk gas from the producers' processing or storage facilities to the domestic markets. A network of distribution pipelines delivers gas from points along the transmission pipeline to the large customers and from gate stations to customers in cities and towns.

The price of reticulated natural gas (being piped natural gas) has been deregulated since the introduction of full retail contestability in Queensland's energy market on 1 July 2007. The retail sector is privately owned and is responsible for setting prices for customers.

There are no Queensland owned gas market participants; the state's involvement is limited to units in exploration and development joint ventures.

## Electricity retail prices

Prices include the cost of generating electricity, transportation costs from the producer to the customer and retail costs.

Either regulation or competition determines costs at each point of the electricity supply chain:

- **Generation**—The price at which the AEMO purchases electricity from the generators is determined by bidding done by the generators for supply of electricity in five-minute intervals into the NEM. Generators bid based on the amount of electricity they are prepared to produce for a specified price. AEMO's systems will produce a spot trade price for the next half-hour supply period, based on all bids received from generators. The bids are ranked from lowest to highest. Supply for that next five minutes then starts, with the generators below that spot trade price creating electricity first, followed by the higher-priced generators as demand increases. Supply and demand is instantaneously matched in real time through this centrally coordinated dispatch process.
- **Transmission and distribution**—As stipulated by the NER, the network revenue allowances are set every five years (being the regulatory period) by the national regulator, the AER. The AER sets a revenue cap, which determines the maximum revenue that the network owner can earn in the regulatory period, that the AER forecasts will cover the entity's efficient cost and provide a commercial return on capital. The return on capital is the largest component of the revenue, primarily driven by the cost of capital and size (including projected investment) of the network's regulated asset base.
- **Retail**—Fixed and variable charges are set by each company for its market customers. Non-market customers pay regulated prices.

The Queensland Competition Authority, acting under the Electricity Act, determines Queensland regulated retail electricity prices annually. These tariffs are established to recover the full cost of supplying electricity to non-market customers, generally on the basis of south-east Queensland location. The government makes community service obligation payments to the retail arm of Ergon Energy to subsidise 33 remote and regional locations to a uniform tariff policy; that is, to ensure power costs are the same, irrespective of the location.

Queensland household electricity customers can either enter into a market contract at agreed prices or pay the regulated prices set by the QCA. The government is planning to remove electricity price regulation in south-east Queensland by 1 July 2015, should certain preconditions be met. This will be replaced by price monitoring by the QCA.

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

**Figure C1**  
Controlled entities for which no opinion will be issued for 2012–13

Entity	Parent entity	Reason
<i>Controlled entities</i>		
Mica Creek Pty Ltd	Stanwell Corporation Limited	Deed of cross guarantee ASIC order
SCL North West Pty Ltd	Stanwell Corporation Limited	Deed of cross guarantee ASIC order
Energy Portfolio 1 Pty Ltd	Stanwell Corporation Limited	Dormant
Glen Wilga Coal Pty Ltd	Stanwell Corporation Limited	Dormant
Goondi Energy Pty Ltd	Stanwell Corporation Limited	Non-reporting
Tarong Energy Corporation Pty Ltd	Stanwell Corporation Limited	Dormant
Tarong Fuel Pty Ltd	Stanwell Corporation Limited	Deed of cross guarantee ASIC order
Tarong North Pty Ltd	Stanwell Corporation Limited	Non-reporting
TEC Coal Pty Ltd	Stanwell Corporation Limited	Deed of cross guarantee ASIC order
TN Power Pty Ltd	Stanwell Corporation Limited	Deed of cross guarantee ASIC order
Kogan Creek Power Pty Ltd	CS Energy Limited	Deed of cross guarantee ASIC order
Kogan Creek Power Station Pty Ltd	CS Energy Limited	Deed of cross guarantee ASIC order
CS Energy Kogan Creek Pty Ltd	CS Energy Limited	Deed of cross guarantee ASIC order
CS Energy Oxyfuel Pty Ltd	CS Energy Limited	Deed of cross guarantee ASIC order
CS Kogan (Australia) Pty Ltd	CS Energy Limited	Deed of cross guarantee ASIC order
Aberdare Collieries Pty Ltd	CS Energy Limited	Deed of cross guarantee ASIC order
Callide Energy Pty Ltd	CS Energy Limited	Deed of cross guarantee ASIC order
CS Energy Group Holdings Pty Ltd	CS Energy Limited	Dormant
CS Energy Group Operations Holdings Pty Ltd	CS Energy Limited	Dormant
Manzillo Insurance (PCC) Ltd—Cell Enmach	CS Energy Limited	Overseas based entity

Entity	Parent entity	Reason
Powerlink Transmission Services Pty Ltd	Queensland Electricity Transmission Corporation Limited (Powerlink)	Deed of cross guarantee ASIC order
Harold Street Holdings Pty Ltd	Queensland Electricity Transmission Corporation Limited (Powerlink)	Deed of cross guarantee ASIC order
Energy Impact Pty Ltd	Energex Limited	Deed of cross guarantee ASIC order
Metering Dynamics Business Support Pty Ltd	Energex Limited	Non-reporting
Queensland Energy Services Team Pty Ltd	Energex Limited	Non-reporting
Varnsdorf Pty Ltd	Energex Limited	Deed of cross guarantee ASIC order
VH Energy Holdings Pty Ltd	Energex Limited	Deed of cross guarantee ASIC order
VH Finance Pty Ltd	Energex Limited	Deed of cross guarantee ASIC order
VH Operations Pty Ltd	Energex Limited	Deed of cross guarantee ASIC order

Source: Queensland Audit Office

# 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
8	Results of audit: Hospital and Health Services entities 2012–13	November 2013
9	Results of audit: Energy sector entities 2012–13	December 2013

Reports to Parliament are available at [www.qao.qld.gov.au](http://www.qao.qld.gov.au)