



Queensland Competition Authority

Cost Review of Aurizon Network's
Capital Expenditure Claim 2011/12

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1. EXECUTIVE SUMMARY

1.1 Introduction

The Queensland Competition Authority (the Authority) is responsible for the economic regulation of the below-rail infrastructure owned by Aurizon Network Pty Ltd (Aurizon Network) (formerly QR Network). Aurizon Network is a wholly owned subsidiary of Aurizon Holdings Limited, a leading vertically integrated national transport provider.

Aurizon Network is responsible for providing, maintaining and managing access to, and operations on, its rail network and associated rail infrastructure. Aurizon Network's rail network totals 2,670 kilometres and consists of coal export heavy haul tracks in central Queensland.

Aurizon Network developed an Access Undertaking (the Access Undertaking) in accordance with section 136 of the Queensland Competition Authority Act 1997 (Qld). In accordance with that Act, the Access Undertaking was endorsed by the Queensland Competition Authority in 1 October 2010.

The Access Undertaking provides a framework for access to Aurizon Network's rail network for the purposes of operating train services, and sets out Aurizon Network's obligations in relation to:

- (a) ringfencing;
- (b) the framework for negotiating access;
- (c) the development of access agreements;
- (d) pricing principles;
- (e) the utilisation of network capacity;
- (f) interface arrangements between Aurizon Network and train operators; and
- (g) reporting.

Clause 9.3.1 of the Access Undertaking requires that Aurizon Network will, unless otherwise agreed between Aurizon Network and the Authority, provide, within four months after the end of each year in the term¹, details of the capital expenditure for that year that Aurizon Network considers should be included in its Regulatory Asset Base (RAB).

In October 2012, Aurizon Network requested an extension to the reporting timeline which was approved by the Authority. As a result, Aurizon Network's submission (the QR Network 2011/12 Capital Expenditure Submission, or Capital Expenditure Submission) was lodged with the Authority in November 2012.

RSM Bird Cameron have been engaged by the Authority as the Independent Auditor to conduct assurance procedures to assist the Authority to determine whether the costs included in the 2012 claim were prudently incurred by Aurizon Network. According to clause 3.3.4 of Schedule A of the Access Undertaking, assessing the prudence of costs involves assessing whether the costs are reasonable for the scope and standard of work done. Clause 3.3.4(c) sets out the matters to be considered in assessing the reasonableness of the cost of works undertaken.

1.2 Conclusion

We have completed our audit procedures, and have identified four “**Medium**” risk issues and one “**Low**” risk issue. In addition, we identified one standalone suggestion for improving current processes in relation to the preparation of the 2011/12 Capital Expenditure Submission. These are summarised in **section 1.5** and discussed in further detail in **Part B** of the Independent Reasonable Assurance Report.

Our reasonable assurance conclusion has been formed on the above basis. Our Independent Reasonable Assurance Report, for the period ended 30 June 2012, which has been prepared pursuant to clause 3.3.4 of Schedule A of Aurizon Network's Access Undertaking, has been included in pages 9 to 11 of this report.

¹ The regulatory period.

1. EXECUTIVE SUMMARY (CONT.)

1.3 Background and Objectives

The primary objective of the engagement conducted by the Independent Auditor, was to form a conclusion as to whether the statement of capital expenditure included in the 2011/12 Capital Expenditure Submission by Aurizon Network, presents fairly in all material respects, the actual costs incurred by Aurizon Network in respect of projects A.02604, A.02222, A.02603, A.02602, A.03473, A.01541, A.02559, A.02523 and A.02648 and that the internal controls maintained by Aurizon Network in relation to the preparation of the statement of capital expenditure have operated effectively during the year ended 30 June 2012.

The 2011/12 Capital Expenditure Submission includes the total capital expenditure that Aurizon Network has considered to be included in the RAB and this is subject to the Authority's approval in accordance with Clause 2 and 3 of Schedule A of Aurizon Network's Access Undertaking.

The RAB includes rail infrastructure required for the operation of coal train services on the regulated network of Queensland. The value of these assets is an important factor used in determining the reference tariffs for coal train services.

As required by Clause 9.3.1, the information to be provided by Aurizon Network includes:

- the name of the project;
- the location of the project (i.e. which system in the CQCR);
- the amount of capital expenditure; and
- information to support the QCA's assessment of the prudence of the capital expenditure in accordance with Clauses 2 and 3 of Schedule A.

The total of the 2011/12 Capital Expenditure Submission was \$1,309,366,469. Approximately 93% of the value of the claim relates to the Goonyella to Abbott Point Expansion (GAPE) project and the Blackwater Feeder Station projects. The total value of these claims represents around \$1,215 million of the \$1,309 million being claimed. As a result, the scope of the audit was limited to capital expenditure claimed for the projects listed in Table 1.1.

Table 1.1: Specific projects that were subject to the audit

Project Number	Project Name	2011/12 Claimable Expenditure (excl. IDC)	Percentage of Total Claim value (excl. IDC)
Blackwater Feeder Station Projects			
A.02604	Wycarbah Feeder Station	\$44,359,199	3.72%
A.02222	Raglan Feeder Station	\$46,148,066	3.87%
A.02603	Duaranga Feeder Station	\$41,553,430	3.48%
A.02602	Bluff Feeder Station	\$37,868,953	3.17%
GAPE Projects			
A.03473	GAPE	\$771,118,899	64.59%
A.01541	GAPE Expansion	\$107,489,204	9.00%
A.02559	GAPE Long Lead Items	\$28,278,584	2.37%
A.02523	GAPE X70 – X100 Early Works	\$13,887,255	1.16%
A.02648	GAPE Electrification Phase	\$7,641,661	0.64%

1. EXECUTIVE SUMMARY (CONT.)

1.3 Background and Objectives (Cont.)

The audit approach focused on key financial reporting risks and the effectiveness of the risk management processes of Aurizon Network (and other stakeholders). This involved:

- gaining an understanding of the projects conducted by Aurizon Network and associated capital expenditure processes;
- gaining an understanding of the significant financial reporting processes, relevant to the capital expenditure, within Aurizon Network;
- identifying key risks and matching those risks to the risk management processes implemented by Aurizon Network management to mitigate risk;
- testing the operation of the key controls that mitigate risk; and
- undertaking substantive audit procedures to address our assessment of the residual risk of material error.

Through our planning procedures we identified the following key risks, which were documented in the Engagement Plan (dated January 2013):

- inclusion of non-capital expenditure within the Claim;
- overstatement of costs in progress claims from Alliance Partners;
- duplication of transactions;
- overstatement of accrued costs at 30 June 2013;
- inclusion of the above rail costs within the Claim;
- incorrectly allocated internal costs where service providers work on multiple projects; and
- capital costs included that relate to works performed post 30 June 2012.

For each risk area, the audit procedures performed and a summary of findings is set out in **Appendix 1**.

1.4 Materiality

We considered materiality when determining the nature, timing and extent of our procedures and evaluating the effect of identified control weaknesses or misstatement of the expenditure of projects that we reviewed on our conclusion. Materiality is addressed in the context of the Authority's objectives relevant to the area of activity being examined, and whether the internal controls will reduce, to an acceptably low level, the risks that threaten achievement of those objectives.

When assessing materiality, we considered qualitative factors as well as quantitative factors, for example:

- the purpose of the engagement and any specific requirements of the terms of the engagement;
- the importance of an identified control weakness for the area of activity and the Authority's overall objectives;
- the Authority's perceptions and/or interest in the area of activity;
- financial impact on all parties;
- the cost of alternative controls relative to their likely benefit;
- the length of time an identified control weakness was in existence; and
- the frequency and severity of control weaknesses identified in the planning stage.

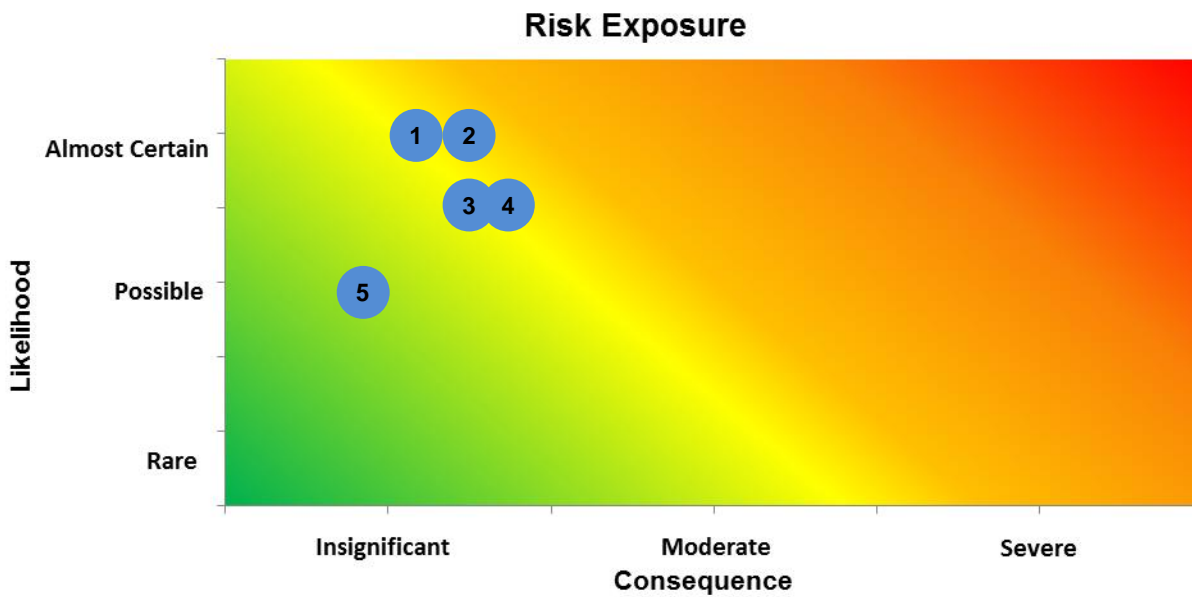
1. EXECUTIVE SUMMARY (CONT.)


1.5 Summary of Audit Findings

We have summarised our audit findings in this section of our report. Each issue raised is assigned a risk rating to indicate our assessment of the degree of exposure of the issue to Aurizon Network, and the urgency of required action. The risk rating definitions are described in **Appendix 2** of this report.


The issues raised are considered to add value to the current practices and processes within Aurizon Network in capital expenditure submissions to the Authority and in meeting their obligations under the Access Undertaking.

The following is a summary of the issues raised:





 Issue identified during the audit of Aurizon Network’s capital expenditure submission (refer to **Part B** for detailed discussions)

The issues identified are summarised below (refer to **Appendix 2** for an explanation of the Risk ratings):

Finding	Risk Rating	Issue & Recommendation
1. Capitalisation of Overhead Costs (Project A.03473)		<p>The Access Undertaking does not include a definition of “capital expenditure”. However, in accordance with Australian Accounting Standard AASB 116 “Property Plant and Equipment”, administration and other general overhead are not considered to be a cost element of an item of property, plant and equipment and therefore cannot be capitalised, as they are not deemed directly attributable. We noted that expenditure capitalised in relation to network construction services for project A.03473 GAPE included an 8% margin on costs incurred for the project. In our review of the methodology forming the basis for the 8% margin, we noted that its purpose is to recover non-directly attributable costs, including general overhead and administration costs. The 8% margin charged to the project amounted to \$6,304,695 (0.53% of the total 2011/12 claim).</p> <p>We recommend an adjustment is processed to project A.03473 reversing costs allocated of \$6,304,695. We also recommend “capital expenditure” is clearly defined in the revised Access Undertaking.</p>



1. EXECUTIVE SUMMARY (CONT.)

1.5 Summary of Audit Findings (Cont.)

Finding	Risk Rating	Issue & Recommendation
2. Inclusion of Non-Capital Costs (Project A.02648 Electrification)	 M	<p>In our review of project A.02648 – GAPE Electrification we noted that total cost amounting to \$7,641,661 (0.64% of the total 2011/12 claim) did not meet the definition of capital expenditure in accordance with Australian Accounting Standard AASB 116 “Property Plant and Equipment”. The project included expenditure that related to concept designs and environmental studies, specific to assessing viability of electrification. Based on the studies conducted it was formally decided to discontinue the project and therefore no future economic benefit exists from works conducted.</p> <p>Clause 2.5 of Schedule A of Aurizon Network’s Access Undertaking states that the Authority will consider for inclusion in the Regulatory Asset Base any capital expenditure for projects that have been formally discontinued. This project satisfies that clause hence its inclusion in the 2011/12 Capital Expenditure Submission. However the expenditure does not meet the accounting definition of capital expenditure.</p> <p>We recommend an adjustment is processed to project A.02648 reversing costs allocated of \$7,641,661 in the 2011-2012 Capital Expenditure Submission. We also recommend “capital expenditure” is clearly defined in the revised Access Undertaking.</p>
3. Documented Approval of Alliance Total Commitment Adjustment	 M	<p>Several Alliances have been utilised for delivering works on Aurizon Network’s projects. For each Alliance, Aurizon Network approved a Total Commitment Expenditure (TCE) based on the scope of works and budget, for approval in accordance with Delegations of Authority. Where variations were required, a Total Commitment Adjustment (TCA) was submitted and subject to approval by the Alliance Leadership Team (ALT) prior to releasing of funds with the SAP budget.</p> <p>In our review of the Coal Connect Alliance TCE of \$289,925,193, for works conducted on project A.03473 – GAPE, we noted that TCA #210 amounting to \$9,099,721 was not formally approved by the ALT, however the funds were released in SAP to process the claim.</p> <p>We recommend that ALT approval is obtained for all TCA’s and filed by Aurizon Network to support adjustment to approved TCEs.</p>

1. EXECUTIVE SUMMARY (CONT.)

1.5 Summary of Audit Findings (Cont.)

Finding	Risk Rating	Issue & Recommendation
4. Adequacy of Project Management Cost Controls		<p>The SAP user access listing for Project A.03473 GAPE included two employees that were not involved in the project at any stage of the project life-cycle, with a “SAP Operations Project Manager” user access level.</p> <p>This user access level provided the employees with the full access rights to the project that included:</p> <ul style="list-style-type: none"> • change control over SAP Work Breakdown Structure (WBS) elements; • edit control over SAP budget; • project release control; and • change to project cost schedule. <p>Additionally, we noted that one employee, with the same access rights above, was not removed when the employee moved permanently off the Project. Whilst we did not note any unauthorised transactions within the testing performed on the project, in material respects, the inappropriate access levels noted reduces the effectiveness of the project management cost controls set up within SAP.</p> <p>We recommend that the current access levels are removed for the three staff identified and Aurizon Network monitor user access levels for open and new projects going forward to ensure inappropriate user access levels are identified in a timely manner.</p>
5. Integration Between Timesheet System and SAP		<p>Aurizon Network uses a system known as JAKs (replaced by Primavera following claim submission) as its time-sheeting system for project delivery staff to ensure appropriate project allocation of labour costs within the GAPE projects. SAP extracts labour quantity data from JAKs.</p> <p>In our testing of labour charges for Project A.03473, we noted two exceptions where the project charge out rate for project delivery staff per JAKs, did not agree to SAP and the employee position level rate. This was due to human error in the manual update of JAKs, where either the wrong cost centre or activity band was allocated. JAKs does not get updated automatically when there are changes to an employee's position level in SAP. The employee's cost centre and activity band are required to be manually updated in JAKs, which exposes Aurizon Network to a risk of inaccurate reporting of labour charges allocated to projects if reliance is placed on JAKs (eg. for budget or cost control).</p> <p>JAKs has now been replaced by Primavera, however the issue still currently exists in Primavera.</p> <p>We recommend Aurizon Network explore options for fully integrating Primavera with SAP to ensure the accuracy of information within Primavera and consistency of data across both systems.</p>

1. EXECUTIVE SUMMARY (CONT.)

1.5 Summary of Audit Findings (Cont.)

Finding	Risk Rating	Issue & Recommendation
<p>6. Record Management of Alliance documentation and files</p>	<p style="text-align: center;">E</p>	<p>Aurizon Network was the owner participant in each of the Alliances formed to conduct works within the GAPE and Blackwater projects. Aurizon Network was responsible for payment and certification of Alliance progress claims, with reliance placed on the governance provided by the Alliance Leadership Teams. We requested the following Alliance documentation:</p> <ul style="list-style-type: none"> • Participant Alliance Agreement; • Alliance Audit Reports; and • Compensation Audit Plans. <p>We noted that the documentation was not easily accessible by Aurizon Network, and, in some cases, could not be located. As a result requests were required to be made from third parties to obtain documentation which Aurizon Network should have maintained within its files. All documentation requested was subsequently located.</p> <p>We recommend that key Alliance documentation is stored electronically within Aurizon Network's document management system to enable accessibility at the request of Auditors or the Authority where applicable. Documentation should include as a minimum:</p> <ul style="list-style-type: none"> • Participant Alliance Agreement; • Alliance Audit Reports; • Compensation Audit Plan; • ALT Minutes; and • ALT approvals of TCAs,



PART A

INDEPENDENT REASONABLE ASSURANCE REPORT

**for the period ended
30 June 2012**

INDEPENDENT AUDITOR'S REPORT IN RELATION TO THE CAPITAL EXPENDITURE COSTS CLAIMED BY AURIZON NETWORK

Part A: Auditors Conclusion

To: the Queensland Competition Authority ("the Authority")

We have:

- (a) audited the accompanying 2011/12 Capital Expenditure Submission ("the Capital Expenditure Submission") of Aurizon Network, in respect of specified Blackwater feeder station and Goonyella to Abbott Point Expansion (GAPE) projects (specifically projects A.02604, A.02222, A.02603, A.02602, A.03473, A.01541, A.02559, A.02523 and A.02648), which has been prepared pursuant to clause 3.3.4 of Schedule A of Aurizon Network's Access Undertaking (the Access Undertaking), to support the opinion below; and
- (b) audited control procedures in relation to the preparation of the Capital Expenditure Submission during the year ended 30 June 2012, in order to express an opinion about their operating effectiveness based on the requirements of the Access Undertaking.

Aurizon Network's responsibility for the Capital Expenditure Submission

Aurizon Network is responsible for the preparation and fair presentation of the Capital Expenditure Submission pursuant to clause 3.3.4 of Schedule A of the Access Undertaking.

Aurizon Network is responsible for determining that the basis of accounting is an acceptable basis for the preparation of the Capital Expenditure Submission in the circumstances. Aurizon Network is also responsible for establishing and maintaining such internal control as determined by management to be necessary to enable the preparation of a Capital Expenditure Submission that is free from material misstatement, whether due to fraud or error and for monitoring compliance with the Access Undertaking.

Our independence and quality control

We have complied with the relevant ethical requirements relating to assurance engagements, which include independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

In accordance with Australian Standard on Quality Control 1, RSM Bird Cameron maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Our responsibility

Audit of statement of capital expenditure costs

Our responsibility is to express an opinion on the Capital Expenditure Submission based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the Capital Expenditure Submission is free from material misstatement and the costs were incurred pursuant to the Access Undertaking.

Our responsibility (cont.)

Audit of statement of capital expenditure costs (cont.)

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Capital Expenditure Submission. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Capital Expenditure Submission, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Capital Expenditure Submission in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, if any, made by management to ensure compliance with the access undertaking.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Audit of controls over the claim

Our responsibility is to express an opinion on the effectiveness of internal controls in relation to the preparation of the Capital Expenditure Submission for the year end 30 June 2012. Our procedures have been conducted in accordance with applicable Standards on Assurance Engagements issued by the Auditing and Assurance Standards Board. The Standards on Assurance Engagements require that we comply with the relevant ethical requirements relating to assurance engagements and plan and perform the audit to obtain reasonable assurance whether the internal controls have been designed and operated effectively to achieve the control objectives in the opinion below.

Our procedures have been undertaken to form an opinion whether, in all material respects, the internal controls in relation to the preparation of the Capital Expenditure Submission were adequately designed and operated effectively to support the opinion below.

Inherent limitations

Because of the inherent limitations of any internal control structure, it is possible that fraud or errors may occur and not be detected. We have not audited the overall internal control structure and no opinion is expressed as to its effectiveness. An audit is not designed to detect all weaknesses in control procedures or all instances of non-compliance as it is not performed continuously throughout the period, and the tests performed are on a sample basis having regard to the nature and size of the entity.

Any projection of the evaluation of internal control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Use of report

This report has been prepared for Aurizon Network for the sole purpose of providing it to the Queensland Competition Authority. Accordingly, we expressly disclaim and do not accept any responsibility or liability to any party other than Aurizon Network and the Queensland Competition Authority for any consequences of reliance on this report for any purpose.

Conclusion

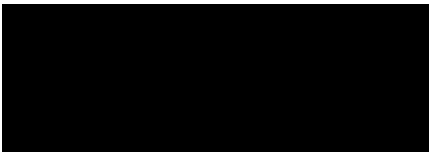
In our opinion:

- a) the Capital Expenditure Submission costs claimed presents fairly, in all material respects, actual costs incurred by Aurizon Network in respect of projects A.02604, A.02222, A.02603, A.02602, A.03473, A.01541, A.02559, A.02523 and A.02648 during the period ended 30 June 2012; and
- b) the internal controls maintained by Aurizon Network in relation to the preparation of the Capital Expenditure Submission costs claimed operated effectively, in all material respects, during the year ended 30 June 2012 based on the requirements of the Access Undertaking.

Basis of Accounting

Without modifying our opinion, we draw attention to clause 3.3.4 of Schedule A of the Access Undertaking which describes the capitalisation requirements. The Aurizon Network Capital Expenditure Submission is prepared by Aurizon Network to provide information to the Queensland Competition Authority. As a result, the Capital Expenditure Submission may not be suitable for another purpose.

RSM BIRD CAMERON



J M IMBERT


Director

Melbourne, Victoria

Dated: 21 June 2013

PART B – DETAILED FINDINGS

1. Capitalisation of Overhead Costs (Project A.03473 GAPE)

Risk Rating	
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Observation

The Access Undertaking does not include a definition of “capital expenditure”. From an accounting viewpoint, expenditure which is capital in nature results in the recognition of an asset (as opposed to an expense). Asset is defined in the “Framework for the Preparation and Presentation of Financial Statements”, paragraph 49, as “a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.” Under the Framework an asset can only be recognised when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead, such a transaction results in the recognition of an expense in the income statement.

Australian Accounting Standard AASB 116 “Property Plant and Equipment” (AASB 116) is the accounting standard relevant for the recognition of assets comprising property, plant and equipment and applies the Framework definition noted above to its conceptual basis. AASB 116 states that any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management can be capitalised as a costs element of property plant and equipment. The standard provides examples of directly attributable costs and non-directly attributable costs. Administration and other general overhead are not considered to be a cost of an item of property, plant and equipment and therefore cannot be capitalised.

We noted that for expenditure capitalised in relation to network construction services for project A.03473 GAPE included an 8% margin. In our review of Aurizon Network’s methodology forming the basis for this margin, we noted that it related to cost recovery of the following:

- Corporate Overhead (CEO’s office, Finance, Human Resources, Operational Excellence);
- Network Overhead (Executive Vice Presidents Office, Network Finance, Network Human Resources, Network Safety); and
- Return on Asset of non-regulated Construction services assets.

These costs are not directly attributable to project A.03473 and therefore cannot be deemed to be capital in nature based on Australian Accounting Standards.

The costs allocated to the project amounted to \$6,304,695 (0.53% of the total 2011/12 claim).

Implication

Overstatement of the 2011-12 Claim in respect to Project A.03473 including non-capital expenditure.

Recommendations

We recommend an adjustment is processed to project A.03473 reversing costs allocated of \$6,304,695. We also recommend “capital expenditure” is clearly defined in the revised Access Undertaking.

PART B – DETAILED FINDINGS (CONT.)

1. Capitalisation of Overhead Costs (Project A.03473 GAPE) (Cont.)

Aurizon Network comments

Further discussion is required on a suitable definition for capital expenditure, and Aurizon Network is open to discussing this as part of the UT4 process. However, given the approach under the current undertaking is to capitalise these costs, Aurizon Network recommends that a consistent approach is maintained for the 2011/12 capital submission.

PART B – DETAILED FINDINGS (CONT.)

2. Inclusion of Non-Capital Costs (Project A.02648 Electrification)

Risk Rating	M
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Observation

In our review of project A.02648 – GAPE Electrification, we noted that the project included expenditure that related to concept designs and environmental studies, specific to assessing the viability of electrification. The aim of the study was to produce a reference estimate on the electrification works to make an informed decision on whether to implement the works or not. Total costs expended over the period of the project amounted to \$7,641,661 (0.64% of the total 2011/12 claim). This project was formally discontinued on November 2009. Costs incurred predominately related to the Coal Power Alliance that was formed to develop a full set of concept drawings to enable a robust estimate of the total costs of electrification works.

As it was decided to not proceed with the electrification works based on the viability assessment conducted, all the costs leading up to the decision made to the discontinuation of the project do not meet the criteria for recognition of an asset as there is no future economic benefit from the costs expended.

We note that in clause 2.5 of Schedule A of Aurizon Network's Access Undertaking, it states that the Authority will consider for inclusion in the Regulatory Asset Base any capital expenditure for projects that have been formally discontinued and this project satisfies that clause, hence, its inclusion. However, as the project was discontinued, it is no longer capital expenditure based on Australian Accounting Standards, as there will be no future economic benefit arising from the project.

Implication

Overstatement of the 2011-12 claim in respect to Project A.02648 being non-capital expenditure.

Recommendations


We recommend an adjustment is processed to project A.02648 reversing costs allocated of \$7,641,661. We also recommend "capital expenditure" is clearly defined in the revised Access Undertaking.

Aurizon Network comments

Further discussion is required on a suitable definition for capital expenditure, and Aurizon Network is open to discussing this as part of the UT4 process. However, given the approach under the current undertaking is to capitalise these costs, Aurizon Network recommends that a consistent approach is maintained for the 2011/12 capital submission.

PART B – DETAILED FINDINGS (CONT.)

3. Documented Approval of Alliance Total Commitment Adjustment

Risk Rating	
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Observation

For each Alliance formed, Aurizon Network approved a Total Commitment Expenditure (TCE) based on the scope of works and budget, and in accordance with its Delegations of Authority. Where variations were required, a Total Commitment Adjustment (TCA) was submitted and subject to approval by the Alliance Leadership Team (ALT) prior to releasing of funds with the SAP budget.

In our review of the Coal Connect Alliance TCE of \$289,925,193, for works conducted on project A.03473 - GAPE we noted that TCA #210 amounting to \$9,099,721 was not formally approved by the ALT, however the funds were released in SAP to process the claim.

Implication

There is a risk of an overstatement of the 2011-12 claim in respect to processing of an unapproved adjustment to Coal Connect's approved TCE.

Recommendations


We recommend that ALT approval is obtained for all future TCA's and filed by Aurizon Network to support adjustment to approved TCEs.

Aurizon Network comments

- Aurizon Network has provided the relevant detail with regards to the non ALT signed TCA. RSM Bird Cameron understood this detail.
- Aurizon Network agrees that TCA should be signed, but in this instance, the TCA was part signed off and only the increase to the TCA was not endorsed. The ALT has disbanded along with the Alliance so no opportunity to sign it off after the fact.

PART B – DETAILED FINDINGS (CONT.)

4. Adequacy of project management cost control

Risk Rating	
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Observation

In the controls testing performed, we noted the SAP user access listing for Project A.03473 GAPE, included two employees that were not involved in the project with a “SAP Operations Project Manager” user access level.

This access level provided the employees with the full access rights to the project including amongst others:-

- change control over SAP WBS elements;
- edit control over SAP budget;
- project release control; and
- change to project cost schedule.

Additionally, we noted that one employee, with the same access rights above, was not removed once moved permanently from the Project. Whilst we did not note any unauthorised transactions within the project, the inappropriate access levels reduce the effectiveness of the project management cost controls that are set up within SAP.

Implication

There is a risk that costs associated with other Aurizon Network projects are allocated to A.03473 GAPE without detection.

Recommendations

We recommend that the current access levels are removed for the three staff identified and Aurizon Network monitor user access levels for open and new projects going forward to ensure inappropriate user access levels are identified in a timely manner.

Aurizon Network comments

Aurizon Network understands the issue as identified and is developing systems to reduce this internal control risk on future projects.

PART B – DETAILED FINDINGS (CONT.)

5. Integration between Timesheet System and SAP

Risk Rating	
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Observation

Aurizon Network uses JAKs (now replaced by Primavera) as its time sheeting system for project delivery staff to ensure appropriate project allocation of labour charges within the GAPE projects. SAP extracts labour quantity data from JAKs to collate the cost of labour for projects. We noted that JAKs is not integrated with SAP, and, as a result, is not automatically updated when there are changes to an employee's position level in SAP. The employee's cost centre and activity band are required to be manually updated in JAKs.

In our testing of labour charges for Project A.03473, we noted two exceptions where the project charge out rate for project delivery staff per electronic timesheets, did not agree to SAP and employee position level rate. This was due to human error in the manual update of JAKs and Primavera, where either the wrong cost centre or activity band was allocated.

JAKs has now been replaced by Primavera, however the issue is still currently prevalent in Primavera.

Implication

There is a risk of inaccurate supporting documentation for labour charges allocated to projects in future audits. Additionally, if reliance is placed on the accuracy of rates within JAKs or Primavera for budget or cost control, there is a risk that control will be ineffective given the inherent risks associated with the manual update of information.

Recommendations


We recommend Aurizon Network fully integrate Primavera with SAP to ensure the accuracy of information within Primavera and consistency of data across both Primavera and SAP.

Aurizon Network comments

- Aurizon Network understands the issue as identified.
- Aurizon Network has strengthened this control by commencing a monthly reconciliation of SAP positions against project charge out rates.

PART B – DETAILED FINDINGS (CONT.)

6. Record Management of Alliances Documentation and Files

Risk Rating	
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Observation

Aurizon Network was the owner participant in each of the Alliances formed to conduct works within the GAPE and Blackwater projects. Aurizon Network was responsible for payment and certification of Alliance progress claims, with reliance placed on the governance provided by the Alliance Leadership Teams. We requested the following Alliance documentation:

- Participant Alliance Agreement;
- Alliance Audit Reports; and
- Compensation Audit Plans.

We noted that the documentation was not easily accessible by Aurizon Network, and, in some cases, could not be located. As a result requests were required to be made to third parties to obtain documentation which Aurizon Network should have maintained within its files. All documentation requested was subsequently located.

Implication

There is a risk of a loss of key documentation supporting capital expenditure claims.

Recommendations

We recommend that key Alliance documentation is stored electronically within Aurizon Network's document management system to enable accessibility at the request of Auditors or the Authority where applicable. Documentation should include as a minimum:

- Participant Alliance Agreement;
- Alliance Audit Reports;
- Compensation Audit Plan;
- ALT Minutes; and
- ALT approvals of TCAs.

Aurizon Network comments

- Aurizon Network understands the issue as identified and is working towards electronic storage of all project documents.
- Aurizon Network is informing external audit providers to projects of the possible future need for access to audit files and workings

APPENDIX 1 – SUMMARY OF AUDIT PROCEDURES

Summary of key risks identified, audit procedures and findings is set out below:

Description of audit risk	Audit Procedures performed	Conclusion/Issues
<p>Capital versus operating expenditures</p> <p>Aurizon Network’s Investment Framework and the document “Accounting Treatments, Capital versus Operating” provides guidance for distinguishing between capital and operating expenditure.</p> <p>There is a risk that non-capital related expenditures are included in Aurizon Network 2011/12 capital expenditure claim for inclusion in the Regulatory Asset Base (RAB).</p> <p>Below rail versus above rail</p> <p>There is a risk that the claim includes costs incurred for above rail activities.</p>	<p>Controls Testing:</p> <p>We tested internal controls over Aurizon Network’s Purchasing Cycle. This included:</p> <ul style="list-style-type: none"> • raising of capital expenditure purchase orders and its approval; • receipting of goods or services and matching to an approved Purchase Order; • matching of invoices received to purchase orders and good receipted notice (where applicable); and • access and changes to the supplier masterfile. <p>We tested the project management cost controls that are set up within SAP. This included:</p> <ul style="list-style-type: none"> • User access within the SAP project budget and funds release. This control prevents access to release funds for Aurizon Network staff not involved in the management and delivery of the projects. • We tested the SAP Active Funds Control. This control prevents costs exceeding approved budgets. Through observation, we tested that a transaction could not be posted to a WBS element that would exceed the budget set within SAP. We verified that the transaction was rejected automatically within SAP. • We tested that formal approval was obtained for each capital project budget, for the projects listed within Table 1.1. We tested that approval obtained was in line with the Delegations of Authority. 	<p>In the controls testing performed, we noted two employees who had no involvement in A.03473 GAPE, had user access rights that included access to release funds. Additionally we noted one employee, with access rights that was not removed once moved permanently from the Project. (Refer to Issue 4)</p> <p>In the detailed testing performed we noted \$6,304,695 expenditure capitalised in relation to network construction services for project A.03473 GAPE that did not meet the definition of asset in accordance with Australian Accounting Standards. (Refer to Issue 1)</p>

APPENDIX 1 – SUMMARY OF AUDIT PROCEDURES (CONT.)

Description of audit risk	Audit Procedures performed	Conclusion/Issues
	<p>Detailed Testing:</p> <ul style="list-style-type: none"> We obtained copies of Actual vs. Budget monthly project management reports for a sample of months in each year since project inception for each project list within Table 1.1, and reviewed explanations for significant budget variances. We obtained the labour build-up rate methodology for Project Delivery Staff (Staff involved in the management and delivery of each Project) and tested if overhead applied was in accordance with Australian Accounting Standards. Using software-assisted statistical sampling in accordance with Auditing Standard ASA 530, we selected a sample of expenditure transactions (excluding Alliance progress Claims) for each project listed in Table 1.1 to test that costs capitalised include only those that are defined by Aurizon Network's Investment Framework Manual and in accordance with Australian Accounting Standards. <p>The following procedures were performed on the samples selected:</p> <ul style="list-style-type: none"> vouched details of the capital expenditure to approved invoices, timesheets or other supporting documentation; tested that the claim expenditure tested was recorded in the correct period; for construction or consultancy progress claims selected, obtained original signed contract to ensure the objective relates to the project we are reviewing, and does not include costs incurred for above rail activities; for labour charges selected within our sample we tested compliance with the labour build-up methodology obtained; and we tested the mathematical accuracy of 2011-2012 claim including the IDC 	<p>Additionally, we noted costs allocated to project to A.02648 – GAPE Electrification Phase \$7,641,661 that related to concept designs and environmental studies, specific to assessing viability of electrification. This project was discontinued, and therefore does not meet the definition of asset in accordance with Australian Accounting Standards. (Refer to Issue 2)</p> <p>We also noted a process improvement opportunity in relation to the link between the JAKs (now replaced by Primavera) time sheeting system and SAP. We noted that the JAKs timesheet system does not get updated automatically when there are changes to an employee's position level in SAP which therefore requires manual intervention and exposes Aurizon Network to incorrect rates being applied in the JAKs and Primavera. (Refer to Issue 5)</p>

APPENDIX 1 – SUMMARY OF AUDIT PROCEDURES (CONT.)

Description of audit risk	Procedures performed	Conclusion/Issues
<p>Overloading in costs by Alliance Partners</p> <p>Costs associated with projects commissioned include claims submitted by various Alliance partners. There is a risk of overstatement in claims or excessive cost build-ups from these external parties.</p>	<p>Controls Testing:</p> <p>We reviewed the work undertaken for independent audits conducted for the following Alliances:</p> <ul style="list-style-type: none"> • Coal Stream (GAPE) • Aspect 3 (GAPE) • Coal Connect (GAPE) • Synergy (GAPE) • TrackPower (Blackwater Feeder Stations) <p>For each of the above, we reviewed work already undertaken by the Alliance Auditor. We considered the following in our assessment of its adequacy:</p> <ul style="list-style-type: none"> • the objectivity of the Alliance Auditor; • the technical competence of the Alliance Auditor; • whether the work of the Alliance Auditors was likely to be carried out with due professional care; • whether there was likely to be effective communication between the alliance auditors and other auditing entities; • the Alliance Auditor had adequate technical training and proficiency; • work performed was appropriately supervised, documented and reviewed; • audit evidence was obtained to enable the Alliance Auditor to draw reasonable conclusion; • conclusions reached were consistent with the results of the work performed; • exceptions identified by the Alliance Auditors were appropriately resolved; • we tested that formal approval was obtained for Total Commitment Expenditures (TCEs) and Total Commitment Adjustments (TCAs) for each Alliance within the audit period; and • we reviewed minutes of ALT meetings from project inception to August 2012 held and assessed the effectiveness of the governance provided on key decisions / approvals on project costing matters throughout Alliance life Cycle. 	<p>In our review of the Coal Connect Alliance's Total Commitment Expenditure (TCE) for project A.03473 - GAPE we noted that Total Commitment Adjustment (TCA) #210 amounting to \$9,099,721 was not formally approved by the Alliance Leadership Team (ALT) (Refer to Issue 3)</p> <p>We noted that Alliance documentation was not easily accessible by Aurizon Network, and, in some cases, could not be found. As a result, requests were required to be made from third parties to obtain documentation which Aurizon Network should have maintained within its files. (Refer to Issue 6).</p>

APPENDIX 1 – SUMMARY OF AUDIT PROCEDURES (CONT.)

Description of audit risk	Procedures performed	Conclusion/Issues
	<p>Detailed Testing:</p> <ul style="list-style-type: none"> • We selected a sample of expenditure transactions specific to the Synergy Alliance in the 2011 and 2012, as the Alliance Audit conducted did not cover that period. For each transaction: <ul style="list-style-type: none"> - we vouched to supporting documentation including approved invoices, timesheets or other supporting documentation; - tested that the expenditure transaction related cost incurred in respect to project A.03473 GAPE; and - for labour charges selected within our sample, we tested that the salary on-cost applied was compliant with the Program Alliance Agreement (PAA). 	
<p>Duplication of expense transactions</p> <p>Given the number of transactions, the period of project, and project staff turnover number of Alliance partners, there is a risk that transactions may have been processed more than once throughout the life of each of project.</p>	<p>Detailed Testing</p> <p>Using Computer-Assisted Audit Techniques, we extracted all transactions that had duplications in all of the following fields, for Project A.03473 GAPE and A.02222 Raglan Feeder Station:</p> <ul style="list-style-type: none"> • Vendor Name; • WBS Element Number; • Purchase Document Number; • Posting Date; • Cost Element; • Quantity; and • Value. <p>There were approximately 20 potential duplications noted within the fields above. Each one was investigated with Aurizon Network and source data was inspected. Based on the testing conducted, there were no duplicated transactions noted (that were not subsequently reversed) in material respects.</p>	<p>Based on the testing conducted there were no duplicated transactions noted (that were not subsequently reversed) in material respects.</p>

APPENDIX 1 – SUMMARY OF AUDIT PROCEDURES (CONT.)

Description of audit risk	Procedures performed	Conclusion/Issues
<p>Accruals and provisions</p> <p>Included in the value of the 2011/12 claim are items comprising of accruals and provisions. Accruals relate to costs incurred but yet to be invoiced or paid, while provisions relate to costs that can be reliably measured, and which Aurizon Network has a present obligation and it is probable that the obligation will be settled in the future, but the timing and amount of settlement is uncertain..</p> <p>As the actual amount of costs incurred is not certain, significant judgment may be exercised when determining amounts to be accrued and/or in estimating provisions.</p> <p>There is a risk of overstatement in accruals and provisions amounts.</p>	<p>Detailed Testing:</p> <ul style="list-style-type: none"> • we selected material accruals within the transaction listing of each project; and • we examined supporting documentation to verify the accuracy of the accrual raised, and, where required, verified reversals. 	<p>There were no issues identified in the testing performed.</p>
<p>Internal service provider charges</p> <p>There is the risk that the costs allocated to the projects by internal services providers are overstated or misallocated.</p>	<p>Detailed Testing:</p> <p>For a sample of internal charges:</p> <ul style="list-style-type: none"> • we examined supporting documentation, such as timesheets and inventory costs where applicable; and • for labour charges selected within our sample, we tested compliance with the labour build-up methodology obtained. 	<p>In the detailed testing performed, we noted \$6,304,695 expenditure capitalised in relation to network construction services for project A.03473 GAPE that did not meet the definition of asset in accordance with Australian Accounting Standards. (Refer to issue 1).</p>

APPENDIX 2 – SCOPE AND APPROACH

Summary of Audit Approach

The table below provides an overview of our approach.

Step	Details
1. Collate relevant data	We worked with the engineering consultant initially to ensure the necessary data was compiled in an efficient manner, and to prevent duplication.
2. Desktop study of Aurizon Network's 2011-12 capital expenditure	We conducted an initial review of total capital expenditure reported in the 2012 Claim to obtain an understanding of the projects involved and processes followed, collation of documents and preliminary interviews of key personnel
3. Select sample of projects	As noted in section 1.3, the scope of our audit was limited to the projects listed in Table 1.1.
4. High level assessment of capital expenditure for the projects listed in table 1.1 against assessment criteria (whether the costs are reasonable for the scope and standard of works done). This will include assessing how the matters set out below were considered, given the circumstances relevant at the time when the costs were incurred or the capital expenditure project was undertaken (as applicable).	This step was conducted concurrently with the detailed testing below (steps 5 – 9), depending on availability of information and access to people. Also, several of the assessment criteria were assessed in conjunction with the engineering consultant, and we have attempted to identify these below.
(i) Aurizon Network's compliance with any applicable procurement strategy approved by the Authority in accordance with Clause 3.1.3; and	Reviewed controls to ensure compliance with the procurement strategy, and detailed testing of compliance for selected transactions (refer step 8).
(ii) the manner in which the capital expenditure project has been managed.	We reviewed the project management approach adopted by Aurizon Network.
5. Assess design effectiveness and operation of key controls	We conducted walkthroughs of the processes Aurizon Network (and other stakeholders, particularly Alliance partners, where possible) has in place to identify and assess the key controls over accounting for capital expenditure and ensuring prudence of costs. We conducted testing of these key controls to assess whether they were operating throughout the year as intended, and to determine the level of control risk. Note this required visits to Aurizon Network (and other stakeholders, as necessary) to hold interviews and review processes.

APPENDIX 2 – SCOPE AND APPROACH (CONT.)







Summary of audit approach (cont.)

Step	Details
6. Comparison to best practice	In reviewing internal controls, we made reference to best practice accounting methodologies. Any areas where we felt improvements could be made were identified and reported to Aurizon Network in this report. Refer to issues 3, 4, 5, and 6.
7. Determine extent of reliance on controls	Based on the assessment of control risk in step 4 above, we determined whether the key controls are operating as prescribed, and if so, reduced audit risk and the level of detailed testing required accordingly.
8. Detailed testing to source records	<p>To conduct the detailed testing, cost structure details included:</p> <ul style="list-style-type: none"> • Project details • Account code • Amount • Description • Source reference <p>Further, we compiled a list of documents that we expected to be made available for our assessment (such as alliance reports where applicable, cost breakdowns of major infrastructure, details of scope changes and cost benefit assessment) to facilitate and expedite the assessment process.</p>
9. Detailed assessment against prudence criteria	Collated results from above testing to form conclusion against cost prudence criteria. We also worked closely with the engineering consultant at this point to consider scope and standard prudence for input into our conclusion.
10. Progress reports provided on an “as needs” basis	Throughout the above testing, we provided the Authority with progress updates on an “as needs” basis.
11. Draft and final reports prior to project completion	We provided a draft of our final report for review by the Authority (and Aurizon Network) at least 2 weeks prior to finalisation. Our final report was provided electronically and in hard copy as required by the Authority.
12. Presentation of findings	The findings of our review were presented to the Authority as necessary.

APPENDIX 2 – SCOPE AND APPROACH (CONT.)

Risk Ratings

The risk ratings applied to assess the issues identified are as follows:

Risk Ratings		
Extreme		Issues which may have a catastrophic impact upon the accuracy and/or prudence of the capital expenditure that has been claimed by Aurizon Network if they are not addressed immediately.
High		Issues which may have a major impact upon the accuracy and or prudence of the capital expenditure that has been claimed by Aurizon Network if they are not addressed as a matter of priority.
Medium		Issues which may have a moderate impact upon the accuracy and/or prudence of the capital expenditure that has been claimed by Aurizon Network if they are not addressed within a reasonable timeframe.
Low		Issues which are not likely to immediately impact upon the accuracy and/or prudence of the capital expenditure, but may in future, if plans are not put in place to rectify the issue.
Improvement		Standalone suggestion for improvement.
Implemented		Issue resolved as recommendation has been implemented during the review.

APPENDIX 3 – ACRONYMS AND ABBREVIATIONS

The table below lists acronyms and abbreviations referred to in this report.

Acronym or Abbreviation	Meaning
AASB	Australian Accounting Standards Board
ALT	Alliance Leadership Team
Aurizon Network	Aurizon Network Pty Ltd
Authority	Queensland Competition Authority
CQCR	Central Queensland Coal Region
GAPE	Goonyella to Abbott Point Expansion
JAKs	Timesheet system
RAB	Regulatory Asset Base
SAP	Accounting System
TCE	Total Commitment Expenditure
TCA	Total Commitment Adjustment
UT4	Aurizon Network's 2013 draft access undertaking
WBS	Work Breakdown Structure

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