



FINANCIAL AUDIT

28 NOVEMBER 2019

Transport 2019

NEW SOUTH WALES AUDITOR-GENERAL'S REPORT

THE ROLE OF THE AUDITOR-GENERAL

The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the *Public Finance and Audit Act 1983* and the *Local Government Act 1993*.

We conduct financial or 'attest' audits of State public sector and local government entities' financial statements. We also audit the Total State Sector Accounts, a consolidation of all agencies' accounts.

Financial audits are designed to add credibility to financial statements, enhancing their value to end-users. Also, the existence of such audits provides a constant stimulus to entities to ensure sound financial management.

Following a financial audit the Audit Office issues a variety of reports to entities and reports periodically to parliament. In combination these reports give opinions on the truth and fairness of financial statements, and comment on entity compliance with certain laws, regulations and government directives. They may comment on financial prudence, probity and waste, and recommend operational improvements.

We also conduct performance audits. These examine whether an entity is carrying out its activities effectively and doing so economically and efficiently and in compliance with relevant laws. Audits may cover all or parts of an entity's operations, or consider particular issues across a number of entities.

As well as financial and performance audits, the Auditor-General carries out special reviews and compliance engagements.

Performance audits are reported separately, with all other audits included in one of the regular volumes of the Auditor-General's Reports to Parliament – Financial Audits.

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In accordance with section 52B of the *Public Finance and Audit Act 1983*, I present a report titled '**Transport 2019**'.

A handwritten signature in black ink, appearing to read 'Margaret Crawford'.

Margaret Crawford

Auditor-General
28 November 2019

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Transport 2019

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Section one

Transport 2019

This report analyses the results of our audits of the Transport cluster agencies for the year ended 30 June 2019.

Executive summary

This report analyses the results of our audits of financial statements of the Transport cluster for the year ended 30 June 2019. The table below summarises our key observations.

1. Machinery of Government changes

Transport for NSW, as the lead agency, will absorb the functions of Roads and Maritime Services

The NSW Government announced its intention to integrate Roads and Maritime Services (RMS) into Transport for NSW (TfNSW) as part of the Machinery of Government changes.

This change was not included in the Administrative Orders as the *Transport Administration Act 1988 No. 109* governs the composition of the Transport cluster. The *Transport Administration Amendment (RMS Dissolution) Act 2019* (the Act) received assent on 22 November 2019. The Act dissolves RMS and transfers the assets, rights and liabilities of RMS to TfNSW. As at the date of this Report, the Act is not yet in force.

Transport is considering the impact of the changes on its operating model and financial reporting.

2. Financial reporting

Audit opinions

Unqualified audit opinions were issued on the 2018–19 financial statements of all agencies in the Transport cluster.

TfNSW and Sydney Metro obtained a three-week extension from NSW Treasury to submit their financial statements for audit to resolve accounting issues surrounding the valuation of property, plant and equipment.

The Department of Transport reported total consolidated property, plant and equipment of \$158 billion at 30 June 2019. In 2018–19, there were issues with asset valuations at TfNSW, RMS, Sydney Metro and Rail Corporation New South Wales (RailCorp), resulting in adjustments after the submission of financial statements for audit and the correction of a prior period error.

There was also a prior period error resulting from an agreement between TfNSW and the former UrbanGrowth Development Corporation due to a lack of assessment of the financial reporting implications at the time of signing the agreement.

Recommendation: Agency finance teams need to be consulted on major business decisions and commercial transactions to assess their accounting impacts at the time of their execution, rather than at the end of a financial year. Agencies also need to resolve all key accounting issues such as valuations as part of the early close procedures.

This would improve the quality of financial reporting and avoid the need for extensions for agencies to submit their financial statements for audit.

Preparedness for new accounting standards

Agencies across the cluster are progressing in their implementation of the new accounting standards.

Transport cluster agencies need to improve their contracts registers to ensure they have a complete list of contracts and agreements to assess the impact of the new accounting standards.

Valuation of assets remains a challenge in the Transport cluster

Whilst agencies complied with the requirements of the accounting standards and NSW Treasury policies on valuations, the Audit Office identified some deficiencies in relation to asset valuations across the cluster.

TfNSW reported a retrospective correction of a prior period error at 1 July 2017 which resulted in a reduction in the valuation of its Country Rail Network earthworks by \$2.1 billion. This was due to survey results which identified the earthworks were flatter and lower than estimated in the valuation at 30 June 2017.

RMS made several adjustments during the year to correct asset values due to changes to valuation assumptions or data improvements. This included:

- reduction of \$318 million in the value of land under roads
- decrease of \$84.9 million to the value of land and buildings
- changes to the value of traffic control and traffic signal network assets, due to data improvements.

Sydney Metro North West officially opened in May 2019 and reported total assets of \$9.1 billion. Sydney Metro derecognised \$322 million in assets constructed to facilitate its operation but transferred to councils and utilities.

Inconsistent accounting policies across the Transport cluster

There was an inconsistency identified in the cluster relating to the valuation of substratum land. In 2018–19, RailCorp derecognised \$109 million of substratum land to ensure consistency in its approach with other Transport agencies.

As the parent entity, the Department of Transport needs to ensure accounting policies are consistently applied across all controlled entities for consolidation purposes. Inconsistencies in the application of accounting standards across agencies will impact comparability of financial reporting and decision making across the Transport cluster.

Recommendation: The Department of Transport should ensure consistent accounting policies are applied across its controlled entities.

Revenue growth

Public transport passenger revenue increased by \$89.0 million (5.9 per cent) in 2018–19, and patronage increased by 37.8 million (4.9 per cent) across all modes of transport based on data provided by TfNSW.

The increase in revenue is mainly due to an increase in patronage as well as the annual increase in fares.

Negative Opal cards

Negative balance Opal cards resulted in \$2.9 million in revenue not collected in 2018–19 (\$10.4 million since the introduction of Opal).

In January 2019, Transport made a change to the Sydney Airport stations to prevent customers with high negative balances exiting the station. In addition, in late 2018, Transport increased the minimum top up values for new cards at the airport stations.

Recommendation (repeat): TfNSW should implement further measures to prevent the loss of revenue from passengers tapping off with negative balance Opal cards.

3. Audit observations

Internal controls

There was an increase in findings on internal controls across the Transport cluster. Key themes relate to information technology, employee leave entitlements and asset management. Twenty-nine per cent of all issues were repeat issues. The majority of the repeat issues related to information technology controls.

Write-off of assets

In addition to a \$322 million derecognition of assets transferred to councils and utilities by Sydney Metro and a \$109 million derecognition of substratum land at RailCorp, the Transport cluster wrote-off \$278 million of assets related to roads, bridges, maritime assets, traffic signals and controls network.

These mainly related to roads, bridges, maritime assets, traffic signals and the control network where new infrastructure assets substantially replaced an existing asset as part of construction activities.

Transport Asset Holding Entity (TAHE)

TAHE was established to be a dedicated asset manager for the delivery of public transport asset management. The *Transport Administration Amendment (Transport Entities) Act 2017* will transition RailCorp into TAHE. RailCorp is now expected to transition to TAHE from 1 July 2020 (previously 1 July 2019). Several working groups have been considering various aspects of the TAHE transition including its status as a for profit Public Trading Enterprise, the operating model and the impact of the new accounting standards AASB 16 'Leases' and AASB 1059 'Service Concession Arrangements: Grantors'. The considerations of these aspects identified several challenges in the implementation of TAHE which has led to the revised transition date. Given the delays in implementation, it is important to clarify the intent of the TAHE model.

Excess annual leave

Twenty-six per cent of Transport employees have annual leave balances exceeding 30 days. Of the employees with excess leave balances, 732 (10.3 per cent) did not take any annual leave in 2018–19.

Recommendation (repeat): Transport entities should further review the approach to managing excess annual leave in 2019–20. They should:

- monitor current and projected leave balances to the end of the financial year each month
- agree formal leave plans with employees to reduce leave balances over an acceptable timeframe
- ensure leave plans are actioned appropriately
- encourage all staff with excess leave balances take a minimum two-week period of leave per year.

Completeness and accuracy of contracts registers

There are no centralised processes to record all significant contracts and agreements in a register across the Transport cluster.

Across the Transport cluster, contracts and agreements are maintained by the individual agencies using disparate registers. Agencies must perform detailed assessments of their existing contracts and agreements to quantify the impact of the new accounting standards (AASB 16 'Leases', AASB 15 'Revenue from Contracts with Customers', AASB 1058 'Income of Not-for-Profit Entities' and AASB 1059 'Service Concession Arrangements: Grantors').

In 2018–19, there was also a prior period error resulting from an agreement between TfNSW and another government agency due to a lack of assessment of the financial reporting implications at the time of signing the agreement.

A lack of a complete register of all contracts and agreements increases the risk that agencies may not be able to assess the full impact of the new accounting standards, as well as perform a complete assessment of the financial reporting implications of contracts and agreements.

Recommendation: Transport agencies should implement a process to centrally capture all significant contracts and agreements entered. This will ensure:

- agencies are fully aware of contractual and other obligations
- appropriate assessment of financial reporting implications
- assessment of new accounting standards, in particular AASB 16 'Leases', AASB 15 'Revenue from Contract with Customers', AASB 1058 'Income of Not-for-Profit Entities' and AASB 1059 'Service Concession Arrangements: Grantors' are accurate and complete.

1. Introduction

This report provides parliament and other users of the Transport cluster's financial statements with the results of our audits, our observations, analysis, conclusions and recommendations in the following areas:

- financial reporting
- audit observations.

This cluster was impacted by the Machinery of Government changes on 1 July 2019. The NSW Government announced its intention to integrate Roads and Maritime Services (RMS) into Transport for NSW (TfNSW). This report is focused on the Transport cluster prior to these changes. Please refer to the section on Machinery of Government changes for more details.

1.1 Snapshot of the cluster

TfNSW is the lead agency in the Transport cluster. It is responsible for the coordination, funding allocation, policy and planning and other delivery functions for transport services.

TfNSW is controlled by the Department of Transport (the Department). The Department does not control the Chief Investigator of the Office of Transport Safety Investigations or Port Authority of New South Wales.



Transport Cluster

Aims to deliver infrastructure and integrated services across road, rail, bus, ferry, light rail, cycling and walking.

$$\begin{array}{rcl} \$14,400\text{m} & + & \$15,100\text{m} = \$29,500\text{m} \\ \text{Budgeted recurrent} & & \text{Budgeted capital} & & \text{Total budget} \\ \text{expenses 2019-20} & & \text{expenditure 2019-20} & & \end{array}$$

The Government's budget papers set priorities for the cluster to contribute to:

Well-connected communities with quality local environments

Making Government work better for you by putting the customer at the centre of everything we do.

Outcomes to be delivered

Accessible transport

Enabling and enhancing the equity and accessibility of the transport system for all customer groups.

Recurrent expenses (M)		Capital expenditure (M)		Total budget (M)
\$932	+	\$457	=	\$1,389

Safe and reliable travel

Delivering ongoing operation, maintenance and overall performance of transport networks, to ensure journey reliability and customer satisfaction.

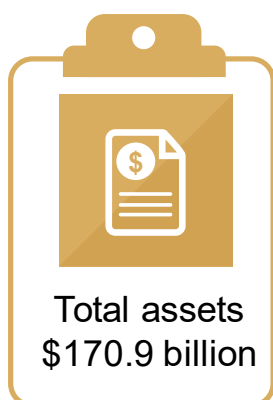
\$12,800	+	\$2,100	=	\$14,900
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Successful places

Enhancing liveability and connectivity by delivering city-shaping infrastructure projects, activating precincts and expanding network capacity.

\$625	+	\$12,500	=	\$13,125
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SOURCE: NSW Budget Papers 2019-20



Notes:

- 1 TfNSW includes Transport Service of New South Wales (Transport Service).
- 2 All NSW TrainLink services are provided by the NSW Government through an overarching entity: NSW Trains.
- 3 Total revenue and expenses include gains and losses.
- 4 The Residual Transport Corporation was established effective 1 July 2017. Financial statements were not submitted for audit and Transport advises that the entity did not trade.
- 5 Figures include the Department of Transport consolidated figures, Port Authority of New South Wales and the Chief Investigator of the Office of Transport Safety Investigations.

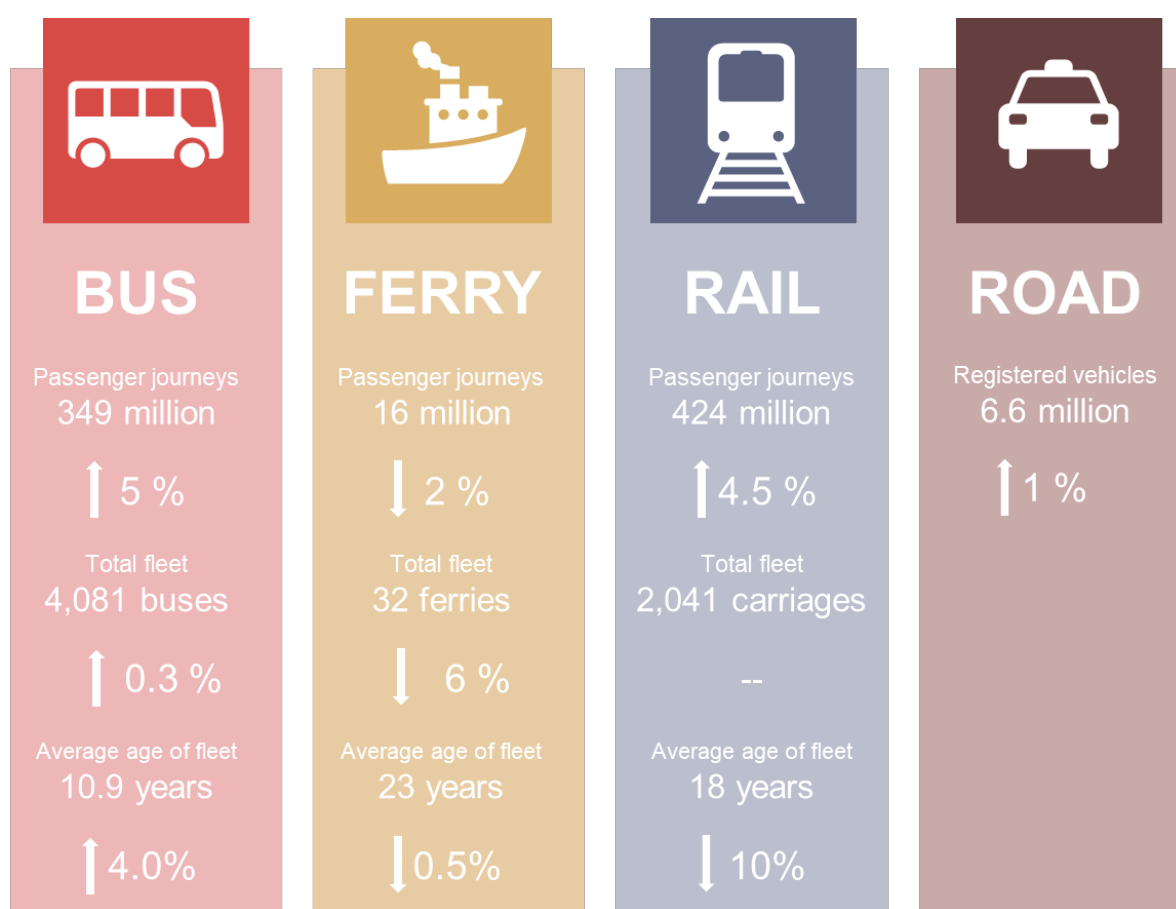
1.2 Changes in the cluster

Sydney Metro was established on 1 July 2018 under the *Transport Administration Amendment (Sydney Metro) Act 2018* as a controlled entity of TfNSW to:

- to deliver safe and reliable metro passenger services in an efficient, effective and financially responsible manner
- to facilitate and carry out the orderly and efficient development of land in the locality of metro stations, depots and stabling yards, and proposed metro stations, depots and stabling yards.

On 26 May 2019, the Metro North West Line opened to the public. The 36-kilometre metro line is a fully automated metro system consisting of 13 stations from Tallawong to Chatswood.

1.3 Operational snapshot



Notes:

1 Movements are a comparison between 2018–19 and 2017–18.

2 Rail includes Sydney Trains and NSW Trains and excludes Light Rail and Sydney Metro.

Source: Information from agencies (unaudited).

1.4 Service delivery in the cluster

The NSW Department of Planning, Industry and Environment projects the population will grow to 9.9 million by 2036. As a result, the NSW Government has made investments on infrastructure projects. In 2018–19, the Transport cluster budgeted to spend \$14.7 billion in capital expenditure mainly on roads, trains, light rail and metro train infrastructure (\$13.8 billion in 2017–18).

Measuring performance

Transport cluster agencies use a range of measures to monitor and manage the performance of their network and services. Measuring performance allows them to focus on service outcomes for customers.

Each year, the Audit Office focuses on an area of performance measure for deeper examination to describe the process and data used. However, as this is not an audit, the Audit Office does not provide assurance over this data.

Key Performance Indicators (KPIs) are regularly monitored by these agencies across each mode of transport. Some of the main KPIs cover punctuality, capacity, customer satisfaction and complaints. This year, the Audit Office reviewed the method transport agencies use to measure train punctuality.

TfNSW has also privatised the operations of some transport services to private operators including buses, light rail, ferries and metro train. The outsourced services are governed through a services contract. This year the Audit Office reviewed how TfNSW hold the bus operators accountable through its bus services contracts.

The operators of various modes of transport self-report KPIs and other operational data to TfNSW. Parliament and the New South Wales public would benefit from independent assurance over the KPIs which are self-reported by operators.

Train punctuality

In 2018–19, there were approximately 424 million (406 million in 2017–18) passenger journeys made using rail services in NSW. Passenger journeys on rail increased 4.5 per cent from the prior year. Train journeys account for nearly 52.8 per cent of all passenger journeys in NSW on the public transport network.

TfNSW considers a train service to be punctual if it stops at all stations as specified in the timetable and arrives at its destination no later than the time shown in the timetable plus an on-time tolerance. The tolerance is five minutes for suburban services, six minutes for intercity services and ten minutes for regional services.

Sydney Trains is the operator of suburban rail services across the metropolitan Sydney area. NSW Trains manages the operation of NSW TrainLink, providing intercity and regional services between Sydney and the Hunter, Central Coast, Blue Mountains, Southern Highlands and Illawarra and South Coast regions.

The punctuality target is 92 per cent for suburban and intercity services and 78 per cent for regional services. For Sydney Trains, the targets apply to trains arriving into Sydney CBD during the morning peak (6 am to 10 am) and departing Sydney CBD during the afternoon peak (3 pm to 7 pm). This means, Sydney Trains must deliver 638 out of 693 punctual train services to meet the target based on the daily working timetable. Punctuality is measured each day.

For NSW Trains, the targets apply to trains arriving into Sydney CBD during the morning peak (6 am to 10 am) and departing Sydney CBD during the afternoon peak (4 pm to 7 pm).

Transport rail entities use various technologies for recording and reporting punctuality. Sydney Trains and NSW Trains (intercity services) use the Train Location System On-Time Running (TLS-OTR) method which uses radio transponders to show the approximate location of a train. NSW Trains' regional and coach service punctuality data is collected using Global Positioning System Data (GPS) in its system, 4trak.

Punctuality information is collected by Sydney Trains and NSW Trains and self-reported to TfNSW. The Sydney Trains data collection process is automated and collated daily. Sydney Trains has implemented a system to check the data is not impacted by outages and other issues. The NSW Trains data collection is largely automated. However, on certain sections of the NSW Trains' Intercity Network, radio transponders are not fitted at the stations as the railway tracks are managed by an external organisation, the Australian Rail Track Corporation. These areas include the end of the Hunter Valley line, end of the South Coast line and end of the Southern Highlands line. Train punctuality is recorded manually for these stations. For coach services, 4trak GPS devices are fitted to all coaches. However, as some coach services are operated through private bus operators, the use of such devices may be inconsistent. Punctuality data for intercity, regional and coach services is validated by NSW Trains through a variety of methods including comparison to vehicle logs and station reports.

Parliament and the New South Wales public will further benefit from independent assurance over the accuracy of self-reported data by Sydney Trains and NSW Trains.

The Audit Office conducted a performance audit of Passenger Rail Punctuality in 2017 and found rail agencies were well placed to manage the forecast increase in passengers up to 2019. However, if recent higher-than-forecasted patronage growth continues, the network may struggle to maintain punctuality in the future periods.

In an upcoming performance audit, 'Transport capacity and reliability', the Audit Office will look at crowding at train stations. The audit will examine how effectively transport agencies manage crowding at selected metropolitan train stations.

Sydney Trains reported it did not meet the punctuality target in 2018–19

In 2018–19, Sydney Trains reported punctuality of 91.3 per cent (91.6 per cent in 2017–18). The T4 Eastern Suburbs and Illawarra Line was the only route that achieved the target in 2018–19.

Sydney Trains punctuality fell following major changes to the public transport timetable on 26 November 2017 which added more than 1,500 extra weekly train services.

NSW Trains reported it did not meet the punctuality target in 2018–19

Punctuality for NSW Trains' Intercity Services lines fell from 91.2 per cent in 2017–18 to 90.5 per cent in 2018–19. For Regional Services, punctuality increased by 0.8 per cent to 79.1 per cent in 2018–19 (78.3 per cent in 2017–18).

However, overall punctuality across all NSW Trains lines has improved over the last five years from an average of 90.7 per cent between 2014–15 to 2018–19.

Bus Services Contracts with private bus operators

Transport manages the delivery of bus services to the public through contracts with each private bus operator. The Service Contracts include key performance indicators (KPIs) set by Transport to measure the bus operators' performance against predetermined goals and objectives.

The KPIs include a range of metrics including boarding, punctuality, cancelled or incomplete trips, accessible bus services, customer complaints, customer response, customer satisfaction, crowding, passenger information, bus presentation, maintenance and defects, preventable incidents, contract bus revenue collection rates, major incident resolution, reporting, provision of information, data maintenance, passenger growth, project on time delivery and CCTV reliability.

Bus operators are required to report against the KPIs each month. Under the contract, the operator must comply with its obligations related to the measurement and reporting of KPIs and the remediation of any breaches. TfNSW reviews the KPIs and data reported by operators each month.

TfNSW informed that it validates the information provided by the bus operators using a range of information, including:

- the Public Transport Information and Priority System (PTIPS) which provides real-time tracking of bus location and status, traffic light priority for late running buses, bus timetable performance and reliability reports and real-time bus arrival information for bus stops
- confirming major defects with RMS
- data from the Opal system
- customer complaints data
- surveys such as customer satisfaction surveys
- Bus Incident Management Database (BIMS) from RMS
- transport officer (revenue protection) reports
- operational spatial database (OSD) from TfNSW supported with data from operator
- site visits
- closed-circuit television (CCTV) footage.

Under the Sydney and Outer Metropolitan Bus Service Contracts (except for the ones with State Transit Authority of NSW), KPIs relating to punctuality, cancelled and incomplete trips, customer complaints, major defects, customer satisfaction, contract bus revenue collection rate, data maintenance and CCTV reliability attract financial penalties.

During 2018–19, one private bus operator paid a fine for major defect breaches (five contract regions in 2017–18). TfNSW advises that one major defect notice was also issued for STA contracts which do not impose financial penalties for failure to meet this target.

With bus contracts signed prior to 2017–18, financial penalties can be imposed on private bus operators if they do not meet punctuality targets at the start of the trip, but not if the middle or end of the trip targets are not met. For contracts that have been renewed or new contracts during 2017–18 and onwards, there are also penalties for not meeting punctuality targets that incorporate performance for the middle and end of the trip.

The punctuality target for bus services is for 95.0 per cent of services to be on time according to published timetables. Data published on TfNSW's website indicates 11 out of the 15 bus regions experienced at least one instance where the monthly punctuality KPI for a bus operator was not met. However, there were no penalties collected by TfNSW for the punctuality KPI in 2018–19. TfNSW reviews the punctuality results reported by private bus operators. Penalties and performance measures may be varied depending on circumstances, such as unexpected traffic accidents. During the 2018–19, two operators were issued penalties for not meeting KPIs on reliability. The penalties were paid in 2019–20.

Crowding on buses

There are no target measures on crowding for bus operators in any bus contract regions. Also, the crowding information is not published for buses in any contract region.

The bus service contracts define a crowded bus as being full on route which leaves customers behind. Crowding on buses increased from last year. In 2017–18, 8,801 services left customers behind due to being full, which increased to 9,698 buses in 2018–19. Majority of these full buses related to Region 3 (Western Sydney services in the Parramatta, Liverpool, Merrylands, Prairiewood and Fairfield areas) and Region 4 (North-western Sydney services in the Castle Hill, Rouse Hill, Dural and Baulkham Hills areas).

Crowding on buses is measured and self-reported by the bus operators to TfNSW as part of the Monthly Operational Reporting obligations. Under the contract, bus operators are required to report all crowded routes to TfNSW. TfNSW reviews the accuracy of the data through comparison with feedback and complaints obtained, internal information, as well as with information from the Opal system and video footage. TfNSW use a model called BOAM (Bus Opal Assignment Model) to identify bus stops and bus routes which experience high demand based on customer Opal taps. TfNSW advised it uses this to assess and plan for changes to service levels (frequency), bus types and routes based on the patronage demand.

In 2015, the Audit Office published a performance audit report on Sydney metropolitan bus contracts. The audit found that while operator performance information was largely valid and reliable, there were opportunities for TfNSW to enhance its electronic information systems to generate discrepancy reports automatically. TfNSW has since introduced the use of data from the Opal revenue system to assist its monitoring of performance by operators. Parliament and the New South Wales public will further benefit from independent assurance over the accuracy of self-reported data from bus operators.

Projects management

The capital budget for the Transport cluster was \$14.7 billion for the year ended 30 June 2019 (\$13.8 billion in 2017–18). This is 60.2 per cent of the total capital budget for New South Wales of \$24.5 billion. The Transport cluster is involved in several significant infrastructure projects. The Audit Office reviewed information on three significant ongoing capital projects in the Transport cluster - CBD and South East Light Rail, WestConnex and NorthConnex. These three projects were selected for review due to their size and significant public interest. The common factors emerging from the review of these projects include:

- a lack of transparency in reporting of project status and costs
- cost overruns and revisions to budgets
- time delays in the delivery of the project.

CBD and South East Light Rail

The CBD and South East Light Rail is a 12-kilometre light rail network that will connect passengers from Circular Quay to Randwick and Kingsford.

The original completion date of March 2019 has been delayed. Transport expects the light rail to commence operation in two stages. Passenger trips are now expected to commence in December 2019 between Circular Quay and Randwick. The second stage to Kingsford is planned to commence in March 2020.

The original budget for the project was \$1.6 billion which was revised to \$2.1 billion in 2014. This was mostly due to mispricing and omissions in the business case. The project also included a contingency fund of \$207 million. The contingency fund was used as at 30 June 2018.

TfNSW has been in dispute with the consortium responsible for the delivery of the project. In May 2019, the parties reached a settlement arrangement resulting in TfNSW agreeing to pay a net settlement amount of \$576 million, which is in addition to the revised budget.

As a result of this settlement, the claim for misleading and deceptive conduct by the design and construction subcontractor was dropped. The debt guarantee of \$500 million by the NSW Government against a borrowing facility provided by two domestic banks to the consortium constructing the light rail was also extinguished.

A statement of claim was filed in the Supreme Court of NSW alleging public and private nuisance as a result of the project. The proceedings have been brought as representative proceedings. TfNSW advise the project specific insurers are managing the conduct of TfNSW's defence, in TfNSW's name. TfNSW disclosed these proceedings as a contingent liability in its financial statements as management believe it is not possible at this stage to estimate the potential financial effect in excess of the insurance coverage from these proceedings.

TfNSW also paid \$37.5 million in total as at 30 June 2019 to small businesses as part of the Small Business Assistance Program. The Small Business Assistance Program was established to assist some small businesses on the light rail alignment impacted by the delays in construction.

The \$2.1 billion budget does not include the net settlement amount or the payments made to the small businesses. The total cost of the project should include all capital and operating expenditure incurred on the project.

It was reported in the media that the Transport Minister recently announced a forecasted revised cost of \$2.9 billion for the project. At the date of this report, the total costings or revised budget have not been made available to the Audit Office. As the project is a Public-Private Partnership, the assets are not recorded in the balance sheet by TfNSW until completion of the works.

Good project management involves implementation of processes to monitor the costs of projects. Transport should have the detailed costings of the project available to update budgets and costs regularly. Given the level of public scrutiny on this project, Transport should improve transparency of costs and budgets through more regular public announcements.

The Audit Office has commenced a follow up performance audit on the project. This audit will consider whether recommendations from our previous audit have been implemented and review the current status and budget of this project. This performance audit is expected to be tabled prior to June 2020.

WestConnex

The WestConnex project is a motorway project that extends the M4, duplicates the M5 East and will link the M4 and M5 motorways with 33 kilometres of new motorway, mostly via tunnels in Sydney.

Up to September 2018, Sydney Motorway Corporation was the delivery agency for all stages of WestConnex, except for part of Stage 3, known as the Rozelle Interchange (or Stage 3B). Upon sale of a 51 per cent stake in WestConnex to the private sector, the private operator remains responsible for the delivery of WestConnex (except for Stage 3B). The Rozelle Interchange is being delivered by RMS, which is responsible for its funding, design, construction and commissioning, and will hand over the Rozelle Interchange to the private operator on its completion. RMS will be required to compensate the private operator for delays in hand over.

WestConnex has a revised budget of approximately \$16.8 billion and comprises three stages. These are detailed below along with the actual or planned completion dates and the budget included in the November 2015 WestConnex Updated Strategic Business Case.

Project stage	Scope	Status at 30 June 2019	Completion date	Budget (\$b)
Stage 1	M4 widening and M4 East	Completed	SM4 Widening - 4 July 2017 M4 East - 13 July 2019	4.3
Stage 2	King Georges Road Interchange Upgrade	Completed	December 2016	0.1
	New M5	Ongoing	New M5 - Planned 2020	5.2*
Stage 3	M4 to M5 link (includes mainline tunnels and Rozelle interchange)	Ongoing	Planned 2023	7.2

* According to the 2019–20 Budget Paper No. 2 Infrastructure Statement this includes \$800 million, which will be allocated toward the delivery of Sydney Gateway.

Source: 2019–20 Budget Paper No. 2 Infrastructure Statement and WestConnex Updated Strategic Business Case (November 2015).

There were two budget revisions since the original business case in 2014. The project's budget was updated to \$15.4 billion in May 2015 and a further increase of \$1.4 billion in October 2015 due to changes to the scope of work. The scope changes include extension of Stage 3 to Anzac Bridge and Victoria Road as well as allow for the future connection of the proposed Western Harbour Tunnel and Beaches Link.

Since commencement, \$2.54 billion in costs have been incurred by RMS to 30 June 2019, but costs financed by the private sector are not available. As the project is a Public-Private Partnership, project costs financed by the private sector are not recognised in RMS' financial statements.

RMS has received significant claims related to different stages of the project from contractors and other parties for unforeseen planning conditions, environmental issues and matters relating to compulsory land acquisitions. As at 30 June 2019, total claims and variations paid or recorded as a liability amounted to \$239 million. RMS determined that the outcome of other claims and variations received could not be reliably determined at 30 June 2019 and up to the date of approving the financial statements.

We conducted a performance audit of the WestConnex business case review process in 2014 and plan to perform another performance audit on WestConnex. This audit will review the effectiveness of responsible agencies in assessing and justifying major scope changes to WestConnex and is expected to be tabled in 2020.

NorthConnex

NorthConnex is a nine-kilometre tolled motorway tunnel being constructed between the M1 Pacific motorway at Wahroonga and the M2 Hills motorway at West Pennant Hills. NorthConnex is funded by the private sector and contributions from the NSW and Australian Governments.

NorthConnex was approved by the NSW Minister for Planning on 13 January 2015 and construction commenced shortly after in February 2015. The original completion date of December 2019 has been revised and the expected date of opening to traffic is now mid-2020.

The total expected cost of the project (including costs financed by the private sector) is \$3.0 billion. The original budget set by RMS for its own portion of project costs was \$971 million. This was revised to \$997 million as a result of the inclusion of the Hornsby Quarry Road Construction Spoil Management project and Woodland Noise wall variation.

RMS advises the completion date was revised as a result of geological tunnelling conditions and logistics associated with the tunnel depth, length and restricted access.

Since January 2015, \$899 million in costs have been incurred to 30 June 2019 with 9.8 per cent of the revised budget remaining as at 30 June 2019. As the project is a Public-Private Partnership, project costs financed by the private sector are not recognised in RMS' financial statements.

2. Machinery of Government changes

Machinery of Government refers to how the government organises the structures and functions of the public service. Machinery of Government changes are where the government reorganises these structures and functions, and are given effect by Administrative orders.

The Transport cluster was impacted by recent Machinery of Government changes. These changes were announced by the Department of Premier and Cabinet but were not included in the Administrative Orders as the *Transport Administration Act 1988 No. 109* governs the composition of the Transport cluster. It was the intention of government to transfer the functions of the RMS into TfNSW. This requires legislative changes to the *Transport Administration Act 1988 No. 109*.

Section highlights

Under the Machinery of Government changes, the NSW Government will transfer the functions of RMS into TfNSW.

- The *Transport Administration Amendment (RMS Dissolution) Act 2019* (the Act) received assent on 22 November 2019.
- The Act will dissolve RMS and transfer its functions, assets, rights and liabilities to TfNSW.
- As at the date of this report, the Act is not yet in force.
- There are risks and challenges for asset and liability transfers, governance and retention of knowledge.
- As of 1 July 2019, administrative arrangements (delegations and reporting line changes) were put in place to enable TfNSW and RMS to operate within a single management structure, while still remaining as separate legal entities.
- Transport is working on a number of options as to how to implement the changes.

2.1 Cluster changes

Transfer of functions of Roads and Maritime Services to Transport for NSW

Transport for NSW, as the lead agency, will absorb the functions of Roads and Maritime Services

The NSW Government announced its intention to integrate RMS into TfNSW as part of the Machinery of Government changes.

As of 1 July 2019, administrative arrangements (delegations and reporting line changes) were put in place to enable TfNSW and RMS to operate within a single management structure, while still remaining as separate legal entities.

On 22 November 2019, the *Transport Administration Amendment (RMS Dissolution) Act 2019*, to dissolve RMS received assent. The Act will also transfer RMS' functions, assets, right and liabilities to TfNSW. As of the date of this report, the Act is not yet in force.

The following matters may create some risks and challenges:

- effectively managing complex asset and liability transfers
- ensuring governance arrangements are appropriate including Audit and Risk Committees
- loss of corporate knowledge from key staff changes.

2.2 Agency preparation and implementation of changes

TfNSW is currently assessing options to implement the changes, including consideration of the operating model and financial reporting.

Both TfNSW and RMS staff are employed by a separate employing agency, Transport Service of New South Wales. This enabled Transport to implement changes to the human resources reporting lines within the Transport cluster effective 1 July 2019 to integrate the two agencies.

3. Financial reporting

Financial reporting is an important element of good governance. Confidence and transparency in public sector decision making are enhanced when financial reporting is accurate and timely.

This chapter outlines our audit observations related to the financial reporting of agencies in the Transport cluster for 2019.

Section highlights

- Unqualified audit opinions were issued on all agencies' financial statements.
- RMS required an extension from NSW Treasury for their early close procedures.
- TfNSW and Sydney Metro required extensions to submit their year-end financial statements.
- Valuation of assets remains a challenge across the cluster.
- There remains Opal cards with negative balances.
- Sydney Metro derecognised assets of \$322 million in relation to assets constructed for third parties.
- Inconsistencies in the application of accounting policies across cluster agencies impact comparability of financial reporting across the Transport cluster.

3.1 Quality of financial reporting

Audit opinions

Unqualified audit opinions were issued on all agencies' financial statements

Unqualified audit opinions were issued on all 30 June 2019 financial statements that were submitted for audit. Sufficient audit evidence was obtained to conclude the financial statements were free of material misstatement.

The valuation of assets continues to create challenges across the cluster. In 2018–19, there were issues with asset valuations at TfNSW, RMS, Sydney Metro and Rail Corporation New South Wales (RailCorp), resulting in adjustments after the submission of financial statements for audit and the correction of a prior period error.

There was also a prior period error resulting from TfNSW entering an agreement with the former UrbanGrowth Development Corporation due to a lack of assessment of the financial reporting implications at the time of signing the agreement.

These matters are covered in more detail under Audit observations.

Recommendation

Agency finance teams need to be consulted on major business decisions and commercial transactions to assess their accounting impacts at the time of their execution, rather than at the end of a financial year. Agencies also need to resolve all key accounting issues such as valuations as part of the early close procedures.

This would improve the quality of financial reporting and avoid the need for extensions for agencies to submit their financial statements for audit.

3.2 Timeliness of financial reporting

RMS required an extension from NSW Treasury for their early close procedures

RMS obtained a one-week extension from NSW Treasury to submit their early close procedures for audit. The extension was requested to finalise the quality review process on its early close procedures. Consequently, the Department of Transport also required an extension due to the consolidation of RMS.

TfNSW and Sydney Metro required extensions to submit their year-end financial statements

TfNSW and Sydney Metro obtained a three-week extension from NSW Treasury to submit their year-end financial statements for audit. The extensions were received to resolve accounting issues surrounding the valuation of property, plant and equipment. These accounting issues had not been resolved as part of the early close procedures.

All other agencies completed early close procedures and submitted financial statements on time.

The table in Appendix one shows the timeliness of financial reporting for cluster agencies.

3.3 Key accounting issues

Valuation of assets

Valuation of assets remains a challenge in the Transport cluster

The Transport cluster has a large, geographically dispersed asset base, requiring significant resources, judgement and estimation techniques to determine fair values. The Department of Transport reported total consolidated property, plant and equipment of \$158 billion at 30 June 2019. Each year, agencies perform a full revaluation of specific classes of assets, with all asset classes subject to a full revaluation over a five-year period. Although, overall, agencies complied with the requirements of the accounting standards and NSW Treasury policies on valuations, the Audit Office noted some deficiencies in the valuation of assets across the Transport cluster.

NSW Treasury policy requires physical assets to be carried at fair value

NSW Treasury policy mandates agencies measure physical non-current assets at fair value in accordance with the revaluation model described in Australian Accounting Standards. This ensures a consistent basis for measurement for all physical assets in the NSW Public Sector.

Valuation of Country Regional Network earthworks at Transport for NSW

TfNSW valued its Country Regional Network (CRN) tunnels and earthwork assets at 30 June 2017. TfNSW's 30 June 2017 financial statements recognised tunnels and earthworks of \$4.2 billion for the first time at 1 July 2016.

During this valuation, a physical inspection of a sample of assets identified TfNSW's database for earthworks was of poor quality and incomplete. In response to these variations, a desktop valuation methodology was adopted using estimations and assumptions.

The Audit Office recommended management establish a complete database of all earthworks, including condition assessments. Over the past two years, TfNSW engaged an engineering company to update the earthworks database. Following the update of the earthworks database, the Audit Office requested TfNSW to review the assumptions used in the 2017 valuation against the actual data obtained. TfNSW engaged a valuer to assess the fair value using the updated database and identified significant variations between the updated database and estimates and assumptions used in the 30 June 2017 valuation. These variations were mainly due to differences in the height of the earthworks, which are now confirmed to be flatter and lower.

In the 2018–19 financial statements, management recognised the resulting decrease in fair value of \$2.1 billion as a retrospective correction of a prior period error at 1 July 2017.

Road and Maritime Services

RMS made several adjustments during the year to the financial statements to correct asset values due to changes to valuation assumptions or data improvements. This included:

- reduction of \$318 million in the value of land under roads due to the incorrect assumptions and judgements used to calculate the width and resulting surface area of land under roads
- reduction of \$84.9 million to the value of land and buildings due to the inclusion of updated information on contaminated land
- changes to the value of traffic control and traffic signal network assets, due to data improvements.

The adjustment to land under roads was identified after the financial statements were submitted for audit and was corrected by RMS prior to the financial statements being approved.

Consistency in valuation approaches across the Transport cluster

There was an inconsistency in the application of accounting policies in the cluster which impacted comparability of financial reporting

There was an inconsistency identified in the cluster relating to the valuation of substratum land. Across the cluster, RMS and Sydney Metro valued substratum land at nil value, while RailCorp recognised substratum land with a value.

As the parent entity, the Department of Transport needs to ensure accounting policies are consistently applied across all controlled entities for consolidation purposes. Inconsistencies in application of accounting policies across agencies impact comparability of financial reporting and decision-making across the Transport cluster.

In 2018–19, The Department of Transport ensured consistency in the valuation approach for substratum land across the consolidated entities. As a result, RailCorp derecognised \$109 million of substratum land.

Recommendation

The Department of Transport should ensure consistent accounting policies are applied across its controlled entities.

Preparedness for new accounting standards

The Transport cluster will implement three new accounting standards (AASB 16 'Leases', AASB 15 'Revenue from Contracts with Customers' and AASB 1058 'Income of Not-for-Profit Entities') for their 2019–20 financial statements, and one new accounting standard (AASB 1059 'Service Concession Arrangements: Grantors') for their 2020–21 financial statements.

Agencies across the cluster are progressing in their implementation of the new standards. They have:

- performed a detailed assessment of the impact of the new standards on their financial statements, existing systems and processes
- prepared accounting position papers documenting the accounting treatment of leases and major income streams, quantifying the impact and highlighting significant management assumptions
- disclosed quantitative information on the financial impact in their 2018–19 financial statements.

Agencies need to improve their contracts registers to ensure they have a complete list of contracts and agreements to assess the impact of the new accounting standards. This is covered in more detail under Audit observations.

3.4 Passenger revenue and patronage

Transport reported that patronage has increased by 4.9 per cent from last year to 802 million, while revenue has increased 5.9 per cent to \$1.6 billion across all modes of transport. Transport advised the increase in revenue was largely due to the increase in patronage as well as the annual increase in fares.

Sydney Metro, which began operation on 26 May 2019, reported passenger journeys of 2.0 million and \$3.5 million in passenger revenue for the period 26 May 2019 to 30 June 2019.

Rail continues to be the most used mode of public transport earning 66 per cent of total passenger revenue in both 2018–19 and 2017–18. It also accounted for 52.8 per cent of total public transport patronage in 2018–19, similar to 2017–18.

Passenger revenue and patronage by transport mode

	Passenger revenue [#]		Movement	Patronage [#]		Movement
Year ended 30 June	2019	2018		2019	2018	
Mode of public transport	\$m	\$m	%	million trips	million trips	%
Rail	1,030	977	5.4	424.1	405.9	4.5
Buses [*]	472	440	7.3	349.1	332.0	5.2
Ferries ^{**}	51	52	(1.9)	16.1	16.4	(1.8)
Light rail ^{***}	13	12	8.3	10.7	10.3	3.9
Metro	3	--	--	2.0	--	--
Total passenger revenue and patronage from public transport	1,569	1,481	5.9	802.0	764.6	4.9

* Passenger revenue for STA and private bus operators.

** Passenger revenue did not include Newcastle Ferries.

*** Passenger revenue and patronage does not include Newcastle Light Rail.

Sources:

Financial statements (audited) and information from TfNSW (unaudited). Revenue excludes those collected by private operators where they set the fares.

Information from TfNSW (unaudited).

There remains Opal cards with negative balances

If a passenger's card has the minimum value when they tap on they will be able to tap off and the card will go into a negative balance. Revenue from unregistered Opal cards with negative balances cannot be recovered unless the passenger tops-up the card.

In January 2019, Transport made a change to the airport stations to prevent customers with high negative balances exiting the station. In addition, in late 2018, Transport increased the minimum top up values for new cards at the Sydney Airport stations.

Although revenue not collected from negative balance Opal cards decreased this year, there was still \$2.9 million revenue not collected in 2018–19 (\$3.8 million in 2017–18), representing 0.4 per cent of Opal card revenue in 2018–19.

TfNSW advise the cumulative balance of negative balance Opal cards is \$10.4 million as at 30 June 2019 since the introduction of Opal cards.

Recommendation (repeat)

TfNSW should implement further measures to prevent the loss of revenue from passengers tapping off with negative balance Opal cards.

Department of Transport consolidation

The Department is a not-for-profit NSW Government entity which controls all transport agencies in the Transport cluster, except the Chief Investigator of the Office of Transport Safety Investigations and the Port Authority of New South Wales. The controlled entities are consolidated in the financial statements of the Department.

The Department's abridged consolidated financial information is shown below.



Total expenses

2019 (\$m)	Variance	2018 (\$m)
12,813	6.0%	12,090

Includes:

- increase in grants and subsidies of \$322 million due to the transfer of third party assets constructed during the Sydney Metro Northwest project
- increase in bus contract payments of \$222 million to the private sector on route previously operated by the State Transit Authority of NSW
- additional \$44.0 million in costs for bus replacement services at Sydney Metro mainly due to the Epping to Chatswood Rail Link closure.



Total revenue

2019 (\$m)	Variance	2018 (\$m)
19,445	5.4%	18,444

Increase in grants and contributions revenue was mainly due to additional \$1.3 billion received from the Crown Entity. This was largely related to the increase in funding for the Sydney Metro City and Southwest Project funded by Restart NSW by \$443 million and increase for Roads and Maritime Services capital program by \$791.5 million funded by the Crown Entity.



Other losses

2019 (\$m)	Variance	2018 (\$m)
(796)	97.7%	(403)

Other losses included:

- \$258 million loss on Integrated Station development agreements for the construction of Metro stations and over-station developments
- \$278 million impairment loss on property, plant and equipment which were replaced by new assets or technology.



Net result

2019 (\$m)	Variance	2018 (\$m)
5,835	2.0%	5,952

Net result decreased due to an increase in expenses and other gains and losses of \$1.1 billion in 2018–19, offset by an increase in total revenue of \$1.0 billion.



Total assets

2019 (\$m)	Variance	2018 (\$m)
170,337	8.3%	157,313

Includes:

- purchase of assets, which included \$5.1 billion for rail systems and \$5.1 billion for roads and maritime infrastructure assets
- increases from asset revaluations (\$3.0 billion).



Total liabilities

2019 (\$m) Variance 2018 (\$m)

13,850 12.9% 12,272

Includes:

- increase in financial liability of \$2.0 billion for the construction of the Sydney Metro Northwest by Northwest Rapid Transit under a Public Private Partnership
- decrease in borrowings of \$571 million due to the transfer of debt related to STA buses and Electronic Ticketing Services to NSW Treasury Corporation.

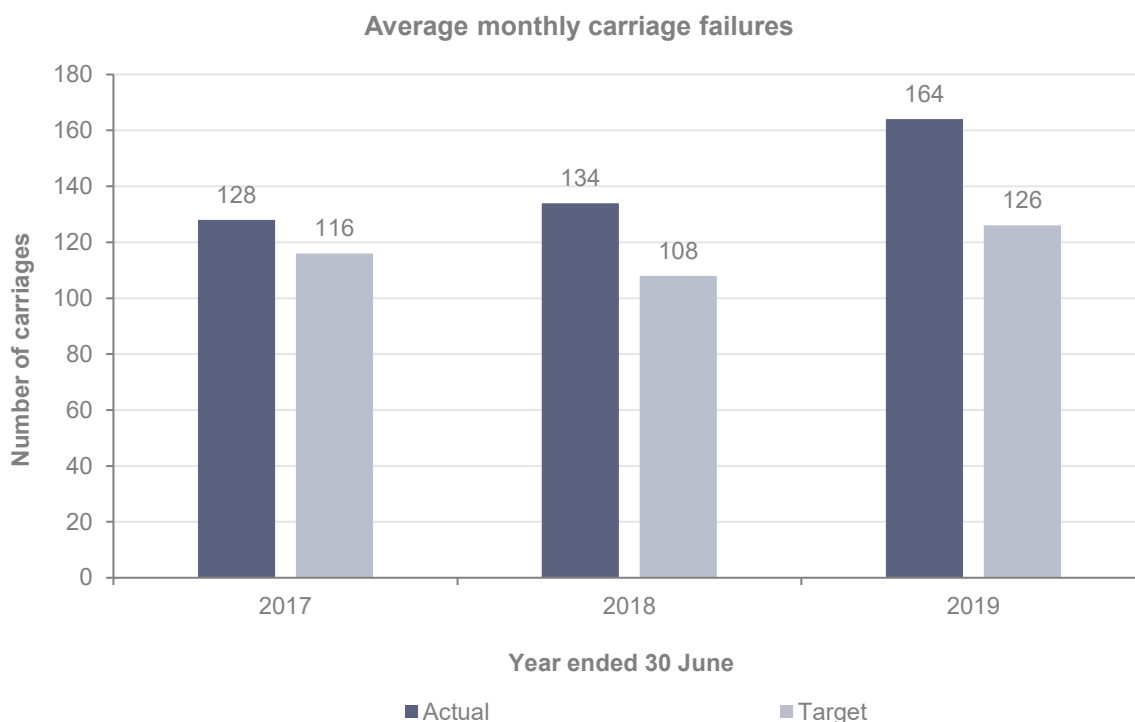
3.5 Fleet ageing and reliability

Rail

Data provided by TfNSW shows that average monthly carriage failures on electric trains increased from 134 carriages in 2017–18 to 164 carriages in 2018–19. This is in the context of increased fleet utilisation due to additional services introduced as part of the More Trains, More Services Program. At the same time, the monthly target increased by 18 carriage failures to 126 in 2018–19, but the average monthly carriage failures above target was 38 during 2018–19 (30 per cent) compared to 26 during 2017–18 (24 per cent). TfNSW advised the monthly carriage failure target has increased in response to the trains being operated more frequently following the timetable change in 2018.

TfNSW advises the uplift in average fleet utilisation has increased the likelihood of train incidents affecting both peak and off-peak services. There were 24 per cent more average monthly peak incidents and 36 per cent more average monthly peak delays in 2018–19 compared to 2017–18.

The graph below shows the actual and targeted reported average monthly electric fleet failures over the last three years.



Source: Transport for NSW unaudited.

The average age of the electric fleet is 18 years (down from 20) with 23 per cent (down from 30 per cent) over 30 years. This is due to 24 new Waratah Series Two trains that are now all in service and the retirement of the S-Set trains, which were introduced in 1972.

The New Intercity Fleet Project will introduce new trains for the NSW Trains services. The completion date for this project is in 2024 per the 2018–19 Budget Papers.

Buses

In 2018–19, total bus numbers increased by 14 to 4,081 and the weighted average age increased from 10.5 to 10.9 years.

The Sydney and Outer Metropolitan Bus Service Contracts (SMBSC and OSMBSC) states that the bus fleet average age must not exceed 12 years. TfNSW advises that except for three OSMBSC regions, all other bus operators had complied with the maximum average age of 12 years. There are no financial penalties or other consequences imposed by TfNSW on operators for exceeding the bus fleet average age.

The SMBSC and OSMBSC also set targets for major preventable incidents and incidences due to failure to conduct contract maintenance. During 2018–19, one private bus operator paid a fine for major defect breaches (five contract regions in 2017–18). TfNSW advises that one major defect notice was also issued for STA contracts which do not impose financial penalties for failure to meet this target.

Ferries

Ferry services are run by a private operator who also perform the maintenance of the ferries under the contract. The average age of vessels has decreased since last year from 23.6 to 23.5 years.

TfNSW reported total ferry breakdowns of 167 for the year ended 30 June 2019 compared to 191 in 2017–18. There are no specific performance indicators relating to breakdowns in the contract with the private operator for the period 28 July 2012 to 27 July 2019.

Under the new Ferry System Contract effective 28 July 2019, KPIs relating to punctuality, cancelled and incomplete trips, customer complaints, asset presentation, asset condition, major and minor defects, revenue collection rate and data maintenance attract financial penalties.

3.6 Establishment of Sydney Metro

Sydney Metro was established under the *Transport Administration Amendment (Sydney Metro) Act 2018* as a controlled entity of TfNSW to:

- to deliver safe and reliable metro passenger services in an efficient, effective and financially responsible manner
- to facilitate and carry out the orderly and efficient development of land in the locality of metro stations, depots and stabling yards, and proposed metro stations, depots and stabling yards.

Sydney Metro prepared financial statements for audit for the first time in 2018–19.

Sydney Metro North West officially opened in May 2019 and reported total value of North West Rail assets of \$9.1 billion. It expensed (derecognised) assets valued at \$322 million in 2018–19

In constructing the Metro North West Line, various assets were built to facilitate its operation. These included pavements, roadworks, electricity and water connections. On completion of the project, these assets and responsibility for maintenance transferred to third parties, primarily councils and utility providers. As the assets were no longer controlled by Sydney Metro, it expensed (derecognised) assets valued at \$322 million in 2018–19.

4. Audit observations

Appropriate financial controls help ensure the efficient and effective use of resources and administration of agency policies. They are essential for quality and timely decision making.

This chapter outlines our observations and insights from our financial statement audits of agencies in the Transport cluster.

Section highlights

- There was an increase in findings on internal controls across the Transport cluster. Twenty-nine per cent of all issues were repeat issues.
- Transport entities wrote-off over \$278 million of assets which were replaced by new assets or technology.
- Twenty-six per cent of Transport employees have excess annual leave.
- There are no processes to ensure all significant contracts and agreements are captured by agencies in a centralised register.

4.1 Internal control deficiencies

Management letter findings

Key themes identified on internal controls related to information technology, asset management and employee leave entitlements. Twenty-nine per cent of all issues were repeat issues

Breakdowns and weaknesses in internal controls increase the risk of fraud and error. The Audit Office reports deficiencies in internal controls, matters of governance interest and unresolved issues identified during our audits to management and those charged with governance of the agencies. The Audit Office does this through management letters, which include observations, related implications, recommendations and risk ratings.

In 2018–19, there were 73 management letter findings raised across the cluster (61 in 2017–18). Twenty-nine per cent of all issues were repeat issues. The majority of the repeat issues related to information technology controls around user access management.

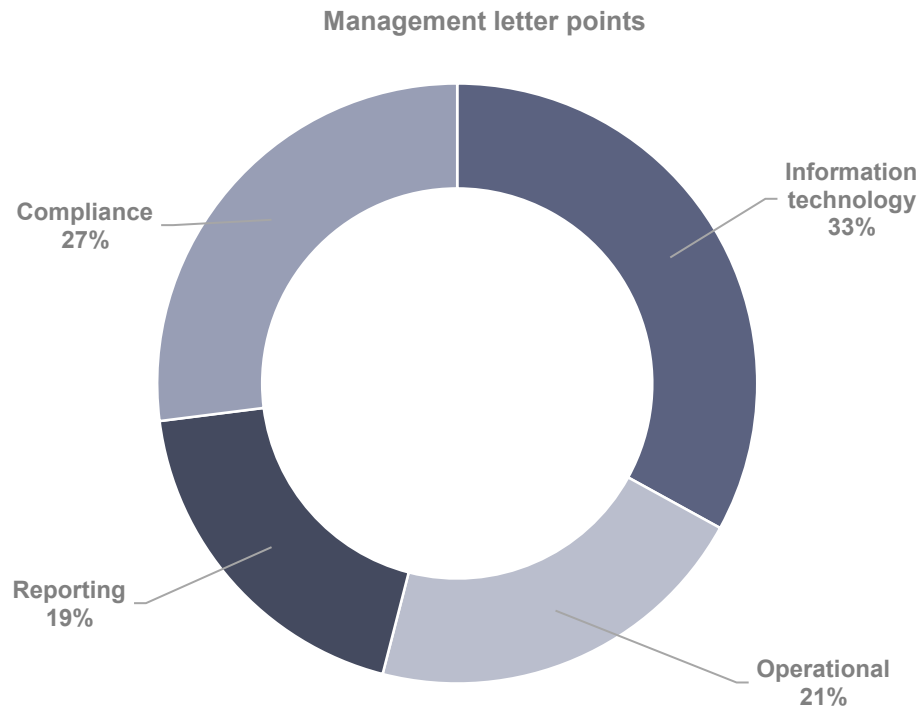
The table below describes the common issues identified across the cluster by category and risk rating.

Category	Risk rating		Issue
Information technology		High: 1 new	The financial audits identified 24 deficiencies in information technology (IT) processes and controls that support the integrity of financial data used to prepare agencies' financial statements. The audits noted issues associated with: • user access management • privileged user activities. Repeat management letter findings related mainly to user access management. The high-risk issue is related to the lack of logging and review of privileged user activities in the Customer Reservation System at NSW Trains.
		Moderate: 6 new, 14 repeat	
		Low: 3 new	
Operational, deficiencies or improvements		Moderate: 7 new, 2 repeat	The financial audits identified internal control weaknesses across key business processes, including: • segregation of duties • asset management and valuation process • data entry of timesheets.
		Low: 6 new	
Financial reporting		Moderate: 6 new, 2 repeat	The financial audit identified opportunities for agencies to strengthen financial reporting, including: • fair value assessment process improvement • contracts and agreement management • timeliness of capitalising completed capital works.
		Low: 6 new	
Compliance with key legislation and/or policies		Moderate: 7 new, 2 repeat	The financial audits identified compliance matters including: • employee leave issues • review of policies.
		Low: 10 new, 1 repeat	

-  Extreme risk from the consequence and/or likelihood of an event that has had, or may have a negative impact on the entity.
-  High risk from the consequence and/or likelihood of an event that has had, or may have a negative impact on the entity.
-  Moderate risk from the consequence and/or likelihood of an event that has had, or may have a negative impact on the entity.
-  Low risk from the consequence and/or likelihood of an event that has had, or may have a negative impact on the entity.

Note: Management letter findings are based either on final management letters issued to agencies, or draft letters where findings have been provided to management.

The graph below shows 33 per cent of reported deficiencies were related to information technology. The remaining matters were split between non-compliance with key legislation and/or policies (27 per cent), operational (21 per cent) and financial reporting (19 per cent).



Source: Audit Office management letters.

Rectifying certain IT deficiencies can take longer than rectifying other control deficiencies. IT fixes may require program changes, system testing and interruptions to services. However, until they are addressed, vulnerabilities may be exploited by internal and external parties and pose a threat to agencies.

The table in Appendix two shows the number of management letter findings for each cluster agency.

4.2 Key issues

Each year our financial audits examine a small number of specific topics across agencies. The Audit Office determines which topics to consider by looking for opportunities to improve public-sector accountability, governance and administration. The Audit Office also considers the risks and challenges to reporting the true financial position and performance of the State and how these may be addressed during our audits.

Risks and challenges that may impact on agencies in the Transport cluster include:

- valuation of assets (covered under Financial reporting)
- write-off of assets
- RailCorp's transition into Transport Asset Holding Entity
- managing excess annual leave
- completeness and accuracy of contracts registers.

Write-off of assets

The Transport cluster wrote-off \$278 million of assets which were replaced by new assets or technology

In addition to a \$322 million derecognition of assets transferred to councils and utilities by Sydney Metro and a \$109 million derecognition of substratum land at RailCorp, the Transport cluster wrote-off \$278 million of assets for the year ended 30 June 2019 (2018: \$199 million).

RMS wrote-off \$216 million of assets for the year ended 30 June 2019 (\$199 million at 30 June 2018). These related to roads, bridges, maritime assets, traffic signals and the control network where new infrastructure assets substantially replaced an existing asset as part of the construction activities. The capitalised value of the original asset is written off.

RailCorp wrote-off \$47.0 million in assets for the year ended 30 June 2019 (\$67.0 million at 30 June 2018) as part of its infrastructure renewal and enhancement activities following upgrades to substation power supply, trackwork and overhead wiring.

Sydney Ferries reported write-down expense of \$16.0 million due to the retirement of six vessels in 2020–21 under their new fleet deployment plan.

Transport Asset Holding Entity (TAHE)

RailCorp is likely to transition to TAHE in July 2020

TAHE was established to be a dedicated asset manager for the delivery of public transport asset management. TAHE was announced in the 2015–16 State Budget. TAHE is proposed to be a commercial for-profit Public Trading Entity that will provide a commercial return to its shareholders. The 2015–16 State Budget papers explained the impact of TAHE on the budget.

The *Transport Administration Amendment (Transport Entities) Act 2017* will convert RailCorp into TAHE. RailCorp was originally expected to transition to TAHE from 1 July 2019. This date has been revised to 1 July 2020. The transfer of public transport assets to TAHE is expected to occur over the next few years.

Since the announcement in 2015–16, several working groups have been considering various aspects of the TAHE transition including its status as a for-profit Public Trading Enterprise, the operating model, which assets to transfer to TAHE, which ones to retain in existing transport agencies and the impact of the new accounting standards AASB 16 'Leases' and AASB 1059 'Service Concession Arrangements: Grantors'. The considerations of these aspects identified several challenges in the implementation of TAHE which has led to the revised transition date. Given the delays in implementation, it is important to clarify the intent of the TAHE model.

The Audit Office will continue to monitor developments on TAHE for any impact to the financial statements.

Excess annual leave

Twenty-six per cent of Transport cluster employees have excess annual leave. Of the employees with excess leave balances, 732 (10.3 per cent) did not take any annual leave in 2018–19

NSW Treasury Circular TC 16-03 'Managing Accrued Recreation Leave Balance' requires agencies to maintain employee recreation leave balances within the 30-day limit on an ongoing basis. Twenty-six per cent of Transport employees have annual leave balances exceeding the 30-day limit. Under some enterprise agreements, staff such as shift workers can accrue up to 40 or 50 days.

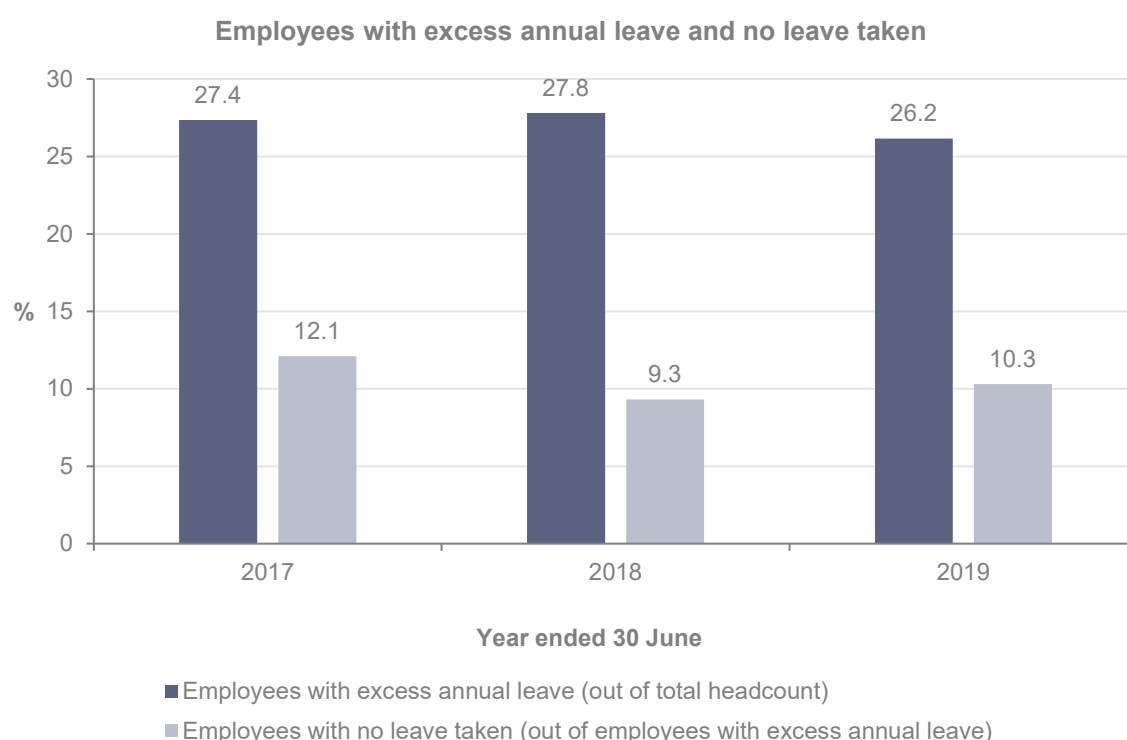
The health and wellbeing of staff can be adversely affected where staff do not take sufficient leave. Service delivery can also be compromised when the health and well-being of Transport staff declines.

Excess leave entitlements negatively impact the cash flow of an organisation, as the amount that will eventually be paid out to meet leave liabilities increases in line with salary and award increases. Leave is remunerated in accordance with the award in effect when it is eventually taken.

Having staff take leave, particularly managerial and administrative staff performing key control functions, reduces fraud risks. Fraud is more likely to be detected when staff members are on leave, and their duties are performed by other people.

Our review of leave entitlements for the Transport cluster identified 7,116 employees (26 per cent of the total headcount) with an annual leave balance exceeding 30 days. The total value of this liability at 30 June 2019 was \$29.6 million. Of the employees with excess leave balances, 732 (10.3 per cent) did not take any annual leave in 2018–19.

Overall, the percentage of employees with excess annual leave has decreased from 27.4 per cent to 26.2 per cent between 2016–17 to 2018–19. There has also been a decrease in percentage of employees with excess annual who did not take annual leave during the year from 12.1 per cent to 10.3 per cent.



Source: Transport agencies.

Recommendation (repeat issue)

Transport entities should further review the approach to managing excess annual leave in 2019–20. They should:

- **monitor current and projected leave balances to the end of the financial year each month**
- **agree formal leave plans with employees to reduce leave balances over an acceptable timeframe**
- **ensure leave plans are actioned appropriately**
- **encourage all staff with excess leave balances take a minimum two-week period of leave per year.**

Completeness and accuracy of contracts registers

There are no centralised processes to record all significant contracts and agreements in a register across the Transport cluster

Across the Transport cluster, contracts and agreements are maintained by the individual agencies using disparate registers.

Our review identified that not all contracts and agreements entered into by transport agencies were captured in the contract registers.

In 2018–19, there was a prior period error resulting from an agreement between TfNSW and another government agency due to a lack of assessment of the financial reporting implications at the time of signing the agreement. In May 2018, TfNSW entered into a Collaboration Agreement with the former UrbanGrowth Development Corporation (UGDC) for the Waterloo Integrated Station Development (ISD). Under the agreement, TfNSW gave control over the Waterloo ISD land to UGDC of \$143 million and recognised revenue and a receivable from UGDC for \$180 million.

This was not recognised in the financial statements for the year ended 30 June 2018 largely due to lack of correspondence with the finance team on potential financial reporting implications of agreements prior to execution, as well as the absence of a centralised contracts and agreements register. In the 2018–19 financial statements, management recognised the transaction as a retrospective correction of a prior period error as at 30 June 2018.

As identified above in Financial Reporting, the Transport cluster will implement three new accounting standards (AASB 16 'Leases', AASB 15 'Revenue from Contracts with Customers', AASB 1058 'Income of Not-for-Profit Entities') for their 2019–20 financial statements, and one new accounting standard (AASB 1059 'Service Concession Arrangements: Grantors') for their 2020–21 financial statements.

Agencies must perform detailed assessments of their existing contracts and agreements to quantify the impact of the new accounting standards. A lack of a complete register of all contracts and agreements increases the risk that agencies may not be able to assess the full impact of the new accounting standards.

Recommendation

Transport agencies should implement a process to capture all significant contracts and agreements in a central register. This will ensure:

- **agencies are fully aware of contractual and other obligations**
- **appropriate assessment of financial reporting implications**
- **assessment of new accounting standards, in particular AASB 16 'Leases', AASB 15 'Revenue from Contract with Customers', AASB 1058 'Income of Not-for-Profit Entities' and AASB 1059 'Service Concession Arrangements: Grantors' are accurate and complete.**

Section two

Appendices

Appendix one – Timeliness of financial reporting by agency

The table below shows the timeliness of financial reporting for cluster agencies.

Cluster agencies	Timeliness of financial reporting		
	Early close procedures	Financial statements	Audit report
Cluster lead entity			
Department of Transport	✓**	✓	✓
Transport for New South Wales	✓	✓***	✓
Transport services providers			
NSW Trains	✓	✓	✓
Rail Corporation New South Wales	✓	✓	✓
Sydney Trains	✓	✓	✓
Roads and Maritime Services	✓**	✓	✓
State Transit Authority of NSW	✓	✓	✓
Sydney Ferries	✓	✓	!****
Sydney Metro	✓	✓**	✓
Other agencies			
Chief Investigator of the Office of Transport Safety Investigations	✓	✓	✓
Transport Service of New South Wales	✓	✓	✓
Port Authority of New South Wales	✓	✓	✓
Residual Transport Corporation *	N/A	N/A	N/A
Key	✓ Statutory reporting deadline was met	! Statutory reporting deadline was not met	

* The Public Finance and Audit Amendment (Financial Reporting and Auditing Exclusions) Regulation 2019 provided relief to Residual Transport Corporation from financial reporting requirements for the year ended 30 June 2019.

** NSW Treasury granted an extension of time for submission of Early Close Procedures to finalise the quality review process.

*** NSW Treasury granted an extension of time for submission of Financial Statements for the resolution of accounting issues.

**** The Audit Office issued the opinion on Sydney Ferries' financial statements one day after the statutory deadline. This was due to a delay in receiving the signed financial statements from the agency.

Appendix two – Management letter findings by agency

The table below lists the management letter findings for each cluster agency.

Management letter findings					
	Extreme	High	Moderate	Low	Repeat [^]
Cluster lead entity					
Transport for New South Wales	--	--	11	5	6
Transport service providers					
NSW Trains	--	1	9	1	5
Rail Corporation New South Wales	--	--	3	3	2
Sydney Trains	--	--	6	4	3
Roads and Maritime Services	--	--	6	1	4
State Transit Authority of NSW	--	--	6	3	1
Sydney Metro	--	--	7	1	--
Other agencies					
Chief Investigator of the Office of Transport Safety Investigations	--	--	1	2	--
Port Authority of New South Wales	--	--	4	7	3

[^] Repeat management letter findings have been classified within the 'High', 'Moderate' and 'Low' columns and form part of the total.

Appendix three – List of 2019 recommendations

The table below lists the recommendations made in this report.

1. Financial reporting

Quality of financial reporting

Agency finance teams need to be consulted on major business decisions and commercial transactions to assess their accounting impacts at the time of their execution, rather than at the end of a financial year. Agencies also need to resolve all key accounting issues such as valuations as part of the early close procedures.



This would improve the quality of financial reporting and avoid the need for extensions for agencies to submit their financial statements for audit.

Consistency of accounting policies

The Department of Transport should ensure consistent accounting policies are applied across its controlled entities.



2. Audit observations

Contract registers do not capture all contracts and agreements

Transport agencies should implement a process to centrally capture all significant contracts and agreements entered. This will ensure:



- agencies are fully aware of contractual and other obligations
- appropriate assessment of financial reporting implications
- assessment of new accounting standards, in particular AASB 16 'Leases', AASB 15 'Revenue from Contract with Customers', AASB 1058 'Income of Not-for-Profit Entities' and AASB 1059 'Service Concession Arrangements: Grantors' are accurate and complete.

Key



Low risk



Medium risks



High risks

Appendix four – Status of 2017 and 2018 recommendations

The table below lists the statuses of the recommendations made in the 2017 and 2018 reports.

Recommendation	Current status	
The cluster lead agency should:		
Implement measures to prevent the loss of revenue from passengers tapping off with negative Opal cards.	Changes were made to the airport stations to prevent customers with high negative balances exiting and to increase the minimum top up values for new cards at these stations. Negative balance Opal cards resulted in \$2.9 million in revenue not collected in 2018–19 (\$10.4 million since the introduction of Opal). TfNSW should implement further measures to prevent the loss of revenue from passengers tapping off with negative balance Opal cards.	—
Develop target measures on crowding for bus operators in all contract regions and publish the results.	Transport for NSW has key performance indicators in its contracts with bus operators which requires the operator to notify the agency of overcrowded routes. There are no current plans to develop targets or publish crowding results, other than through transport apps which provide bus loading data on scheduled services.	—
Rail Corporation New South Wales and Sydney Trains:		
The transparency of operations of signalling priorities with operators will be improved with the creation of TAHE and the operation of the new Rail Operations Centre (ROC) in 2018.	A revised operations protocol was made effective from 1 January 2018. The protocol continues to be based around ensuring the least number of passengers are impacted by any issues on the network. TAHE is not yet in operation.	—
NSW Trains and Chief Investigator of the Office of Transport Safety Investigations should:		
Continue to focus on strategies to improve financial sustainability and less reliance on the NSW Government funding.	NSW Trains continues to require a letter of financial support and reported an increase in negative net assets this financial year compared to 2018. The agency advised that management has implemented budget control measures, regional pricing reviews, benchmarking and outsourcing to improve cost recovery. The recommendation was not addressed by OTSI as the agency does not generate revenue and is reliant on NSW Government funding.	—

Recommendation		Current status
The Transport cluster agencies should:		
Remove user access for terminated staff on a timely basis and ensure all user reviews are completed so access rights are appropriate.	There were further user access issues across the cluster identified as part of our 2018–19 audits in relation to active accounts belonging to terminated staff.	
Continue reviewing the effectiveness of approaches to managing excessive annual leave.	Employees continue to have excessive annual leave. Agencies advised they have policies to manage excessive annual leave and leave plans were developed for employees with excessive leave at most agencies. However, 10.3 per cent of employees with excessive leave balances did not take any leave in 2018–19.	
Key	 Fully addressed	 Partially addressed  Not addressed

Appendix five – Cluster agencies

Agency

Cluster lead entity

Department of Transport*

[Transport for New South Wales](#)

Transport service providers

[NSW Trains](#)

[Rail Corporation New South Wales](#)

[Sydney Trains](#)

[Roads and Maritime Services](#)

[State Transit Authority of NSW](#)

Sydney Ferries*

[Sydney Metro](#)

Other agencies

[Chief Investigator of the Office of Transport Safety Investigations](#)

Transport Service of New South Wales*

[Port Authority of New South Wales](#)

Residual Transport Corporation*

* Entity does not have a website.

OUR VISION

Our insights inform and challenge government to improve outcomes for citizens.

OUR PURPOSE

To help parliament hold government accountable for its use of public resources.

OUR VALUES

Pride in purpose

Curious and open-minded

Valuing people

Contagious integrity

Courage (even when it's uncomfortable)

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