FINANCIAL AUDIT 21 DECEMBER 2022

Transport and Infrastructure 2022

NEW SOUTH WALES AUDITOR-GENERAL'S REPORT

audit office
OF NEW SOUTH WALES

THE ROLE OF THE AUDITOR-GENERAL

The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the *Government Sector 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 Consolidated State Financial Statements, a consolidation of all state public sector agencies' financial statements.

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 internal controls and governance, and 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, compliance engagements and audits requested under section 27B(3) of the *Government Sector Audit Act 1983,* and section 421E of the *Local Government Act 1993*.

AUDITOR-GENERAL NEW SOUTH WALES

GPO Box 12
Sydney NSW 2001

The Legislative Assembly
Parliament House
Sydney NSW 2000

The Legislative Council
Parliament House
Sydney NSW 2000

In accordance with section 52B of the *Government Sector Audit Act 1983*, I present a report titled **'Transport and Infrastructure 2022'**.

Margaret Crawford
Auditor-General for New South Wales
21 December 2022

RECONCILIATION COMMITMENT STATEMENT

The Audit Office of New South Wales pay our respect and recognise Aboriginal people as the traditional custodians of the land in NSW.

We recognise that Aboriginal people, as custodians, have a spiritual, social and cultural connection with their lands and waters, and have made and continue to make a rich, unique and lasting contribution to the State. We are committed to continue learning about Aboriginal and Torres Strait Islander peoples' history and culture.

We honour and thank the traditional owners of the land on which our office is located, the Gadigal people of the Eora nation, and the traditional owners of the lands on which our staff live and work. We pay our respects to their Elders past and present, and to the next generation of leaders.

auditoffice OF NEW SOUTH WALES

Banner image: 'Yarning Circle' by Caitlin Liddle, Audit Office Indigenous Internship Program participant used with permission.

contents

Transport and Infrastructure

Section one

Transport and Infrastructure 2022

This report analyses the results of our audits of the Transport and Infrastructure agencies for the year ended 30 June 2022.

1. Introduction

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

- financial reporting
- audit observations.

1.1 Snapshot of the cluster

Transport and Infrastructure

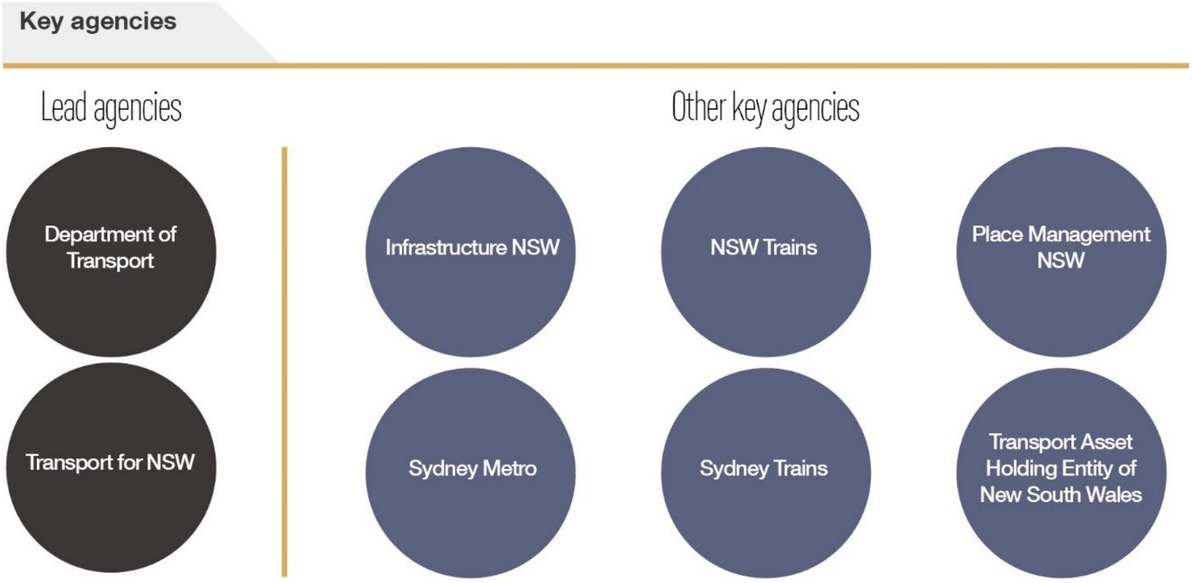
Delivering and operating integrated services and infrastructure across all modes of public, private and active transport.

State outcomes

Connecting our customers' whole lives
Delivering, operating and maintaining services and infrastructure, focused on reliability, availability and customer experience.

Successful places for communities
Creating places that integrate the right mix of infrastructure, services, access and experiences for communities, supporting them to achieve their desired social, cultural and economic outcomes.

Transport systems and solutions enabling economic activity
Powering and connecting a globally competitive, inclusive and sustainable New South Wales and driving economic growth, creating a sustainable infrastructure legacy, and improving quality of life for the people of New South Wales.



Source: NSW Budget Papers 2022–23.

Transport for NSW is the lead agency in the cluster. It is responsible for the coordination, funding allocation, policy and planning and other delivery functions for transport services. Department of Transport is the entity that employs the Secretary, Transport for NSW. From 1 April 2022, the Department of Transport also provided personnel services in respect of the employees enabling the functions of the cities group in the Transport and Infrastructure cluster as part of the Machinery of Government changes.

The *Transport Administration Act 1988* states that the affairs of Transport for NSW are to be managed and controlled by the Secretary of the Department of Transport. Transport for NSW is therefore a controlled entity of Department of Transport. Consistent with the secretary's power of direction under the *Transport Administration Act 1988*, Department of Transport and Transport for NSW control the following cluster agencies:

- Sydney Ferries
- State Transit Authority
- Sydney Trains
- NSW Trains
- Sydney Metro
- Transport Service of New South Wales
- Residual Transport Corporation.

The remaining agencies in the cluster are not controlled by the Department of Transport or Transport for NSW.

Transport Asset Holding Entity of New South Wales (TAHE) and Port Authority of New South Wales, as State Owned Corporations (SOC), are agencies in the Transport and Infrastructure cluster.

1.2 Changes to the cluster

In December 2021, the Premier announced a range of changes to Transport's ministerial portfolios. These changes resulted in the expansion of the Transport cluster with the additional ministerial portfolio of Infrastructure, Cities and Active Transport whereby the following agencies and functional groups have joined the renamed Transport and Infrastructure cluster from 1 April 2022:

- five trusts:
  - Centennial Park and Moore Park Trust
  - Luna Park Reserve Trust
  - Royal Botanic Gardens and Domain Trust
  - Parramatta Park Trust
  - Western Sydney Parklands Trust
- Place Management NSW
- Infrastructure NSW
- Greater Cities Commission – previously Greater Sydney Commission
- Cities group – the cities and active transport division. The cities and active transport division is not a standalone entity and is part of the Department of Transport.

2. 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 and Infrastructure cluster (the cluster) for 2022.

Section highlights

- Unqualified audit opinions were issued on all Transport and Infrastructure cluster agencies' financial statements.
- An 'Other Matter' paragraph was included in the Transport Asset Holding Entity of New South Wales' (TAHE) Independent Auditor's Report to draw attention to TAHE's reliance on government-funded customers.
- An 'Emphasis of Matter' paragraph was included in the State Transit Authority of New South Wales' (the authority) Independent Auditor's Report to draw attention to management's disclosures that State Transit Authority of New South Wales' financial statements for the year ended 30 June 2022 were prepared on a liquidation basis as the authority's principal activities ceased operations on 3 April 2022.
- While TAHE's valuation of assets at 30 June 2022 was within an acceptable range of valuation outcomes, there remained significant differences in assumptions used when compared with relevant market benchmarks.
- Sydney Metro corrected two prior period errors of $1.5 billion and $51 million in accounting and valuation of assets, and double counting of assets capitalised in infrastructure as well as assets under construction respectively.

2.1 Cluster financial information 2022

Agency	Total Assets $m	Total Liabilities $m	Total income* $m	Total expenses** $m
Principal agencies				
Department of Transport (parent entity)	14	10	91	86
Transport for NSW	157,814	24,144	29,424	23,985
Other cluster agencies listed in Appendix A of Treasury Direction TD21-02				
Centennial Park and Moore Park Trust	1,505	14	62	43
Greater Cities Commission	3	5	28	27
Infrastructure NSW	1,533	971	840	394
Luna Park Reserve Trust	49	1	2	3

Agency	Total Assets $m	Total Liabilities $m	Total income* $m	Total expenses** $m
NSW Trains	942	1,025	1,148	1,145
Place Management NSW	2,990	1,846	317	331
Royal Botanic Gardens and Domain Trust	1,038	19	72	60
State Transit Authority of New South Wales	--	--	222	267
Sydney Ferries	190	10	44	12
Sydney Metro	29,622	3,173	8,116	2,011
Sydney Trains	5,620	5,853	4,061	4,053
Transport Asset Holding Entity of New South Wales	24,842	3,890	968	1,381
Western Sydney Parklands Trust	1,511	43	112	19
Other cluster agencies				
Port Authority of New South Wales	704	290	191	160
Parramatta Park Trust	113	5	6	6
Transport Service of New South Wales	396	396	2,509	2,511

* Total revenue includes other gains, gains on disposal, government and other contributions and reversal of impairment losses, which are shown separately on the financial statements.

** Total expenses include other losses, income tax equivalent expense (only for for-profit entities in the cluster) and impairment losses on financial assets, which are shown separately on the financial statements.

Note: Chief Investigator of the Office of Transport Safety Investigations, Residual Transport Corporation of New South Wales, Infrastructure NSW Staff Agency and Greater Cities Commission Staff Agency have assessed and determined they met the reporting exemption criteria under the GSF Regulation, and therefore were not required to prepare annual financial statements.

Source: Agencies audited 2021–22 financial statements.

2.2 Quality of financial reporting

Audit opinions

Unqualified audit opinions were issued on agencies' financial statements

Unqualified audit opinions were issued on all cluster agencies' 30 June 2022 financial statements. Sufficient and appropriate audit evidence was obtained to conclude the financial statements were free of material misstatement.

TAHE’s Independent Auditor’s Report includes an 'Other Matter' paragraph to draw attention to TAHE's reliance on government-funded customers

An 'Other Matter' paragraph was included in TAHE's Independent Auditor's Report for its 30 June 2022 financial statements which draws attention to TAHE's reliance on government-funded customers.

'Other Matter' paragraphs are included in an agency's Independent Auditor's Report for matters that have not been explicitly presented or disclosed by the agency in its certified financial statements. Whilst they do not constitute a qualification, they do highlight matters that are, in our judgement, relevant to Parliament's understanding of the audit.

TAHE is a for-profit entity within the Public Non-Financial Corporation (PNFC) sector. On 14 December 2021, TAHE's shareholding ministers requested that TAHE target an average 2.5% return per annum on the General Government Sector's (GGS) contributed equity in TAHE. This target return supports the recognition of funding from the GGS to TAHE as contributed equity as opposed to a grant expense.

TAHE's ability to generate a 2.5% return is, based on current projections, highly dependent on 'access and licence fees' revenue from Sydney Trains and NSW Trains (the Operators), which are funded by the NSW Budget. The access and licence fees TAHE earns from the Operators are contractually agreed for ten years from 2021–22 to 2030–31 and represent over 80% of TAHE's projected revenue over this period. The Operators themselves are wholly reliant on NSW Budget funding to pay these fees to TAHE.

The NSW Budget 2022–23 has committed $5.5 billion to fund the Operators, to support their payment of access and licence fees agreed on 23 June 2022. However, this funding extends only to the end of the forward estimates period in 2025–26, which falls short of the ten-year contractual period to 2030–31 and the projected period to 2045–46 to achieve the 2.5% return. The Operators will require an additional $10.2 billion in Budget funding to meet their contractual obligations to TAHE from 2026–27 to 2030–31, and a further projected funding of $50.8 billion from 2031–32 to 2045–46. This additional funding is not within the government's published Budget figures, leading to uncertainty on whether the government-funded Operators can pay access and licence fees beyond the forward estimates period of 2025–26.

State Transit Authority of New South Wales' Independent Auditor's Report includes an 'Emphasis of Matter'

The NSW Government put the State Transit Authority of New South Wales' three bus contract regions, Regions 7, 8 and 9, out to competitive tender as part of wider changes to the Sydney bus network. These contracts were the main activities of substance for the State Transit Authority of New South Wales. Accordingly, management assessed that the State Transit Authority of New South Wales' principal activities ceased operations on 3 April 2022 and determined that the going concern basis of preparation of the financial statements for 30 June 2022 was not appropriate.

We included an 'Emphasis of Matter' paragraph in the Independent Auditor's Report for State Transit Authority of New South Wales' 30 June 2022 financial statements. This was to draw users' attention to management's disclosures that State Transit Authority of New South Wales' financial statements for the year ended 30 June 2022 were prepared on a liquidation basis as the authority's principal activities ceased operations on 3 April 2022.

Refer to Section 2.4 'Key accounting issues' below.

Unqualified audit opinion was issued on three acquittal audits, one remains in progress

Acquittal audits ensure that financial information or special purpose financial statements prepared by agencies for certain grant programs comply with the terms and conditions of the grant funding agreements.

The following acquittal audits were completed during 2021–22:

- Transport for NSW – an audit was conducted to determine if the special purpose financial statements prepared for the Local Roads and Community Infrastructure Program were prepared in accordance with the requirements of the COVID-19 Local Roads and Community Infrastructure Program guidelines.
- Transport for NSW – an audit was conducted to determine if the special purpose financial statement presented in Part 1 - Chief Executive Officer's Financial Statement for the Roads to Recovery Program, was prepared in accordance with the requirements of Section 90 of the *National Land Transport Act 2014*.
- Transport for NSW – an audit was conducted to determine if the financial statement of Black Spot Projects was prepared in accordance with the requirements of Section 82(a) of the *National Land Transport Act 2014*.

The following acquittal audit is in progress:

- Transport for NSW – an audit is being conducted to determine if the Investment Projects Annual Financial Statement was prepared in accordance with the requirements of Section 21(b) of the *National Land Transport Act 2014*.

This acquittal is expected to be completed by the end of January 2023.

The number of identified monetary misstatements decreased in 2021–22

The number of monetary misstatements identified during the audits of cluster agencies' financial statements decreased from 52 in 2020–21 to 19 in 2021–22. A monetary misstatement is an error in amount recognised in the financial statements initially submitted for audit.

Reported corrected misstatements decreased from 41 in 2020–21 to 14 with a gross value of $415 million in 2021–22. Reported uncorrected misstatements decreased from 11 in 2020–21 to five with a gross value of $22.5 million in 2021–22.

The table below shows the number and quantum of monetary misstatements for the past two years.

Year ended 30 June	2022		2021*	
	✔	!	✔	!
Less than $50,000	1	--	3	5
$50,000 to $249,999	--	--	7	2
$250,000 to $999,999	5	3	4	2
$1 million to $4,999,999	1	1	3	1
$5 million and greater	7	1	24	1
Total number of misstatements	**14**	**5**	**41**	**11**

Key ✔ **Corrected misstatements** ! **Uncorrected misstatements**

* The number of misstatements for 2021 have been updated from the previous year's Transport report to reflect the misstatements of the entities that have joined the Transport and Infrastructure cluster after the Machinery of Government changes.

Source: Engagement Closing Reports issued by the Audit Office of New South Wales.

Refer to Appendix one for details of corrected and uncorrected monetary misstatements by agency.

Of the 14 corrected monetary misstatements, seven had a gross value of greater than $5 million and related to the following:

Agency	Description of corrected misstatements > $5 million
Transport for NSW	Transport for NSW overstated the liabilities vested from State Transit Authority by $132.5 million. This was in relation to the superannuation defined benefit liability which had already been assumed by the Crown.
	Transport for NSW identified it had understated receivables from Sydney Harbour Tunnel sinking fund by $36.3 million.
	Transport for NSW identified that several leases commenced in 2020–21 were recorded in the financial statements in 2021–22. The impact of these leases was $19.6 million.
Sydney Ferries	Sydney Ferries understated its grant revenue by $23.2 million. Initially, Sydney Ferries deferred these grants and recognised it as a liability. However, as there was no enforceable agreement relating to this grant, under AASB 1058 'Income of Not-for-Profit Entities', the revenue should be recorded on cash receipt.

Agency	Description of corrected misstatements > $5 million
Transport Service of New South Wales	Transport Service of New South Wales overstated its personnel services receivables by $132.5 million. The underlying associated liability for the superannuation defined benefit was assumed by the Crown on 6 December 2021. At the point, Transport Service of New South Wales no longer had a right to receive this amount from State Transit Authority or Transport for NSW.
Western Sydney Parklands Trust	During 2021–22, Transport for NSW compulsorily acquired a parcel of land from Western Sydney Parklands Trust resulting in an increment to the fair value of the land by $44.6 million. Western Sydney Parklands Trust recognised the increment through gain on sale when it should have taken it through the asset revaluation reserve.
	Western Sydney Parklands Trust understated its lease receivables by $22.2 million, of which $17.8 million resulted in a correction of a prior period error. Refer to Section 2.4 'Key accounting issues' below.

Of the five uncorrected monetary misstatements, one had a gross value of greater than $5 million, which comprise the following:

Agency	Description of uncorrected misstatements > $5 million
Transport for NSW	Transport for NSW identified several leases commenced in 2021–22 were not recorded in the financial statements in 2021–22. The impact of these leases was $17.4 million.

Four agencies were exempted from financial reporting in 2021–22

Part 3A Division 2 of the Government Sector Finance Regulation 2018 (GSF Regulation) prescribes certain kinds of Government Sector Finance (GSF) agencies not to be a reporting GSF agency. For 2021–22, the following cluster agencies have assessed and determined they met the reporting exemption criteria under the GSF Regulation, and therefore were not required to prepare annual financial statements:

Exempted agencies	GSF Regulation reference	Basis for reporting exemption
Small agencies		
Residual Transport Corporation of New South Wales Chief Investigator of the Office of Transport Safety Investigations	Part 3A, Division 2, Section 9D of the GSF Regulation	GSF Regulation prescribes a GSF agency meeting all the following requirements not to be a reporting GSF agency: • the assets, liabilities, income, expense, commitments and contingent liabilities of the agency are each less than $5 million • the total cash or cash equivalent held by the agency is less than $2.5 million • at least 95% of the agency's income is derived from money paid out of the Consolidated Fund or money provided by other GSF agencies • the agency does not administer legislation for a minister by or under which members of the public are regulated.

Exempted agencies	GSF Regulation reference	Basis for reporting exemption
		The department has assessed these two agencies against the above criteria, and concluded they have met all the requirements. Hence, they were not required to prepare financial statements in 2021–22.
Infrastructure Staff Agency Greater Cities Commission Staff Agency	Part 3A, Division 2, Section 9F of the GSF Regulation	GSF Regulation prescribes a GSF agency that comprises solely of persons who are employed to enable another particular GSF agency to exercise its function not to be a reporting GSF agency. Infrastructure NSW Staff Agency and Greater Cities Commission Staff Agency satisfied this requirement and therefore were exempted from preparing financial statements in 2021–22.

In 2020–21, these four agencies were exempted from financial reporting Part 3A Division 2 of the GSF Regulation.

2.3 Timeliness of financial reporting

Early close procedures

Early close mandatory procedures were submitted on time for all cluster agencies

NSW Treasury introduced early close procedures to improve the quality and timeliness of year-end financial statements. In April 2022, NSW Treasury reissued Treasurer's Direction TD19-02 'Mandatory Early Close as at 31 March each year' (TD19-02) and released Treasury Policy and Guidelines TPG22-11 'Agency Direction for the 2021–22 Mandatory Early Close'. These pronouncements require the GSF agencies listed in Appendix A of TD19-02 to perform the mandatory early close procedures and provide the outcomes to the audit team by 27 April 2022. The 17 mandatory procedures are listed in Appendix two.

Cluster agencies met the statutory deadline for submitting their 2021–22 early close financial statements and other mandatory procedures.

Agencies need to improve their completion of early close procedures

The following cluster agencies did not complete all mandatory early close procedures:

Cluster agencies	Not completed	Description of incomplete early close procedures
Other agencies listed in Appendix A of TD19-02		
Sydney Metro	1	• Sydney Metro identified a prior period error as part of the comprehensive revaluation of its Metro Northwest rail assets which was considered to be material. This required retrospective restatement in the 30 June 2022 financial statements in accordance with 'AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors'. This prior period error was not reflected in the financial statements for early close.
Centennial Park and Moore Park Trust	1	• Centennial Park and Moore Park Trust did not provide documentation for certain judgements over the valuation of property, plant and equipment work-in-progress balance and infrastructure systems (trees).

Cluster agencies	Not completed	Description of incomplete early close procedures
Royal Botanic Gardens and Domain Trust	1	• Royal Botanic Gardens and Domain Trust did not have a documented procedural guideline for interagency confirmations.
Western Sydney Parklands Trust	1	• As part of the fair value assessment of property, plant and equipment, Western Sydney Parklands Trust: – adjusted the carrying values to reflect the current year's indices but not the cumulative movement since the last comprehensive valuation for buildings, plant and equipment and infrastructure – did not provide evidence of review of approval of the valuer's report – did not provide evidence of review of useful lives and impairment of assets – did not provide evidence that a fair value assessment had been performed for biodiversity assets.
Infrastructure NSW	1	• At the early close reporting period, Infrastructure NSW was in the process of addressing prior year recommendations including the GovConnect issues.
Greater Cities Commission	1	• During the year the Greater Cities Commission entered into a new lease agreement for 6 Parramatta Square. This arrangement was not reflected in the proforma accounts as the lease data was not provided by Property NSW.
Other cluster agencies		
Parramatta Park Trust (the trust)	2	• As part of the fair value assessment of property, plant and equipment, Parramatta Park Trust: – adjusted the carrying values to reflect the current year's indices but not the cumulative movement since the last comprehensive valuation for buildings, plant and equipment and infrastructure – did not provide evidence of review of approval of the valuer's report – did not perform a fair value assessment for infrastructure systems (trees) – did not provide evidence of review of useful lives and impairment of assets – did not account for lands transferred in and out because of lands swapped between the trust and Venues NSW. • Parramatta Park Trust did not document significant management judgments and assumptions around the fair value of infrastructure systems (trees).

Source: Reports on early close procedures 2022 issued by the Audit Office of New South Wales.

Year-end financial reporting

NSW Treasury required all agencies to submit their financial statements by 1 August 2022

In June 2022, NSW Treasury issued a suite of Treasurer's Directions and Treasury Policy and Guidelines for 2021–22 financial reporting requirements and timetables:

- Treasurer's Direction TD21-02 'Mandatory Annual Returns to Treasury' (TD21-02) and Treasury Policy and Guidelines TPG22-16 'Agency Direction for the 2021–22 Mandatory Annual Returns to Treasury' require agencies listed in the Appendix A of TD21-02 to submit their 2021–22 financial statements to both NSW Treasury and the Audit Office by 1 August 2022
- Treasury Policy and Guidelines TPG22-17 'Agency guidelines for the 2021–22 Mandatory Annual Returns to Treasury for NSW public sector agencies that are not included in TD21-02' requires NSW public sector agencies not listed in Appendix A of TD21-02 to submit their draft 2021–22 financial statements to NSW Treasury by 1 August 2022
- Treasurer's Direction TD21-03 'Submission of Annual GSF Financial Statements to the Auditor-General' requires reporting GSF agencies that are not listed in Appendix A of TD21-02 to submit their annual financial statements for audit within six weeks after the year-end.

The following agencies obtained NSW Treasury's approval to extend submission of their 30 June 2022 financial statements:

Cluster agencies	Revised deadline	Reason
Transport Asset Holding Entity of New South Wales	22 August 2022	Additional time requested to address accounting issues around valuation of assets.
Department of Transport	26 August 2022	The Department of Transport can only start to prepare its consolidated financial statements after all its controlled entities have submitted their financial statements. The usual process is three to four weeks after the controlled entities submit their financial statements. The controlled entities submitted their financial statements on 1 August 2022.

Financial statements were submitted on time

Cluster agencies met the reporting deadlines for submitting their 2021–22 year-end financial statements.

The *Government Sector Audit Act 1983* does not specify the statutory deadline for issuing the audit reports. At the date of this report, the audits of all cluster agencies financial statements have been completed.

The table in Appendix three shows the timeliness of the year-end financial reporting for cluster agencies.

2.4 Key accounting issues

Accounting for assets

TAHE valuation of assets

Treasury Policy Paper TPP 21-09 'Valuation of Physical Non-Current Assets at Fair Value' recognises that for for-profit entities holding infrastructure assets, the appropriate fair value will be limited to the lower of the income approach and the cost approach. TAHE is a for-profit entity.

The most common income approach applied is a present value technique based on discounted cashflows referred to as the Discounted Cashflow Method (DCF). This valuation technique is subject to significant judgement and assumptions.

TAHE determined a fair value range from $15.2 billion to $18.15 billion at 30 June 2022 of its property, plant and equipment and related intangibles. TAHE adopted the high range of the valuation of $18.15 billion. This resulted in an increase of $54.6 million (2021: a decrease of $20.3 billion).

We reviewed TAHE's valuation and determined a valuation range from $17.4 billion to $22.1 billion. TAHE's adopted valuation was within our range.

Similar to previous year, the difference between the TAHE valuation range and the audit valuation range arose due to higher discount rates adopted by TAHE. A discount rate reflects the compensation a market participant will seek for bearing uncertainty inherent in expected cash flows. Discount rates increase, as the risk of achieving forecast cash flows increases. In a DCF valuation, higher discount rates drive lower values for assets, reflecting prima facie, a reasonable market participant will pay a higher price for an asset whose cash flows bear lower uncertainty than an asset whose cash flows bear greater uncertainty.

In our view, TAHE's cash flows should be considered at the lower end of the risk spectrum warranting the application of a lower discount rate, because:

- TAHE is the monopoly rail infrastructure asset owner with Sydney Trains and NSW Trains are reliant on TAHE's assets to conduct its operations and no other alternatives are available
- of limited operational and maintenance capital expenditure risk as the public operators are required to fund the operational maintenance costs for TAHE's assets and NSW Treasury funds the capital maintenance expense through equity injections
- the cash flows for the regulated and unregulated assets are contracted for ten years under the Track Access Agreements and Licence, Agency and Maintenance Deed
- the risks identified by TAHE management are relevant to any comparable business. However, given Sydney Trains and NSW Trains pays for the maintenance and there is certainty for TAHE's capex funding through equity injections, we feel TAHE has lower risk compared to other comparable regulated companies.

For further details refer to Section 3 'Audit observations' below.

Sydney Metro fair value assessment of assets under construction

Treasury Policy Paper TPP 21-09 'Valuation of Physical Non-Current Assets at Fair Value' states that in some circumstances, management need to assess whether the construction costs are materially different to fair value. Where the construction costs incurred to date are materially different to fair value, agencies are required to revalue the assets under construction.

Historically, Sydney Metro reported assets under construction at cost. In 2021–22, management assessed the fair value of assets under construction. This was due to the clarification provided in the Treasury policy requiring agencies to assess fair value of assets under construction over a substantial number of years where historical costs may no longer accurately reflect fair value. Sydney Metro's projects commenced in 2016. These significant infrastructure projects occur over a substantial number of years and the result of increases in key cost inputs such as materials and labour meant historical costs no longer accurately reflect fair value. Given construction of Sydney Metro's projects occur over a substantial number of years, this resulted in a material prior period error, which required the opening assets, revaluation reserves and retained earnings of the earliest comparative period (that is, 1 July 2020) to be restated in accordance with AASB 108.

This was retrospectively corrected as a prior period error in Sydney Metro's financial statements and resulted in the following impacts on the 1 July 2020 balances and the 30 June 2021 balances:

- decrease in value of property, plant and equipment as at 1 July 2020 by $154 million
- decrease in value of property, plant and equipment as at 30 June 2021 by $1.4 billion.

Sydney Metro Stabling Facility assets

Sydney Metro identified that Northwest infrastructure assets at the Sydney Metro Stabling Facility at Tallawong were overstated by $51 million. This was due to these assets being recorded at fair value as part of the Northwest infrastructure assets and were also recorded in the City and Southwest Rail Systems assets under construction in 2018–19.

This was retrospectively corrected as a prior period error in Sydney Metro's financial statements at 1 July 2020.

Franchising of bus operations

Impact of franchising of bus operations on State Transit Authority of New South Wales' financial statements

The State Transit Authority of New South Wales' (the authority) three bus contract regions, Regions 7, 8 and 9, were put out to competitive tender as part of wider changes to the Sydney bus network, with the new operators planned to take over operations in three stages. As at 30 June 2022, all three regions were transferred to the external operators.

These contracts were the main activities of substance for the State Transit Authority of New South Wales. All unsettled assets and liabilities were transferred to Transport for NSW on 30 April 2022. The authority will continue to exist as a legal entity for the foreseeable future until dissolved by Parliament.

Accordingly, management assessed the State Transit Authority of New South Wales' principal activities ceased operations on 3 April 2022 and determined that the going concern basis of preparation of the financial statements for 30 June 2022 was not appropriate.

We included an 'Emphasis of Matter' paragraph in the Independent Auditor's Report for State Transit Authority of New South Wales' 30 June 2022 financial statements. This was to draw users' attention to management's disclosures that State Transit Authority of New South Wales' financial statements for the year ended 30 June 2022 were prepared on a liquidation basis as the authority's principal activities ceased operations on 3 April 2022.

Intra-government property leases managed by Property NSW

The changes in office accommodation arrangement with Property NSW resulted in derecognition of right-of-use assets and lease liabilities

Property NSW (PNSW) is responsible for managing most of the state government agencies leased real estate property portfolio. During 2021–22, PNSW made some changes to its intra-government lease arrangements, including rewriting the standard Client Acceptance Letter (CAL) to include a 'Relocation and substitution right' clause. This clause allows PNSW to relocate agencies to other locations and remove their right to control the use of the identified accommodations. As a result, the new CALs no longer constitute a lease under AASB 16 'Leases'. The changes became effective from 30 June 2022.

Five cluster agencies accepted the changes to their office accommodation arrangements with PNSW. This has resulted in:

- the derecognition of $709.2 million of right-of-use (ROU) assets
- the derecognition of $814.6 million of lease liabilities
- $105.5 million of gains on derecognition recorded in the Statement of Comprehensive Income.

Going forward, these agencies will recognise the office accommodation payments as expenses in the Statement of Comprehensive Income. Agencies will continue to recognise the fit-outs and make good provisions.

Emerging matter – superannuation guarantee contributions for annual leave loading

Superannuation guarantee charges are payable on ordinary time earnings. Annual leave loading was originally an entitlement incorporated into awards to compensate employees for the lost opportunity to receive overtime and/or penalty rates while on annual leave. However, few employers, including the Transport and Infrastructure cluster agencies, retained evidence that there was a nexus between paying leave loading and the lost opportunity to receive overtime or penalty rates. The Australian Taxation Office's guidance was that in these circumstances, the leave loading was ordinary times earnings and the superannuation guarantee levy was payable. The Transport cluster agencies had commenced paying superannuation on leave from 2019, in accordance with that guidance.

Subsequent to balance date, a decision was handed down in the Federal Court of Australia. The case was the *Finance Sector Union of Australia v Commonwealth Bank of Australia [2022] FedCFamC2G 409*. It confirmed that, in relation to the industrial agreement considered in that case, annual leave loading did not form part of ordinary time earnings. The decision found that the payment of annual leave loading was not referable to ordinary hours of work or to ordinary rates of pay. Therefore, there was no requirement for employers to pay superannuation contributions under superannuation guarantee legislation.

The cluster agencies re-evaluated their position and determined that it was not probable a liability arose to pay superannuation on annual leave loading. Nonetheless, all of these agencies continue the practice of paying the superannuation guarantee levy on annual leave loading. This position will be reassessed in future reporting periods.

Appropriations framework

The GSF Act requires that money not be paid out of the Consolidated Fund except under the authority of an Act, such as the annual Appropriation Act or GSF Act. This means a minister is only authorised to spend out of the Consolidated Fund the amount they have been appropriated by the relevant Act(s).

An appropriation sets aside amounts of money for a particular purpose up to a particular limit. In NSW, appropriations are generally made through:

- the annual Appropriation Act – this is an Act to appropriate out of the Consolidated Fund sums for the services of the government for the relevant financial year. These appropriations are made to the responsible ministers of principal departments, special offices and certain Special Deposits Accounts (SDA)
- the GSF Act – this Act allows the responsible minister of a GSF agency to be given an appropriation out of the Consolidated Fund, at the time the agency receives or recovers any deemed appropriation money. Deemed appropriation money is defined in Section 4.7(3) of the GSF Act.

Ministers can delegate and sub-delegate appropriation expenditure functions to accountable authorities and officers of GSF agencies. Any spending by accountable authorities and officers of GSF agencies in excess of the amount appropriated to their relevant minister would be made contrary to Section 4.6(1) of the GSF Act.

Appropriations can also be made to SDAs for the particular use and purpose of the SDA. Money held in an SDA does not form part of the Consolidated Fund, is for a particular purpose, and can only be applied towards that purpose. The enabling legislation of the SDA will typically specify who administers the account, what money must be paid into it and what money can be paid out of it.

Records had not been adequately maintained in the past to support amounts appropriated to particular Special Deposits Accounts

The Audit Office sought advice from the Crown Solicitor's Office (CSO) regarding appropriations made into SDAs, including the Transport for NSW Fund. Further details will be included in our 'State Finances 2022' report.

This CSO advice confirmed that in relation to the relevant SDAs:

- upon the appropriation under the *Appropriation Act 2020* and *Appropriation Act 2021* taking effect, the whole sum appropriated to the relevant SDA was taken to form part of the SDA and to have been paid out of the Consolidated Fund
- the hypothecation of those appropriated sums into the relevant SDA account occurred automatically by operation of law upon the relevant appropriation taking effect, that is, 1 July 2020 and 1 July 2021 respectively. Specifically, in relation to the Transport for NSW Fund, although the appropriation was made for the services of Transport for NSW, which was defined to include a reference to the Department of Transport, in the absence of any determination by the relevant minister apportioning the appropriation between Transport for NSW and the Department of Transport, the appropriated sum was hypothecated into the Transport for NSW Fund
- the legislative alteration of the amount of the funds attributable to the respective ledger accounts (Consolidated Fund vs the relevant SDA) did not depend on any actual movement of funds between bank accounts (including the movement of money to any bank accounts maintained in respect of the relevant SDA)
- the appropriations should be considered to have been 'applied' in full, for the purposes of Section 4.8 of the GSF Act at the start of the annual reporting period in which the appropriations were made
- no subsequent action by government, short of legislative amendment, would have the legal effect of reversing that hypothecation.

The responsible managers of the relevant SDAs are required, under Section 4.16 of the GSF Act, to keep 'records and other information' concerning the operation of an SDA, including information about the amounts appropriated under any Act or law for payment into the account. To the extent this has not occurred, it should be corrected going back to the inception of the relevant SDA account. Therefore, an exercise was required to determine the full extent of amounts appropriated to the relevant SDAs that had not been identified as being available for immediate use by the relevant SDAs. This exercise identified a cumulative amount of $6.3 billion as at 30 June 2022 ($5.9 billion) not previously identified that had been appropriated for 2021–22 and prior years relating to the Transport for NSW SDA. This issue has been addressed and appropriate note disclosures were included in the financial statements for the year ended 30 June 2022.

Accounting for finance leases

Western Sydney Parklands Trust corrected a prior period error retrospectively for the accounting for finance leases

Management of Western Sydney Parklands Trust identified several misstatements relating to its finance lease arrangements where it is the lessor. These errors largely arose due to the following incorrect factors being applied to its lease accounting model, including:

- lease inception dates applied incorrectly
- applying freehold lease value instead of freehold development value in determining the leased assets' fair values
- using incorrect minimum lease payments
- incorrectly excluding improvements to land that are estimated to have a residual value at the end of the lease term.

The above factors resulted in material errors affecting both the current year and previous year financial statements. This was retrospectively corrected in the financial statements of Western Sydney Parklands Trust as at 1 July 2020 and resulted in a cumulative correction of the opening equity at 1 July 2020 of $17.8 million.

2.5 Key financial statement risks

The table below details our specific audit coverage and response over key areas of financial statements risks that had the potential to impact the financial statements of significant cluster agencies.

Transport for NSW

Transport for NSW is the lead agency of the cluster. Its role is to lead the development of a safe, efficient, integrated transport system that keeps people and goods moving, connects communities and shapes the future of New South Wales' cities, centres and regions.

Transport for NSW is responsible for strategy, planning, policy, regulation, funding allocation and other non-service delivery functions for all modes of transport in New South Wales including road, rail, ferry, light rail, point to point, regional air, cycling and walking.

	Key financial statement risk	Audit response
Property, plant and equipment - $15.2 billion	Transport for NSW's property, plant and equipment consists of specialised assets such as roads, bridges and tunnels, rail systems, and specialised land and building assets, which are measured at fair value based on their current replacement cost. Our audit risk rating for property, plant and equipment is **higher** because these assets are proportionately significant to the financial statements of Transport for NSW and are subject to management judgements and estimates when determining their fair values. These judgements and estimates often require the assistance of a qualified valuer upon revaluation.	Our audit procedures included: • testing the accuracy and completeness of the asset register • reviewing the appropriateness of the valuation approach • ensuring assumptions and judgments applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.

Transport Asset Holding Entity of New South Wales

The Transport Asset Holding Entity of New South Wales is a statutory State Owned Corporation and owner of rail property assets including property, rolling stock and rail infrastructure in the Sydney metropolitan area and country locations in New South Wales.

These assets are made available to Sydney Trains and NSW Trains for their operations. The Transport Asset Holding Entity of New South Wales also provides rail infrastructure to third-party operators under the terms of track access agreements.

	Key financial statement risk	Audit response
Property, plant and equipment - $23.8 billion	TAHE's property, plant and equipment consists of specialised assets such as track work and infrastructure, rolling stock, land, buildings, and plant and machinery at fair value based on the income approach. Our audit risk rating for property, plant and equipment is **higher** because these assets are proportionately significant to the financial statements of TAHE, and are subject to management judgements and estimates when determining their fair values. These judgements and estimates often require the assistance of a qualified valuer upon revaluation.	Our audit procedures included: • testing the accuracy and completeness of the asset register • reviewing the appropriateness of the valuation approach • ensuring assumptions and judgments applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards. We reviewed the reasonableness of the judgements and assumptions used by TAHE in determining the fair value. For further details see Section 3 'Audit observations' below.
Control of assets - $23.8 billion	At 30 June 2022, TAHE's statement of financial position reported $23.8 billion in property, plant and equipment, and $646 million in depreciation expenses. To recognise an asset, an entity must demonstrate that it controls the future economic benefits embodied in the asset. Indicators of accounting 'control' include the ability to direct the use of the asset and/or prevent other entities directing its use, and obtain substantially all of the economic benefits from the asset. TAHE has agreements with other parties: • that provide exclusive or non-exclusive rights to use assets vested in TAHE • to manage the use of its assets as an agent. TAHE is also subject to an Operating Licence issued by the portfolio minister for the period 1 July 2021 to 30 June 2023, which impose limits on its legislative functions detailed in the *Transport Administration Act 1988*.	Our audit procedures included: • reviewing management's assessment of control • examining relevant legislation and regulations and contractual agreements, including the Operating Licence to assess indicators of control against relevant Australian Accounting Standards • reviewing the presentation of the financial statements against the requirements of applicable Australian Accounting Standards. For the current year (and as was the case in the prior year), the legal form of the arrangements established imply TAHE has control over the assets. However, risks remain as TAHE is in its early stages, and the actual substance of operations will need to be observed and considered. This was included as a high-risk management letter finding. Whilst we accepted TAHE's position on control for the current year, this will remain an area of audit focus in future years as the substance of the arrangements put into place need to be confirmed by observation.

	Key financial statement risk	Audit response
	Our audit risk rating for control over assets is **higher** because significant judgements required to determine 'control' over assets, including: • how this interacts with TAHE's legislative functions and Operating Licence • the determination of principal and agent under the relevant agreements.	Future limitations to the degree of control TAHE, and its board, can exercise over its functions may impact the degree of control TAHE has over its assets going forward. As part of the 2022–23 audit, we will continue to monitor and assess whether, in substance, these assets continue to be controlled by TAHE and whether, in substance, TAHE can operate as an independent SOC. For further details on this matter refer to Section 3 'Audit observations' below.

Department of Transport

The Department of Transport is a NSW government entity controlled by the NSW Total State Sector. The *Transport Administration Act 1988* states that the affairs of Transport for NSW are to be managed and controlled by the Secretary. The Secretary is defined as the Secretary of the Department of Transport.

The Department of Transport consolidates Transport for NSW, NSW Trains, State Transit Authority of New South Wales, Sydney Ferries, Sydney Metro, Sydney Trains, Transport Service of New South Wales and the Residual Transport Corporation which are under its control.

	Key financial statement risk	Audit response
Machinery of Government changes - $519,000 (net liabilities transferred)	In December 2021, the Premier announced a range of changes to Transport's ministerial portfolios. These changes resulted in the expansion of the Transport cluster with the additional ministerial portfolio of Infrastructure, Cities and Active Transport whereby the following agencies and functional groups have joined the renamed Transport and Infrastructure cluster from 1 April 2022: • five trusts: – Centennial Park and Moore Park Trust – Luna Park Reserve Trust – Royal Botanic Gardens and Domain Trust – Parramatta Park Trust – Western Sydney Parklands Trust • Place Management NSW • Infrastructure NSW • Greater Cities Commission – previously Greater Sydney Commission • Cities group – cities and active transport division. The cities and active transport division is not a standalone entity and is part of the Department of Transport. Our audit risk rating is **higher** because the financial statements may be misstated due to: • completeness and accuracy of transfer of assets and liabilities at fair value, including employee leave liabilities • disruption and gaps in internal control environments due to staffing, process and system changes • unclear roles and responsibilities • staff incurring expenditure without the proper delegation.	Our audit procedures included: • assessing the reasonableness of the fair value of assets and liabilities transferred out of and into the Department of Transport • obtaining inter-entity confirmations and sign-offs for transferred/split functions, funds and activities and reviewing delegation instruments to ensure these are up to date • reviewing significant accounting issues including whether the Department of Transport controlled the newly transferred entities, accounting for employment arrangements and appropriations • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards. For further details, please refer to Section 1 'Introduction' above.

Sydney Metro

Sydney Metro is a NSW government agency constituted to deliver safe and reliable metro passenger services in an efficient, effective and financially responsible manner, and to facilitate and carry out the orderly and efficient development of land in the locality of metro infrastructure.

	Key financial statement risk	Audit response
Property, plant and equipment - $26.3 billion	Sydney Metro's property, plant and equipment consists of specialised assets such as infrastructure assets, rolling stock, and land and buildings, which are measured at fair value based on their current replacement cost. Our audit risk rating for property, plant and equipment is **higher** because these assets are proportionately significant to the financial statements of Sydney Metro, and are subject to management judgements and estimates when determining their fair values. These judgements and estimates often require the assistance of a qualified valuer upon revaluation.	Our audit procedures included: • testing the accuracy and completeness of the asset register • reviewing the appropriateness of the valuation approach • ensuring assumptions and judgments applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.

Sydney Trains

Sydney Trains is a statutory authority and operates rail services across the metropolitan Sydney area. Its objective is to deliver safe, customer focused, reliable and clean rail services in an efficient, effective and financially responsible manner.

	Key financial statement risk	Audit response
Right of use asset and lease liability - $4.5 billion asset and $4.6 billion liability	On 1 July 2021, Sydney Trains entered into new ten-year access and licence agreements with TAHE. These agreements provided Sydney Trains access to: • the Metropolitan Rail Network • TAHE's rolling stock and station assets. Sydney Trains was required to assess the financial reporting implications of these agreements under AASB 16 'Leases'. The licence agreement for TAHE's rolling stock and station assets was deemed as a lease under the accounting standards. These agreements were revised on 23 June 2022 to incorporate updated fees for the ten-year contract period. Our audit risk rating for the right of use asset and lease liability was **higher** because this was the first year of recognition, these are proportionately significant to the financial statements of Sydney Trains and are subject to assumptions and judgements.	Our audit procedures included: • reviewing the appropriateness of the calculations of the right of use asset and lease liability • ensuring assumptions and judgements applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.

NSW Trains

NSW Trains is a statutory authority and manages the operation of NSW TrainLink, providing services between Sydney and the Hunter, Central Coast, Blue Mountains, Southern Highlands and Illawarra and South Coast regions. Its principal objective is to deliver safe and reliable railway and coach passenger services in New South Wales in an efficient, effective and financially responsible manner.

	Key financial statement risk	Audit response
Right of use asset and lease liability - $703 million asset and $751 million liability	On 1 July 2021, NSW Trains entered into new ten-year access and licence agreements with TAHE. These agreements provided NSW Trains access to: • the Metropolitan Rail Network • TAHE's rolling stock and station assets. NSW Trains was required to assess the financial reporting implications of these agreements under AASB 16 'Leases'. The licence agreement for TAHE's rolling stock and station assets was deemed as a lease under the accounting standards. These agreements were revised on 23 June 2022 to incorporate updated fees for the ten-year contract period. Our audit risk rating for the right of use asset and lease liability was **higher** because this was the first year of recognition, these are proportionately significant to the financial statements of NSW Trains and are subject to assumptions and judgements.	Our audit procedures included: • reviewing the appropriateness of the calculations of the right of use asset and lease liability • ensuring assumptions and judgements applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.

State Transit Authority of New South Wales

State Transit Authority of New South Wales is a statutory authority and provided bus services in metropolitan Sydney under the Sydney Metropolitan Bus Service Contracts. It operated under five-year contracts with the NSW Government in three contract regions. As at 30 June 2022, all three contracts have been awarded to external operators to operate the bus services.

	Key financial statement risk	Audit response
Franchising of bus operations	State Transit Authority of New South Wales operated three contract regions under contract from the NSW Government. These three contracts were put out to competitive tender as part of wider changes to the Sydney bus network, with the new operators planned to take over operations in three stages. As at 30 June 2022, all three regions were transferred to the external operators. Our audit risk rating for preparation of the financial statements under a going concern basis is **higher** because of the significance of the impact that the franchising of bus contracts will have on the going concern assertion for the preparation of the financial statements. Furthermore, it will have a pervasive impact on the disclosures in the financial statements.	Our audit procedures included: • evaluation of the appropriateness of management's assessment that the financial statements should not be prepared under a going concern basis • assessing the appropriateness of management's estimate of liabilities • reviewing the appropriateness of management's assessment of the impact on the fair value and impairment of assets • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.

Sydney Ferries

Sydney Ferries is a statutory corporation initially established to deliver public ferry services in Sydney. Since July 2012, an external operator was awarded a contract to operate ferry services on Port Jackson and the Parramatta River. The external operator leases the vessels, land and buildings from Sydney Ferries.

	Key financial statement risk	Audit response
Property, plant and equipment - $98.7 million	Sydney Ferries' property, plant and equipment consists of ferries, land and buildings, and property, plant and equipment, which are measured at fair value based on their current replacement cost. Our audit risk rating for property, plant and equipment is **higher** because these assets are proportionately significant to the financial statements of Sydney Ferries, and are subject to management judgements and estimates when determining their fair values. These judgements and estimates often require the assistance of a qualified valuer upon revaluation.	Our audit procedures included: • testing the accuracy and completeness of the asset register • reviewing the appropriateness of the valuation approach • ensuring assumptions and judgments applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.

Infrastructure NSW

Infrastructure New South Wales (INSW) was established in July 2011 as a statutory authority under the *Infrastructure NSW Act 2011*. It provides independent advice to help the government identify, prioritise project delivery, and place management of critical public infrastructure across New South Wales.

	Key financial statement risk	Audit response
Property, plant and equipment - $690 million	Infrastructure NSW's property, plant and equipment consists of land and buildings, infrastructure, plant and equipment and leasehold improvements, which are measured at fair value based on their current replacement cost. Our audit risk rating for property, plant and equipment is **higher** because these assets are proportionately significant to the financial statements of Infrastructure NSW, and are subject to management judgements and estimates when determining their fair values. These judgements and estimates often require the assistance of a qualified valuer upon revaluation.	Our audit procedures included: • testing the accuracy and completeness of the asset register • reviewing the appropriateness of the valuation approach • ensuring assumptions and judgments applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.
Development of Barangaroo Precinct	Infrastructure NSW's finance lease receivable relating to its South Barangaroo development were impacted by the recognition of development fee in respect of early substantial commencement of site R5 in June 2022 and increase in design and construction costs for One Sydney Harbour (site R4a) compared to initial forecasts included in the previous finance lease model. Our audit risk rating is **higher** because Barangaroo is a project of state significance involving significant judgments and complexities.	Our audit procedures included: • reviewing management's assessment of the impact of lease modification • ensuring assumptions and judgments applied are reasonable • reviewing the presentation of the financial statements in accordance with the Australian Accounting Standards.

Place Management NSW

Place Management NSW is responsible for the management of:

- Sydney's historically and culturally significant waterfront locations, including The Rocks and Darling Harbour
- major commercial and retail leases and provides facilities and asset management services within the precincts
- Public Private Partnership of ICC Sydney convention, exhibition and entertainment venues in Darling Harbour.

	Key financial statement risk	Audit response
Property, plant and equipment - $1.9 billion	Place Management NSW's property, plant and equipment mainly consists of: • land and buildings • service concession assets. These assets are measured at fair value based on their current replacement cost or market value. Our audit risk rating for property, plant and equipment is **higher** because these assets are proportionately significant to Place Management NSW's financial statements and are subject to management judgements and estimates when determining their fair values. These judgements and estimates often require the assistance of a qualified valuer.	Our audit procedures included: • testing the accuracy and completeness of the asset register • reviewing the appropriateness of the valuation methods, assumptions and judgements applied • reviewing the presentation in the financial statements in accordance with Australian Accounting Standards.

3. 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 cluster.

Section highlights

- The number of findings reported to management decreased from 87 in 2020–21 to 59 in 2021–22.
- Repeat findings accounted for 54.2% of management letter points. Many repeat findings related to controls over payroll, including management of annual leave and processing of timesheets, management of conflicts of interests, weaknesses in controls over information technology user access administration and password management.
- One new high-risk issue was identified in 2020–21, and four high-risk repeat issues remained.
- The five high-risk issues arose from the audit in the cluster, with respect to:
  - control over TAHE assets and operations (repeat)
  - TAHE detailed business modelling to support returns (repeat)
  - valuation of trees (repeat for Parramatta Park Trust and Centennial Park and Moore Park Trust)
  - TAHE asset valuations.

3.1 Findings reported to management

The number of findings reported to management has decreased, and 54.2% were repeat issues

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

In 2021–22, there were 59 findings raised across the cluster (87 in 2020–21). Repeat findings accounted for 54.2% of management letter points in 2021–22 (35.6% in 2020–21).

The most common repeat issues related to weaknesses in controls over payroll, including management of annual leave and processing of timesheets, management of conflicts of interests, weaknesses in controls over information technology user access administration and password management.

A delay in implementing audit recommendations increases the risk of intentional and accidental errors in processing information, producing management reports, and generating financial statements. This can impair decision-making, affect service delivery and expose agencies to fraud, financial loss and reputational damage. Poor controls may also mean agency staff are less likely to follow internal policies, inadvertently causing the agency not to comply with legislation, regulation and central agency policies.

2021–22 audits identified five high-risk findings

High-risk findings, including repeat findings, were reported at the following cluster agencies:

<table>
<tr><th>Agency</th><th>Description</th></tr>
<tr><td colspan="2">2021–22 findings</td></tr>
<tr><td>TAHE</td><td>Control of assets (partial repeat)
The State Owned Corporations Act 1989 maintains that all decisions relating to the operation of a statutory SOC are to be made by or under the authority of the board. However, under the Transport Administration Act 1988, the functions of TAHE may only be exercised under one or more Operating Licences issued by the portfolio minister. The current Operating Licence confers terms and conditions for TAHE to carry out its functions, and imposes constraints on TAHE, including (but not limited to):
• railway operations not permitted
• transport services not permitted
• TAHE must not carry out maintenance of its assets.

Management assessed control and provided the audit team with an assessment outlining how it has exercised authority and control over its assets during the year, as well as operate as an independent SOC.
Consistent with the prior year, we did not find evidence that, in form, the assets held by TAHE are not controlled by TAHE. However, given the constraints that can be imposed through the Operating Licence, there is a risk that limitations could be placed on the operations or functions of TAHE. The current Operating Licence issued by the Minister for Transport effective from 1 July 2021 was expected to expire on 30 June 2023. We understand TAHE has requested and received approval for an extension of the Operating Licence for one year, to 30 June 2024. As part of our audit for the year ending 30 June 2023, we will monitor and assess whether in substance, these assets continue to be controlled by TAHE and whether, in substance, TAHE can operate as an independent SOC.</td></tr>
<tr><td>TAHE</td><td>Detailed business modelling to support returns (partial repeat)
Last year we noted the Statement of Corporate Intent (SCI) and ten-year business plan was based on the previous expected return of 1.5%. In the current year, management have developed a 35-year long-term model. Management have advised the SCI and ten-year business plan has been aligned to the 35-year model. Management advised the ten-year forward estimates that were finalised in May/June 2022 were used in the long-range model and formed the basis of input into the State Budget. They were also included in the SCI and business plan that have been submitted to shareholding ministers and approved in November 2022.
While management has developed a 35-year long term financial model to support the returns, we note this will be refined over the next few years. Furthermore, these are forecasted figures and we have not seen sufficient evidence of whether this reflects reality (that is, Dividends representing a return on equity) as it is still very early. Therefore, this will remain a high-risk matter until we have seen sufficient evidence of reality to the forecasted figures.</td></tr>
</table>

Agency	Description
2021–22 findings	
TAHE	**Asset valuation (new)** The overall discount rate applied by management's experts is high compared to market benchmarks. This has resulted in a significant gap between our range and the midpoint of TAHE's range. The TAHE midpoint does not fall within our range. This has not resulted in an impact on our audit opinion as TAHE has selected the high end of their range which is within our range. However, this creates a high risk as there are still some significant differences in the assumptions adopted in the valuation. Management explained they had selected the high end of the range as this was consistent with the use of the high end in last year's valuation. Management believe this is supported by the fact that no increase has been applied to return on assets, no commercial development has been incorporated and the increase in weighted average cost of capital (WACC) year on year would otherwise have driven a reduction. There was no further robust documentation for selecting the high end of the range. Furthermore, TAHE does not have a board-approved valuation policy that articulates how management selects the point within the valuation range provided by their expert for board endorsement. We also noted that while TAHE's expert incorporated further supporting information in its valuation reports for 30 June 2022, they undertook more limited support compared to prior year in quantifying the Asset Specific Risk Premium (ASRP) in the discount rate for the terminal value. We note TAHE's experts performed cross checks to support the overall valuation conclusion. In the prior year, probability weights were applied to specific scenarios that could impact the business for the terminal period in order to quantify the ASRP. However, we were instead advised that their ASRP selection this year was based on professional judgement considering the outcome of various sensitivities to the overall value.
Parramatta Park Trust	**Accounting and valuation of tree assets (repeat)** The Parramatta Park Trust (PPT) records tree assets in its financial statements, which are subject to fair value measurement. Issues were identified in relation to the tree assets' valuation methodology, depreciation and consumption of utility, accounting treatment for removal/ disposal of trees, and dependency on professional experts. Not appropriately addressing these issues increases the risk of material misstatements in PPT's financial statements.
Centennial Park and Moore Park Trust	**Accounting and valuation of tree assets (repeat)** The Centennial Park and Moore Park Trust (CPMPT) records tree assets in its financial statements, which are subject to fair value measurement. Issues were identified in relation to the tree assets' valuation methodology, depreciation and consumption of utility, accounting treatment for removal/ disposal of trees, and dependency on professional experts. Not appropriately addressing these issues increases the risk of material misstatements in CPMPT's financial statements.

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

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

Risk rating	Issue
Information technology	
Moderate: 1 repeat Low: 4 new, 1 repeat	The financial audits identified internal control deficiencies in information technology processes and controls that support the integrity of financial data used to prepare agencies' financial statements. Of particular concern are issues associated with: • monitoring of privileged user or user access • disaster recovery planning • delays in deactivating terminated users.
Internal control deficiencies or improvements	
Moderate: 5 new, 9 repeat Low: 6 new, 4 repeat	The financial audits identified internal control deficiencies across key business processes, including: • management of payroll master file • missing information in contract registers • segregation of duties in the process for the hiring of new employees • changes to financial delegation limits.
Financial reporting	
High: 1 new, 3 repeat Moderate: 3 new, 4 repeat	The financial audits identified deficiencies or risks in the financial reporting processes, including: • valuation of assets (TAHE) • detailed business modelling to support returns (TAHE) • accounting and valuation of trees (Parramatta Park Trust and Centennial Park and Moore Park Trust). Refer below for further details on TAHE matters.
Governance and oversight	
High: 1 repeat	The financial audit identified risks around the control over TAHE assets and operations. Refer below for further details.
Non-compliance with key legislation and/or central agency policies	
Moderate: 6 new, 6 repeat Low: 2 new, 3 repeat	The financial audits identified deficiencies in process impacting compliance with key legislation and central agency policies, including: • conflicts of interest management • management of gifts and benefits • source to contract procurement.

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 agreed with management.

The number of moderate risk findings decreased from prior year

There were 34 moderate risk findings reported in 2021–22, representing a 35.8% decrease from 2020–21. Of these, 20 were repeat findings, and 14 were new issues.

Moderate risk findings mainly related to:

- changes to the financial delegation limits
- management of payroll masterfile
- conflicts of interest management
- management of gifts and benefits
- source to contract procurement
- segregation of duties in the process for the hiring of new employees
- missing information in contract registers.

Transport Asset Holding Entity

Background

The establishment of TAHE was originally announced by the NSW Government in the 2015–16 State Budget. On 1 July 2020, the former Rail Corporation New South Wales (RailCorp), a not-for-profit entity, transitioned to the Transport Asset Holding Entity of New South Wales (TAHE), a for-profit statutory State Owned Corporation under the *Transport Administration Act 1988*. There was no change in the structure of TAHE as a new entity was not created. Ownership remains fully with the government. TAHE, and the former RailCorp, were both classified as Public Non-Financial Corporation (PNFC) entities within the Total State Sector Accounts.

Prior to 1 July 2015, the government paid appropriations to Transport for NSW, a General Government Sector (GGS) agency, to construct transport assets. When completed, these assets were granted to the former RailCorp, a not for-profit entity within the PNFC sector. The grants to the former RailCorp were recorded as an expense in the State's GGS Budget result.

From 1 July 2015, the government announced the creation of TAHE (a dedicated asset manager). Funding for new capital projects was to be provided through equity injections and was no longer recorded as an expense to the GGS Budget, even though the business model was yet to be determined. The change, as explained in the 2015–16 State Budget, was due to the expectation that the former RailCorp will transition to TAHE, which was intended, over time to provide a sufficient rate of return. That Budget also highlighted how the change, which was largely a change in the basis of accounting, was intended to improve the GGS Budget result each year. In total, the GGS has contributed approximately $13.4 billion to TAHE since 2015–16. This includes the equity injections from the GGS to TAHE made in the current year of $2.3 billion.

NSW Treasury initially set a timetable for the stand-up of TAHE of 1 July 2019, which included finalising the business model, operating model and contracts for the use of TAHE's assets. The enactment of the *Transport Administration Act 1988* resulted in RailCorp transitioning to TAHE on 1 July 2020, 12 months after its originally planned operational date. Contributions paid to the former RailCorp and subsequently to TAHE by the GGS were treated as equity investments from July 2015 forward. This treatment continued, despite delays in settling the business model.

The premise of the change from grants expense to equity injections was based on the expectation that TAHE would provide a sufficient rate of return in the future. There must be a reasonable expectation that TAHE will generate a sufficient rate of return for the government to treat the funding it provides to TAHE as an equity contribution in the GGS budget. For further details on the discussion on sufficient rate of return, refer to 'State Finances 2021'.

Last year, our review of all evidence received prior to 14 December 2021 indicated the GGS's expected returns were below the Reserve Bank's long-term inflation target and that there was no expectation it could recover a significant asset revaluation loss. The revenue arrangements at that time, reflected a shareholders' expected rate of return of only 1.5% per annum of contributed equity and did not include recovery of the revaluation loss of $20.3 billion incurred in 2020–21.

On 14 December 2021, to avoid a qualified audit opinion, the NSW Government made the decision to increase TAHE's expected rate of return to 2.5%, equal to the Reserve Bank's long-term inflation target. This resulted in the TAHE shareholding ministers requesting that TAHE renegotiate the access fees and licence fees payable under the operating agreements between TAHE and Sydney Trains and NSW Trains (the Operators). The renegotiation was to target an average return to the GGS of 2.5% on the equity contributed.

On 18 December 2021, Transport for NSW, TAHE and the Operators, Sydney Trains and NSW Trains, entered into a Heads of Agreement (HoA). The HoA proposed indicative future access and licence fees that would form the basis of negotiations to meet the revised shareholders' expectation of a return of 2.5% per annum of contributed equity inclusive of recovering the holding (revaluation) loss of $20.3 billion. This represented an increase from the contracts that reflected a shareholders' expected rate of return of 1.5% per annum of contributed equity without an intention to recover the holding loss. The HoA reflected an intention between all parties to revise the contractual agreements to increase future access and licence fees by $5.2 billion.

Refer to 'Transport 2021' and 'State Finances 2021' for further details and subsequent impacts.

Access and licence fees

Revised commercial agreements were signed between TAHE, the Operators and Transport for NSW on 23 June 2022 to reflect the access and licence fees detailed in the 18 December 2021 Heads of Agreement

Last year's 'Transport 2021' report recommended TAHE needed to finalise revised commercial agreements to reflect the access and licence fees detailed in the 18 December 2021 HoA. As these agreements were not executed by 30 June 2021, last year's audit opinion for TAHE included an Emphasis of Matter drawing attention to the uncertainty that existed at balance date as these agreements were not finalised.

On 23 June 2022, the revised commercial agreements were signed between TAHE, the Operators and Transport for NSW through a deed of variation. The revised .for the ten-year period 2021–22 to 2030–31 was $16.6 billion, which is $520 million less than the HoA fees of $17.1 billion.

Comparison	FY22 $M	FY23 $M	FY24 $M	FY25 $M	FY26 $M	FY27 $M	FY28 $M	FY29 $M	FY30 $M	FY31 $M	Total $M
Revised commercial agreements	641.1	911.8	1,298.1	1,585	1,807.3	1,921.8	1,992	2,065.4	2,139.1	2,252.8	16,614.4
HoA	679.9	1,081.4	1,236	1,398.9	1,645.8	1,826.1	2,023.3	2,209.4	2,404.5	2,629.2	17,134.6
Difference	**(38.8)**	**(169.6)**	**62.1**	**186.1**	**161.5**	**95.7**	**(31.3)**	**(144)**	**(265.4)**	**(376.4)**	**(520.2)**

TAHE's main customers principally rely on government funding to pay access and licence fees

Whilst TAHE has agreed ten-year access and licence fees of $16.6 billion with its two main customers, Sydney Trains and NSW Trains, these two Operators significantly rely on government funding when making these payments to TAHE. At 30 June 2022, TAHE's expected return of 2.5% inclusive of recovering the holding (revaluation) loss, is contingent upon the GGS funding the Operators to support their payment of access and licence fees that have been agreed with TAHE for the ten-year contracted period and beyond to 2045–46.

TAHE received an unqualified audit opinion with an Other Matter paragraph drawing attention to the significant reliance on government-funded customers

Last year, the TAHE Independent Auditor's Report included an Emphasis of Matter. This was in relation to significant uncertainty in judgements used in the valuation. There was uncertainty because:

- there was a HoA instead of revised signed agreements
- a significant portion of the ten-year contracted fees were beyond the forward estimates period and yet to be provided for in government Budget figures
- a significant portion of the fair value of the assets is reflected in the terminal value which is outside the contracted period.

The revised access and licence agreements were signed on 23 June 2022, to reflect the access and licence fees in the HoA. The uncertainty around the HoA was resolved.

In the current year, the TAHE Independent Auditor's Report included an Other Matter paragraph to draw attention to the fact that TAHE has a dependence on two major customers (Sydney Trains and NSW Trains) who rely on government funding to be able to pay the access and licence fees. We felt it was important to draw this point out in the audit opinion as TAHE's ability to generate the 2.5% return is heavily reliant on the government grants provided to the Operators. This reflects a circularity in the flow of funds. There is also a risk that any change in the funding arrangements for the Operators could impact TAHE's projected cash flows.

TAHE's ability to generate a 2.5% return is, based on current projections, highly dependent on 'access and licence fees' revenue from Sydney Trains and NSW Trains (the Operators), which are funded by the NSW Budget. The access and licence fees TAHE earns from the Operators are contractually agreed for ten years from 2021–22 to 2030–31 and represent over 80% of TAHE's projected revenue over this period. The Operators themselves are wholly reliant on NSW Budget funding to pay these fees to TAHE.

The NSW Budget 2022–23 has committed $5.5 billion to fund the Operators, to support their payment of access and licence fees agreed on 23 June 2022. However, this funding extends only to the end of the forward estimates period in 2025–26, which falls short of the ten-year contractual period to 2030–31 and the projected period to 2045–46 to achieve the 2.5% return. The government will need to fund the Operators an additional $10.2 billion in Budget funding to meet their contractual obligations to TAHE from 2026–27 to 2030–31, and a further projected funding of $50.8 billion from 2031–32 to 2045–46. This is needed to ensure the government continues to demonstrate its expected return on investment of 2.5%. This additional funding is not within the government's published 2022-23 NSW Budget figures, leading to uncertainty on whether the government-funded Operators can pay access and licence fees beyond the forward estimates period of 2025–26.

	2022–26[1] $ billion	2027–2031[2] $ billion	2032–46 $billion	Total $billion
Access and licence fees	5.5	10.2	50.8	66.5

1 Represents the 2022–23 Budget year and three-year forward estimates which includes FY2024–26

2 Whilst excluded from the 2022–23 NSW Budget, these access and licence fees are included in the ten-year commercial agreement between TAHE, Operators and TfNSW.

Significant funding uncertainties remain

While the ten-year access and licence fee agreements were communicated to the NSW Government's Expenditure Review Committee, it is yet to be fully provided for in the government's budget figures. As TAHE's projections are highly dependent on the Operators as its key customers, it remains critical that the government continue to provide sufficient funding to the Operators so they can pay to access and use TAHE assets.

The government has estimated $38 billion in returns (equivalent to 2.5% on contributed equity) is to be earned from its investment in TAHE over the period from 1 July 2022 to 30 June 2046. As previously reported, TAHE derives most of its revenue from access and licence fee agreements from the Operators, who in turn are both funded by grants through TfNSW from the GGS. More than 95% of these returns are estimated to be earned outside of the ten-year contract period (terminating 30 June 2031).

	2022–26[1] $ billion	2027–2031[2] $ billion	2032–46 $billion	Total $billion
Returns to GGS	1.8	4.7	31.5	37.9

1 Represents the 2022–23 Budget year and three-year forward estimates which includes; 2023–24, 2024–25 and 2025–26.

2 Whilst excluded from the 2022–23 NSW Budget, these access and licence fees are included in the ten-year commercial agreement between TAHE, Operators and TfNSW.

There remains risk that:

- TAHE will not be able to recontract for access and licence fees at a level that is consistent with current projections
- future governments' funding to TAHE's key customers will not be sufficient to fund payment of access and licence fees at a level that is consistent with current projections
- TAHE will be unable to grow its non-government revenues.

Further details will be included in the ‘State Finances 2022’ report.

In 2021–22, TAHE and NSW Treasury prepared further modelling to support the Government's intent to earn a 2.5% return inclusive of recovering the holding (revaluation) loss of $20.3 billion on its investment in TAHE

Last year's 'Transport 2021' report highlighted that NSW Treasury should, with TAHE, prepare robust projections and business plans to support the expected returns forecast beyond 2030–31.

This year TAHE engaged an expert to help develop a model demonstrating the government's expected returns from its investment in TAHE. The model mathematically forecasts that returns of 2.5% will be achieved by 2046 and this will include recovery of the revaluation losses of $20.3 billion relating to 2020–21.

The current model includes some key assumptions:

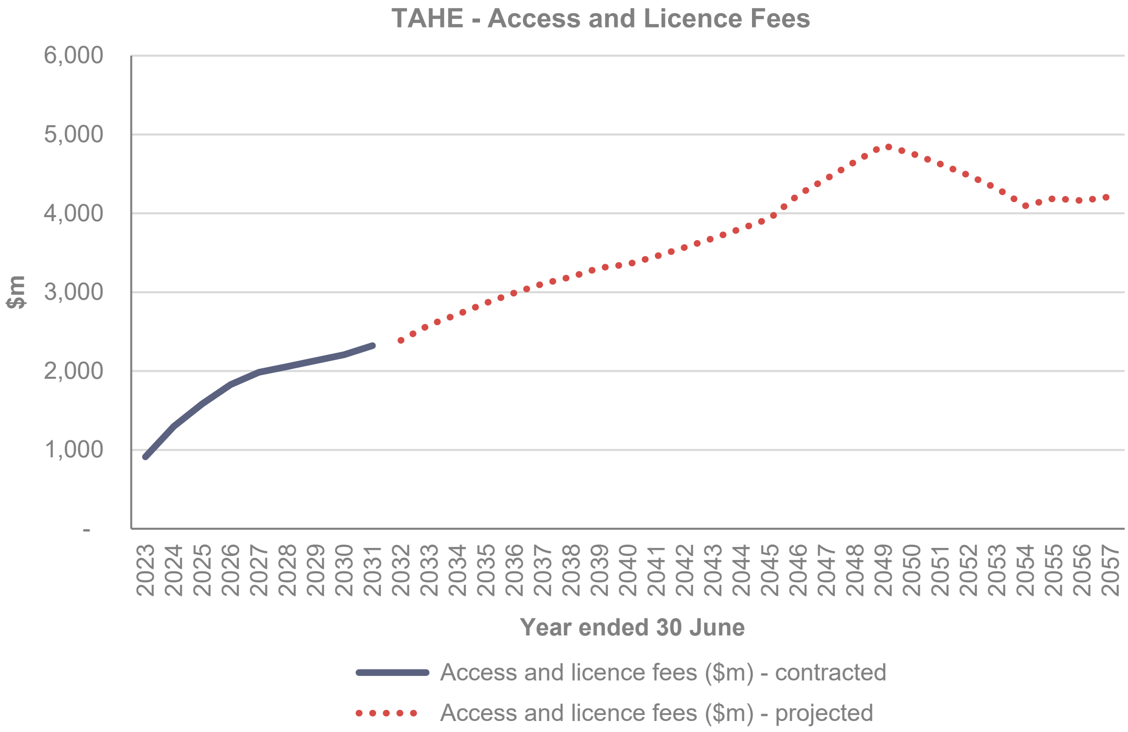
- the main source of revenue is the access and licence fees expected from the two public rail operators (Sydney Trains and NSW Trains) contributing to more than 80% of TAHE's projected revenue. The rail operators are largely funded by the government when paying access and licence fees to TAHE.
- for the first ten years, the access and licence fees are based on the signed agreements between TAHE and the public rail operators.
- Beyond the ten-year contracted period, the model assumes existing contractual terms for access and licence fees will continue unchanged allowing for an annual rise for inflation (2.5% per annum), and increased fees to enable a 7.62% return for renewed assets.
- the capital expenditure included in the model is only the amounts approved by the Expenditure Review Committee (ERC) as part of the ten-year forecast. The model beyond ten years includes expected investment in renewed and replacement assets but excludes any forecasts relating to growth capex that is not approved by the ERC, and any related depreciation expenses for this growth capex.

While management has developed a 35-year long term financial model to support the returns, we note this will be refined over the next few years. Furthermore, these are forecasted figures and we have not seen sufficient evidence of whether this reflects reality (that is, the achievement of Dividends representing a return on equity) as it is still very early. Therefore, this will remain a high-risk matter until we have seen sufficient evidence of reality to the forecasted figures.

TAHE returns are contingent upon government funding the Operators, the circularity in flow of funds remains a concern

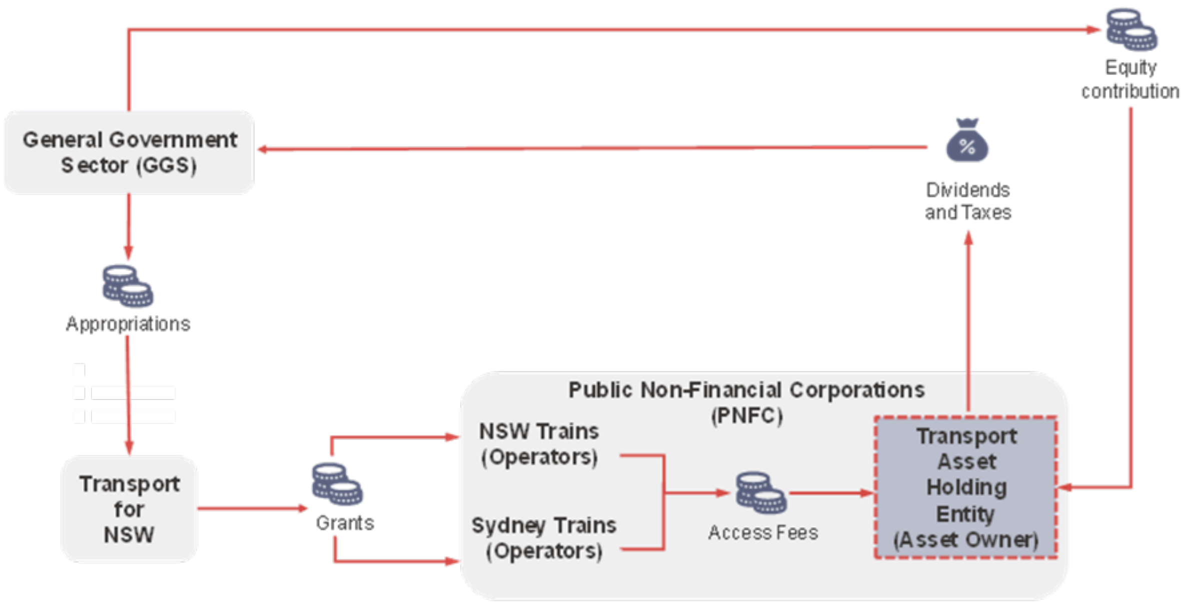
The reliance on access and licence fees as TAHE's major source of income to support the expected returns creates a risk due to the circularity of the flow of funds. TAHE's ability to generate the expected return based on the current modelling is heavily reliant on the government funding the public rail operators. The model assumes that future governments will continue to fund the public rail operators to be able to recontract for access and licence fees at a level that is consistent with the current projections.

The graph below shows the contracted access and licence fee revenue for TAHE from 2022–23 to 2022–31 and the projected access and licence fee revenue from 2031–32 to 2056–57 (to the end of the 35-year projections):



Source: TAHE (unaudited).

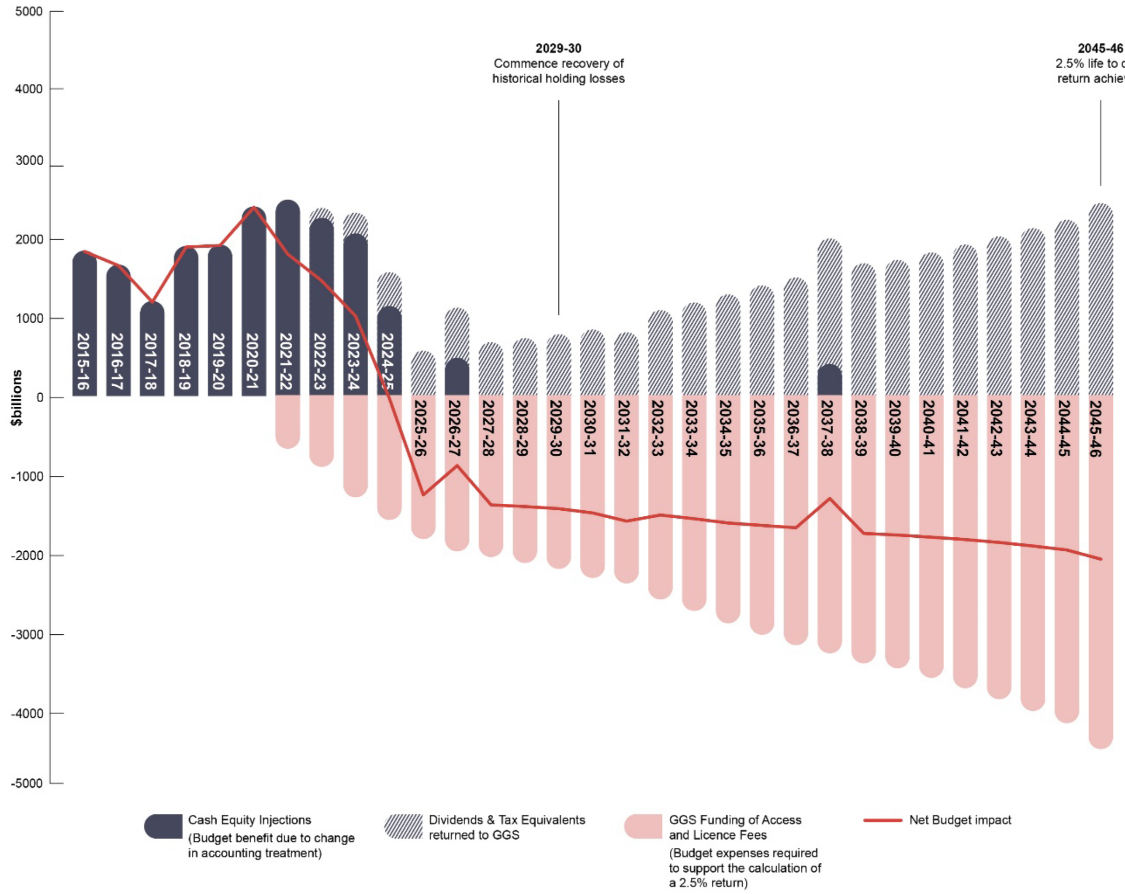
There remains a risk that TAHE will not be able to generate a sufficient return on the NSW Government's investment without relying on increased funding to the public rail operators so they in turn can pay the higher access and licence fees. Current modelling highlights that TAHE remains largely reliant, through to 2046, on increasing fees paid by the public rail operators who remain principally reliant on GGS Budget grants. What is critical to the returns model is the government continues to fund both Operators through grants to TfNSW, so that TAHE can earn access and licence fees. This in turn relies on an obligation for future governments to provide additional funding to public rail operators in order to preserve the treatment of government's investment in TAHE as an equity contribution. If government funding ceases, then it will be unlikely that returns of 2.5% can be achieved particularly given the Operators contribute to more than 80% of TAHE's projected revenue to 2046. The circularity in flow of funds between transport agencies in the GGS and PNFC sectors was reported in last year's 'Transport 2021' report and is again shown in the diagram below.



The current model also does not include any other significant sources of revenue beyond the access and licence fees. TAHE generates a small portion of its income from transactions with the private sector but the model projects more than 80% of the revenue to support the expected return of 2.5% is derived from the access and licence fees from the public operators. At this point in time, nothing beyond the access and licence fees has been approved or finalised as a main source of revenue. There is a risk that TAHE's ability to generate returns on government investment from other sources may not be achievable or sustainable.

There is negative net impact on the Budget after 2024–25 and this will grow in the future

There are some key points to highlight with this modelling and these are best conveyed with the graph below. This graph shows total cash injections made by the GGS since the government first announced the creation of TAHE as a for-profit entity in the 2015–16 NSW Budget. It also conveys the forecast returns from TAHE to the GGS and the level of funding Operators will need from the GGS to pay TAHE's access and license fees over the 30-year period. These cash flows are key inputs used in the modelling which calculates a 2.5% return from TAHE inclusive of recovering the holding (revaluation) loss of $20.3 billion.



Most of the equity contributions by the GGS to TAHE are forecast to be made by 2024–25. If the government continues to demonstrate a reasonable rate of return over the next three years, these transfers will not impact the budget result as they would be treated as an equity injection rather than a capital transfer expense. During this same timeframe, GGS grant funding needed to help Operators pay TAHE access and licence fees are their lowest and increase over the later years.

The graph conveys there is negative net impact on the Budget after 2024–25 and this negative impact continues to grow. The current forward estimates period in the Budget is 2025–26. Majority of this negative impact on the Budget is beyond the forward estimates period. This means the funding burden of no further cash equity injections and increasing future access and license fees payable by the operators to TAHE will be borne by subsequent governments. This money would need to be funded by the GGS, with the risk that additional expenses to the budget result will result in later years.

The ongoing requirement for TAHE to make a sufficient rate of return creates an obligation for future governments

Current modelling obliges future NSW Governments to fund to the public rail operators to maintain TAHE's achievement of a sufficient rate of return and the subsequent preservation of the treatment of government's investment in TAHE as an equity contribution. Treasury advises that the government expects to largely cease providing funding for capital projects via equity investments from 2026. However, the modelling for this decision is based on the assumption that TAHE accumulates sufficient cash over time, from access and licence fees, to fund approved future capital expenditures. As a result, in order to make a return on its investment in TAHE, the NSW Government needs to continue to fund the public rail operators so that they can pay these access and licence fees to TAHE. If this does not continue, and if TAHE can no longer provide a reasonable expectation of a sufficient rate of return, then the government's investment in TAHE will need to be treated as expenditure. This would result in significant deterioration in the GGS Budget result.

Sufficient evidence that the forecast figures in the model will reflect the actual results of TAHE’s operations is yet to be observed. NSW Treasury and TAHE have estimated the Government's return from its investment in TAHE to be $37.9 billion (which includes dividends, tax and undistributed profits) over the period from 1 July 2022 to 30 June 2046. The majority of these returns ($31.5 billion) are estimated to be generated between 2032 and 2046.

To date, TAHE has not generated a return on investment, although it did declare a dividend of $71.2 million in 2021–22. However, since TAHE did not actually make a profit in 2021–22 (loss of $412.9 million) and its retained earnings were negative as well, this dividend is effectively a return *of* the government's previous investment in TAHE, and not a return *on* investment.

There is a high risk that TAHE’s returns in the long-term model will not eventuate as forecast. This will remain a high-risk matter until sufficient evidence is observed of actual results over the years compared to what has been included in the forecast when assessing returns. The uncertainty has been raised as a high-risk matter in a management letter to TAHE.

TAHE's contracts with its key customers (the two government rail operators Sydney Trains and NSW Trains) specified access and licence fees that were below the regulated maximum

The Independent Pricing and Regulatory Tribunal (IPART) NSW Rail Access Undertaking (NSW RAU) sets out the pricing principles that TAHE needs to apply for access to the regulated assets (rail network). The NSW RAU sets out the principles to calculate a floor and ceiling price. The access fees TAHE sets for the access seekers should be above the floor price and must be below the ceiling price. IPART assess compliance with the ceiling test on an annual basis.

These pricing principles are not required to be applied to the unregulated assets (train stations and rolling stock). This means TAHE does not have to comply with any ceiling tests for its pricing on its licencing arrangements to provide access to its trains stations and rolling stock.

The fees contracted between TAHE and the Operators are significantly lower than the maximum allowable revenue established by the NSW RAU. Furthermore, the licence fees to access stations and rolling stock are not regulated by IPART. Even though there is no regulatory impediment for TAHE to charge higher track access and licence fees, it does not do so. Higher fees would have likely impacted the GGS Budget, as these fees are funded by the GGS through grants to the Operators (that is, Sydney Trains and NSW Trains).

The access and licence fees set by TAHE have a significant impact on the valuation of its assets. Higher access and licence fees will result in a higher value of its assets using the Discounted Cash Flow (DCF) method valuation. Refer below for further details on this method of valuation. Setting access and licence fees below the IPART regulated maximum was one of the main reasons for the significant decrement of $20.3 billion in 2020–21.

In addition, the current arrangements between TAHE and the private operators result in access prices that are below the floor price in accordance with the IPART NSW RAU for the Country Regional Network. Furthermore, NSW Trains are charged a very low fee for access to the Country Regional Network. TAHE receives grants from Transport for NSW to cover the shortfall between access fee revenue and the maintenance expense for the Country Regional Network. However, TAHE is required to continue providing access to this network as it is required for the passenger services and freight movements to regional and interstate areas. This results in the Country Regional Network generating income that is far less than what it costs to operate and maintain the network. This results in value of nil for the Country Regional Network using the DCF valuation method.

For further details on the IPART pricing principles, refer to 'Transport 2021'. We note IPART is currently reviewing the NSW RAU. IPART expects to provide its final report on this review to the Minister of Customer Service by May 2023.

Valuation of TAHE assets

Although TAHE's selected valuation of assets falls within an acceptable range, similar to last year, there is still a significant gap between our acceptable range and TAHE's range

TAHE continued to value its property, plant and equipment as at 30 June 2022 using a valuation approach based on its DCF. The DCF method uses the relevant cash inflows and outflows related to the assets and applies a discount rate to these cash flows to calculate a present value of these assets. The model is subject to judgements and assumptions, particularly those related to the discount rate used within the model.

Finalisation of access and licence agreements with Sydney Trains and NSW Trains prior to 30 June 2022 enabled TAHE to revise these revenue forecasts to 2031.

TAHE used a DCF model to determine the total fair value of its cash generating units (its assets) being Metropolitan Regulated Assets, Metropolitan and Regional Unregulated Assets and the Country Regional Rail Network. At 30 June 2022, the fair value of TAHE's non-current physical assets were valued at $18.15 billion. This resulted in an increment of $54.6 million ($20.3 billion decrement in 2020–21).

When setting access and licence fees, TAHE continues to expect a return on equity injections made to the former RailCorp from 2015–16 onwards. This means all of the assets previously granted to, or acquired by, the former RailCorp prior to 2015 are excluded when calculating access and licence fees. The cash flows are not reflective of the full asset base, but were used to value the full asset base. The contracted cash flows from the licence and access fees with Sydney Trains and NSW Trains are based on the expected rate of return determined by the shareholding ministers on the equity contributions received from 2015–16 onwards. The remaining asset base is considered to be 'gifted assets' from the government to TAHE, on the basis that the government has already paid for those assets by way of grants. TAHE continues to maintain there is no expectation from government for TAHE to generate revenue from access and licence fees from the gifted asset base. The access and licence fees set by TAHE have a significant impact on the valuation of its assets. The exclusion of the assets prior to 2015–16 when setting access and licence fees was one of the main reasons for the significant decrement of $20.3 billion in 2020–21.

The Country Regional Network continues to be valued at nil as the income it generates is far less than what it costs to operate and maintain the network. Despite TAHE being a for-profit entity, it is required to continue providing access to this network as it is required for the passenger services and freight movements to regional and interstate areas.

Key inputs to the DCF model are the access and licence fees, which are charged to TAHE's key customers, Sydney Trains and NSW Trains, and discount rates to discount the expected cash flows to their present values.

While some inputs to the DCF are known, such as the access and licence agreements signed on 23 June 2022, other inputs, such as discount rates are subjective. Therefore, judgments applied in complex valuations are reflected through a high and a low range of valuation outcomes to allow for this level of subjectivity. A wide range is used when valuing assets of this nature to recognise there are judgements and subjectivity in the process. The width of the range reflects the complexity of the judgments and assumptions and the sensitivity to even small changes to inputs within the DCF model.

Based on the revised access and licence agreements signed on 23 June 2022, TAHE developed a range of estimated outcomes of $15.2 billion to $18.15 billion and adopted the high end of this range to estimate the value of its assets to be $18.15 billion. Management explained the use of the high end of the range was consistent with the use of the high end in the prior year valuation. The Audit Office assessed the appropriate valuation range was between $17.4 billion and $22.1 billion. This range was based on what we observed to be relevant risk factors appropriate to TAHE's circumstances, the nature of its business and comparable industry benchmarks.

TAHE's adopted valuation was within the acceptable range. The table below shows the value ranges:

	Valuation range		
	Low ($'bn)	**Mid ($'bn)**	**High ($'bn)**
TAHE range	15.20	16.55	18.15
Audit range	17.40	19.50	22.10

The key differences between management and the Audit Office's ranges related to the application of different discount rates to TAHE's expected cash flows. A discount rate reflects the compensation a market participant will seek for bearing uncertainty inherent in expected cash flows. Discount rates increase, as the risk of achieving forecast cash flows increases. In a DCF valuation, higher discount rates drive lower values for assets, reflecting prima facie, a reasonable market participant will pay a higher price for an asset whose cash flows bear lower uncertainty than an asset whose cash flows bear greater uncertainty.

We considered TAHE's range of overall discount rate high compared to relevant market benchmarks. This has resulted in a significant gap between our acceptable range and the midpoint of TAHE's range. The TAHE midpoint does not fall within our acceptable range. This has not resulted in an impact on our audit opinion as TAHE has selected the high end of the range which is within our range. However, this creates a high risk as there are still some significant differences in the assumptions adopted in the valuation and has been reflected as high risk issue in our Management Letter (refer above).

The audit evidence presented to us indicated the risk TAHE's expected cash flows would not be achieved was comparatively lower, relative to management's assessment of risk. Consequently, lower discount rates were more appropriate in the circumstances and in line with comparable benchmarks. In our view, TAHE's cash flows should be considered at the lower end of the risk spectrum warranting the application of a lower discount rate, because TAHE:

- is the monopoly provider of rail infrastructure asset to Sydney Trains and NSW Trains (both NSW government entities). Both public sector operators are reliant on TAHE's assets to conduct their operations. No alternative suppliers are available, nor are other participants likely to enter the market
- retains limited operational and maintenance capital expenditure risk as the public rail operators are required to fund the operational maintenance costs for TAHE's assets and NSW Treasury funds the capital maintenance expense through equity injections
- has contractual cash flows for its regulated and unregulated assets under ten-year Track Access Agreements and Licence, Agency and Maintenance Deeds
- has not identified any risks that are not relevant to any other comparable regulated businesses.

Control of assets

On transition of the former RailCorp to TAHE on 1 July 2020, management determined TAHE maintains accounting control of the assets held by TAHE. The Framework for the Preparation and Presentation of Financial Statements, AASB 116 'Property, Plant and Equipment' and AASB 15 'Revenue from Contracts with Customers' states that to fulfil the criteria to recognise assets, an entity must demonstrate control over them. This refers to TAHE's ability to direct the use of, and obtain substantially all of, the remaining benefits from the asset as well as the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

For the current year, the legal form of the arrangements established imply TAHE has control over the assets. Collectively, in form, the legal arrangements supported TAHE's assertion over its control over the assets as at 30 June 2022. However, risks remain as TAHE is in its early stages, and the actual substance of operations will need to be observed and considered. This was included as a high-risk management letter finding again this year.

Under the *Transport Administration Act 1988* (TAA), the functions of TAHE may only be exercised under one or more Operating Licences issued by the portfolio minister. The current Operating Licence confers terms and conditions for TAHE to carry out its functions, and imposes certain constraints on TAHE, including (but not limited to):

- railway operations not permitted
- transport services not permitted
- TAHE must not carry out maintenance of its assets.

Such operating licences are short term in nature, and the TAA allows the portfolio minister to grant one or more operating licences to TAHE and may amend, substitute, or impose or revoke conditions of the Operating Licence. Furthermore, the Statement of Expectations issued by the portfolio minister outlines the minister's expectations of TAHE in ensuring the government's priorities for the transport sector are met.

Given the restrictions that can be placed on the entity through the Operating Licence, and the ability to make further changes to the Operating Licence and Statement of Expectations set by the portfolio minister, there is a risk there could be limitations placed on the board of directors to operate with sufficient independence in its decision-making with respect to the operations of TAHE. Over time, this may further impact the degree of control required by TAHE to satisfy the recognition criteria over its assets. It may also fundamentally change the presentation of TAHE's financial statements.

TAHE's original portfolio minister was the Minister for Transport who approved, on 30 June 2020, the issuing of an interim 12-month Operating Licence to enable TAHE to commence operating on 1 July 2020. The Minister for Transport then granted TAHE's current Operating Licence effective 1 July 2021 to 30 June 2023. After TAHE requested a 12-month extension to its current Operating Licence, its next Operating Licence is now due on 1 July 2024. The current portfolio minister is the Minister for Infrastructure, Cities and Active Transport.

We accepted TAHE's position on control for the current year. It will remain an area of audit focus in future years as the substance of the arrangements put into place need to be confirmed by observation

Management assessed control and provided the audit team with an assessment outlining how it has exercised authority and control over its assets during the year, as well as operate as an independent SOC.

Consistent with the prior year, we did not find evidence that, in form, the assets held by TAHE are not controlled by TAHE. However, given the constraints that can be imposed through the Operating Licence, there is a risk that limitations could be placed on the operations or functions of TAHE. Future limitations to the degree of control TAHE, and its board, can exercise over its functions may impact the degree of control TAHE has over its assets going forward. The current Operating Licence issued by the Minister for Transport effective from 1 July 2021 was expected to expire on 30 June 2023. TAHE has requested and received approval for an extension of the Operating Licence for one year, to 30 June 2024. As part of the 2022–23 audit, we will continue to monitor and assess whether, in substance, these assets continue to be controlled by TAHE and whether, in substance, TAHE can operate as an independent SOC. We require management continue to demonstrate that TAHE continues to maintain control over its assets and has the ability to operate as an independent SOC.

Recommendation

NSW Treasury and TAHE should continue to monitor the risk that control of TAHE assets could change in future reporting periods. TAHE must continue to demonstrate control of its assets or the current accounting presentation would need to be reconsidered.

Upcoming performance audit on TAHE

A performance audit on the establishment of Transport Asset Holding Entity (TAHE) is currently in progress. This audit will examine the effectiveness of NSW government agencies' design and implementation of TAHE including whether the process was cohesive and transparent, whether agencies' roles and responsibilities were clear, and whether agencies effectively identified and managed certain risks. We plan to table this report in January 2023.

Section two

Appendices

Appendix one – Misstatements in financial statements submitted for audit

	2021–22			2020–21		
	Uncorrected	Corrected	Total	Uncorrected	Corrected	Total
Department of Transport	--	--	--	--	2	2
Transport for NSW	1	3	4	1	6	7
Centennial Park and Moore Park Trust	--	--	--	5	1	6
Greater Cities Commission	--	--	--	2	2	4
Infrastructure NSW	1	1	2	--	1	1
Luna Park Reserve Trust	--	1	1	--	2	2
NSW Trains	--	--	--	--	--	--
Parramatta Park Trust	--	1	1	2	-	2
Place Management NSW	--	1	1	--	3	3
Port Authority of New South Wales	-	1	1	-	1	1
Royal Botanic Gardens and Domain Trust	--	--	--	--	8	8
State Transit Authority of New South Wales	1	--	1	--	1	1
Sydney Ferries	--	1	1	--	--	--
Sydney Metro	2	1	3	1	6	7
Sydney Trains	--	--	--	--	--	--
Transport Asset Holding Entity of New South Wales	--	--	--	--	7	7
Transport Service of New South Wales	--	1	1	--	1	1
Western Sydney Parklands Trust	--	3	3	--	--	--

Note: Chief Investigator of the Office of Transport Safety Investigations, Residual Transport Corporation of New South Wales, Infrastructure NSW Staff Agency and Greater Cities Commission Staff Agency have assessed and determined they met the reporting exemption criteria under the GSF Regulation, and therefore were not required to prepare annual financial statements.

Source: Engagement Closing Reports issued to cluster agencies.

Appendix two – Early close procedures

No.	Procedure	Description
1	Proforma financial statements	Complete proforma financial statements and ensure management has reviewed the statements and the supporting working papers.
2	Fair value assessment of property, plant and equipment	Perform and document an annual assessment of the fair value of property, plant and equipment, their useful lives and residual values, and the reasons why the carrying value was not materially different to the fair value. This assessment is performed between comprehensive revaluations.
3	Revaluation of property, plant and equipment	Complete the comprehensive revaluation of property, plant and equipment by early close.
4	Update employee annual leave provisions	Reconcile and calculate annual leave provisions. The balances calculated for the early close 31 March financial statements must be rolled forward with adjustments for monthly accruals and actual payments as part of the 30 June financial statements.
5	Inter and intra (cluster) agency transactions and balances	Agree and confirm all inter and intra (cluster) agency balances and transactions with the counterparty agency.
6	Significant management judgements and assumptions	Document all significant management judgements and assumptions made when estimating transactions and balances.
7	Reconciliation of key account balances	Reconcile all key account balances (including annual leave provisions) and clear reconciling items.
8	Reconcile March 2022 month-end Prime submission to the proforma financial statements	Reconcile the March 2022 month-end Prime submission to the proforma financial statements and provide explanations for variances above $5 million.
9	Changes in accounting policy	Review and agree changes in accounting policy with the principal cluster agency.
10	Finalise right-of-use assets and lease liability balances	Ensure that all lease arrangements are accurate and complete.
11	Finalise assessment of all revenue contracts	Ensure revenue is accurate and complete and has been correctly accounted for under AASB 15 'Revenue from Contracts with Customers' or AASB 1058 'Income of Not-for-Profit Entities'.
12	Correction of material prior period errors	Confirm there are no changes to the 2020–21 closing balances. Proposed changes are accompanied by journals, explanations and proposed disclosures.
13	Monthly management reports	Perform variance analysis with meaningful explanations for actuals versus Budget, and year-to-date actuals for the previous year.
14	Accounting treatment for restructures and discontinued /abolished agencies	Identify and document the accounting treatment for changes to agency structures resulting from legislative or other changes.
15	Delegations	Ensure all material transactions are supported by appropriate delegations.

No.	Procedure	Description
16	Prior year Management Letter and Engagement Closing Report issues	Agreed action plans are in place to address prior year Management Letter and Engagement Closing Report issues. Explanations are provided for any unresolved issues(s).
17	Complete Commonwealth Funding Agreement – Revenue Assessment Form for Commonwealth Funding Agreements	Complete and return the ‘Commonwealth Funding Agreement – Revenue Assessment Form for Commonwealth Funding Agreements’ for all new and amended Commonwealth Funding Agreements entered or amended during the 2021–22 financial year.

Appendix three – Timeliness of financial reporting

Cluster agencies	2021–22 Financial statements submission	Date audit report was issued
Department of Transport*	⊖	9 November 2022
Transport for NSW	✔	9 November 2022
Centennial Park and Moore Park Trust	✔	15 November 2022
Greater Cities Commission	✔	24 October 2022
Infrastructure NSW	✔	7 October 2022
Luna Park Reserve Trust	✔	11 October 2022
NSW Trains	✔	7 October 2022
Parramatta Park Trust	✔	15 November 2022
Place Management NSW	✔	11 October 2022
Port Authority of New South Wales	✔	7 September 2022
Royal Botanic Gardens and Domain Trust	✔	31 October 2022
State Transit Authority of New South Wales	✔	19 October 2022
Sydney Ferries	✔	12 October 2022
Sydney Metro	✔	5 October 2022
Sydney Trains	✔	10 October 2022
Transport Asset Holding Entity of New South Wales	⊖	28 October 2022
Transport Service of New South Wales	✔	8 November 2022
Western Sydney Parklands Trust	✔	16 November 2022

✔ Treasury's reporting deadline was met.

⊖ Treasury's approved extension timeframe was met.

! Treasury's reporting deadline was not met.

* The audit of Department of Transport was completed on 9 November 2022, following completion of the audit of all of its controlled entities.

Appendix four – Financial data

	Total assets		Total liabilities		Total revenue*		Total expense**	
	2022 $m	2021 $m	2022 $m	2021 $m	2022 $m	2021 $m	2022 $m	2021 $m
Cluster lead entity								
Department of Transport (Parent Entity)	14	--	10	--	91	1	86	1
Transport for NSW	157,814	146,847	24,144	26,141	29,424	24,480	23,985	20,082
Other cluster agencies listed in Appendix A of Treasury Direction TD21-02								
Centennial Park and Moore Park Trust	1,505	1,370	14	8	62	58	43	38
Greater Cities Commission	3	3	5	5	28	21	27	22
Infrastructure NSW	1,533	2,113	971	1,244	840	757	394	327
Luna Park Reserve Trust	49	45	1	0	2	2	3	1
NSW Trains	942	198	1,025	359	1,148	910	1,145	854
Place Management NSW	2,990	2,877	1,846	1,853	317	283	331	269
Royal Botanic Gardens and Domain Trust	1,038	983	19	21	72	106	60	63
State Transit Authority of New South Wales	--	100	--	272	222	468	267	434
Sydney Ferries	190	152	10	9	44	8	12	13
Sydney Metro	29,622	22,651	3,173	4,027	8,116	4,700	2,011	2,119
Sydney Trains	5,620	3,150	5,853	3,627	4,061	3,776	4,053	3,802
Transport Asset Holding Entity of New South Wales	24,842	22,133	3,890	3,563	968	349	1,381	17,880
Western Sydney Parklands Trust	1,511	1,344	43	40	112	65	19	16

	Total assets		Total liabilities		Total revenue*		Total expense**	
	2022 $m	2021 $m	2022 $m	2021 $m	2022 $m	2021 $m	2022 $m	2021 $m
Other cluster agencies								
Parramatta Park Trust	113	111	5	6	6	34	6	5
Port Authority of New South Wales	704	660	290	284	191	182	160	155
Transport Service of New South Wales	396	573	396	573	2,509	2,244	2,511	2,256

* Total revenue includes other gains, gains on disposal, government and other contributions and reversal of impairment losses which are shown separately on the financial statements.

** Total expense includes other losses, income tax equivalent expense and impairment losses on financial assets which are shown separately on the financial statements.

Note: Chief Investigator of the Office of Transport Safety Investigations, Residual Transport Corporation of New South Wales, Infrastructure NSW Staff Agency and Greater Cities Commission Staff Agency have assessed and determined they met the reporting exemption criteria under the GSF Regulation, and therefore were not required to prepare annual financial statements.

Source: Agencies audited 2021–22 financial statements.

Professional people with purpose

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)

Level 19, Darling Park Tower 2
201 Sussex Street
Sydney NSW 2000 Australia

PHONE +61 2 9275 7100

mail@audit.nsw.gov.au

Office hours: 8.30am-5.00pm
Monday to Friday.