

# AUDITOR-GENERAL'S REPORT PERFORMANCE AUDIT

## Coal Mining Royalties

NSW Department of Industry and Investment  
NSW Treasury



The Legislative Assembly  
Parliament House  
SYDNEY NSW 2000

The Legislative Council  
Parliament House  
SYDNEY NSW 2000

In accordance with section 38E of the *Public Finance and Audit Act 1983*, I present a report titled **Coal Mining Royalties: Department of Industry and Investment, and NSW Treasury**.

A handwritten signature in black ink that reads "Peter Achterstraat".

Peter Achterstraat  
Auditor-General

Sydney  
November 2010

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## Executive summary

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## Background

The people of NSW own the minerals on Crown land and private land. The Government allows mining companies, via leases, to extract and sell these minerals for a price. This price is known as a 'royalty'.

Mining royalties are a source of significant revenue to NSW. In 2008-09, the Government received \$1.28 billion in mining royalties representing about 2.6 per cent of the total revenue collected by the Government that year. Coal accounted for over 95 per cent of the royalties.

The revenue the Government receives from mining royalties has increased substantially in recent times. Royalty revenue increased by 123 per cent between 2007-08 and 2008-09 (from \$573 million to \$1.28 billion), largely due to a sharp rise in coal export prices and increases in royalty rates.

The Royalty and Statistics Branch of the NSW Department of Industry and Investment (DII) administers the collection of mining royalties.

This audit examined how well DII ensures mining lease holders pay the royalties they owe the State on time. Specifically, the audit assessed whether DII:

- has complete, accurate, and up-to-date information on leases
- has clear rules for calculating and collecting royalties
- identifies late and inaccurate royalty returns
- undertakes comprehensive quality audits to validate royalty payments
- acts on late and inaccurate returns.

The audit focused on royalties collected from coal extracted from Crown land. See Appendix 1.

## Audit conclusion

DII cannot assure the people of NSW that all royalties owed are being paid in full. This is because it does not have sufficiently robust systems and processes to identify what is owed and to make sure it is paid.

What needs to be paid is complex to calculate and guidance on this is inadequate. Auditing and monitoring processes for royalties are not strong enough. Penalties do not apply to underpayments, even if persistent, as long as some payment is made on time.

We estimate that at least \$8 million more in coal royalties could have been collected between 2004-05 and 2008-09.

A major overhaul of the administrative arrangements for collecting royalties is needed.

One way to achieve a more robust and structured approach would be to transfer the function to the Office of State Revenue (OSR) which specialises in identifying and collecting revenue owed to the State. That would also achieve a desirable separation between DII's roles as both regulator of the mining industry, and facilitator of increased investment in the industry. This option should be reviewed.

## Supporting findings

DII could not demonstrate that all its information that supports the collection of royalties is accurate and current. DII's current approach to validating information is not sufficiently systematic to give adequate assurance that changes are captured in a timely manner, and critical information is kept accurate and up-to-date. Data quality assurance standards and procedures have not been developed, and there is no documented evidence of regular data reviews.

The rules on when to pay are clear. However, the rules for calculating coal mining royalties are complex. DII has not made it easy enough for coal mining lease holders to work out what they owe. DII does not provide comprehensive guidance on the specific rules for coal mining royalties to lease holders, and relies too much on individual staff to clarify the rules. As a result, there is little assurance that the rules have been applied properly and consistently, and that all companies have met their obligations.

DII identifies late royalty payments, and promptly follows up with lease holders. However, DII cannot assess from the royalty returns, which are self-assessed by lease holders, whether the royalty being paid is likely to be correct. Unlike in some other jurisdictions, NSW coal mining lease holders do not have to provide supporting evidence or independent verification of the amount paid. As a result, in-depth audits by DII are the sole mechanism to determine the validity of royalty payments. Also, DII relies on a manual royalty return system which is highly inefficient.

Given the importance of audits in validating payments, DII is not auditing well enough, and is not doing enough audits. DII has not developed and documented audit procedures, practices vary between auditors, and there is no effective quality assurance process. Audits take too long, do not cover every royalty year for each client, and are not well targeted. DII's policy is to audit all coal mining lease holders at least every two years, but this is not happening. This has a real implication. DII's audits led to the recovery of \$3.9 million additional royalties over five years, but a more robust auditing regime could have recovered more. We estimate the potential revenue leakage in this five-year period to be at least \$8 million.

DII penalises late payments of royalties but not incorrect payments. Penalties for late payments are not a strong enough deterrent. Over the last five financial years, DII collected about \$470,000 in interest charged for late payments, and over a third of coal mining lease holders paid late at least once a year. There is no escalation of penalties for persistently late payers. No penalty applies for underpayments, if a payment was made on time. Penalties need to cover incorrect returns, and be escalated for repeat offenders.

## Recommendations

1. To ensure information that supports the collection of coal mining royalties is accurate and current, DII should :
  - develop data quality assurance standards and procedures (page 10)
  - maintain records of annual data validation reviews (page 10)
  - implement the electronic data integration project by June 2013 (page 10).
2. To help mining lease holders comply with the rules, DII should develop comprehensive compliance guidance for coal royalties (page 11).
3. To improve the accuracy of returns and the efficiency of the royalty return system, DII should:
  - require coal mining lease holders to provide supporting evidence with their annual returns (page 13)
  - require coal mining lease holders to undertake an independent limited assurance audit of annual returns (page 13)
  - implement an online royalty return system by June 2013 (page 13).
4. To ensure a more structured approach and effective audits, DII should:
  - develop a risk-based audit program to better target audit resources (page 16)
  - for each audit undertaken, extend the scope from the current one year's royalties to all years since the previous audit (page 16)
  - develop audit procedures and train staff (page 16)
  - monitor and report on audit progress and findings, and the effectiveness of its compliance activities (page 16)
  - develop a staff rotation policy to better manage the perception of independence (page 16).
5. To improve compliance, DII should:
  - penalise underpayments of royalties identified in audits and annual returns exceeding a certain percentage (e.g. two per cent) of royalties owed for the year (page 18)
  - escalate penalties for consistent late payments of royalties (page 18).
6. NSW Treasury, in consultation with DII and the Department of Premier and Cabinet, should undertake a detailed review of the merits of transferring the administration of royalties to the Office of State Revenue by June 2011 (page 16).



## Response from the NSW Department of Industry and Investment

*Thank you for your letter of 29 October 2010 seeking a formal response to the final report for the performance audit on administering coal mining royalties in NSW.*

*All of the report's recommendations are accepted.*

*However there are concerns with the report's conclusions and the tone of the commentary for each section which do not accurately portray how effective or efficient the current royalty system is. The Department has provided the Audit Office with commentary and supportive evidence, much of which is not reflected in the final report.*

*The report indicates there may be a revenue leakage within the auditing program. It states "it is difficult to say exactly" but still provide an estimate of \$8 million over 5 years, or approximately 0.27% of royalty collected in that period. This calculation is extremely subjective and relies on assumptions that all audits will produce additional revenue.*

*In regard to the accurate and current information on coal royalty payments, the granting of a coal lease is a detailed process involving numerous government agencies. The Department believes that its systems and controls are sufficient to ensure that each coal lease is accurately identified.*

*In respect of the consideration to transfer the royalty administration to OSR this would need to be reviewed, particularly in relation to whether OSR has the appropriate expertise to fulfil the task. I note that no other State has royalties administered by their Office of State Revenue. In all instances it is the relevant industry Department.*

*(signed)*

*Barry Buffier  
Acting Director-General*

*Dated: 18 November 2010*

## Response from NSW Treasury

*Thank you for the opportunity to provide a response to the Performance Audit on the administration of coal mining royalties in NSW.*

*Royalties received from mining are an important revenue source for the State. I would therefore welcome any measure that could improve efficiency in the collection of these royalties.*

*I note with particular interest the recommendation for a detailed review of the merits of transferring the administration of mining royalties to the Office of State Revenue (OSR). As you identify in your report, the only other state or territory that currently operates under this administrative model is the Northern Territory.*

*Such a change for NSW would represent a significant adjustment to current practice and would require extensive consultation with OSR and the current administrative body for coal royalties, the Department of Industry and Investment.*

*NSW Treasury appreciates the effort of the Audit Office in completing this audit, and intends to explore the recommendation of reviewing the merits of transferring the administration of royalties to OSR by June 2011.*

*(signed)*

*Michael Schur  
Secretary*

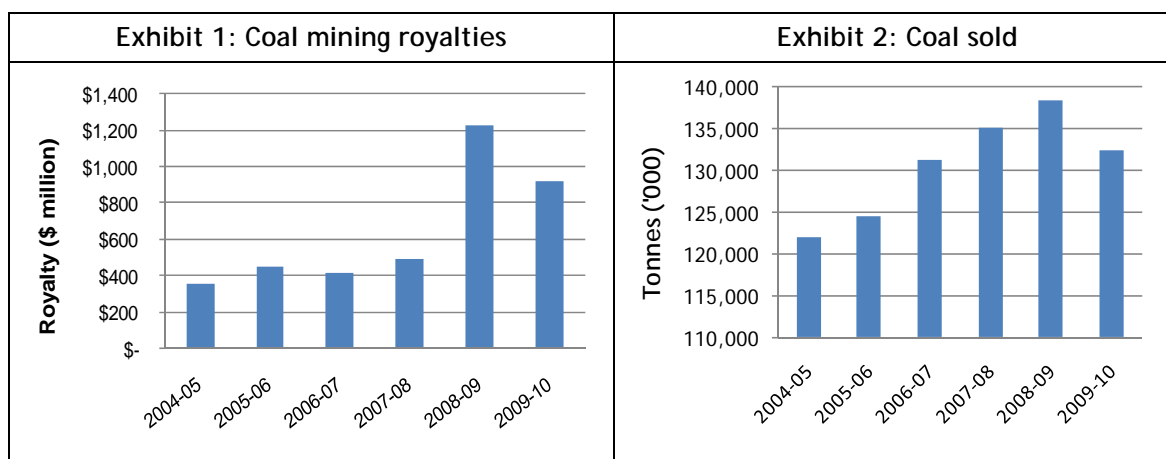
*Dated: 17 November 2010*

## Key findings

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## 1 Coal royalties in NSW

Between 2004-05 and 2008-09, coal royalty revenue increased from \$354 million to \$1,227 million (a 247 per cent increase), and sales volumes increased from 122 million tonnes to 138 million tonnes (around 13 per cent increase).



Source: NSW Department of Industry and Investment

Source: NSW Minerals Council, Key industry statistics 2009

Note: 2009-10 is an estimate based on DII's data and does not include June 2010.

The Hunter region contributes over 70 per cent of coal royalty revenue and employs around 68 per cent (over 10,000) of people in the NSW mining sector.

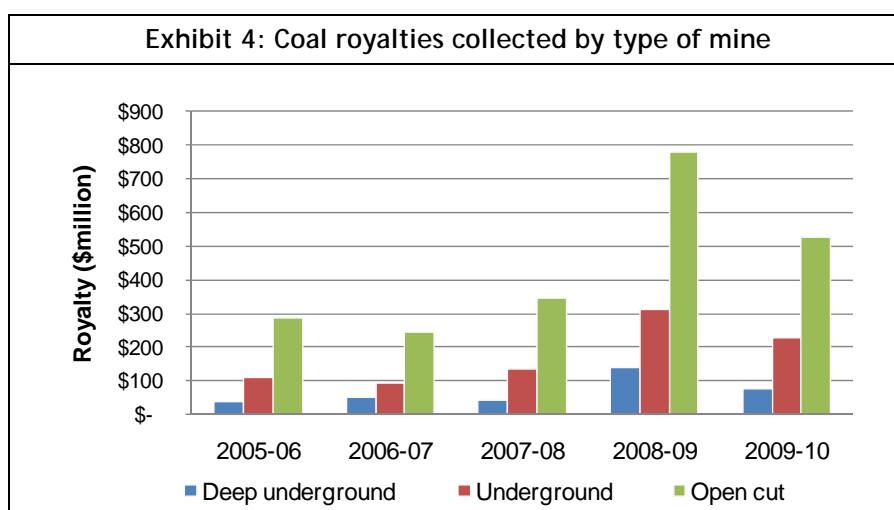
Exhibit 3: Coal royalties collected by region - 2008-09		
NSW region	Royalties (\$millions)	Percentage
Gloucester	\$21	2%
Gunnedah	\$46	4%
Hunter	\$897	73%
Southern	\$141	11%
Western	\$128	10%
Total	\$1,233*	100%

Source: NSW Parliamentary Library Research Service, e-brief 8/10

Note: \*DII advised that there is a variance between this figure which is based on annual royalty returns and their figure of \$1,227 which is based on royalties collected.

NSW has:

- about 60 coal mining lease holders
- 340 coal mining leases, although only about a third (around 100) are active and generate royalties
- 31 open cut mines, and 29 underground mines, contributing about 63 per cent and 37 per cent of coal royalties collected in the last five financial years respectively.



Source: NSW Department of Industry and Investment

Appendix 2 shows the 2008-09 contribution of the top 10 minerals to royalty revenue.

In our audit we focused on whether:

- DII makes sure that it knows who should be paying royalties
- DII makes sure that obligations are clear to help mining lease holders comply
- DII makes sure that returns come in on time, and does some high-level checks of their accuracy and validity
- DII does in-depth, risk-based audits
- DII penalises lease holders who continually make late or inaccurate returns to encourage compliance.

## 2 Does DII have accurate and current information on who should be paying coal mining royalties?

### Conclusion

DII could not demonstrate that all its information that supports the collection of royalties is accurate and current.

DII needs accurate and current information on all mining lease holders, and associated mining leases and mining operations in order to properly administer the collection of royalties.

DII advised that it checks the client database's accuracy each year (i.e. the allocation of a lease to a royalty client/mine in the royalty information management system, and all changes in lease arrangements), but it could not provide evidence:

- to show this has occurred
- of the method DII uses to do this.

DII could not produce records of any data validation reviews, their findings and/or actions taken. Also, DII has not developed quality assurance standards and procedures for data validation.

DII's current approach to validating information is not sufficiently systematic to give adequate assurance that changes are captured in a timely manner, and critical information is kept accurate and up-to-date in the royalty information management system.

DII advised that it is implementing an electronic data integration project that would ensure information that supports the collection of royalties is updated electronically. We support such an approach, providing it is implemented effectively. We understand this project is expected to be complete by June 2013.

- Recommendations** To ensure information that supports the collection of coal mining royalties is accurate and current, DII should :
- develop data quality assurance standards and procedures
  - maintain records of annual data validation reviews
  - implement the electronic data integration project by June 2013.

### **3 Has DII made it easy for mining companies to determine what they need to pay and when?**

**Conclusion**

The rules on when to pay are clear. However, the rules for calculating coal mining royalties are complex. DII has not made it easy enough for coal mining lease holders to work out what they owe. DII does not provide comprehensive guidance on the specific rules for coal mining royalties to lease holders, and relies too much on individual staff to clarify the rules. As a result, there is little assurance that the rules have been applied properly and consistently, and that all companies have met their obligations.

The calculation of royalties is based on 'self-assessment'. The lease holders are required to calculate the royalties due, and lodge monthly returns. They are also required to submit an annual return by 31 July so they can make adjustments for any overpayment or underpayment made in the previous 12 months.

Payment of monthly royalties by coal mining lease holders gives the State a steady cash flow, and DII an early warning of the risk of bad debts.

From 1 July 2004, the NSW Government abolished the volume-based flat rate royalties for coal (\$1.70 per tonne of coal) and replaced it with an ad valorem (value-based) regime where royalty is charged as a percentage of the value of coal production (total revenue less allowable deductions).

Three royalty rates apply depending on the mining method:

- 6.2 per cent for deep underground mines
- 7.2 per cent for underground mines
- 8.2 per cent for open cut mines.

NSW is the only State in Australia that has three rates applying to different types of mines, which can be complex to administer. Appendix 3 outlines the coal royalty regimes in other Australian jurisdictions.

The rules and three different royalty rates can also be complex to apply to different operational mining settings.

As a result, mining lease holders need help to apply the appropriate rules to their particular circumstances.

However, DII does not have comprehensive compliance guidelines on the specific rules for coal mining royalties. Information currently available to lease holders and staff is fragmented, and out-of-date.

There is too much reliance placed on individual DII staff to clarify the rules for coal mining lease holders. There is no system to ensure the advice provided by these staff is both accurate and consistent, such as a database of advice/precedents, and guidelines.

Examples of areas where more specific guidance would be helpful to both coal mining lease holders and staff, include:

- specifying which foreign currencies conversion rates lease holders can use for export coal; this is not specified at present
- defining what constitutes a simple coal wash as opposed to a full coal wash, as this affects what is claimed as allowable deductions
- clarifying how coal loans, borrowings, and swaps between lease holders should be accounted for
- determining an arm's length value for coal sales to a related company.

More guidance would also be useful when the rules change. DII advised that more errors are found in royalty returns when changes to the coal royalty regime occur. For example, in January 2009, the NSW Government increased the three coal royalty rates by 1.2 per cent and reduced the allowable deductions that can be claimed, e.g. the cost of coal transportation was generally no longer accepted as a deduction.

Introducing changes in the middle of a financial year added to the complexity of calculating royalties, as different rules applied to the two halves of the year, e.g. the treatment of coal stockpiles extracted before and after January 2009.

#### Exhibit 5 : Practices in Queensland

Queensland provides comprehensive guidance on the rules for coal with detailed examples of how the royalty is calculated, for both domestic and export coal. The guidelines are updated as necessary to reflect changes in the rules and lessons learnt from mining lease holders' feedback and audits.

Source: Audit Office research

DII advised that coal guidelines are being developed and will be published shortly on their website.

**Recommendation** To help mining lease holders comply with the rules, DII should develop comprehensive compliance guidance for coal royalties.

#### 4 Does DII make sure that royalty returns come in on time, and check their accuracy and validity?

##### Conclusion

DII identifies late royalty payments, and promptly follows up with lease holders. However, DII cannot assess from the royalty returns, which are self-assessed by lease holders, whether the royalty being paid is likely to be correct. Unlike in some other jurisdictions, NSW coal mining lease holders do not have to provide supporting evidence or independent verification of the amount paid. As a result, in-depth audits by DII are the sole mechanism to determine the validity of royalty payments. Also, DII relies on a manual royalty return system which is highly inefficient.

DII identifies late payments through reconciliation of returns and payments. If the royalty is a day or more late, interest is charged. DII alerts late payers promptly.

DII can only identify mathematical errors in returns. Unlike in some other jurisdictions, coal mining lease holders are not required to provide supporting evidence with their returns, or independent verification of the amount paid. So DII is unable to perform a desk-top check of the validity of royalty estimates.

As a result, audits are the sole reliable mechanism to determine if the correct amount was paid.

Also, the method by which coal mining lease holders provide information to DII is not efficient or user friendly. Lease holders have to fill out royalty returns manually and lodge them with DII via email, fax or mail. Returns include the quantity and value of sales, production volumes, and allowable expenses for the month associated with each active lease.

DII staff transpose data manually from these returns into the royalty database, and match details of returns to leases. In this day and age, we expected to find a streamlined, electronic data exchange system which is easy for lease holders to use and eliminates data entry duplication. The absence of such a system has diverted resources from auditing to the low-value task of retyping data from a piece of paper into the database.



Exhibit 6: Practices in other Australian jurisdictions
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<p>Although, the Northern Territory and Western Australia do not have significant coal industries, we consider the following aspects of royalty administration as good practices.</p>
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<p><b>Northern Territory</b></p>
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<p>Upon lodgement of a royalty return, the information contained in the return is reviewed against various risk indicators. Where the risk is considered to be significant, the royalty payer is requested to provide further verification or an audit is undertaken.</p>
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<p><b>Western Australia</b></p>
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<p>Royalty return lodgement can be made either by mail, fax, and e-mail or via the 'Royalty Online' system which enables direct data entry by the client.</p>
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<p><b>Queensland</b></p>
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<p>It has dedicated staff managing returns and not an auditor.</p>
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Source: Audit Office research

We are pleased to learn that DII is implementing a project to provide online access for coal mining lease holders to replace the current manual returns. This project is expected to be complete by June 2013.

- Recommendations** To improve the accuracy of returns and the efficiency of the royalty return system, DII should:
- require coal mining lease holders to provide supporting evidence with their annual returns
  - require coal mining lease holders to undertake an independent limited assurance audit of annual returns
  - implement an online royalty return system by June 2013.

## 5 Are DII's audits done well, and does DII do enough of them?

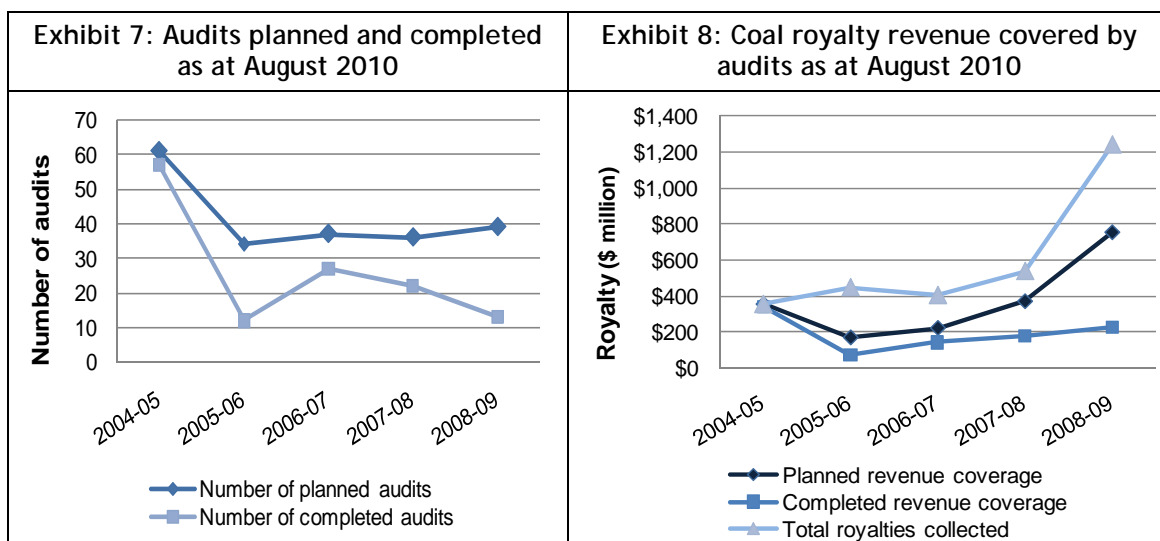
**Conclusion**

<p>Audits are virtually the only means DII has to ensure that mining lease holders pay what they owe. DII is not auditing well enough, and is not doing enough audits. DII has not developed and documented audit procedures, practices vary between auditors, and there is no effective quality assurance process. Audits take too long, do not cover every royalty year for each client, and are not well targeted. DII's policy is to audit all coal mining lease holders at least every two years, but this is not happening. This has a real implication. DII's audits led to the recovery of \$3.9 million additional royalties over five years, but a more robust auditing regime could have recovered more. We estimate the potential revenue leakage in this five-year period to be at least \$8 million.</p>
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DII collects royalties for coal and other minerals from over 300 mining lease holders. Coal mining lease holders pay about 95 per cent of the mineral royalties collected in NSW but represent only about 20 per cent of DII's mining lease holders.

DII's policy is to audit all coal mining lease holders at least every two years. This is not happening. Between 2005-06 and 2009-10, DII completed on average two thirds of the number of planned audits, and one in every five lease holders was not audited every second year. DII planned to do 39 audits during 2009-10, but as at August 2010 had only completed 13 audits, or a third.

DII has since advised that it has completed another seven audits in September and expects to complete the rest of the 2009-10 audit program by 30 November 2010.



Source: NSW Department of Industry and Investment

Source: NSW Department of Industry and Investment

For the last three years, DII had only three auditors. Two auditors' positions have been vacant for at least three years. DII advised that this is due to the Government staff freeze.

If staffing is to remain at the current level, DII may need to target its resources better. Rather than continuing to try and audit every client every two years, which has proven unachievable, it may need to adopt a risk-based approach where coal mining lease holders that make lower payments and have a good track record are audited less.

We also identified opportunities to improve how the audits are done.

We found there were no documented audit procedures, and significant variations between auditors in the level and quality of audit documentation.

This made it difficult to assess whether all necessary records provided by coal mining lease holders were examined, which records supported the audit findings, and whether findings informed the audit program. We also noted that the majority of audits focused on the assessment of one royalty year only, meaning other years since the last audit remained unaudited.

DII advised that it has already commenced drafting audit procedures.

We also found:

- audits take too long to finish, with some taking over three years
- an audit for the same client can start before the previous audit is completed
- no structured approach to monitoring the progress of audits
- no assessment or reporting on the quality, findings and effectiveness of audits
- no documented policy for staff rotation across mining lease holders.

Exhibit 9: Practices in Queensland
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<p>Queensland has 44 individual coal mining operations, some consisting of both open cut and underground operations. In terms of audits, Queensland anticipates to visit 25 locations over a period of two years and to finalise audits within six months. Each audit generally examines all royalties paid in all previous unaudited years. This means they potentially cover 100 per cent of revenue paid by each audited client. In contrast, NSW DII's audits covered on average a third of the royalties collected.</p>
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Source: Audit Office research

Delays in finalising audits may delay the recovery of any identified outstanding royalty. Also, poor implementation of the audit program raises the risk of potential revenue leakages remaining unidentified.

DII's audits recovered a net \$3.9 million in royalty underpayments from 2004-05 to 2008-09, representing a recovery rate of 0.13 per cent. DII advised that this amount represents only what has been recovered, but more was identified and is still to be recovered. DII could not give us an estimate of this amount.

#### Revenue leakage estimates

We are in no doubt that if DII did more higher quality audits, more revenue would have been raised. It is difficult to say exactly how much more, but our best estimate is that revenue leakage has been at least \$8 million over the period 2004-05 to 2008-09.

Over this five year period, DII's audits have covered around one third of the royalties collected, and have identified and subsequently collected an additional \$3.9 million. If the audits had covered all the royalties collected in that period, DII could have raised over \$8 million extra revenue.

Our assessment of DII's performance strongly suggests that an option which should be considered is the transfer of minerals royalty collection to the Office of State Revenue which specialises in the collection of State taxes. This would also achieve a desirable separation between DII's roles as both regulator of the mining industry, and facilitator of increased investment in the industry. It is also consistent with the practice in the Northern Territory where the Territory Revenue Office administers the mining royalties, and not the Department of Resources.

- Recommendations** To ensure a more structured approach and effective audits, DII should:
- develop a risk-based audit program to better target audit resources
  - for each audit undertaken, extend the scope from the current one year's royalties to all years since the previous audit
  - develop audit procedures and train staff
  - monitor and report on audit progress and findings, and the effectiveness of its compliance activities
  - develop a staff rotation policy to better manage the perception of independence.

NSW Treasury, in consultation with DII and the Department of Premier and Cabinet, should undertake a detailed review of the merits of transferring the administration of royalties to the Office of State Revenue by June 2011.

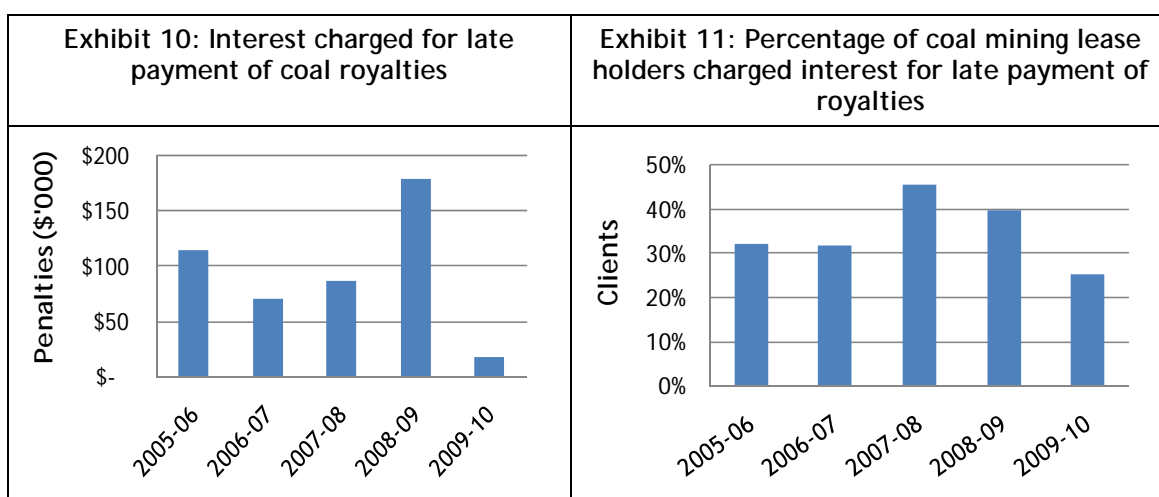
## 6 Does DII take appropriate action where payments are late or wrong?

### Conclusion

DII penalises late payments of royalties but not incorrect payments. Penalties for late payments are not a strong enough deterrent. Over the last five financial years, DII collected about \$470,000 in interest charged for late payments, and over a third of coal mining lease holders paid late at least once a year. There is no escalation of penalties for persistently late payers. No penalty applies for underpayments, if a payment was made on time. Penalties need to cover incorrect returns, and be escalated for repeat offenders.

Between 2005-06 and 2009-10, on average 95 per cent of returns were submitted on time. However, DII collected around \$470,000 from penalties on late returns, and on average:

- more than one in three coal mining lease holders was charged interest for late payment at least once a year
- 15 per cent of coal mining lease holders paid late at least twice a year
- five coal mining lease holders made late payments consistently for five years
- 20 per cent of coal mining lease holders contributed 80 per cent of the interest collected.



Source: NSW Department of Industry and Investment

Source: NSW Department of Industry and Investment

This suggests that current penalties for late payments of royalties may not be a strong enough deterrent for non-compliance. As a matter of principle, the penalty for repeat offenders should be escalated.

Our evidence also shows that there is no incentive to pay the correct royalty. Currently, no penalty applies to underpayments identified either through audits or adjustments made by coal mining lease holders in annual returns. This suggests there is scope for a broader application of penalties.

Over \$17 million of underpaid royalties was recovered through audits and adjustments, but to which no penalty applied, as the following Exhibit shows.

Exhibit 12: Royalties identified and recovered through audits and annual adjustments between 2004-05 and 2008-09 (\$million)			
	Audits	Annual adjustments	Total
Overpayments	-\$5.3	-\$10.4	-\$15.8
Underpayments	\$9.2	\$8.1	\$17.3
Total	\$3.9	-\$2.3	\$1.5

Source: NSW Department of Industry and Investment

While there may be legitimate business reasons for these underpayments, they should not exceed a certain percentage of the total annual royalties paid by a client to discourage any potential abuse of the system.

As recommended in section four of this report, requiring coal mining lease holders to undertake an independent limited assurance audit of their annual royalty returns before they are submitted is likely to improve the level of accuracy and minimise adjustments. Also, penalising significant upward adjustments in annual returns or underpayments identified through audits would likely improve compliance.

- Recommendations** To improve compliance, DII should:
- penalise underpayments of royalties identified in audits and annual returns exceeding a certain percentage (e.g. two per cent) of royalties owed for the year
  - escalate penalties for consistent late payments of royalties.

## Appendices

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## Appendix 1 About the audit

<b>Audit objective</b>	This audit examined how well the Department of Industry and Investment (DII) ensures mining lease holders pay the royalties they owe the State on time.
<b>Audit criteria</b>	<p>We used the following audit criteria (the 'what should be') to judge performance:</p> <ul style="list-style-type: none"><li>▪ DII has complete, accurate, and up-to-date information on leases</li><li>▪ DII has clear rules for calculating and collecting royalties</li><li>▪ DII identifies late and inaccurate royalty returns</li><li>▪ DII undertakes comprehensive quality audits to validate royalty payments</li><li>▪ DII acts on late and inaccurate returns.</li></ul> <p>We based these standards on our research of current thinking and guidance on better practice. They have been discussed, and wherever possible, agreed with those we are auditing.</p>
<b>Audit scope</b>	<p>The audit focused on:</p> <ul style="list-style-type: none"><li>▪ royalties collected from coal extracted from Crown land</li><li>▪ returns checked and audits conducted</li><li>▪ use of penalties</li><li>▪ performance over the last five financial years.</li></ul> <p>The audit excluded:</p> <ul style="list-style-type: none"><li>▪ non-coal royalties which constitute only 5 per cent of all royalties</li><li>▪ granting of exploration and mining leases, and revenue generated from such activities</li><li>▪ disbursement of royalties to private mineral owners</li><li>▪ auditing returns prepared and submitted by lease holders.</li></ul>
<b>Audit approach</b>	<p>The audit team acquired subject matter expertise by:</p> <ul style="list-style-type: none"><li>▪ interviewing and examining relevant documents, including guidelines, reports, case files, strategies, and reviews relating to the administration of coal mining royalties</li><li>▪ discussion with relevant DII staff</li><li>▪ discussion with representatives of key stakeholders, including the NSW Minerals Council.</li></ul> <p>We also examined the administration of royalties in other jurisdictions.</p>
<b>Audit selection</b>	We use a strategic approach to selecting performance audits, which balances our performance audit program to reflect issues of interest to Parliament and the community. Details of our approach to selecting topics and our forward program are available on our website.
<b>Audit methodology</b>	Our performance audit methodology is designed to satisfy Australian Standard on Assurance Engagements ASAE 3500 on performance engagements, and to reflect current thinking on performance auditing practices.



Audits are produced under the Office's quality control policies and practices, including a quality management system certified to International Standard ISO 9001. Our processes have also been designed to comply with the *Public Finance and Audit Act 1983*.

**Acknowledgement** We gratefully acknowledge the co-operation and assistance provided by the NSW Department of Industry and Investment.

**Audit team** Our team leader for this performance audit was Henriette Zeitoun, who was assisted by Bettina Ocias. Giulia Vitetta provided direction and quality assurance.

**Audit cost** Including staff costs, printing costs, and overheads, the estimated cost of the audit is \$183,000.

**Appendix 2      Top ten minerals' contribution to royalties in 2008-09**

Mineral	Royalty revenue (million)	Percent of total royalty revenue
Coal	\$1,227.0	95.86%
Gold	\$23.5	1.84%
Copper	\$17.8	1.39%
Lead	\$2.9	0.23%
Zinc	\$2.2	0.17%
Limestone	\$1.7	0.13%
Zircon	\$1.3	0.10%
Rutile	\$1.3	0.10%
Silver	\$0.7	0.06%
Iron minerals	\$0.4	0.03%
Others	\$1.2	0.09%
<b>Total</b>	<b>\$1,280.0</b>	<b>100.00%</b>

Source: NSW Department of Industry and Investment

**Appendix 3 Coal royalty regimes in Australia**

	NSW	Qld	NT*	WA	SA	Vic	Tas
Total mineral royalties (2008-09)	\$1,280 million	\$3,342 million	\$203 million	\$3,200 million	\$85 million	\$46 million	\$28 million
Coal royalties (2008-09)	\$1,227 million	\$3,102 million	\$0	Not available	Not available	Not available	Not available
Royalty type	Ad valorem	Ad valorem	Profit-based	<ul style="list-style-type: none"> <li>▪ Ad valorem (export)</li> <li>▪ Quantum (domestic)</li> </ul>	Ad valorem	Ad valorem	Profit-based
Royalty rate	<ul style="list-style-type: none"> <li>▪ 6.2% deep underground</li> <li>▪ 7.2% underground</li> <li>▪ 8.2% open cut</li> </ul>	7% for coal up to \$100 per tonne and 10% of the value thereafter	20%	<ul style="list-style-type: none"> <li>▪ 7.5% (export)</li> <li>▪ \$2.50 per tonne adjusted annually (domestic)</li> </ul>	<ul style="list-style-type: none"> <li>▪ 5%</li> <li>▪ 2% for 5 years of a new mine (royalty derived on a cent per gigajoule basis indexed by the consumer price index)</li> </ul>	\$0.0663 per gigajoule of energy multiplied by the consumer price index	1.6% of net sales plus a profit component to a maximum total royalty of 5% of net sales
Self- assessment	✓	✓	x Royalty returns are to be assessed by the Mineral Secretary	✓	✓	✓	✓
Frequency of returns	Monthly	Quarterly	Six-monthly	Monthly	Six-monthly	Annually	Quarterly
Supporting evidence required with returns	x	x	✓	x	x	x	✓

	NSW	Qld	NT*	WA	SA	Vic	Tas
Frequency of audits by government agency	At least every two years	At least every three years	Risk-based	For royalties <ul style="list-style-type: none"> <li>▪ over \$100,000, at least yearly</li> <li>▪ between \$30,000 and \$100,000, every two years</li> <li>▪ below \$30,000, every three years</li> </ul>	Annually	Annually	Every two years
Audit coverage	Generally one royalty year	Generally all royalty years		All royalty years	All royalty years	All royalty years	Not always all royalty years
Number of royalty auditors	4**	1.5	Generally between 2 to 3	9	Subcontracted on a need basis	3 to 5	1
Independent audits required	x	x	✓	x	x	x	✓
Agency administering royalties	Department of Industry and Investment	Department of Employment, Economic Development and Innovation	Territory Revenue Office	Department of Mines and Petroleum	Primary Industries and Resources South Australia	Department of Primary Industries	Department of Infrastructure, Energy and Resources

Source: Audit Office research

Notes: \* Northern Territory currently does not have any coal mines.

\*\* DII advised that this is equivalent to two full-time staff.

Ad valorem - percentage of value of minerals extracted.

Quantum - flat rate per tonne of coal extracted.

## Performance Audits by the Audit Office of New South Wales

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## Performance Auditing

### What are performance audits?

Performance audits determine whether an agency is carrying out its activities effectively, and doing so economically and efficiently and in compliance with all relevant laws.

The activities examined by a performance audit may include a government program, all or part of a government agency or consider particular issues which affect the whole public sector. They cannot question the merits of Government policy objectives.

The Auditor-General's mandate to undertake performance audits is set out in the *Public Finance and Audit Act 1983*.

### Why do we conduct performance audits?

Performance audits provide independent assurance to Parliament and the public that government funds are being spent efficiently, economically or effectively and in accordance with the law.

Through their recommendations, performance audits seek to improve the efficiency and effectiveness of government agencies so that the community receives value for money from government services.

Performance audits also focus on assisting accountability processes by holding managers to account for agency performance.

Performance audits are selected at the discretion of the Auditor-General who seeks input from Parliamentarians, the public, agencies and Audit Office research.

### What happens during the phases of a performance audit?

Performance audits have three key phases: planning, fieldwork and report writing. They can take up to nine months to complete, depending on the audit's scope.

During the planning phase the audit team develops an understanding of agency activities and defines the objective and scope of the audit.

The planning phase also identifies the audit criteria. These are standards of performance against which the agency or program activities are assessed. Criteria may be based on best practice, government targets, benchmarks or published guidelines.

At the completion of fieldwork the audit team meets with agency management to discuss all significant matters arising out of the audit. Following this, a draft performance audit report is prepared.

The audit team then meets with agency management to check that facts presented in the draft report are accurate and that recommendations are practical and appropriate.

A final report is then provided to the CEO for comment. The relevant Minister and the Treasurer are also provided with a copy of the final report. The report tabled in Parliament includes a response from the CEO on the report's conclusion and recommendations. In multiple agency performance audits there may be responses from more than one agency or from a nominated coordinating agency.

### Do we check to see if recommendations have been implemented?

Following the tabling of the report in Parliament, agencies are requested to advise the Audit Office on action taken, or proposed, against each of the report's recommendations. It is usual for agency audit committees to monitor progress with the implementation of recommendations.

In addition, it is the practice of Parliament's Public Accounts Committee (PAC) to conduct reviews or hold inquiries into matters raised in performance audit reports. The reviews and inquiries are usually held 12 months after the report is tabled. These reports are available on the Parliamentary website.

### Who audits the auditors?

Our performance audits are subject to internal and external quality reviews against relevant Australian and international standards.

Internal quality control review of each audit ensures compliance with Australian assurance standards. Periodic review by other Audit Offices tests our activities against best practice. We are also subject to independent audits of our quality management system to maintain certification under ISO 9001.

The PAC is also responsible for overseeing the performance of the Audit Office and conducts a review of our operations every three years. The review's report is tabled in Parliament and available on its website.

### Who pays for performance audits?

No fee is charged for performance audits. Our performance audit services are funded by the NSW Parliament.

### Further information and copies of reports

For further information, including copies of performance audit reports and a list of audits currently in-progress, please see our website [www.audit.nsw.gov.au](http://www.audit.nsw.gov.au) or contact us on 9275 7100.

## Performance Audit Reports

No	Agency or Issues Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
208	Department of Industry and Investment NSW Treasury	<i>Coal Mining Royalties</i>	November 2010
207	Whole of Government electronic information security	<i>Electronic Information Security</i>	20 October 2010
206	NSW Health NSW Ambulance Service	<i>Helicopter Emergency Medical Service Contract</i>	22 September 2010
205	Department of Environment, Climate Change and Water	<i>Protecting the Environment: Pollution Incidents</i>	15 September 2010
204	Corrective Services NSW	<i>Home Detention</i>	8 September 2010
203	Australian Museum	<i>Knowing the Collections</i>	1 September 2010
202	Industry & Investment NSW Homebush Motor Racing Authority Events NSW	<i>Government Investment in V8 Supercar Races at Sydney Olympic Park</i>	23 June 2010
201	Department of Premier and Cabinet	<i>Severance Payments to Special Temporary Employees</i>	16 June 2010
200	Department of Human Services - Ageing, Disability and Home Care	<i>Access to Overnight Centre-Based Disability Respite</i>	5 May 2010
199	Department of Premier and Cabinet NSW Treasury WorkCover NSW	<i>Injury Management in the NSW Public Sector</i>	31 March 2010
198	NSW Transport and Infrastructure	<i>Improving the Performance of Metropolitan Bus Services</i>	10 March 2010
197	Roads and Traffic Authority of NSW	<i>Improving Road Safety: School Zones</i>	25 February 2010
196	NSW Commission for Children and Young People	<i>Working with Children Check</i>	24 February 2010
195	NSW Police Force NSW Department of Health	<i>Managing Forensic Analysis - Fingerprints and DNA</i>	10 February 2010
194	Department of Premier and Cabinet Department of Services, Technology and Administration NSW Treasury	<i>Government Advertising</i>	10 December 2009
193	Roads and Traffic Authority of NSW	<i>Handback of the M4 Tollway</i>	27 October 2009
192	Department of Services, Technology and Administration	<i>Government Licensing Project</i>	7 October 2009
191	Land and Property Management Authority Maritime Authority of NSW	<i>Administering Domestic Waterfront Tenancies</i>	23 September 2009
190	Department of Environment, Climate Change and Water NSW Environmental Trust	<i>Environmental Grants Administration</i>	26 August 2009
189	NSW Attorney General's Department NSW Department of Health NSW Police Force	<i>Helping Aboriginal Defendants through MERIT</i>	5 August 2009

No	Agency or Issues Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
188	NSW Department of Health	<i>Tackling Cancer with Radiotherapy</i>	23 June 2009
187	Roads and Traffic Authority of NSW	<i>Improving Road Safety - Heavy Vehicles</i>	13 May 2009
186	Grants	<i>Grants Administration</i>	6 May 2009
185	Forests NSW	<i>Sustaining Native Forest Operations</i>	29 April 2009
184	NSW Police Force	<i>Managing Injured Police</i>	10 December 2008
183	Department of Education and Training	<i>Improving Literacy and Numeracy in NSW Public Schools</i>	22 October 2008
182	Department of Health	<i>Delivering Health Care out of Hospitals</i>	24 September 2008
181	Department of Environment and Climate Change	<i>Recycling and Reuse of Waste in the NSW Public Sector</i>	11 June 2008
180	Follow-up of 2003 Performance Audit	<i>Protecting Our Rivers</i>	21 May 2008
179	NSW Office of Liquor, Gaming and Racing; NSW Police Force	<i>Working with Hotels and Clubs to reduce alcohol-related crime</i>	23 April 2008
178	Greyhound and Harness Racing Regulatory Authority	<i>Managing the Amalgamation of the Greyhound and Harness Racing Regulatory Authority</i>	3 April 2008
177	Office of the Director of Public Prosecutions	<i>Efficiency of the Office of the Director of Public Prosecutions</i>	26 March 2008
176*	Better Practice Guide	<i>Implementing Successful Amalgamations</i>	5 March 2008
175	Department of Commerce Department of Primary Industries	<i>Managing Departmental Amalgamations</i>	5 March 2008
174	Department of Education and Training	<i>Ageing workforce - Teachers</i>	13 February 2008
173	NSW Police Force	<i>Police Rostering</i>	5 December 2007
172	Department of Primary Industries	<i>Improving Efficiency of Irrigation Water Use on Farms</i>	21 November 2007
171	Department of Premier and Cabinet Department of Commerce	<i>Government Advertising</i>	29 August 2007
170	RailCorp	<i>Signal Failures on the Metropolitan Rail Network</i>	15 August 2007
169	NSW Police Force	<i>Dealing with Household Burglaries</i>	27 June 2007
168	Ministry of Transport	<i>Connecting with Public Transport</i>	6 June 2007

\* Better Practice Guides

#### Performance audits on our website

A list of performance audits tabled or published since March 1997, as well as those currently in progress, can be found on our website [www.audit.nsw.gov.au](http://www.audit.nsw.gov.au).

If you have any problems accessing these reports, or are seeking older reports, please contact our Office Services Manager on (02) 9275 7116.