

STATEMENT OF REASONS

Electricity Industry Performance Code - Independent Compliance Audit Guidelines

The Commission has published Independent Compliance Audit Guidelines (Guidelines) in accordance with section 7 of the *Utilities Commission Act 2000* and clause 1.5 of Electricity Industry Performance Code (EIP Code).

Background

Under the EIP Code, electricity entities are required to submit to the Commission a report on their actual performance in the financial year against the performance indicators set out in the EIP Code (generators and retailers must submit their report by 31 August and network entities must submit their report by 31 October).

Clause 6.1.1(a) of the EIP Code requires an electricity entity to periodically collect and maintain data (in connection with the target standards, performance indicators or reporting requirements) as is reasonably sufficient for the purpose of complying with its obligations under the EIP Code, and enabling the Commission to perform its functions under the EIP Code.

To ensure compliance with clause 6.1.1(a), clause 6.2 of the EIP Code places an obligation on electricity entities to undertake an independent audit at least once every three years for each performance indicator that the electricity entity is required to report against.

The intent of the Guidelines is to assist electricity entities meeting their obligations under clause 6.2 of the EIP Code.

Consideration of Submissions

On 16 June 2020, the Commission published draft Guidelines, inviting feedback from all electricity supply industry stakeholders. Submissions closed on 28 July 2020, with the Commission receiving four submissions from Energy Developments Limited (EDL), Jacana Energy (Jacana), Territory Generation (TGen) and Power and Water Corporation (PWC). The submissions are available on the Commission's website.

In general, all of the stakeholders that provided submissions were supportive of the draft Guidelines. The specific issues raised by stakeholders in their submissions were considered by the Commission, and are summarised below:

Clause 2 – Audit Period

Jacana and PWC sought clarification on the due dates for the independent auditor's report to be submitted to the Commission. Draft clauses 2.1.2 and 2.1.3 stipulate a due date, whereas draft clause 3.2.1 referred to "as soon as practical once the independent report is complete". The Commission has amended draft clause 3.2.1 to remove the confusion.

Jacana expressed concern at the ability for retail entities to meet the 30 November deadline for the submission of the independent auditor's report to the Commission. This is due to the limited amount of time between the finalisation and publication of these Guidelines and the deadline, and the requirement to consult with the Commission on the scope of the audit, and the process to appoint an independent auditor.

The Commission acknowledges the timeframe set out in draft clause 2.1.2 is limited for the first independent compliance audit, but does not think this will be an ongoing issue as retailers and generators will know what is expected of them for future audits, and may commence the consultation and engagement processes much earlier in order to meet the 30 November deadline. As a result, the Guidelines have been amended to include a transitional provision extending the due date for the independent audit report for retailers and generators, to 31 January. This applies only to the first independent audit.

PWC has raised a similar concern in regards to clause draft 2.1.3 for network service providers. However, the due date for the independent audit report for network service providers is approximately five months away and therefore, the Commission does not think it is necessary to extend this due date.

Clause 3 – Audit Scope and Reporting

Jacana recommended the Commission provide a standard audit scope (i.e. a template) to promote consistency across similar entities and to ensure no variations are made to the scope once the audit has commenced.

The Commission believes this is unnecessary as draft clauses 3.1.3, 3.1.4 and 3.1.5 of the draft Guidelines already offer direction as to what is expected in the scope. However, the Commission has amended draft clause 3.1.2 to include the requirement for the scope to be approved to provide comfort to electricity entities that the scope will not change once approved by the Commission.

In its submission, PWC raised the concern there is a risk of duplication of effort and cost due to its obligations to audit both the EIP Code and its response the Australian Energy Regulator's (AER) annual Regulatory Information Notice (RIN). PWC states the same information and processes are audited for both the RIN and EIP Code. PWC suggest targeting the EIP Code audit to the areas not audited as part of the RIN response, and using the outcomes of the RIN audit for the EIP Code audit, where there is duplication.

The Commission is comfortable with this approach, as long as PWC provides evidence that the audit for its submission to the AER for the RIN response meets the definition of "independent" in accordance with the Commission's Compliance Framework and Reporting Guidelines. PWC would then submit its scope and choice of auditor to the Commission for consultation for the EIP Code independent compliance audit, demonstrating how its audit for the RIN response meets the relevant clauses of EIP Code, in order for the Commission to accept it in lieu of an additional audit.

PWC sought clarification as to what constitutes the independent auditor's "final" report, as referred to in draft clause 3.2.1. PWC's interpretation is that the report is "final" after

management responses to the draft report have been consolidated, and PWC's Audit and Risk Management Committee endorsement has been provided in line with PWC's governance framework.

The Commission does not accept this interpretation. The auditor must conduct the audit independently and objectively (as per clause 3.65 of the Commission's Compliance Framework and Reporting Guidelines), and the "final" report of the independent auditor is the report that is deemed the "final" report by the independent auditor, and not through PWC's internal processes.

Clause 3.2.2 states that the independent auditor's final report should be accompanied by a signed statement from the Chief Executive Officer (CEO) acknowledging the findings and providing comments in response. Draft clause 3.2.1 has been amended to require the final report to be provided to the Commission within one month following the due date set out in clauses 2.1.2 and 2.1.3 above. This provides the CEO one month to review the independent auditor's final report and prepare a statement for submission to the Commission.

PWC requested clarification on draft clause 3.2.3 and the frequency expectations for it to inform the Commission on its progress to address areas on non-compliance (if found in the audit). PWC requested that updates be provided to the Commission every two months, in line with its current processes. The Commission accepts PWC's suggestion and has amended draft clause 3.2.3.

Clause 4 – Appointing and Independent Auditor

EDL recommended the draft Guidelines should include a requirement for the Commission to provide justification to the electricity entity in the event that it deems an independent auditor unsuitable. The Commission has amended draft clause 4.1.5 to reflect this.

Jacana agrees that internal auditors are insufficiently independent to conduct a compliance audit, however it made the submission that a distinction can be drawn between an audit of the veracity and accuracy of the data reported under clause 6.1 of the Code and a compliance audit.

Whilst the distinction is noted, the Commission believes it would be very difficult, onerous and confusing to try to differentiate the "degrees of independence" necessary for the auditor based on the specific/individual function being carried out. It is the Commission's position that an internal auditor does not meet the definition of "independent" in the Commission's Compliance Framework and Reporting Guidelines as it may have a direct or indirect commercial interest in, or obligation to, the entity it is auditing.

Jacana made the submission that it reserves the right to consult with the Commission on the appointment of an internal auditor to undertake an audit if an independent auditor cannot be engaged and complete the audit by 30 November. As discussed above, the deadline for the initial independent audit has been extended for retailers and generators, which addresses this issue.

The Commission encourages all electricity entities to engage with the Commission as early as possible if there are any concerns with meeting any of its obligations under the regulatory framework, to avoid becoming non-compliant.

Other

EDL requested the Commission consider how an auditor will assess the influence of the volatility of natural resources on the performance indicators as part of the audit scope and development.

As this issue is about the performance indicators in Schedule 2 of the EIP Code (rather than an issue specific to the draft Guidelines), it will be considered as part of the review of the EIP Code, which the Commission will release an Issues Paper on, in September 2020.

Commencement of the Guidelines

In making the Guidelines, the Commission has considered the object of the *Utilities Commission Act 2000* (UC Act) and has had regard to section 6(2) of the UC Act and all matters it is required to consider under the EIP Code.

The Guidelines take effect from the date of publication on the Commission's website.

Lyndon Rowe
Utilities Commissioner
3 September 2020