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Dear Lew,

Compliance Audit Framework for the Electricity Sector

Thank you for the opportunity to comment on the Discussion Paper on Compliance Audit Framework for the Electricity Sector.

When the original structure of compliance management of the South Australian Electricity regulation was released it followed what was then an unusual pattern. The Licence was an enabling document, Codes specified operating and regulatory requirements and Guidelines provided for reporting of issues on a Quarterly and Annual basis. Most of these elements followed from and improved on prior work (mainly in Victoria). The unusual aspect was the requirement for the reports to be signed, certified, by the corporate governance framework, that is, the CEO and an independent director.

Most previous structures in technical and operational regulation required management sign off and external audit. Most infamous among these were issues associated in electricity with the requirement to have external engineers certify Distribution Asset valuations in a number of jurisdictions around the world, and in Australia with a number of failures of external audit based regulation of the Banking system, some of which occurred in the South Australian economy.

It is now becoming apparent that certification of compliance is more rigorously grounded in systems based approaches, as part of organizational compliance management. This approach can most recently be observed in the design of the Financial Services Reform Act requirements.

This approach relies on holistic application of the organisation, in this case Power*direct*, building Regulatory Compliance into other Risk Management systems operating in the organisation. Effectively ESCoSA is then receiving the same assurance about compliance as are the directors of the organisation.

In a design of this type the method and assumptions associated with external audit are in our view of critical to its stability.

Where an agency (or the Directors) have an evidentiary and substantive basis for concern then its is entirely appropriate to request an external review of the item of concern. If the basis of concern is then established, there is a further rationale for external review of the systemic rectification of that concern by the organisation. However, if external audit is imposed without

an evidentiary and substantive basis for concern then that audit ceases to become investigatory and becomes instead the basis of reliance – removing the rationale for the original scheme.

This may be illustrated by example. In NSW the Retail compliance system is contained in the IPART Compliance Manual. We have been informed that between 6 and 12 months after our market entry an external audit will be conducted of our compliance systems, mandated by IPART and paid for by Power*direct*. That is, the audit will be performed irrespective of any evidence as to the non performance of the system. Subsequent compliance certifications by directors will therefore be based from an examination of any factors in a period that would have material impact on the view as reported by the External Auditor that would thereby require notification or re-auditing.

In the alternative, certification for South Australian Compliance is an examination of any factors that would cause the Director to alter their view about levels of compliance that would threaten the certification they are providing, a much higher standard of test.

Power*direct* would be concerned if ESCoSA recommends implementation of Licensee funded Audit, in any circumstances where there is not an evidentiary and substantive basis for concern that can be provided to the Licensee prior to the agreement of the audit scope as proposed in s2.3. It is of course entirely possibly for agreed audit scopes as part of ESCoSA investigation of concerns similar to processes described in s3.3 of the Discussion Paper.

Specific responses to the questions posed in s3 of the paper:-

- Power*direct* does not believe it is necessary for the Commission to create a series of audits of the data provided by the Licensees. We would be concerned at such a retrograde step in the design of compliance reporting in South Australia. We would most certainly resist any approach that suggested Power*direct* should fund such a change.
- s3.2 asserts that the South Australian electricity market is still "embryonic". Power*direct* very strongly resists this assertion. While there is considerable political and vested interest agitation about electricity issues in South Australia, this is more a result of the Political market place than the Electricity one and shares a lack of data with other issues that attract political attention. There is no evidence in levels Ombudsman activity, or other failures of regulation, that would justify increased reporting as envisaged by s3.2 (at p 20.)
- 2 of the 4 examples given in s3.3 were about performance issues in the provision of supply services by a monopoly, and one about potential preservation of the monopoly. All three discuss the evidentiary and substantive basis for the concerns at the heart of the audit. Similarly, an evidentiary and substantive basis for concern was provided for the investigation of the Retail issue. This approach is consistent with the views put by Power*direct* above.

Yours faithfully,

Andrew Bonwick

Andrew Bonwick
Chief Executive Officer