

10 June 2004

Chairperson
Essential Services Commission of South Australia
MAC Building
Level 8, 50 Pirie Street
ADELAIDE SA 5000

Attention: Pat Walsh

Dear Lew,

Discussion paper – Compliance Audit Framework for the Electricity Sector.

ETSA Utilities submits the following comments on the discussion paper.

General

The discussion paper does not, in our view, provide sufficient justification to warrant the changes proposed to the current auditing arrangements. ETSA Utilities has developed a strong audit and compliance framework as regards its legal and regulatory obligations. Quarterly compliance reports are submitted to the Compliance Committee and the results of any regulatory compliance audits undertaken are reported directly to the Audit Committee. Both of these Board sub-committees consist of entirely of non-executive ('independent') directors and proceedings of both Committees are reported to the Board. The Commission has not identified areas where non-compliances have not been reported to the Commission as required under the current framework.

ETSA Utilities considers that the proposed framework of independent audits will be more intrusive and significantly increase the costs associated with the compliance framework, while at the same time not offering any further improvements or benefits beyond those attained under the current arrangements.

Specific

Section 2

The Commission seeks comments on the general approach to compliance auditing, using an independent external auditor, as encompassed in the four steps outlined above. With reference to the appointment of the auditor, the Commission also seeks comments on the appropriateness of a tripartite agreement between the relevant parties (as required by the ESCV Guideline No.9) or any other alternative.

Section 2.3: Conduct Of Compliance Audits (page 10)

- (i) Defining Audit Scope – the proposed approach is not particularly different to that currently undertaken with respect to regulatory compliance audits presently undertaken by ETSA Utilities. The present approach is to meet with the ESCOSA representatives during the development of the Operational Compliance and Audit Plan (OCAP) and ascertain areas of significant regulatory importance. The OCAP is developed concurrently with ETSA Utilities' (internal) Audit Plan for the coming calendar year.

The proposed 'development of the audit scope by the Commission including comments from ETSA Utilities' is considered to be not significantly different to the current approach whereby ETSA Utilities develops the scope with comments being offered by the Commission.

- (ii) Appointment of Auditor – in the ETSA Utilities' context the current approach of compliance audits being conducted through the Internal Audit function of the licensee is considered preferable on the basis that:

- Unlike other electricity industry businesses operating in SA, ETSA Utilities has an in-house manager for its internal audit function (Manager Audit Services).
- Manager Audit Services, who coordinates and manages the compliance audits, reports directly to the Chairman of ETSA Utilities ensuring the independence of assurance work undertaken;
- The outcomes of all compliance audits are reported by Manager Audit Services to the Board Audit Committee;
- The involvement of Manager Audit Services ensures the smooth conduct of reviews within the business. ETSA Utilities' experience is that with this 'internal' representation the contracted audit firms (business or engineering) are able to more successfully and efficiently conduct their assurance work. Additionally, Manager Audit Services is very familiar with the compliance framework of the business and the regulatory obligations applicable.
- Due to the overall volume of work undertaken as part of the ETSA Utilities' Audit Plan, the business is able to contract audit resources on a reduced daily rate than would be otherwise available. The approximate cost of undertaking compliance audits is presently in the vicinity of \$30,000 covering 40 days of commercial and engineering audit work.
- ETSA Utilities has in the past met with ESCOSA representatives prior to audit commencement to ascertain or confirm areas of audit focus.

Should, as per the proposal, ESCOSA prefer a direct contracting approach with an appropriate audit firm – rather than through ETSA Utilities' internal audit function – then ESCOSA should directly contract with the audit firms. It is our view that audit firms should be restricted to those firms who undertake audits in line with professional standards, rather than consulting firms.

ETSA Utilities considers that the Victorian Guideline provides the appropriate direction in regard to the appointment of auditors by providing the following requirements in clause 3.1.1 which is reproduced below:

3.1.1 The audit team must have:

- (a) skill and substantial experience in, and detailed knowledge of, quality assurance, including operational or compliance auditing;*
 - (b) where relevant, skill and substantial experience in, and detailed knowledge of, science or engineering, asset management, information systems and customer service; and*
 - (c) detailed knowledge of the electricity industry.*
- (iii) Conduct of Audit – the ESCOSA proposal is similar to present practice. We have not applied compliance grades in the past, however we would consider the statistical methodology proposed at the time.
- (iv) Reporting the Results of the Audit – also similar to current practice re the report format. The proposed report format and provision of draft to ESCOSA are acceptable to ETSA Utilities.

If ESCoSA wishes to proceed with a more formalised independent audit approach then a tripartite agreement would formalise the current arrangements where the Commission, ETSA Utilities and the Auditor have input into the Audit Scope etc.

For ETSA Utilities to provide an informed comment on the expected work volume and cost increase with the adoption of your proposal it is imperative that the definition of “significant regulatory importance” be defined. ESCoSA provides the following guidance:

In the Commission view, such an approach would lead to a situation where compliance audits are reserved to matters of significant regulatory importance – for example, where significant consumer impact may result from non-compliance and where the Commission has reason to believe that some level of non-compliance may already exist.”

However, the last part of the example indicates that even a very minor breach would become significant and require an independent audit. This would considerably increase the volume of audits and the costs associated with the audits. ETSA Utilities currently would report these minor breaches in accordance with Guideline No.4 and detail actions to remedy but not audit them. Follow-up audits of non-compliance are generally reserved for material breaches.

It is unclear from the paper, the expected volume of audits required under your proposal.

Section 3

The Commission seeks comments on the application of the audit framework outlines in this paper to provide assurance regarding the quality of performance data supplied by the licensees.

General comments: ETSA Utilities has in the past conducted compliance reviews of 'Performance Data Quality Assurance', FRC Compliance, Distribution Code Chapter 3 and reliability performance. Currently we are undertaking compliance regarding ESCOSA Guideline 9 (ring-fencing) and Guideline 11 (Supply charges for multiple connection points).

The Commission seeks comments on the application of the audit framework outlined in section 2 of this paper to FRC regulatory obligations of electricity licensees. Is it necessary at the present time to initiate a program of compliance audits relating to FRC obligations? If so, should the audits, at least in the first instance, be restricted to the indicative list of obligations contained in Table 3 above.

With respect to FRC Auditing; ETSA Utilities commenced reviews of FRC regulatory compliance in mid 2003. A first phase process review was completed in 2003 and reported to the February 2004 Audit Committee meeting. In early 2004 a second phase adherence review was undertaken with respect to a range of key obligations arising from the Distribution Code, Metering Code, Metrology Procedures and Consumer Transfer and Consent Code. It is proposed, in line with the OCAP to revisit these key obligations on a regular cycle.

ETSA Utilities considers that no further audits of its FRC obligation are required in the near future.

The Commission seeks comments on the application of the audit framework outlined in this paper to the regulatory obligations associated with the three examples described above as well as to any other obligations of particular licensees. The Commission stresses again that it intends to use Guideline No.4 compliance reporting approach as the corner stone of its overall compliance framework, and that the use of compliance audits would be restricted to key obligations as determined by means of a risk assessment.

ETSA Utilities has undertaken audits of the areas detailed in the examples above, in some case ESCoSA has undertaken independent audits of these area as well. The audits have found general compliance with the obligations. Currently ESCoSA has the right to undertake independent audit of our compliance with obligations and as highlighted in the examples, has undertaken independent audits.

ETSA Utilities undertakes annual audits of its Safety and Technical Management Plan (STMP) using an external provider. This Plan will be expanded to include maintenance and reliability once the Legislative requirements are established by the Government. The Office of the Technical Regulator also undertakes its own annual audits of our STMP. We consider that any auditing of our obligations should be coordinated to ensure that there is no duplication of auditing between ESCoSA and OTR. This coordination has already been achieved in our performance reporting requirements.

ETSA Utilities annually has an audit of our reported reliability performance for the Performance Incentive scheme undertaken by an external provider. The results of this scheme must be certified by the Chairman of ETSA Utilities.

The Commission's current approach to regulatory reporting and auditing is set out in Guideline No.4. It specifies the Commission's requirements for the reporting of compliance. This approach is aimed at minimising costs and disruptions to licensee, while ensuring that compliance systems exist and operate efficiently and effectively. We consider that the current arrangements are working effectively and efficiently within ETSA Utilities and meeting the requirements of the Commission, and therefore the proposal would appear to be against your stated objective, by increasing the costs and disruption to ETSA Utilities.

Also there appears to be no significant benefit in adopting the proposed approach as this would increase our current costs to expand the audits beyond that currently required by ESCoSA. ETSA Utilities would still undertake its own audits associated with all its obligations as currently. Any concerns that ETSA Utilities has would be incorporated into these audits.

We consider that there needs to be a clear distinction between an audit and a review. An audit determines whether we are complying with specific obligations by using our business practices and processes, whether documented or not. A review generally is required where an external expert is required to express an 'opinion' about whether we are using "best endeavours" or not. Clearly, an opinion on best endeavours requires a significant degree of judgement by the reviewer.

If you have any queries or questions please contact Mr Grant Cox on 8404 5012.

Yours sincerely,



Eric Lindner
General Manager Corporate Affairs
ETSA Utilities