ELECTRICITY COMPLIANCE AUDIT FRAMEWORK

FINAL DECISION

September 2004

ELECTRICITY

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GLOSSARY

AS/NZS4360:1999	Australian and New Zealand Standard on Risk Management, as amended
COMMISSION	Essential Services Commission of South Australia
DISCUSSION PAPER	Refers to the Commission's "Compliance Audit Framework for the Electricity Sector", Discussion Paper, April 2004
ELECTRICITY ACT	*Electricity Act 1996* (SA)
ELECTRICITY INDUSTRY GUIDELINE NO. 4	Refers to the Commission's "Electricity Industry Guideline No. 4: Compliance Systems and Reporting", February 2003
ENERGY INDUSTRY GUIDELINE NO. 4	Refers to the Commission's "Energy Industry Guideline No. 4: Compliance Systems and Reporting", September 2004
ESC ACT	*Essential Services Commission Act 2002* (SA)
ESCV	Essential Services Commission of Victoria
ESCV ELECTRICITY INDUSTRY GUIDELINE NO. 9	Refers to the ESCV's "Electricity Industry Guideline No. 9: Regulatory Audits of Distribution and Retail Businesses" Issue 3, March 2003
FRC	Full Retail Contestability
GAS ACT	*Gas Act 1997* (SA)
MWH	Mega Watt hour
OCAP	Operational and Compliance Audit Plan
OTR	Office of the Technical Regulator
RMR	Retail Market Rules, as defined in the Gas Act
TJ	Terajoule

1 INTRODUCTION

In April 2004, the Commission released a discussion paper entitled "Compliance Audit Framework for the Electricity Sector" (the "discussion paper"). The purpose of this paper was to provide a basis for consulting with stakeholders on the introduction of a compliance audit framework aimed at complementing the existing compliance reporting framework established by the "Electricity Industry Guideline No. 4: Compliance Systems and Reporting"[1] ("Electricity Industry Guideline No. 4"). The paper proposed an approach to the conduct of compliance audits comprising: consideration of the audit scope; appointment of the auditor; conduct of the audit; and reporting of the audit results. It also discussed several possible areas of application of the proposed audit framework.

The Commission received eleven submissions on the issues raised in the discussion paper. In reaching its final position on the matter of the compliance audit framework to be applied to the electricity supply industry, as expressed in the current paper, the Commission has taken into account the views expressed in these submissions.

Stakeholder comments are summarised in section 2 of this paper. The Commission's decision is set out in section 3 of this paper, while section 4 deals with implementation processes for the audit compliance framework. Appendix A consists of an overview of the risk assessment and audit scope of planned compliance audits.

The discussion paper, submissions and this final decision are available from the Commission's website (http://www.escosa.sa.gov.au).

[1] In May 2004, the Commission released a draft "Energy Industry Guideline No. 4: Compliance Systems and Reporting" accompanied by a discussion paper (both documents are available from the Commission's website). This discussion paper developed arguments for the application of the electricity industry compliance framework - established under "Electricity Industry Guideline No. 4: Compliance Systems and Reporting" in June 2000 - to the gas industry. The paper also referred to minor changes to the application of Energy Industry Guideline No. 4 to electricity licensees. Further to a process of public consultation and a final decision by the Commission in August 2004, Energy Industry Guideline No. 4 subsumed Electricity Industry Guideline No. 4. Changes associated with the introduction of the present compliance audit framework will be incorporated in the new Energy Industry Guideline No. 4.


ESSENTIAL SERVICES COMMISSION
OF SOUTH AUSTRALIA

2 SUBMISSIONS RECEIVED

The Commission received eleven submissions on the compliance audit framework for the electricity supply industry. Nine of these were from the following licensees:

- Powerdirect;
- Country Energy;
- NRG Flinders;
- TXU;
- Envestra;
- ETSA Utilities;
- Origin Energy;
- AGL; and
- International Power.

The Consumer Advisory Committee[2] and the Minister for Energy also provided comments.

A brief summary of the key issues raised by these parties is provided below. The Commission's response and final decision are contained in section 3 of this paper.

2.1 Powerdirect

Powerdirect provides an overview on the structure of compliance management of the South Australian electricity regulation and the trend towards certification of compliance that is "more rigorously grounded in system based approaches, as part of organizational compliance management". It comments that the "method and assumptions associated with external audit" are critical to the stability of the present day compliance system based approaches. Powerdirect is supportive of external audits only where there is an "evidentiary and substantive basis for concern". With regard to the proposed audits of performance data, as contemplated in the discussion paper, the submission describes these audits as being "unnecessary" and a "retrograde step in the design of compliance reporting" that will be resisted should Powerdirect be asked to fund such audits. Powerdirect suggests that there is no evidence in "Ombudsman activity, or other failures of regulation, that would justify increased reporting". Finally, it notes that the Commission's approach in relation to the compliance matters mentioned in section 3.3 of the discussion paper (involving ETSA Utilities and AGL) is consistent with their view that

[2] This body is established by the Commission under section 14A of the Electricity Act and section 7 of the Gas Act and has a membership drawn from peak bodies representing a wide range of interests: customers generally; rural and remote customers; recipients of community service obligations; environmental interest groups; local government; and industry and commerce. The organisations currently represented on the Committee are: Business SA; Council on the Ageing (SA) Inc; Conservation Council of SA; Electricity Industry Ombudsman of South Australia; Local Government Association; Property Council of SA; SA Council of Social Services Inc; SA Farmers Federation; Western Region Anti-Poverty Forum.

external audits should be conducted only where there is an “evidentiary and substantive basis for concern”.

2.2 Country Energy

In general, Country Energy agrees with the Commission’s proposed implementation of a more robust approach to compliance auditing that complements the existing compliance reporting framework, and agrees with the four-step approach to the conduct of compliance audits. In discussing this approach, Country Energy makes the following specific comments: (i) in determining the audit scope, it supports the adoption of a risk assessment framework similar to that adopted by Victorian and New South Wales regulators, to be used as a guiding principle to “keep the audit regime cost-effective”; (ii) Country Energy agrees with the involvement of external auditors, but calls for consideration to be given to the financial burden of such audits, especially where there are existing arrangements between the licensee and a third party for the conduct of internal audits; it proposes, as an added discipline, that “the Commission fund, at least in part, any obligation over and above that already undertaken”, and dismisses tripartite agreements unless these are “extended to include some sharing of costs”; (iii) Country Energy “accepts that the conduct of audits must incorporate certain minimum requirements”, viewing the ESCV Electricity Industry Guideline No. 9 as a good example on this aspect; (iv) it supports the proposed arrangements for reporting of audit reports and views them as being consistent with the Commission’s objective to “promote a culture of continuous improvement in regulatory compliance”, in so far as the licensee would be given an opportunity to rectify any non-compliance prior to it exercising enforcement powers.

With regard to the application of this framework to FRC and performance reporting obligations as proposed in the discussion paper, Country Energy “appreciates the need to ensure that policy objectives are being satisfied, especially concerning FRC compliance and the integrity of performance data”. Acknowledging that it is not currently engaged in the marketing or sale of electricity to small customers in South Australia, Country Energy believes that the application of an audit program at this early stage may be of limited benefit, suggesting that Electricity Industry Guideline No. 4 be “given a chance” to operate in regard to performance data and FRC compliance.

2.3 NRG Flinders

NRG Flinders acknowledges the Commission’s “efforts in seeking to bring greater certainty and clarity to the compliance audit process” and seeks confirmation that the proposed compliance audit framework will not impact on the existing compliance reporting and auditing process under Electricity Industry Guideline No. 4. Noting that interstate audit processes focus on the regulatory obligations of retailers and distributors, NRG Flinders suggests that the Commission satisfies itself that the compliance obligations imposed on South Australian licensees are “not more onerous than those applied interstate”, to “ensure that competitive neutrality is not compromised” and to promote consistency across jurisdictions. NRG Flinders agrees that audits should be reserved for

"matters of significant regulatory importance" and argues that "it is not immediately apparent [why] the use of an outsourced internal auditor for specific compliance audits specified by [the Commission] would necessarily be inappropriate from the perspective of independence and diligence in the conduct of the audit" (considering this option "a more economical use of auditing resources"). NRG Flinders notes that, based on the "intent of the 'regulatory bargain'", the Commission's range of areas for potential auditing are primarily related to the obligations of regulated segments of the industry, adding that a "significant case would need to be mounted to extend the scope of the specific audits" beyond these areas. The submission also notes that "there is no case for widespread compliance auditing of FRC obligations at the present time, and that compliance auditing in the area should therefore be carefully targeted at critical obligations where compliance issues have arisen".

2.4 TXU

TXU indicates general support for a compliance audit framework "that is consistent with other jurisdictions, complements the existing compliance reporting framework and minimises disruption or unnecessary costs". It specifically addresses the issue of tripartite agreements by highlighting a degree of uncertainty in the application of the conditions of engagement of auditors set out in the ESCV Electricity Industry Guideline No. 9. TXU expresses a preference for either a "direct agreement between the auditor and the retailer, of which the guideline forms part of the contract" or, should a tripartite agreement also be adopted in South Australia, the inclusion of all mandatory conditions of engagement in such an agreement. TXU also seeks further clarification on what previous audit results would be included in the Commission's risk assessment should a clause similar to 4.2.3[3] of the ESCV Electricity Industry Guideline No. 9 be adopted in South Australia.

2.5 Envestra

Envestra's submission begins by noting that "there are material differences between the importance of gas and electricity in the community" and that "therefore the Commission may approach the framework for electricity and gas differently". It agrees with the use of compliance audits being "restricted to key obligations as determined by means of a risk assessment approach", and suggests that the compliance approach used by the Office of the Technical Regulator ("OTR"), as outlined in the discussion paper, is adequate and appropriate for the gas industry. In relation to tripartite agreements, Envestra comments that it has found the ESCV's approach to be "overly bureaucratic and legalistic". It also suggests that the ESCV's statistical approach to compliance grading "unwarranted" and not cost effective. Envestra believes that the ESCV's measures are not "in keeping with good regulation, whereby step increases in regulatory measures and controls only occur where there is evidence or good reason to believe they are warranted". The submission notes that, while Envestra is not qualified to comment on the adequacy of existing

[3] The clause requires the ESCV to "have regard to the extent to which a licensee's performance of an obligation is already audited under a separate regulatory requirement".

systems or auditing practices in the South Australian electricity sector, due consideration should be given to the "adequacy of current systems before instituting more complex and costly arrangements".

2.6 ETSA Utilities

ETSA Utilities suggests that the discussion paper does not provide "sufficient justification to warrant the proposed changes to the current auditing arrangements", noting that it has already instituted a "strong audit and compliance framework as regards its legal and regulatory compliance obligations". It considers the proposed framework to be intrusive and costly, while not providing any further improvements or benefits beyond those attained under the existing arrangements. With regard to the proposed four-step approach to compliance auditing, ETSA Utilities comments that: (i) the proposed process for defining the audit scope is not particularly different to the process that is already used by ETSA Utilities through its internal audit function; (ii) concerning the appointment of an auditor, use of the internal audit function is preferred since it involves consultation with the Commission but that, in the event that the audit framework require a "direct contracting approach with an appropriate audit firm", the Commission "should directly contract with the audit firms" and restrict the process to auditing firms rather than consulting firms; (iii) in conducting the audit, the Commission's proposal is "similar to present practice" and that, in relation to compliance grades which it has not applied in the past, "it would consider the statistical methodology proposed at the time"; (iv) the Commission's proposed report format is also "similar to current practice" and that its format and provision of draft report to the Commission are acceptable.

ETSA Utilities expresses the view that, if the Commission "wishes to proceed with a more formalised independent audit approach", then a tripartite agreement should be used to formalise all arrangements. ETSA Utilities refers to its cyclical FRC regulatory compliance reviews commenced in mid-2003, and "considers that no further audits of its FRC obligations are required in the near future". It requests the Commission to ensure that there is no duplication in any auditing of ETSA Utilities' obligations, mentioning the OTR's annual audits as an example. Given the efficiency and effectiveness of the current compliance reporting arrangements under Electricity Industry Guideline No. 4, ETSA Utilities reiterates that "there appears to be no significant benefit in adopting the proposed approach" since this would lead to increased compliance costs.

2.7 Origin Energy

Origin Energy is supportive of the Commission's intention to use the existing compliance reporting approach, "with the use of compliance audits restricted to key obligations as determined by a risk assessment approach". It proposes an approach whereby a licensee could "obtain credits towards, or exemptions from, audits" by taking an holistic approach which considers conducted internal regulatory compliance audits and external audits in other jurisdictions as well as "market driven needs". Specific to the Commission's four-step auditing approach, Origin Energy comments that it: (i) supports the view that

"compliance audits should be reserved for matters of significant regulatory importance, which may have significant consumer impact", proposing flexibility in applying "different timeframes[4] and audit scope to different licensees on a need basis'"; (ii) favours the Commission approving external auditors or establishing "a pre-approved shortlist of audit firms" for licensees to choose from, and remuneration to be considered "on a case-by-case basis" without any tripartite agreement, which is seen as "cumbersome and of no benefit"; (iii) "supports the current best practice audit methodology" reflected in the audit framework; (iv) expects "to review and provide comment on a draft audit report" and "strongly opposes the publication of comparison reports", recommending that the distribution of a final report be agreed prior to the commencement of the audit.

With regard to the application of the audit framework, Origin Energy recognises the importance of the Commission being provided with quality performance data, but requests that consideration be given to any internal or independent audit already conducted that validates the licensee's systems. With regard to FRC compliance, Origin Energy suggests that it is "too early for [the Commission] to initiate a regulatory compliance audit" in this area, stating no apparent benefit emerged from an early audit conducted in New South Wales, and "no adverse effect on customers" was found from an audit conducted in Victoria twelve months after FRC commencement. Origin Energy also suggests that, where a customer complaint is specific to a particular licensee, only that licensee should be subjected to compliance audits.

2.8 AGL

AGL states that it "agrees in principle" with the proposed audit framework. Specifically, AGL: (i) comments that, on the process of identifying risks, any submissions received from interested parties "be considered as only one input into the assessment of audit scope"; (ii) supports the adoption of a simpler method of appointing auditors as opposed to the "unnecessarily onerous" tripartite agreement process adopted in Victoria (which has given rise to "liability and indemnity issues between the retailers and the auditors"), and suggests that licensees appoint auditors with the Commission's approval; (iii) indicates that it would welcome "any discussion on sample size formulation and confidence levels", preferring the adoption of a "standard throughout all compliance audits".

In relation to the application of the compliance audit framework, as proposed in the discussion paper, AGL "agrees that the performance information provided by licensees should be accurate and compiled in accordance with the relevant guideline" and would prefer the sampling approach outlined in section 2.3 of the discussion paper for audits in this area. AGL also indicates that it supports the Commission's comments as to the "need for consumer confidence" in FRC, but proposes that audits in this area "be delayed until such time that the FRC initiated changes have been fully established and implemented" by FRC retailers.

[4] The Commission acknowledges that in informal discussions with this licensee on potential FRC-related audits, the last quarter of the year was identified as the most suitable period for regulatory compliance audits due to its business peak periods.

2.9 International Power

International Power indicates that it has “no objection” to the proposed conduct of audits and comments favourably on the retention of the existing compliance report sign-off provisions of Electricity Industry Guideline No. 4.

2.10 Minister for Energy

The Minister advises of the Government’s agreement on the “need to ensure a high level of compliance within the electricity supply industry”, and support for the proposed auditing framework. The submission also indicates that the Government is satisfied with the proposed four-step auditing approach and the “application of the framework to all regulatory obligations, particularly those that have caused concerns for [the Commission], such as submission of inaccurate performance data”. The Minister indicates that the Government is strongly of the view that auditors should be appointed “by either [the Commission] directly or via a tripartite agreement”, due to the concerns with potential conflicts that appointment by the licensee may give rise to.

2.11 Consumer Advisory Committee

At a meeting on 4 May 2004, the Committee discussed and endorsed the proposed introduction of the compliance audit framework as outlined in the discussion paper, also making reference to various concerns that have arisen from marketing practices in the FRC retail market. For this reason the Committee stressed that consideration of the impact on consumers should be a fundamental part of the risk assessment process.

3 FINAL DECISION

The majority of the submissions received (summarised in section 2) are predominantly in support of the Commission's proposed development and introduction of a more structured approach to compliance auditing that complements the existing compliance reporting framework. Several licensees expressed general support for the proposed audit framework, while the Minister for Energy and the Consumer Advisory Committee indicated strong support for application of the framework to specific regulatory obligations, including FRC-related matters.

However, ETSA Utilities argued that there was no justification to warrant changes to the current auditing arrangements used within its organisation, while Powerdirect expressed concern with the instability that may be caused to existing system-based compliance certification processes, should the proposed audit framework be implemented in the absence of any "evidentiary or substantive basis". In its preliminary comments, Envestra urged the Commission to consider the adequacy of current compliance systems before adopting "more complex and costly arrangements", and suggested that differences between the electricity and gas industries suggested the need for a different approach to be adopted for compliance matters.

The existence of audit frameworks similar to that proposed by the Commission, is testimony to the fact that "Investigation and surveillance are key functions of regulatory authorities whether they are financial regulators, occupational health and safety, safe foods or trade practices and consumer protection"[5]. The Commission does not believe that the proposed framework amounts to a significant change to current compliance arrangements. It endorses the view of Powerdirect that the issues that are to be the subject of compliance audits should be substantive and that, in general, some evidence of a breach should exist.

- As detailed in section 2.3 of the discussion paper, Electricity Industry Guideline No. 4 (as subsumed by Energy Guideline No. 4) already envisages the use of audits in three ways, undertaken by either the licensee or the Commission, as do licence conditions derived from the provisions of the Electricity and Gas Acts[6]. The purpose of the compliance audit framework as proposed in the discussion paper is to develop a more structured and robust approach to compliance auditing, thus providing greater clarification and foresight in the conduct of future audits on issues of significant concern.
- In the discussion paper, the Commission acknowledged that, while discussions on the introduction of the proposed auditing framework arguably called for a reconsideration of the manner in which compliance matters are identified and regulatory compliance audits are conducted in South Australia, this did not

5 "Surviving surveillance - managing regulatory investigation and monitoring" seminars, Australian Compliance Institute, 2004.
6 Refer to sections 21 and 25 of the respective Act.

constitute a departure from the basic compliance reporting framework under Electricity Industry Guideline No. 4 (as subsumed by Energy Guideline No. 4).

- In relation to the comment by Envestra about the need to consider differences between the electricity and gas industries in deciding on compliance approaches to be adopted in these industries, the Commission believes that such industry differences will more likely be reflected in the frequency of compliance audits, and in the nature of compliance obligations that are to be audited, rather than in the general framework to be applied to the respective industries. It is the Commission's view that the same general approach to compliance reporting and auditing should be applied to the electricity and gas supply industries in South Australia.

The Commission confirms that it will adopt the compliance auditing framework as proposed in the discussion paper, "Compliance Audit Framework for the Electricity Sector", released in April 2004. This approach to compliance auditing complements the existing compliance reporting framework established by the Commission. However, the Commission will require that a substantive case be made before it authorises specific audits. Electricity Industry Guideline No. 4 (as subsumed by Energy Industry Guideline No. 4), will be modified during 2004/05 to incorporate this approach to compliance auditing.

- Apart from the foregoing comments, the topics raised in the submissions received are covered by the following headings and decisions:

3.1 Identifying matters for auditing

To date, the Commission has identified the need for regulatory compliance audits in a number of ways, including:

- The formal reporting of non-compliance with the licence and Code provisions, through immediate, quarterly or annual compliance reports;
- Informal reporting by, and dialogue with, the licensee on compliance matters;
- Information sharing mechanisms and referrals involving other authorities such as the Energy Industry Ombudsman of South Australia, the Office of the Minister for Energy, and OTR; and
- External sources such as consumer complaints, media reports and commentary.

These sources of compliance information provide the Commission with an insight into those areas that might be subject to audit, particularly if it is apparent that there may be systemic issues of concern or non-compliance with licence and Code obligations among licensees. The revised compliance audit framework is designed to enhance this system via the adoption of a risk-based approach that has received strong support from licensees and the Government.

In determining areas of regulatory concern and having regard to its statutory functions and objectives, the Commission confirms that it will adopt a risk management process that reflects the principles and processes in Australian and New Zealand Standard on Risk Management, AS/NZS4360:1999. This process is summarised in Table 1 below:

Table 1: Steps of the risk management approach embodied in AS/NZS4360:1999

1. *Establishing the context* – for the purposes of the present exercise, the context is the legal and regulatory environment that applies to the South Australian electricity sector as well as the Commission's regulatory functions and objectives;

2. *Identifying the risks* – this is based on a clear understanding of the relevant legislation and other instruments (such as Industry Codes) and an identification of the risks that may arise by considering both empirical data and public context;

3. *Analysing the risks* – requiring a consideration of the consequences, by reference to likelihood and impact, of the regulatory risks that may arise from time to time;

4. *Evaluating the risks* – this is a "screening" process where risks are examined in the context of any acceptable level of regulatory risk tolerance and the attitude of stakeholders towards managing the potential risks identified;

5. *Treating the risks* – a process which involves determining what action to take, having regard to the existing compliance measures in place (i.e. annual reporting under Energy Industry Guideline No. 4) and any action by stakeholders to address the issue of regulatory concern and avoid its reoccurrence.

Notwithstanding this approach, the Commission expects and encourages licensees to conduct their own risk assessments to ensure that they identify, analyse, evaluate and treat all compliance risks applicable to their authorised operations.

In general, the Commission would expect some evidence (e.g. customer complaints) of a breach of a given regulatory obligation before it would contemplate a compliance audit. However, the Commission also acknowledges that the risk assessment process may establish that the consequences and likelihood of a regulatory breach are such as to require regulatory compliance action, in the form of an audit, irrespective of the presence of evidence of a breach.

TXU requested clarification on whether the Commission will adopt provisions similar to those under clause 4.2.3 of the ESCV Electricity Industry Guideline No. 9, requiring the Commission to have regard to the extent to which a licensee's performance of an obligation is already audited under a separate regulatory requirement. In addition, Origin Energy suggested a system of credits towards, or exemptions from, audits based on, *inter alia*, completed internal regulatory compliance audits. ETSA Utilities also requested that use of the internal audit function be considered where possible. In relation to these matters, the Commission notes that:

- It is entirely logical to take account of any separate audits of a particular regulatory obligation before applying the Commission's compliance audit framework to that obligation; and
- Complete reliance by the Commission on past internal audits would be at divergence with the need for external compliance verification and may give rise to valid concerns associated with the issue of independence, from the licensee, of the underlying internal audit function (whether or not that function is outsourced).

Nevertheless, the Commission encourages each licensee to use internal audit functions where possible as an integral part of the licensee's regulatory compliance system. In submitting compliance reports to the Commission pursuant to Energy Industry Guideline No 4, licensees are required to attest to the effectiveness of their compliance systems, and both the licensee and the Commission can have greater confidence about this matter if internal audit has given some assurance regarding compliance system effectiveness.

Origin Energy's suggestion for a system of credits or exemptions is also based on external audits conducted in other jurisdictions. Given the different market characteristics and regulation of each jurisdiction, the Commission believes that it would be difficult to administer a system of credits, or exemptions from, audits on issues of significant regulatory concern arising from South Australian regulation.

Notwithstanding this, the Commission will use its discretion in determining whether or not audits in other jurisdictions should limit, in any way, the definition of its audit scope for any given licensee. In making such a decision, at a minimum, the Commission expects audits in other jurisdictions to:

- Cover subject matter and/or regulatory concerns that are similar (in terms of regulatory operation, impact and consequences) to those considered for auditing by the Commission; and
- To have been conducted under direction of another regulator under similar guidelines to those of the Commission's audit framework; and
- To have been conducted no more than twelve months prior to the Commission's issue of a written statement outlining its audit scope.

With regard to ETSA Utilities' concern of duplication on, for example, safety and technical audits already conducted by the OTR, the Commission notes that it already has in place arrangements to ensure that such overlap does not occur. It is the Commission's preference that the OTR be solely responsible for auditing in areas of safety and technical regulation in both the electricity and gas industries. Should other areas of potential regulation overlap be identified, the Commission will endeavour to minimise any audit duplication that may exist.

3.2 Defining the audit scope

In actioning the proposed compliance audit framework, the Commission confirms that it will dialogue with the relevant licensee(s) regarding the need for, and scope of, compliance audits in a particular area. The aim of this dialogue is to ensure that audits are reserved to those targeted matters as determined by the aforementioned risk-based approach.

The audit scope will be finalised by the Commission by way of a written statement to the licensee(s), after it has considered comments from the licensee(s)[7] and will include a list of obligations to be audited at a minimum, specific compliance issues and timeframes for the audit.

Depending on the nature of the given compliance matter for auditing (including any urgency in addressing it), the Commission will endeavour to adopt flexible timeframes in the conduct of audits to minimise the level of disruption to businesses and to meet market needs. On this point, having participated as an observer to the ESCV's review of its retail audit program held in May 2004, the Commission understands that the electricity retail licence holders present at that feedback and planning session nominated the periods 'March to June' and 'September to November' as being suitable times for the conduct of regulatory compliance audits. Given that no submission specifically dealt with this aspect, the Commission will endeavour to restrict the conduct of audits of retail businesses to the aforementioned periods.

3.3 Appointment of the auditor and remuneration

Submissions on this issue varied, with only two licensees (ETSA Utilities and NRG Flinders) indicating preference for an internal audit function in the conduct of compliance audits proposed under the new framework. In implementing a framework designed to complement, and provide verification for, the existing compliance reporting framework, the Commission notes that the use of an internal audit function (even where this is outsourced) raises significant issues of independence as discussed above. Again, however, the Commission emphasises the important role of the internal audit function in ensuring that an effective compliance system is in place.

The Minister for Energy has indicated that the "Government is strongly of the view that the appointment of an auditor by either the Commission directly or via a tripartite agreement is less likely to raise concerns with potential conflicts of interest than appointment of an auditor by the licensee". Given the impracticalities mentioned by those licensees who have already been exposed to a system of tripartite agreements (as required under the ESCV Electricity Industry Guideline No. 9), the Commission has decided not to adopt a similar system in South Australia. As set out in the April 2004 discussion paper, the Commission will deal with the appointment of auditors through:

[7] And where appropriate, from other stakeholders.

- Appointment by the licensee(s) subject to the Commission's approval; or
- Direct appointment by the Commission[8].

In all instances, due consideration will be given to any actual or perceived conflict of interest that may exist between certain licensees and auditors by requiring both parties to disclose to the Commission any such interest.

ETSA Utilities has called for the appointment of auditors to be restricted to "those firms who undertake audits in line with professional standards, rather than consulting firms". The Commission acknowledges the distinction drawn by ETSA Utilities between consultant reviews and professional audits, and will nominate or approve (as the case may be) the use of audit firms that demonstrate they are suitably capable of conducting regulatory compliance audits.

On the issue of remuneration, the Commission again highlights the fact that, pursuant to clause of 3.1.1.2 of Electricity Industry Guideline No. 4 (as subsumed by Energy Industry Guideline No. 4), a licensee must, if requested by the Commission, pay for the cost of independent, external audits. The Commission does however reconfirm that remuneration will either be dealt with through the Commission or the licensee(s), as determined by the Commission on a case-by-case basis. Broadly speaking, the Commission is of the view that compliance issues involving a particular licensee should result in that licensee alone being responsible for funding an audit, whereas audits in areas such as FRC compliance (refer to annexure A of this paper), which involve a specific sector of the electricity sector and therefore a number of licensees, may result in the Commission initially contributing in part, or fully, to the cost of such compliance audits.

3.4 Conduct of the audit

As indicated in the discussion paper, the intent of the compliance reporting scheme specified in Electricity Industry Guideline No. 4 (as subsumed by Energy Industry Guideline No. 4) is to provide assurance to the Commission that each licensee has in place a compliance system that is effective in itself and that the system is being applied rigorously. This includes effective means of monitoring and dealing with any non-compliances. Where deemed necessary, the proposed regime of compliance auditing will be used to review similar matters, at least in relation to the obligations that are the subject of the audit.

The Commission confirms that, as part of the conduct of an audit, it will require the following minimum requirements to be incorporated into the audit methodology:

- Analysis of documented procedures that provide guidance to staff in complying with the obligation;

[8] In the interest of consistency, the option for direct appointment of a single audit firm by the Commission will be favoured in situations where specific matters (e.g. FRC compliance), involve a specific sector of the electricity supply industry, and therefore a number of licensees.

- Interviewing responsible staff to establish the level of understanding of the documented procedures;
- Analysis of quality controls to identify whether or not non-compliance is detected and reported for correction;
- Analysis of a sample of cases to establish the extent to which the obligations have actually been delivered; and
- Assessment of the licensee's plans to ensure compliance in cases of significant non-compliance.

Consistent with the approach taken by the ESCV under its Electricity Industry Guideline No. 9, the Commission expects that a sample of cases will be reviewed to establish a level of compliance with the particular obligations.

The Commission also confirms its view that an important aspect of the audit is forming a view as to the degree of compliance of the licensee with the regulatory obligations audited. In some cases, it may be possible to assess the degree of compliance with a particular obligation and produce a compliance grading. In others, it may be possible to review compliance issues and produce an appropriate grading.

The Commission confirms that prior to the commencement of an audit, the approach will be reviewed with the auditor and discussed with the licensee. Any dispute that may arise concerning the proposed audit process will be considered and resolved by the Commission.

With regard to the conditions of engagement underpinning the conduct of the audit, the assurance that the audit will be undertaken, and results provided, in the manner required by the Commission will be drawn from the general compliance auditing licence obligations that apply to all licensees as well as the statutory powers invested upon the Commission in the event of a breach of such conditions. The Commission will require that the underlying contract with the auditor provide that:

- The audit is to be conducted in accordance with any requirements of the Commission, as specified by Electricity Industry Guideline No. 4 (as subsumed by Energy Industry Guideline No. 4)[9]; and
- The auditor must provide a draft report of the audit to the licensee for comment and, where the auditor is appointed by the licensee subject to the Commission's approval, the licensee must not unreasonably withhold payment to the auditor or seek to terminate the contract over a disputed audit finding.

The Commission expects that the discussions with the licensees related to defining the audit scope, as well as the briefing session(s) with the appointed auditor prior to the

[9] Or as specified by the Commission directly (pursuant to the relevant compliance audits licence condition) until such time as Energy Industry Guideline No. 4 does not fully incorporate details of the new audit framework.

commencement of an audit, will provide sufficient opportunity to explain and clarify the Commission's expectations about the conduct of the audit and reporting requirements.

In order to minimise additional costs or delays, in the event of a request for the change of a nominated auditor or changes to an audit team, prior to granting its approval, the Commission will require assurance by the new auditor or audit team that the audit will continue to be conducted in a manner that conforms with the audit framework requirements and reflects the previous auditor or audit team's methodology including, whenever possible, its timeframes.

3.5 Reporting the results of the audit

Only two licensees have provided comments specifically related to this final step of the approach to the conduct of compliance audits: Country Energy supported the proposed arrangement, indicating that they were consistent with the Commission's promotion of "a culture of continuous improvement in regulatory compliance". AGL stated that it expected "to review and provide comment on a draft audit report", and it opposed the publication of "comparison reports", requesting that the distribution of the final report by the Commission be agreed with the licensee prior to the commencement of an audit.

The Commission confirms that the reporting arrangements under the framework in question will be based on the following measures:

- The external auditor will prepare a detailed report outlining the scope of the audit, the methodology used in the conduct of the audit, and the degree of compliance identified by the auditor for each regulatory obligation considered in the audit. Such a report will include details of any significant non-compliance identified in the audit and the actions being taken by the licensee to rectify such non-compliances. The report will be accompanied by a statement from the leader of the audit team that provides certification to the Commission regarding these matters.
- The report will be provided as a draft to both the licensee and the Commission for initial comment. Any dispute between the licensee and the auditor concerning an audit finding is to be referred to the Commission for consideration and resolution.
- The auditor will provide a final report to both the Commission and the licensee. The Commission will use its own discretion in determining the publication of any audit report or results noting, however, that freedom of information legislation may, in any event, render this information publicly available[10].
- Once provided with a final report, the Board of the licensee(s) must consider the final report and provide a statement to the Commission regarding action it is taking in relation to any non-compliances identified in the report.

[10] For further clarification on the arrangements relating to the confidentiality of information relied upon by the Commission, refer to clause 1.4 of Electricity Industry Guideline No. 4 (as subsumed by Energy Industry Guideline No. 4).

At a minimum, the Commission will monitor matters arising from compliance audits via the compliance reporting arrangements of Electricity Industry Guideline No. 4 (as subsumed by Energy Industry Guideline No. 4).

3.6 Application of the compliance audit framework

The discussion paper suggested a number of areas that might be the subject of audits using the compliance audit framework as proposed in that paper. These included certain FRC compliance obligations as well as quality of performance data submitted by licensees to the Commission.

The Commission notes that, in general, licensees as well as the Government and the Consumer Advisory Committee gave strong recognition to the need for confidence in FRC compliance and the integrity of performance data submitted to the Commission by licensees.

In response to those submissions that call for consideration to be given to the existing compliance arrangements, the Commission reiterates that the revised audit framework is not intended to replace the existing reporting arrangements under Electricity Industry Guideline No. 4 (as subsumed by Energy Industry Guideline No. 4) nor is it intended to revoke the internal audit functions that certain licensees are using to provide oversight of compliance with their regulatory obligations. The main purpose of this more structured and robust approach, is to provide greater clarification and foresight in the conduct of future audits in areas of significant concern, and also to provide external assurance on the level of compliance in such areas of regulatory concern.

A number of licensees have also expressed the view that audits of FRC compliance at the present time would be premature. On the other hand, the Consumer Advisory Community has voiced concerns with current marketing practices in the electricity supply industry, such concerns being partly consistent with other market information available to the Commission. However, the Commission notes that over eighteen months have elapsed since FRC commencement in the South Australian electricity market, which is a period either consistent with or significantly longer than those elapsed in other jurisdictions, between the time of their respective FRC commencement and conduct of compliance audits. The Commission believes that non-compliance with certain FRC obligations could have potentially serious implications for the affected customers and the developing market.

On the issue of performance data quality assurance, the Commission again notes that notwithstanding the current level of assurance being provided by licensees, the Commission's own reasonableness checks of performance data have frequently revealed errors in that data. The increasing number of electricity retailers now being required to submit performance data has amplified the potential for data errors to corrupt the Commission's assessment of market performance. Furthermore, the Commission's assessment of performance by ETSA Utilities, for example, in relation to reliability of

supply, is highly dependent on the quality of performance data submitted by ETSA Utilities. The importance of audits, proposed in the discussion paper released in April 2004, was acknowledged by other licensees and the Minister for Energy.

Having had regard to its regulatory functions and objectives, as well as the risks associated in both fields, the Commission confirms its intention to conduct compliance audits on performance data quality assurance and FRC compliance during the 2004/2005. Appendix A of this paper provides an overview of the Commission's risk assessment regarding compliance in these two areas, and discusses the possible scope of audits. The Commission will communicate directly with the affected licensees regarding such audits in accordance with the compliance audit framework that has now been adopted by the Commission.

4 NEXT STEPS

The Commission envisages conducting regulatory compliance audits based on the regulatory compliance audit framework, as determined necessary by the Commission in both the electricity and gas sectors.

Appendix A to this paper provides an overview of the Commission's risk assessment for two specific areas of recent concern to the Commission, i.e. quality of performance data reported to the Commission by licensees, and compliance with certain FRC regulatory obligations. The Appendix also discusses the possible scope of audits in these areas. It is expected that independent external audits in these areas, for selected electricity licensees, will commence in the last quarter of 2004. The Commission will liaise with the affected licensees concerning these audits as required by the compliance audit framework. Similar audits may be applied to the gas industry in future, but such application would be the subject of a separate consultation process.

The Commission confirms that it will vary the Energy Industry Guideline No. 4 to incorporate the revised audit compliance framework during the 2004/2005 compliance period[11].

[11] Until such time as the new Energy Industry Guideline No. 4 is varied in such a manner, the Commission will direct licensees to conduct any audits, as required by the Commission, in a manner approved by the Commission, pursuant to the relevant licence condition.


ESSENTIAL SERVICES COMMISSION
OF SOUTH AUSTRALIA

APPENDIX A: OVERVIEW OF RISK ASSESSMENT FOR PROPOSED COMPLIANCE AUDITS

Compliance with FRC Obligations

1.1 Background

Electricity Full Retail Competition (FRC) commenced in South Australia on 1 January 2003. Since that date, small customers (consuming less than 160 MWh per annum) have been able to choose their own retailer. At present, five retailers are marketing and selling electricity to small customers in South Australia, *viz*. AGL, Origin Energy, TXU, Powerdirect and EnergyAustralia. The Electricity Act and Regulations provide an overarching regulatory framework to govern the operations of electricity retailers in their dealings with small customers. In particular, AGL is established as the retailer with the obligation to sell electricity to any small customer under so-called standing contract obligations, the terms of which are approved by the Commission. All five retailers are offering market contracts to small customers with prices that, in general, undercut the standing contract price.

The Commission has put in place a significant regulatory regime to seek to protect the interests of small customers in the new competitive environment. In establishing this regime, the Commission has sought to balance the need to promote competition, which suggests a light-handed approach to regulation, against the need to ensure that customers are adequately protected. A key aspect of the Commission's approach in this area has been the establishment of Energy Marketing, Customer Transfer and Consent, and Retail Codes, with which licensees are required to comply as a licence condition. These Codes govern certain aspects of the marketing conduct of retailers, the means by which customers consent to enter into market contracts, and the means by which customers are to be protected once the contract has commenced.

1.2 Overview of risk assessment and audit arrangements

In the broadest sense, an audit program of FRC obligations is intended to ensure compliance by relevant licensees with the regulatory regime and in turn assure the Commission and the wider community that small customers are receiving appropriate consumer protection as is intended by the regulatory framework.

Consistent with the experience in other jurisdictions, the drivers for the conduct of FRC audits in the South Australian electricity supply industry include[12]:

- Confident and empowered consumers are essential to the operation of a mature competitive market. Through exercising choice freely consumers will ensure that the benefits of competition are realised;

[12] Office of Gas and Electricity Markets (UK), "Making markets work for consumers: Ofgem's approach to securing compliance with supply licence obligations and consumer protection legislation", July 2003.

- Consumer confidence is underpinned by supplier compliance with legal and licence obligations; and
- Suppliers can be incentivised to comply with their licence obligations, the incentive to comply can be provided by positive encouragement of 'compliant cultures' and by credible enforcement arrangements.

At the present time, the major concern is to ensure that consumers can have a high degree of assurance concerning the compliance by retailers with obligations related to the formation of market contracts.

The Commission considers that it is important to the future development of the market that consumers have confidence in the integrity of the processes related to the establishment of market contracts between customers and retailers. The developing nature of the market is such that the existing compliance reporting may not be able to identify any emerging issues in this area of the market. For this reason, compliance audits are seen as the best method to identify, analyse, evaluate and treat potential FRC compliance risks and weaknesses in the compliance systems of licensees.

It is proposed that the electricity FRC compliance audit program be conducted in phases, with an initial emphasis on retailers that have been operating in the small customer market in South Australia for at least 12 months, i.e. AGL SA, Origin and TXU. It is not proposed that the distributor, ETSA Utilities, be involved in this first phase of the FRC compliance audit program. As stated previously, the audit program will focus on certain key regulatory obligations associated with the establishment of market contracts between retailers and customers, the nature of those contracts, and the transfer of customers between retailers at the time of commencement of those contracts.

These obligations are considered important to audit for compliance at the present time given the relatively immature nature of the South Australian electricity small customer market.

The Codes of most relevance to a program of FRC audits are:

- The Energy Marketing Code, which ensures appropriate standards for the marketing of electricity by retailers to small customers. The Code therefore deals with those issues that precede the entering into of a contract between a retailer and small customers;
- The Energy Retail Code, which establishes a comprehensive consumer protection regime associated with the sale of electricity by retailers to small customers, including service standards to be met by such retailers. The Code specifies the terms of the standing sale contract required to be offered by AGL, and certain mandatory provisions for market contracts;
- The Energy Customer Transfer and Consent Code, which governs the conditions under which consumers may be transferred from one retailer to another retailer, limits the grounds on which a customer transfer may be prevented, and sets

standards for explicit informed consent. The Code is applicable to both retailers and ETSA Utilities;

In particular, audits of retailer obligations arising from the Marketing Code are considered to be of high priority. The impact, adverse or otherwise, that marketing conduct can have on small customers suggests that the Marketing Code is a logical starting point in auditing retailers' compliance from a consumer protection perspective.

In addition, audit of a small number of requirements in the Customer Transfer and Consent Code is considered important, while certain requirements in the Retail Code related to the content of market contracts, the handling of customer disputes, and ensuring the customer's rights and obligations are known to the customer are also considered important from an audit perspective. The Commission believes that non-compliance with these conditions could have potentially serious implications for the affected customers and confidence in the market.

- Tables 1 - 3 below specify in detail the provisions from the Marketing Code, Customer Transfer and Consent Code and the Retail Code that the Commission believes should be included in the FRC compliance audit program, and the rationale for this assessment. As stated previously, all of these conditions are associated with the process of inducing customers to enter into market contracts, the nature of those contracts, the transfer of such customers from one retailer to another, and ensuring that customers are informed about their rights and obligations.

Table 1: Obligations from Marketing Code (dated March 2004) to be included in the FRC compliance audit program

MARKETING CODE	
Clause 3	Statement of Compliance ▲ A r***etailer*** is required to use its best endeavours to obtain a written statement from ***non-regulated marketers*** confirming that the latter comply with the *Energy Marketing Code*. This requirement applies where ***non-regulated marketers*** have introduced a ***customer*** to a ***retailer***, or arranged or facilitated a ***contract*** on behalf of a ***retailer***. This clause seeks to promote a level of assurance about the nature of the marketing activities of non-regulated entities, for which retailers have some responsibility (for example refer to clause 2.3). The audit of compliance with this clause will involve the production of evidence by retailers, that they have used their best endeavours to obtain a written statement of compliance from their service providers.
Clauses 4 - 12	Conduct Standards ▲ While engaged in ***marketing***, ***marketers*** or ***salespersons*** are required to comply with relevant conduct standards set out in these clauses (e.g. time of contact, identification, termination of contact, marketing in person, by telephone and by electronic means). This is of particular importance given the developing nature of the competitive market in South Australia and the effects that marketing practices may have on consumer choice. The audit should review internal procedures designed to ensure adherence with these standards.

Clause 13	Record Keeping Standards ▲ ***Marketers*** are required to use ***best endeavours*** to keep records related to their ***marketing contacts*** for the purposes highlighted in this clause, for at least one year from the date of such contacts. Records of market contacts are an important means of ensuring the integrity of the marketing process. The audit will involve consideration of evidence that marketers have used best endeavours to keep the relevant records.
Clause 14	Disclosure Statement ▲ ***Marketers*** are required to provide to ***customers*** a written disclosure statement under the circumstances and containing the information as set out in the clause. The written disclosure statement provides fundamental information to the customer about the nature of the market contract. To ensure compliance with this requirement it will be necessary to examine the contents of the relevant disclosure statements, as provided to customers. Any customer complaint in relation to the provision, or failure to provide, the said statement should also be considered.
Clause 16	Consent ▲ Whenever ***marketers*** are required to obtain the consent of a ***customer*** (e.g. consent to enter into a market contract), they are required to obtain ***explicit informed consent*** (as defined in the clause 2 of the Customer Transfer and Consent Code), obtained only after a process of disclosure to the ***customer*** related to the consequences of providing such consent. ***Marketers*** are further required to retain consent records for a period of 2 years, in an appropriate format for the purposes highlighted in this clause. Obtaining explicit informed consent is fundamental to ensuring that the customer has knowingly entered into a contract. Examining the relevant records and procedures used in obtaining such consent will test compliance with this requirement. Any customer complaint in relation to the giving, or otherwise, of the required consent should also be considered.

Table 2: Obligations from Retail Code (dated March 2004) to be included in the FRC compliance audit program

RETAIL CODE	
Clause 1.3.1 – 1.3.2	Market Contracts ▲ ***Contracts*** offered to ***customers*** must comply with at least the provisions of Part A of the Code that are not permitted to be varied under this clause. The minimum provisions of Part A of the Code represent an important consumer protection for small customers. Verification of compliance with these obligations will be achieved by examining market contracts and dealings with customers.
Clause 1.3.3	Cooling-off ▲ A r***etailer*** must ensure that a ***contract*** entered into with a ***customer*** confers on the ***customer*** the right to rescind the ***contract*** within 10 ***business days*** of receipt by the ***customer*** of the ***disclosure statement*** for the ***contract***, in accordance with the criteria set out in the clause. The cooling-off clause is a further important consumer protection for small customers. Verification of compliance with this requirement will again be achieved by examining the relevant contractual documents, and should also consider any relevant customer complaint.

Clause 1.6.1(b), (d) Clause 1.6.2(a), (d)	Termination of customer sale contracts by small customers ▲ A ***retailer*** must ensure that each ***market contract*** with a ***customer*** confers on the ***customer*** the right to effect an in-situ termination of that ***market contract*** by providing at least 20 ***business days*** notice. ▲ Where a ***customer*** has entered into a ***fixed-term market contract*** with a ***retailer*** and has effected an ***in-situ termination*** of that contract prior to the expiry of the ***fixed-term***, the ***retailer*** may only impose an early termination charge based on the criteria set-out in clause 1.6.1(d)(i) and (ii). ▲ A ***retailer*** must ensure that each ***market contract*** with a ***customer*** confers on the ***customer*** the right to effect an in-situ termination of that ***market contract*** by providing at least 3 ***business days*** notice where the ***customer*** requires such a termination due to vacation of the ***supply address***. ▲ Where a ***customer*** has entered into a ***fixed-term market contract*** with a ***retailer*** and has effected an ***in-situ termination*** of that contract prior to the expiry of the ***fixed-term*** due to vacation of a supply address, the ***retailer*** may only impose an early termination charge based on the criteria set-out in clause 1.6.2(d)(i) and (ii). To ascertain compliance with the above timeframes and criteria it will be necessary to audit the relevant termination cases handled by the respective retailer. The audit of this area should also consider any relevant customer complaint.
Clause 2.1	Customer Charter ▲ A ***retailer*** is required to provide a copy of its ***Customer Charter***, containing items as specified in clause 2.1.4, to a ***customer*** with whom it has entered into a ***market contract*** as soon as possible after it has entered into that contact. The Customer Charter is an important document setting out the rights and obligations of the customer. Failure to provide this document to the customer may leave the customer seriously uninformed about those matters. The audit of this area should review the content of Customer Charters developed by retailers and whether or not customers that have entered into market contracts have received a copy of the relevant Charter.

Table 3. Obligations from Customer Transfer and Consent Code (dated March 2004) to be included in the FRC compliance audit program.

CUSTOMER TRANSFER AND CONSENT CODE	
Clause 2	Consent ▲ A ***retailer*** must not initiate or effect the transfer of a ***customer*** without obtaining the ***explicit informed consent*** of that ***customer***, as specified in this clause. Further, ***retailers*** are required to retain transfer consent records for a period of at least 2 years, in an appropriate format for the purposes highlighted in this clause. It is vital to ensure that customers are not transferred without relevant consent. This is considered to be a major area of risk. Examining the relevant records and procedures used in obtaining such consent will test compliance with this requirement. Any customer complaint in relation to the giving, or otherwise, of the relevant consent should also be considered.

It is proposed that this first phase of the FRC compliance audit program, involving the retailers AGL, Origin and TXU, be undertaken in the last quarter of 2004 and be completed over a one-month period. This phase of the program would be extended to

encompass the compliance of Powerdirect and EnergyAustralia (which both commenced retailing to small customers in South Australia during 2004) with the obligations listed in Tables 1 – 3 in the first quarter of 2005.

2. Compliance with Performance Reporting Requirements

2.1 Background

In accordance with its regulatory objectives, the Commission monitors, and regularly reports on, the performance of regulated businesses and of the markets in which those businesses operate. Licensees are required, as a condition of licence, to provide to the Commission such performance information as the Commission may require to undertake its performance monitoring and other functions. Pursuant to such licence conditions, the Commission has established Guidelines[13] specifying its information requirements.

2.2 Overview of risk assessment and audit arrangements

The information requirement Guidelines prepared by the Commission require that the relevant licensee submit with the information a Responsibility Statement signed by a Senior Officer or Director of the licensee, evidencing responsibility for information provided to the Commission, and in particular that the information has been prepared in accordance with the Guideline. The licensee is also required to ensure that information provided to the Commission in accordance with the relevant Guideline is able to be verified. The Guidelines require that the Commission may require independent assurance to be provided by the licensee in relation to any performance information submitted by the licensee. The Commission has established such a requirement because it is concerned to ensure that information submitted to it by each licensee does not prejudice its understanding of the operations of the licensee and of the electricity supply industry as a whole. Thus far, the Commission has sought assurance from the internal audit functions of ETSA Utilities and AGL concerning certain aspects of the performance information submitted to it in accordance with the Guidelines.

Critical issues for the Commission at the present time in this respect include:

- *Quality of performance information submitted by retailers selling electricity to small customers*. Energy Industry Guideline No. 2 outlines the reporting requirements for such retailers which cover performance against service standards specified in the Energy Retail Code, and information about customer numbers and sales, and levels of customer service, particularly for customers experiencing payment difficulties. The Commission believes that the consequences of such performance information containing material errors would be significant, possibly leading to erroneous judgements being made by the Commission about the state of competition in the

[13] Refer to Electricity Industry Guideline No. 1, "*Electricity Regulatory Information Requirements - Distribution* "; Energy Industry Guideline No. 2, "*Energy Information Requirements – Retail*". These Guidelines are available from the Commission website.

retail market and about the level of customer protections that should be provided to customers in that market.

- Quality of information submitted by ETSA Utilities to the Commission, particularly in relation to such matters as reliability and quality of supply. Electricity Industry Guideline No. 1 outlines the reporting requirements for ETSA Utilities, which deal largely with performance against certain obligations contained in the Electricity Distribution Code, including reliability and quality of supply standards. ETSA Utilities is the monopoly electricity distributor in South Australia, and the Commission regulates both the amount of revenue that ETSA Utilities can receive through the charges it levies on customers as well as the level of performance that it is required to provide to customers – i.e. the Commission regulates both sides of the so-called "regulatory bargain" for ETSA Utilities. Material errors in the information supplied to the Commission regarding such performance may lead the Commission to form an incorrect opinion regarding the outcomes of the regulatory bargain[14]. The Commission regards this as being a critical matter in relation to a monopoly distributor.

Licensees would need to establish documented procedures for use by staff, detailing the manner of preparation of performance reports for the Commission in accordance with the relevant Guidelines. Information systems would need to capture the relevant data and assemble it in a suitable form for reporting to the Commission. The fundamental questions for the audit of performance data concerns whether or not the reported data accords with the specifications of the relevant Guideline; this requires that both the documented procedures of the licensee as well as its information systems be scrutinised by the auditor. The Commission would require assurance that the reported performance data is based on sound information systems and documented procedures that are consistent with the Commission's information specifications and are being followed by staff[15].

The Commission intends that audits of the performance data reported by retailers selling to small customers as well as by ETSA Utilities be undertaken during the first quarter of 2005.

[14] It is noted that, in relation to financial performance, Electricity Industry Guideline No. 1 specifies an annual auditing process for regulatory accounts. Thus the audits of performance information for ETSA Utilities as discussed here do not extend to financial information reported in accordance with the Guideline.

[15] Refer to the ESCV Electricity Industry Guideline No. 9 for a detailed discussion of the compliance issues associated with performance data reported by electricity licensees.