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**FINAL DECISION –  
GUIDELINE 22 – REGULATORY  
AUDITS OF ENERGY BUSINESSES**

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# 1 OVERVIEW

## 1.1 Background

The Essential Services Commission (**the Commission**) is the independent economic regulator established by the Victorian Government to license and regulate prescribed essential utility services, including the generation, transmission, supply and sale of energy.

Its role is specified in provisions of the *Electricity Industry Act 2000 (EI Act)*, *Gas Industry Act 2001 (GI Act)* and is subject to the Commission's objectives under the *Essential Services Commission Act 2001 (ESC Act)*.

As conditions of their licences, businesses must comply with applicable legislation, orders, codes and guidelines. They may also be required to report breaches as the Commission requires. To assess licensees' ongoing compliance and their technical capacity to retain their licences, the Commission investigates reported breaches and analyses complaints it receives directly or through the Energy and Water Ombudsman Victoria (**EWOV**).

The Commission requires energy retailers periodically to undertake independent audits of their compliance with their obligations. This program has been extended to licensed energy distribution businesses, following the publication of a Ministerial Order in June 2013 (the **Clarification Order**). This order clarified the Commission's role of enforcing certain provisions of the Electricity Distribution Code and of Orders in Council relating to the Advanced Metering Infrastructure (**AMI**) rollout. The Clarification Order does not limit the scope of regulatory audits of energy distributors conducted in accordance with conditions of their licences.

## 1.2 The auditing framework

The Commission conducts its program of regulatory audits according to a framework based on:

- Guideline 22 – Regulatory Audits of Energy Businesses;
- a tripartite Audit Deed;
- a standard Audit Report format.

Amendments to these elements of the framework have now been finalised to address limitations of the Commission's current audit methodology and streamline its compliance assurance approach. These limitations led to insufficient



Commission control over the process, delays in completing and reporting audits, and lack of consistency between audits.

The amendments are intended to address these matters and ensure that the Commission has a best practice audit methodology applicable for all licence types and a framework that reflects the Commission's ongoing role.

### 1.3 Consultation

On 23 March 2013, the Commission released three documents for public consultation. They were:

- Draft Decision – Guideline 22 – Regulatory Audits of Energy Businesses
- Draft Energy Industries Guideline No. 22 Regulatory Audits of Energy Businesses
- Revised Audit Deed (Marked up version)

#### *Submissions*

In April 2013, the Commission received nine submissions from stakeholders on the draft framework. One submission was confidential; the eight submissions which were provided for public viewing were from the following stakeholders:

- AGL Energy Limited (**AGL**)
- CitiPower/Powercor (**CP/PC**)
- Consumer Utilities Advocacy Centre (**CUAC**)
- Deloitte Touche Tohmatsu (**Deloitte**)
- Energy and Water Ombudsman (Victoria) (**EWOV**)
- EnergyAustralia (**EA**)
- Origin Energy Retail Ltd (**OE**)
- SP AusNet (**SPA**)

Some of the submissions commented on the regulatory powers and responsibilities of the Commission and the Australian Energy Regulator (**AER**), and the AER's regulatory framework and recent work program.

While these comments may assist the Commission's assessment of regulatory risk and its planning of further audits, they were not immediately relevant to the issue for consultation. This issue concerned making the Commission's audit framework deliver more timely audits, better focused on matters of concern across the operations of the licensees that the Commission is charged to regulate in different sectors of the energy industry.

### 1.4 Structure of the paper

Chapter 2, the Final Decision, is structured according to the nature of the issues discussed.



- Audits of distribution businesses in general
- Audits of retailers in general
- Auditor panel
- Tripartite Audit Deed
- Annual audit program & Risk assessment
- Annual audit program & Timing of audits
- Audit standards
- Individual audit scope & Risk assessment
- Assessments of compliance
- Materiality
- Timescale to complete audit
- Rating scheme
- Reporting and publication
- Subsequent use of Audit Reports and documents

Chapter 3, sets out the Next Steps to implementing the changes

Appendix A - Audit Report Template

## **1.5 Related documents**

During this review, the Commission published some guidance notes for auditors in draft form. Because the Guideline published here relates to regulatory obligations of licensees, the material directed to auditors is not included. Separate guidance notes or statements for auditors will be issued in due course.



## 2 FINAL DECISION – AUDIT FRAMEWORK

Several submissions expressed general support for improved guidelines for the conduct of audits, as part of a robust regulatory framework, in the interest of Victorian consumers.

Two submissions were received about the Commission's proposal to return to independent regulatory auditing of distribution businesses. For the most part, these submissions sought reasons for the Commission's proposal but did not comment in great detail on the changed framework that the Commission proposes. The distributors made these submissions before the Clarification Order was published.

### 2.1 Audits of distribution businesses in general

#### 2.1.1 Duplication of AER regulation

##### *Submissions*

CP/PC opposed the Commission's intention to conduct regulatory audits of distribution businesses, as a duplication of the AER's existing requirements for information reporting and compliance monitoring, audits, Board resolutions, and statutory declarations.

CP/PC stated that there was no clear understanding of distribution-related obligations for which the Commission was responsible. The distributor suggested that there might be no distributor-related obligations that the Commission was empowered to enforce and audit. Any additional audits imposed by the Commission would be duplicative and impose a substantial impost on distribution businesses ultimately its customers.

SPA noted that, although some current regulatory instruments were issued under the Commission's powers, the AER now managed compliance with the whole range of distributor obligations: economic and non-economic. The distributor questioned the respective roles of the Commission and the AER in ensuring distribution businesses compliance.

SPA asked for details of the overall compliance regime for distribution obligations and the roles of the Commission and the AER, and asked what need there was for the Commission to audit distribution businesses.





Another submission suggested that the auditor's ability to use the work of other parties (such as other independent or internal auditors) should be assessed in accordance with existing auditing standards. The same was true of reliance upon management's representations. The Audit Report and Executive Summary should provide a suitable comment.

### *Discussion*

The Clarification Order now specifies the Commission's role in enforcing certain distributor-related obligations related to the AMI rollout. The Commission's ongoing responsibility for licensing distributors requires it to monitor and enforce their compliance with other non-economic regulatory obligations.

The Commission agrees to communicate with distributors on the overall compliance regime for distribution obligations and the roles of the Commission and the AER.

The Commission does not consider that its audits of Distribution businesses would be duplicative. The distribution businesses operate in Victoria according to a licence issued by the Commission. As a condition of their licences, distributors are subject to regulatory audits. The present consultation deals with the method of conduct, not the existence, of these audits.

The Commission accepts the suggestion regarding the auditor's use of other suitably qualified parties' work. To the extent practicable, the Commission will accept material that licensees have provided to other regulators in the course of reviews or audits, where the material satisfies the Commission's need for independent verification of the information it requires.

The Australian Standard ASAE 3100 referenced in the Draft Guideline 22 allows the auditor to place reliance on any relevant testing of compliance controls performed by the internal compliance function where appropriate. The Commission will also clarify that the auditor may make use of independent audits in arriving at findings on relevant issues. This potentially would apply to audits conducted for the AER. In deciding how far to use these independent audit findings, the auditor will be guided by professional judgement and existing auditing standards.

### **FINAL DECISION**

The Commission will amend **chapter 6 - Conducting the audit** in **Guideline 22**, to clarify that the auditor may make use of independent audits where relevant in arriving at findings on relevant issues.



### 2.1.2 Need for auditing

#### *Submissions*

SPA outlined the monitoring and reporting that the AER required of the distributor, while not requiring formal compliance audits, and asked the Commission to provide some understanding of the perceived need for Commission audits of Distributor obligations.

#### *Discussion*

The Commission considers that, in order to discharge its own statutory responsibilities, it needs independent verification of licensees' compliance with their regulatory obligations.

### 2.1.3 Approach to auditing

#### *Submissions*

SPA expressed concern if the proposed audits by the Commission were going to introduce a second 'parallel' compliance regime for distributor obligations, with a different approach from that of the AER. The Commission's proposed approach, while legitimate, would require SPA to re-establish arrangements for participation in such audits, but in the medium term the compliance approach of the AER, as the national regulator, would apply. SPA therefore suggested the Commission should consider using an approach better aligned to the AER's, and asked why the Commission could not do so.

#### *Discussion*

The Commission agrees that insofar as is possible there should be a good alignment between its audit framework and that of the AER.

### 2.1.4 Scope of auditing

#### *Submissions*

SPA noted that the Draft Decision did not identify distribution issues that the Commission would audit, and asked the Commission to make clear what these were.

#### *Discussion*

The Commission acknowledges the omission. The issues are: clauses of the AMI Cost Recovery Order relating to the AMI rollout period, rollout schedule and distributors' risk management; clauses of the AMI Specifications Order related to compliance with Functionality and Service Levels Specifications. The Clarification Order also identified Electricity Distribution Code obligations related to reliability of supply for Special Needs customers and quality of supply. These issues, as well as selected distribution licence conditions, are auditable.



The Commission will communicate with the distribution businesses on the scope of all planned audits.

## 2.2 Audits of retailers in general

### *Submissions*

EA expressed its support for regulatory audits in general, and the extension of the Commission's audit program to other sectors of the energy industry.

CUAC submitted that audits were critically important to ensuring compliance but reports should be published promptly in a transparent way.

EWOV submitted that recent audits had highlighted the difficulties that some energy businesses had in managing the timely completion of audits, in ensuring robust compliance and reporting, and in meeting the undertakings they gave to the Commission. EWOV assumed that the Commission planned to take action to rectify audit findings.

### *Discussion*

The Commission agrees that reports should be published in a timeframe that makes them relevant to the industry and Victorian consumers alike. Significant elements of the present consultation are designed to overcome difficulties that have been experienced in pursuing this aim.

In addition to publishing Audit Reports, the Commission will also consider enhancements to its communications and compliance reporting to make the information widely available and accessible.

## 2.3 Auditor panel

### *Submissions*

Deloitte expressed support in general for appointing a panel of auditors, for greater effectiveness, efficiency, quality and consistency of results.

Another submission suggested that regulatory audits should be undertaken by those with the required capability and competency for the work, and that establishing such a panel should expedite the approval process for audit engagements.

CUAC also expressed general support for establishing a panel of auditors.

Others opposed the use of the panel or expressed concern about the method of implementation. These submissions are outlined and discussed in sections 2.3.1 to 2.3.3.



### 2.3.1 Cost and availability

#### *Submissions*

AGL opposed the establishment of a panel of auditors for energy regulatory audits, considering it represented an unnecessary cost. It was unlikely to change measurable outcomes and the Commission had not proposed any evaluation of the results. AGL contended that the Commission should approve suitable auditors, proposed by licensees and engaged directly by them, subject to the terms of the Deed and other necessary conditions.

EA was not opposed to the use of empanelled auditors, but noted that a panel might limit the number of qualified auditors available.

CP/PC recommended that there should also be an avenue for engaging a licensee's preferred auditor, if not already a panel member.

#### *Discussion*

The Commission notes AGL's concerns but considers that consistent use of empanelled auditors with continuity of service can be expected to improve the efficiency, effectiveness and consistency of auditing, to contain its cost and to clarify the auditor/client relationship. The auditor's relationship must be independent, serving not only the licensee, but the regulator as well. The Commission intends to evaluate the performance of empanelled auditors, based on a series of KPIs including: ability to meet the prescribed timeframes; compliance with the Audit Deed; management of conflicts of interest; and quality of outputs.

The Commission accepts the CP/PC submission. Once a panel is in place, the Commission will still consider nominations of other auditors to conduct an individual audit or join the panel. The fact that the auditor of a licensee's statutory accounts (or other preferred auditor) is not empanelled would not preclude them from making representations to the auditor conducting the Commission's regulatory audit, if doing so could enhance the quality of the audit, the findings or recommendations.

### 2.3.2 Time and efficiency

#### *Submissions*

SPA referred to the time that selecting the panel might take before audits could start, the limited number of audit teams that might be available to complete the audit program, and the benefits arising from continuity of membership of the panel.

SPA also said that the Draft Guideline 22 provided excessive detail of the process to be followed in approving auditors for an assignment, if they were already approved as panel members.



### *Discussion*

The Commission notes SPA's concern about the time to empanel auditors but considers that the process can be conducted separately from and in parallel with planning the audit program and the individual audits. Hence the timing of audits should be affected minimally in the first year and not at all in subsequent years. As stated above, the Commission sees there are benefits of continuity of service on the audit panel.

The Commission accepts there was unnecessary detail in the Draft Guideline on approving the engagement of empanelled auditors. For such approvals, the Commission will require only an assurance that the firm's recent, current or proposed work for the licensee does not affect the auditor's independence or cause a potential conflict of interest. Material relevant only to the empanelment process will be removed to a separate Panel Tender document. The Commission will amend the text to clarify the point.

#### **FINAL DECISION**

The Commission will amend **s. 4.3** of **Guideline 22** to refer to the appointment of non-panel auditors on an exception basis, and **s. 4.4** to clarify the simplified process for selecting an auditor from a firm that is already a panel member.

The Commission will also delete sub clauses **(i)-(ii) of cl. 10(a)** and **cl. 10(b)-(e)** of the **Audit Deed**.

### **2.3.3 Independence**

#### *Submission*

Another submission emphasised the need to consider the independence of the auditor with reference to existing ethical standards.

#### *Discussion*

The Commission considers that control frameworks and individual professional ethics are well enough established in reputable audit and consultancy businesses and that appropriate standards will be applied.

## **2.4 Tripartite Audit Deed**

### **2.4.1 Tripartite nature**

#### *Submission*

CP/PC referred to past experience of delays, costs and inefficiency when finalising the Tripartite Deed in an earlier form for previous audits. Instead, it recommended



that distribution businesses should engage their auditors directly, as is done for AER's purposes, with a statutory declaration from the Chief Executive Officer for the Commission's comfort.

#### *Discussion*

The Commission notes the concern of CP/PC but considers that direct engagement has also been problematic in the past, as auditor selection has sometimes been difficult and time consuming. Through a tripartite Deed, the Commission can best protect the consumers' interests while recognising those of the licensee and the auditor.

### **2.4.2 Amendment of the Deed**

#### *Submissions*

OE submitted that licensees and their auditors should be able to challenge any provision of the Deed before entering into it for any audit engagement.

Deloitte submitted that the Deed as set out would be acceptable subject to possible amendment in its treatment of Auditor Intellectual Property; Indemnities and Insurance; and the Draft Audit Report (purpose and use).

#### *Discussion*

The Commission notes the concerns of OE and Deloitte and intends to avoid protracted negotiations over the wording of the Deed. The Commission will entertain discussion of details with auditors applying to join the panel, but thereafter, a standard form of Deed will be used.

Exceptionally, if an auditor or licensee has a concern with details that do not materially alter the purpose of the Deed, the Commission agrees to consider variation of the deed.

## **2.5 Annual audit program & Risk assessment**

### **2.5.1 Risk assessment**

#### *Submissions*

OE and Deloitte noted that the Draft Guideline 22 gave little explanation of how the Commission would assess the likelihood of a licensee's non-compliance that would drive the frequency of audits. The auditor recommended communicating the method and the results of assessments to licensees and auditors.

EA submitted that, in the Draft Decision section 1.3.2, the proposed risk factors were weighted towards selecting the larger retailers for auditing. In EA's view, although the impact of compliance breaches on a larger number of customers was relevant, smaller retailers that entered the Victorian market more recently posed



greater risks through aggressive marketing, inexperience and unsophisticated systems and procedures.

EA also expressed concern at the Commission's proposed use of EWOV complaint statistics for risk assessment. The number of complaints would not reflect actual compliance performance because it was affected by the numbers of residential and non-residential customers, the extent of the retailer's marketing activity and whether or not its bills showed EWOV's details. Moreover, because of the way complaints were registered and reported, their number could exceed the number of actual compliance breaches. For this reason, the Commission should apply a weighting factor to this indicator.

EA also submitted that, if a different regulator's audit had found non-compliance in an entity also licensed by the Commission, then that entity should be allowed time to undertake remedial action before the Commission scheduled an audit.

### *Discussion*

The Commission emphasises that the assessment of 'likely or known' non-compliance, as stated in section 3.2.5 of the Draft Guideline 22, is only intended to produce a simple high, medium or low rating. When considered together with other available information (such as breach reports and previous audits) and the possible consequences, it only assists the Commission to decide whether to bring forward or delay an audit of an area. Therefore, the Commission considers that it is not necessary to formalise guidelines for this assessment process further. The assessments undertaken would necessarily be documented internally, however, and this would serve to aid consistency and improvement over time.

The Commission agrees with EA and will give due weight to the past performance of licensees in a sector of the industry. The Commission also agrees that EWOV data is most useful as guidance in risk assessment but not necessarily as the sole determinant of risk and will use it accordingly.

The Commission also agrees that, when it plans a program of audits of licensees and documents the minimum scope, it will be mindful of areas where reported non-compliance has not been corrected. Auditors may be directed to assess relevant matters such as the resourcing and management of the work in progress, and to confirm the adequacy of remedial action.

## **2.5.2 Phasing of risk assessment**

### *Submission*

Another submission emphasised that audits should focus on the licensees representing the greatest assessed risk or impact on consumers, and proposed a two-phase form of audit. The auditor would first assess a licensee's compliance framework and the risks of non-compliance. This assessment would then be combined with the Commission's own, to identify the higher risk licensees and



determine the specific areas of operation to be tested for compliance. Such an approach should not be rejected because of potentially increased cost.

#### *Discussion*

The Commission emphasises that it will not—at least initially—require auditors or others to perform this risk assessment, but will complete the task in-house, in consultation with licensees, as an element of planning its work program.

The Commission recognises though that there may be benefits from adopting a two-phase form of audit, although it could be expected to extend the overall time to complete the audit program. Further consideration will be given to this approach in due course.

### **2.5.3 Other regulators' audits**

#### *Submission*

EA urged the Commission to give due consideration of other regulators' audits of an entity in assessing if a further audit is needed. Even if the results of another regulatory audit had been unfavourable, the Commission should consider allowing the licensee time to remedy the issues found, before initiating another audit.

#### *Discussion*

The Commission agrees with EA and fully intends to give due consideration to other relevant audits of a licensee's compliance, as the Draft Guideline 22 s. 3.2.8 shows. Where such audits have made significant findings of concern, then the Commission may require the licensee to give an undertaking to remedy non-compliance within an acceptable timeframe, or may take any other appropriate regulatory response.

## **2.6 Annual audit program & Timing of audits**

#### *Submissions*

SPA expressed concern about the compressed timelines between delivery of the final Guideline 22, formulating the audit plan, empanelling Auditors and resourcing the engagements. EA made a similar submission. The distributor asked the Commission to outline the lead times for DB audits.

#### *Discussion*

The Commission appreciates these difficulties and will not schedule audits before February 2014.

The Commission will consult further with the licensees on the timing of audits.





## 2.7 Audit standards

### *Submissions*

CUAC expressed support for references to the application of Australian Standards.

AGL expressed concern that the Draft Decision did not identify deficiencies in the audit methods adopted in the past. Nevertheless, the Draft Guideline 22 provided that auditors base their work on *ASAE 3100 Compliance Engagements*, and apply other specific Australian and other Standards for risk and compliance as appropriate. AGL considered that adopting these standards would unduly limit auditors' exercise of their skills in future.

Deloitte submitted that the Commission should provide more guidance to auditors; for instance on:

- other matters such as 'compliance culture' that ASAE 3100 does not cover;
- which elements being audited should be considered in forming the opinion; and
- whether a positive 'reasonable assurance' opinion was required or a negative 'limited assurance' one.

Deloitte also noted that the Draft Guideline 22 referred to several Standards and suggested the auditors would need further guidance on when these should be applied.

### *Discussion*

The Commission considers that a more consistent application of relevant Standards will lead to Audit Reports that may have a clearer focus on the licensees' compliance frameworks, with assessments that may be compared more reliably.

The Commission notes AGL's concern but considers that applying relevant Standards will not unduly constrain the auditors. Further, the Standards have support from professionals in the field. While the quality of regulatory audits will always depend in large measure on auditors' exercise of professional skill and judgement, lack of clearly articulated standards may have contributed to the variability of results in the past.

The Commission considers that the other Standards such as AS 3806-2006 Compliance Programs give appropriate guidance on matters such as 'compliance culture'. The Commission needs to establish the program of licensees to be audited, and the scope of obligations to be covered in each regulatory audit, and may document other guidance on the conduct of audits. In doing so, the Commission will define the elements to be considered in forming an opinion, whether reasonable assurance or limited assurance is required and, if necessary, the standards by which assessments should be made.



## 2.8 Individual audit scope & Risk assessment

### 2.8.1 Process and use of risk assessments

#### *Submissions*

Origin submitted that the term 'high risk obligations' used in the Draft Guideline 22 should be clarified in terms of the process for identifying 'high risks' and whether this forms part of the external audit or of the licensee's internal monitoring framework.

Deloitte noted that the Draft Guideline 22 required licensees to conduct their own risk assessment at an obligation level but did not state how this should be done. The Commission could usefully provide further guidance and also require the licensee to share their risk assessment with the relevant auditor and the Commission.

Another submission suggested that tailoring audit scopes in accordance with individual retailer risk assessments was an economical approach but it did not deliver a standardised set of results on which to measure performance across an industry sector.

#### *Discussion*

Licensees are generally required as a licence condition to monitor their compliance. They are not formally obliged to comply with the Australian Standard *AS 3806-2006 Compliance programs* in so doing. Nevertheless, the Standard, referenced in Draft Guideline 22, provides adequate guidance and justification for licensees to perform such assessments, as well as guidance to the auditor in assessing the licensee's compliance program or framework in due course.

The Commission therefore expects that all licensees' compliance frameworks will include some form of assessment of the risk of non-compliance. The Commission will clarify its requirement that the licensee to be audited must identify to the auditor and the Commission any regulatory obligations that fall within the general area proposed for audit and that, in the view of the licensee, should be added to the draft scope because of a high level of risk as assessed by the licensee. The Commission will then determine whether its priorities require these obligations to be included in the scope of the audit.

The Commission accepts in principle the submission that individual audit scopes tailored to each licensee's risk profile do not provide strict comparability of results, but considers that the reduction in regulatory burden warrants adopting the approach.



#### **FINAL DECISION**

The Commission will amend **s. 3.2.7 of Guideline 22** to clarify the process by which the licensee must ensure that all high risk obligations are considered for inclusion in the final Audit Scope.

### **2.8.2 Phasing of risk assessment**

#### *Submission*

One submission suggested that it would be difficult for the auditor to identify high-risk obligations at the stage when the audit scope is being finalised, and again recommended a two-phase approach to the audits, as noted in section 2.5.2.

#### *Discussion*

The Commission refers again to its response in section 2.5.2.

### **2.8.3 Risk appetite**

#### *Submissions*

Origin submitted that an assessment of a licensee's risk appetite is an internal function and should not form part of the external audit. Furthermore, Auditors were not equipped to manage this component due to the complexity of the task and the lack of guidance provided by the Commission.

Deloitte noted that the Draft Guideline 22 referred to 'compliance risk appetite' which was not a defined term, and submitted that auditors needed further guidance. Similarly, another submission suggested that assessment of a responsible party's risk appetite was a subjective assessment that the licensee should undertake rather than the auditor.

#### *Discussion*

The Commission accepts the submissions, will remove the requirement for this assessment, but will keep this issue under review.

#### **FINAL DECISION**

The Commission will delete **s. 5.2 – Licensee's compliance risk appetite of Guideline 22**.



## 2.8.4 Obligations in the Scope

### *Submission*

One submission noted that the Draft Guideline 22 did not refer to assessments of the 'ongoing financial viability' of a licensee—which was a condition of the original grant of the licence.

SPA noted that the Draft Guideline 22 s. 5.1.2 referred to 'obligations and any other matters' in the audit scope, and questioned what these other matters might be.

CUAC's submission identified the following matters, to be considered in establishing the scope of regulatory audits.

Retail performance indicators: CUAC referred to possible unreliability and inaccuracy of data, as acknowledged in the Commission's *Energy Retailers Comparative Performance Report – Customer service 2011-12*. Some retailers had not resubmitted data that had failed to meet the required standards in the previous audit. CUAC instanced figures for wrongful disconnection cases, which were fewer when reported by retailers to the Commission than when reported by EWOV. Customers and consumer advocates needed reliable and accurate data to assess retailers' performance and compliance levels, particularly in relation to disconnections.

Complaints: CUAC submitted that, for comparability, retailers needed to use a common definition of complaints. EWOV statistics for total complaints were increasing, due to in part to concerns about solar generation, smart meters, two retailers' billing system problems, and energy affordability.

Hardship and assistance: CUAC submitted that market participants needed to work together to ensure better outcomes for consumers, through appropriate access to payment assistance and hardship support and minimising the number of disconnections.

### *Discussion*

In response to the submission that assessment of a licensee's financial viability might be undertaken, the Commission agrees this would be within its powers to conduct, and may be considered for inclusion in the 2014 Audit Program. However, it is also an issue that is being examined in the Commission's current Licensing Framework Review.

The Commission notes that 'other matters' may be included in an audit scope, for example:

- performance indicators (generally defined in a reporting specification) to be tested for reliability and accuracy
- specific compliance issues necessary to the proper performance of an obligation.



For other matters that may be identified from time to time, it would be inappropriate to circumscribe the Commission's power of audit. The Guideline will be amended to provide the required clarity.

The Commission notes CUAC's concerns and confirms that compliance with obligations in the following areas will be audited when indicated by risk assessments.

Retail performance indicators: The acknowledged need for more targeted and timely audits that allow more effective follow-up is a main reason for the present review of the auditing framework.

Complaints: the Commission requires retailers to define, handle and report complaints according to common Standards set out in the Energy Retail Code and the Information Specification. Compliance with these obligations is an appropriate and likely element of retailer compliance audits.

Hardship and assistance: the Commission agrees with CUAC on the importance of considering audits of regulatory obligations that have the potential to affect the interests of low income and vulnerable consumers. Compliance with ERC obligations around disconnection of customers in financial difficulties, and with the retailers' own Hardship Policies, is a matter that the Commission will consider for forthcoming retailer audits.

#### **FINAL DECISION**

The Commission will amend **s. 5** of **Guideline 22** to clarify that, as well as regulatory obligations, the other matters in the scope to be audited will be performance indicators and specific compliance issues.


## **2.9 Assessments of compliance**

### **2.9.1 Change management**

#### *Submission*

Energy Australia submitted that the Commission's Draft Decision was unrealistic in expecting audits of regulatory information to cover change management in IT systems. The auditor would be asked to assess whether procedural controls were modified to adapt to changing requirements, and whether IT system changes were reliably implemented. However:

- uncertainty and the pace of change in the regulatory environment made it hard for licensees to modify controls in a timely manner; and

- 
- IT system audits were also difficult, time-consuming and costly, particularly when third-party service providers were involved.

### *Discussion*

As a general point, the Commission is required to ensure the licensees' compliance with the performance-reporting obligation. In doing so, it should not and will not avoid enforcement action merely because compliance would be difficult or inconvenient.

The Draft Decision raised the question of change management as a requirement for a reliable compliance framework in the context of performance reporting. It was in that context that recent audits found significant related issues. However:

- If an auditor finds that a licensee has not fully updated its controls to meet a change in regulatory requirements, the Commission agrees there is a need to consider how recently the change was made. In such a case, the Commission will always work with the licensee to ensure that problems are resolved in a timely and effective way at least cost.
- The Commission does not in general seek a full audit of the IT systems that a licensee employs. Nevertheless, licensees must be able to demonstrate that, when they modify their systems, they do so in a controlled manner. As stated elsewhere in this paper, the auditor may be able to use the work of other independent or internal auditors in assessing the change-management controls.

Control of change management is of equal or greater importance in compliance with other licence obligations, particularly when licensees are amending or replacing their major business systems.

Where risk assessments point to the need, auditors will be directed to consider relevant matters, in the form specific compliance issues identified in the Scope.

### **2.9.2 Other matters**

#### *Submission*

Another submission suggested the following:

- The confidence level with which the auditor is required to express a compliance grade (generally, 90% per cent) determines the extent of work that the auditor needs to perform. This should be documented in the Audit Report.
- The time a licensee takes to report a compliance breach to the Commission is a measure of its compliance that auditors should consider.
- Type 1 or Type 2 compliance breaches should be subject to follow-up audits of remedial action.



### *Discussion*

The Commission generally accepts the submissions on these other matters:

- The Audit Report should show the confidence level for the compliance grades assessed. The detailed report will outline the work performed.
- Breach reporting to the Commission may be considered as part of the Monitoring / feedback element of a licensee's compliance program. The auditor may consider the time taken to report compliance breaches and may comment on it where exceptional or relevant in the auditor's view. The Commission may provide further guidance to auditors, in Scope documents or otherwise.
- The Commission will consider the need for follow-up audits of remedial action in respect of significant compliance breaches.

#### **FINAL DECISION**

The Commission will amend **s. 7.7. Level of confidence, s. 7.11 Executive Summary** and **s. 7.12 Detailed Report of Guideline 22** with the necessary details on confidence level.

## **2.10 Materiality**

### *Submission*

One submission stated that the Commission should define materiality as it relates to the performance of specific compliance procedures.

### *Discussion*

Where possible, the Commission does define what it considers a material exception, so that auditors may assess licensees' compliance as consistently as possible. For a performance-reporting obligation where material errors in accuracy can be defined, sections 7.2.3 and 7.12.1 of Guideline 22 are relevant. They provide that an accuracy grade other than **1** or **2**, meaning an error greater than  $\pm 5$  per cent, represents a material exception. For other regulatory obligations, the materiality of an exception will depend on the nature of the obligation itself and the Commission makes the necessary statement in Audit Scopes.

## **2.11 Timescale to complete audit**

### *Submissions*

CUAC expressed support for the proposed inclusion of timeframes for various milestones of an audit but in OE's view, it was impractical and restrictive to impose



hard-coded timeframes and milestones without an awareness of the scope, approach and operational constraints posed in each audit engagement.

AGL submitted that the three-month timeline set by the Commission would be difficult to achieve. It meant that the licensee would be able to work with the auditor for only eight weeks, which might be insufficient.

Deloitte supported the inclusion of a timeline for the audit process from the start of fieldwork, but recommended that the Commission clarify its expectations for the earlier stages of planning. The auditor recommended that the timeline shown as a table in the Draft Guideline 22 should also show which stakeholders were involved at each stage. Another submission supported the proposed timeframes but recommended some flexibility, especially where a licensee has outsourced functions that are to be audited.

Deloitte also recommended setting key performance indicators for each auditor and licensee, to measure the timeliness of completion of each of the main stages of the audit.

#### *Discussion*

In response to AGL's view about the appropriateness of the Commission setting a three-month timeline for completion of fieldwork and reporting, the Commission notes this is a target intended to improve the timeliness of reporting.

In the past, some audit reports were of diminished value as too much time had elapsed between identifying a problem that required audit and assurance, and issuing a report with recommended action. In future, the timeline may be extended beyond three months only if the complexity or the difficulty of an audit so requires. Extensions will be granted at the Commission's discretion and in consultation with the auditor and the licensee.

The Commission acknowledges Deloitte's view that there is little documentation in the audit framework of the planning stage before fieldwork. This is expected to include activities such as the licensee providing Audit Reports and background information, the auditor providing schedule of data requirements and interviews. The Commission will amend Guideline 22 to show these activities and the parties involved at each stage of the audit.

The Commission will also consider establishing key performance indicators for licensees and auditors after the first round of audits, in the light of its experience with the amended audit process.





## FINAL DECISION

The Commission will insert **s. 5.4 – Planning** in **Guideline 22** and extend the table at **s. 8.1.5** to clarify the basic points about planning the audit and coordination of participants.

The Commission will amend **s. 5.5** and **s. 8.1.5** of **Guideline 22** to clarify the matter of timeline flexibility and consultation, and the involvement of the parties in each stage.

## 2.12 Rating scheme

### *Submissions*

CUAC supported the auditors' use of a common grading system for consistent assessment of compliance. Deloitte specifically supported the use of the Harvey Ball symbols for this purpose.

SPA found that the proposed use of Harvey Balls was unclear; in particular, the Draft Guideline 22 did not indicate whether they were to be used to grade compliance with the performance reporting obligation. SPA raised several detailed questions about the application of the different Harvey Ball symbols to the five aspects or control areas of compliance, in arriving at a rating for a regulatory obligation other than performance reporting.

OE did not comment on the Harvey Balls, but submitted that the proposed representation of overall compliance in an area by use of Traffic Light symbols would be over-simplified, subjective and better suited to graphic presentations.

### *Discussion*

The Commission remains of the view that the Traffic Light representation usefully conveys the impact of a complex multi-factor evaluation. In this process, the auditor assesses the nature and significance of any findings in the five different aspects or areas of compliance management, as expressed with the Harvey Ball ratings. The auditor expresses this assessment with a Traffic Light indicator of overall compliance.

The Commission does not consider that such an assessment is more subjective than any other exercise of professional judgement informed by knowledge of the facts.

However, the Commission accepts the need to provide further detail of the assessment process in the documentation of its compliance framework.



## FINAL DECISION

The Commission will amend **s. 7.4 – Step one** and **7.5 – Step two** in **Guideline 22**:

- to document its expectations for mapping multiple Harvey Ball ratings to a single Traffic Light indicator
- to address other points of confusion that stakeholders have identified.

## 2.13 Reporting and publication

### *Submission*

CUAC supported the use of a consistent reporting format to aid publication and comparison of Audit Reports. CUAC referred to its earlier advice and encouragement to the Commission to publish reports with three months of completing an audit.

### *Discussion*

The redefinition of the reporting process in the present consultation is intended to provide the desired consistency and timeliness.

### 2.13.1 Purpose of draft

#### *Submissions*

SPA questioned the Commission's need of a copy of the draft Audit Report. OE submitted that an auditor's draft report was always a working paper that potentially contained inaccuracies that the licensee had not yet seen or corrected. For this reason, the Commission should not rely on it or publish it.

EA expressed strong opposition to the publication of auditors' draft or final reports, on the grounds that the process might discourage open disclosure by the licensee and through enquiry by the auditor. Publication of such reports also raised the possibility of unintended disclosure of unredacted personal information. Further, the retailer did not consider there was a public benefit from publication, provided remedial action was appropriate.

Another submission recommended that the Guideline and the Final Decision should clearly show that parties should not rely on the auditor's draft report, the function of which was to set out the apparent issues for review and confirmation of factual accuracy.



### *Discussion*

The Commission confirms that it intends to review draft Audit Reports for several reasons before they are finalised for publishing on the website, including:

- to verify the clarity of the reported issues, the adequacy of coverage achieved by the auditor and the possible need for an extension of time;
- to understand the significance of any findings; and
- to assess the adequacy of the response proposed by the licensee.

The Commission agrees with OE and EA that the publication of unverified draft reports is undesirable and is not intended. If the auditor fails to provide a final report within the required timeframe, however, the Commission may publish any information it deems appropriate.

The Commission also agrees that parties should not rely on the draft report but it does not agree on a need to amend Guideline 22 or other document in the Audit Framework for this purpose. The Commission considers that such a proviso can more effectively be stated by the Auditor in the opening text of the draft report itself.

#### **FINAL DECISION**

The Commission will amend **s. 7.13** of **Guideline 22** to clarify that it does not intend to publish unverified draft reports.

### **2.13.2 Timing and revision**

#### *Submission*

SPA submitted that ten days between issuing the draft and final reports provided little time to negotiate any disagreements on the text.

EA said that an auditor and the licensee audited would sometimes agree on changes to a draft report, so that the final report would better reflect the circumstances. Requiring the Commission to approve all material changes would introduce unwanted delays into the process. Further, a definition of materiality was required.

#### *Discussion*

The Commission agrees that 10 days is not long if extensive negotiation is still needed at the draft report stage. However, the Commission expects the licensee and the auditor to have reached agreement on the facts and their significance during the weeks allowed for fieldwork and drafting of the report. The Commission



will clarify that the Final Report is to be submitted on a date specified in the Audit Scope.

The Commission notes EA's concerns about the Commission's review of changes from draft to final report, but will reserve the right to question any amendment.

#### **FINAL DECISION**

The Commission will amend the table in **s. 8.1.5** of **Guideline 22** to specify that audit reports are to be provided by the date specified in the Audit Scope, and **cl. 6.4** of the **Deed** to remove the need for Commission approval of changes between Draft and Final versions of the Audit Report.

### **2.13.3 Content of final report**

#### *Submission*

AGL noted that Audit Reports as defined in Draft Guideline 22 s. 7.12.1 would contain proprietary and confidential material, disclosure of which might breach the confidentiality obligations of the licensee.

OE submitted that Audit Reports might contain commercially sensitive information that should be removed before publication.

Another submission provided further recommendations for the content of reports:

- The Audit Report itself and the Executive Summary should identify the nature and extent of the audit work performed, and the 'reasonable' or 'limited' level of assurance that was obtained.
- The auditor would need to include certain acknowledgements in the text of the Report and Summary. These documents would need to define the role of the auditor in seeking and assessing information, and the licensee in providing the information and related assurances of its reliability.

#### *Discussion*

The Commission shares the retailers' concern to prevent unintended disclosure of proprietary, confidential or commercially sensitive information. The appendix to the Draft Decision shows that Audit Reports are to be written in summary form and therefore details of individual transactions are not for disclosure.

Licensees would have the opportunity to identify and redact or remove such material, both when providing original records to the auditor and later, when reviewing the auditor's initial findings or the draft report.



The Commission accepts that the Audit Report and Executive Summary should identify the nature and extent of the audit work performed. It is felt that the auditor can be relied upon to include in the 'Limitations' section of the Audit Report a brief caveat or statement of the acknowledgements required, as indicated in the Template.

The Commission will amend Guideline 22 to require the auditor to express the level of assurance that was obtained and to permit the inclusion of the acknowledgements the auditor requires.

#### **FINAL DECISION**

The Commission will amend **s. 7.11** and **s. 7.12** of **Guideline 22** to require a statement of the level of assurance, and **s. 7.9** to permit the inclusion of necessary caveat or acknowledgements.

### **2.13.4 Compliance Plan and 30-day response**

#### *Submission*

Deloitte noted that the Draft Guideline 22 s. 7.12.1(e) required the Audit Report (in both draft and final form) to include the Compliance Plan of the licensee, although s. 8.1.2 allowed the licensee a further 30 days to provide a detailed remedial action plan. The auditor recommended clarifying the purpose of the Compliance Plans in the Audit Reports, the depth of detail required and whether feedback from the licensee was required at this stage.

It was also Deloitte's view that requiring the licensee to provide a formal response to the Audit Report within 30 days was not an opportunity to contest the findings or the remedial actions required.

#### *Discussion*

The Commission intends the Compliance Plan published in the Final Report, at a minimum, to document opportunities for improvement and compliance. It should also show the commitment of the licensee to appropriate action although the deadlines for completion may still be provisional. However, the Commission recognises the difficulty of evaluating the Compliance Plan before remedial action is undertaken, as required in the Draft Decision, and will remove the requirement.

The response that the licensee provides within 30 days of the end of the audit should detail specific actions with milestones, deadlines and formal undertakings if required.

The Commission does not expect the licensee to renegotiate the findings and recommendations with the auditor at this stage. But consultation that possibly



includes the Commission, to assess the appropriate remedial action in some cases, may be required.

#### **FINAL DECISION**

The Commission will amend **s. 7.12.1** and **s. 8.1.2 of Guideline 22** to clarify the requirements of the Compliance Plan in the Audit Report and the details of remedial actions that the licensee provides in its 30-day response to the audit.

### **2.13.5 Licensee's endorsement**

#### *Submission*

SPA also asked the Commission to confirm if Board endorsement was required at this stage of the audit, when the Final Report was first available.

OE suggested that requiring the Board to consider the Audit Reports before the close-out meeting was impractical. A delegated officer of the licensee might do this.

#### *Discussion*

The Commission considers that the Audit Findings and Compliance Plan in the Final Audit Report require endorsement at a senior level that represents the interests of both management and equity holders.

### **2.14 Subsequent use of Audit Reports and documents**

#### *Submission*

One submission commented on the way that Audit Report and other documents might be used after completion of the audit. It suggested that the Revised Audit Deed in cl. 7.3 and 7.4 should not permit the Commission to sub-license the auditor's reports and workpapers, for consultants, sub-contractors and others to use, adapt and reproduce.

Alternatively, it was submitted that the Commission might in effect use only the facts determined by the auditor but not the findings, conclusions and recommendations arising from them, and might not identify the material as being the work of the auditor.

#### *Decision*

The intention of these clauses of the Deed is to make available the work of one auditor, to be checked by another. The Commission agrees to clarify the Deed so as to limit the future use of the material appropriately.



### **FINAL DECISION**

The Commission will amend the **Revised Audit Deed cl. 7.3** and **cl. 7.4** to clarify the limited purposes for which it might provide the original auditor's reports and workpapers to another auditor, consultant or sub-contractor, which will exclude their use for commercial gain.



### 3 NEXT STEPS

After publishing the revised Guideline 22 and standard Tripartite Audit Deed, the Commission will:

- proceed to consider expressions of interest from suitably qualified audit firms in joining a panel;
- continue planning an audit program for the AMI rollout, in discussion with licensed energy distributors;
- undertake further planning for its regulatory audit program of licensed energy distributors and retailers, document the minimum scope of the required audits (including the level of assurance required) and schedule them in discussion with the licensees concerned;
- discuss with the AER its approach to independent regulatory auditing of distribution businesses, its understanding of relevant regulatory risk and the coverage it has achieved and planned over the medium term;
- start planning a regulatory audit program of other distribution licence conditions, in discussion with licensed energy distributors; and
- conduct its program of planned audits.

In the light of its experience with the planning, conduct and reporting of regulatory audits in the new framework, the Commission will consider the need to:

- document further general guidance to auditors on the conduct of the audits;
- establish key performance indicators for licensees and auditors;
- schedule follow-up audits of licensees where significant compliance breaches have been identified; and
- reintroduce the assessment of the risk appetite into auditing framework.





## APPENDIX A - AUDIT REPORT TEMPLATE

This appendix sets out the required content and treatment of the Executive Summary of the audit report, but not its physical layout, which is subject to change according to the scope and requirements of individual audits. Detailed instructions on the report format will be provided at the time that an audit scope is issued.

### **Audit Report – Required content**

[Addressee(s) – include Ms. / Mr. and full name, e.g. Dr Ron Ben-David]

[Title]

[Entity Name]

[City and Country]

#### **Scope**

*This section should provide the reader with an overview of the audit scope and test period. This may include a brief reference to the Electricity Industry Act 2000 and Gas Industry Act 2001 and the Commission’s Regulatory Audit – Minimum Audit Scope.*

*This section may also include a brief reference to the standards that the auditor adheres to when performing the review (Standard on Assurance Engagements ASAE 3100 Compliance Engagements).*

*Notes to Consider – Keep this section concise. Do not use this section to enumerate all the obligations selected by the Commission for review. The detailed scope should form part of the Executive Summary. Do not also use this section to provide details of the auditor’s Approach to Sampling, Methodology, Overview of Testing, Compliance Grades, Systems and Processes. This information may form part of the Detailed Audit Report as an Appendix.*

#### **Limitations**

*This section should allow the reader to understand the inherent limitations of the retailer’s internal control environment, and limitations of the auditor’s review as it is not designed to detect all weaknesses, provide absolute assurance, etc.*

*This section may also include a brief statement on the distribution and use of the report, the person or entity that may be entitled to rely on the report, and the responsibility that the auditor accepts for the reliance that may be placed on the report.*



*Notes to Consider – Keep this section concise with key statements relating to the limitations of the auditor’s review and report.*

**Observations and Conclusion<sup>1</sup>**

*This section should include a statement that allows the reader to grasp a level of assurance on the retailer’s overall compliance framework, improvements noted since the last review, significant non-compliance issues, and other matters that need to be highlighted to the Commission.*

*Notes to Consider – Keep this section concise with key statements relating to an auditor’s opinion on the overall compliance of the retailer. Do not use this section to enumerate significant audit findings as these should form part of the Executive Summary. Target audience includes senior executive management of the Commission and licensed energy business. The signed letter serves as the cover letter for the Executive Summary.*

Name of Audit Firm

Name and Signature of Partner

Date

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<sup>1</sup> ASAE 3100 suggests the inclusion of sections on Respective Responsibilities and Use of Report, and wording for the Conclusion in the case of a qualified or unqualified opinion. These elements are not required for the Commission’s purposes.



## Executive Summary – Proposed Format

### Background

*This section should provide the reader with a brief description of the nature of the review, and an auditor’s statement confirming that GL No. 22 and Tripartite Audit Deed have been complied with when the audit was performed.*

*Notes to Consider – Keep this section concise. Key statements should mainly relate to the Commission’s requirement for a compliance review conducted by an independent auditor.*

### Scope

*This section should provide the reader with information on the audit scope and objectives and test period including the prescribed compliance grades. This may include a brief reference to the Commission’s Regulatory Audit – Minimum Audit Scope.*

*Notes to Consider – Keep this section concise. Do not use this section to explain each compliance grade.*

### Audit Findings and Management Compliance Plans

*This section should provide a summary of audit findings and management compliance plans (if available). A brief reference to GL No. 22 compliance grades should be made. The table only contains (1) non-compliance and partial compliance (for obligations), and (2) worse than B2 (for regulatory information).*

*Subheadings (such as ‘Energy Licence’ etc. below) would normally be replaced by text reflecting the subject matter of a group of obligations in the audit scope – e.g. ‘Complaint management’.*

Audit Findings		Management Compliance Plans
<b>A. Energy Licence</b>		
A.1	Summary of Significant Non-Compliance (cause and significance of the audit finding)	<i>Summary of Key Management Action Plans</i> A.1.1 A.2.1 <i>Expected Completion Date:</i>



Audit Findings	Management Compliance Plans
<b>B. Energy Codes</b>	
B.1 Summary of Significant Non-Compliance (cause and significance of the audit finding)	<i>Summary of Key Management Action Plans</i>  B.1.1 B.1.2  <i>Expected Completion Date:</i>
B.2 Summary of Significant Non-Compliance (cause and significance of the audit finding)	<i>Summary of Key Management Action Plans</i>  B.2.1 B.2.2  <i>Expected Completion Date:</i>
<b>C. Energy Guidelines</b>	
C.1 Summary of Significant Non-Compliance (cause and significance of the audit finding)	<i>Summary of Key Management Action Plans</i>  C.1.1 C.1.2  <i>Expected Completion Date:</i>
<b>D. Regulatory Reporting</b>	
D.1 Summary of Significant Non-Compliance (cause and significance of the audit finding)	<i>Summary of Key Management Action Plans</i>  D.1.1  ...  <i>Expected Completion Date:</i>

*To provide the reader with a balanced report, a brief statement may be made to state the number or brief description of items with 'A' or 'B' compliance grades (for regulatory information) and those classified as 'general compliance' (for licence obligations).*



*The table in this section should also provide the reader with the auditor's brief assessment on the retailer's compliance plans (if available) and the status of such plans as of the issue date of the Audit Report.*

*Summary of Key Management Action Plans should identify the root cause rather than the symptoms of the problem, and address the root cause to minimize (or prevent) non-compliance from recurring.*

*Expected Completion Date should be the date when the new process or controls have been implemented and tested by management. For example, it may take at least six months for new process or controls to be proven effective and sustainable.*

*Notes to Consider – Provide the reader with a concise description of the significant non-compliance and the corresponding compliance plan. Do not use the table to provide the specific details of the non-compliance.*

*A brief reference to the Detailed Audit Report may be made to let the reader know that detailed information on the audit findings stated in the table above is available in a separate report. The Detailed Audit Report also contains the details of items with 'A' or 'B' compliance grades (for regulatory information) and those classified as 'general compliance' (for licence obligations).*

### **Other Matters**

*This section should only be used when an auditor believes that important information should form part of the Executive Summary to apprise the Commission management, but does not belong to any of the above category. This may include any observations or additional comments related to the Conclusion of the signed Auditor's Report.*

*This section may also include other key observations that the auditor believes are necessary to support the audit conclusion such as the extent to which compliance risk is articulated, treated or managed in the organization, or the extent to which the licensee manages its compliance program with relevant standards (i.e., AS ISO 10002–2006 Customer satisfaction - Guidelines for complaints handling or AS 3806–2006 Compliance Program).*

*Notes to Consider – Any limitations on scope or change of IT systems that affected the test period or sample size should still be reported under the Scope section. Any changes to this format must be discussed with the Commission and be guided by the suggestions set out in ASAE 3100.*

**Auditor's statement**

**In our opinion, GL No. 22 – Regulatory Audits of Energy Businesses and the Tripartite Audit Deed dated [ ] between [Auditor] [Licensee] and the Essential Services Commission of Victoria have been complied with in all material and relevant respects, in conducting the agreed procedures, making findings and preparing the report.**

**The key findings set out above reflect in all material respects the professional opinion of the auditor to the level of confidence specified by the Essential Services Commission of Victoria and consistent with the audit approach and methodology described in this report (specifically the Standard on Assurance Engagements ASAE 3100 Compliance Engagements).**

**Auditor**

**Melbourne**

**Date**