

# Review of participant audit regime

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## Decisions and reasons paper

27 June 2016



## Version control

Version	Date amended	Comments



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# 1 The Authority has reviewed the participant audit regime

- 1.1 The Electricity Authority (Authority) is an independent Crown entity charged with promoting competition in, reliable supply by, and the efficient operation of the electricity industry for the long-term benefit of consumers.
- 1.2 The participant audit regime is the audit, certification, and approval processes that apply to auditors, participants, and the Authority under Parts 10, 11, and 15 of the Electricity Industry Participation Code 2010 (Code).
- 1.3 Between 10 November and 22 December 2015, the Authority consulted on a proposal to:
  - (a) clarify the purpose of the audit regime, and ensure it is well defined and aligned with the Authority's statutory objective
  - (b) improve the governance of the audit regime and better align it with international audit best practice
  - (c) improve the operational efficiency of the audit regime and support for the decisions being made as a result of audits.
- 1.4 The Authority received 18 submissions from both industry and non-industry participants
  - (a) eight from certified reconciliation participants
  - (b) four from distributors
  - (c) one from an MEP
  - (d) three from organisations with approved auditors
  - (e) two from organisations that are not industry participants or approved auditors.
- 1.5 This paper describes the decisions reached by the Authority based on the consultation, and the reason for each decision.

# 2 The Authority has decided to amend the Code

- 2.1 Following consultation, the Authority has decided to:
  - (a) amend Parts 10, 11, and 15 of the Code, including to inserting a new Part 16A (as set out in Table 1)
  - (b) update the existing guidelines and the proposed guidelines, auditor protocol and risk-based planning procedure.
- 2.2 Table 1 summaries the changes made to what was proposed in consultation paper, as a result of the consultation submissions.

**Table 1: Summary of changes following consultation**

Consultation Reference	Code changes	Other changes
A.1.1	Renumber Part 15A of the Code as Part 16A. Include a purpose statement for the new Part 16A.	
B.1.1		Incorporate relevant portions of ISO 19011:2011 into the auditor protocol.
B.2.1		Risk-based audit planning procedure to include consideration of a participant's history of ongoing non-compliance in terms of the materiality of that non-compliance and the risk it creates for the market.
B.3.1	Modify the timeframe for auditor rotation to the greater of every two years or two audits (excluding material change audits). Add an 'unless approved by the Authority' clause to allow a participant to continue to use the same auditor beyond the maximum permissible timeframe if agreed by the Authority. Remove the requirement for participants to notify the Authority of the appointment of an auditor and the ability of the Authority to reject appointment of an auditor.	
C.1.1	Amend clause 16A.12 to remove the requirement for an auditor to submit a draft audit report.	
C.1.3	Revise the wording of clause 16A.11 to describe a material change in terms of a change that is likely to affect the ability of the participant to comply with the Code.	Update participant audit guidelines to provide guidance on how to assess whether a change is material.
C.1.6		Update auditor protocol in regard to the evaluation of agent audits. Update auditor protocol to require agent auditors to clearly identify whether participants are in breach of the Code.

Consultation Reference	Code changes	Other changes
C.2.1		Develop a mechanism that will allow participants to notify the Authority of any items in the audit report or compliance plan that should not be made public and instead make public the reason the information has been withheld. Publicise a summary of the Authority's reason for any decision in relation to the audit.
C.3.2	Amend the wording of clause 16A.9 to require the Authority to provide a participant with the Authority's reason for requiring an audit to focus on a specific issue or issues.	Amend the auditor protocol to include a step for an auditor to sign-off the audit's scope as part of the auditor engagement.
C.5.2	Revoke clause 15.38A and clause 5(1A) of Schedule 15.1 to remove the requirement for reconciliation participants and dispatchable load purchasers to hold quality certification.	Amend the audit guidelines to include a requirement to assess a participant's documented processes.
C.5.3	As per C.5.2	
C.7.1	New clauses 15.37B and 16A.26(2) to require the regular audit to include an assessment of the accuracy of the distributed unmetered load (DUML) database compared to the actual DUML in the field. This replaces the requirement for a separate full field audit.	DUML audit guidelines to include information on how to assess the accuracy of the database compared to the load in the field.

Source: Electricity Authority

## 3 Overview of the Authority's proposals

- 3.1 The Authority separated its proposals into the following three areas:
- 3.2 **Area A:** to clarify the purpose of the participant audit regime.
- 3.3 **Area B:** to improve the governance of the audit regime, and better align it with international audit best practice by:
- setting formal auditor assurance standards
  - adopting a risk-based audit planning procedure
  - more directly managing auditor objectivity and conflicts of interests.



3.4 **Area C:** to improve the operational efficiency of the audit regime and better align it with the Authority's statutory objective by addressing operational issues with:

- decision-making
- transparency in decisions
- participant education
- manual processes
- quality certification
- new entrant retailers
- DUML.

## 4 The Authority's reasons for its decisions

### 4.1 Area A: to clarify the purpose of the audit regime

#### A.1.1 Purpose of the audit regime

4.1.1 The Authority proposed to clarify the purpose of the audit regime by including the following new purpose statement:

*The purpose of the audit regime is to:*

- *evaluate participants' compliance with the Code and to help ensure the ongoing accurate and efficient operation of the wholesale electricity market settlement process*
- *enable the Authority to make an informed decision regarding the certification, approval, and audit frequency of participants.*

The proposed purpose of the audit regime would apply more broadly than the purpose of the Code amendments, so was not intended to be incorporated into the Code.

4.1.2 The new purpose clause required a consequential revocation of clause 11.10(3), which defined the purpose of the audit regime for distributor audits.

#### **Submissions generally supported the proposed purpose**

4.1.3 Most submissions supported the proposed purpose of the audit regime.

4.1.4 Three submissions did not support the proposed purpose because:

- (a) the proposed purpose conflicts with the Authority's compliance philosophy<sup>1</sup>
- (b) the existing compliance focus is appropriate.

4.1.5 The Authority disagrees that the proposed purpose conflicts with the Authority's compliance philosophy. We believe it complements the compliance philosophy through the focus on the accurate and efficient operation of the wholesale market. The compliance function of the Authority is a distinctly separate role from the Authority's role in assurance and operation of the electricity market.

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<sup>1</sup> Our compliance philosophy is to encourage continuous improvement by industry participants in the effective, efficient and reliable operation of the electricity industry for the long-term benefit of consumers.

<http://www.ea.govt.nz/code-and-compliance/compliance/about-compliance/>

- 4.1.6 Accordingly, the Authority considers that care needs to be taken to ensure there is a clear separation between:
- (a) the Authority supporting the efficient operation of the market, including assurance activities
  - (b) the Authority enforcing compliance with the Code.
- 4.1.7 The Authority disagrees that the existing focus on participant compliance with the Code is appropriate. An assessment of compliance does not provide meaningful information about how effectively the market is operating, or the impact of any issues created due to breaches of the Code.
- Submissions were split on the inclusion of the purpose into the Code**
- 4.1.8 Six submitters did not support the proposal that the purpose of the audit statement not be incorporated into the Code.
- 4.1.9 Key points raised by submitters were:
- (a) If the purpose was not incorporated into the Code the Authority could change the purpose of the audit regime without notice or consultation with the industry.
  - (b) The purpose statement should sit at the head of a part of the Code dedicated for audit purposes, eg, Part 16. This approach is consistent with other legislation such as the Electricity Industry Act 2010 and Part 6 of the Code which include purpose statements.
  - (c) Each auditable participant class may need its own customised purpose statement.
- 4.1.10 The Authority acknowledges that guidelines can be amended more readily than the Code. However, we do not consider there are significant risks associated with using guidelines to communicate the purpose of the audit regime. The Authority considers that to be effective, any change to the purpose of the audit regime would need to be clearly communicated and consulted on with auditors and audited participants.
- 4.1.11 The Authority also considers that the Code is not an appropriate mechanism to communicate the purpose of a regime that is not itself defined by the Code. The Authority does agree that a purpose statement can be included in the new Part 16A of the Code to clarify what Part 16A intends to achieve.
- 4.1.12 We agree that there should be a dedicated part of the Code for audit purposes. The Authority has decided to create a new Part 16A for this purpose.
- 4.1.13 We agree that other legislation, including section 4 of the Electricity Industry Act 2010, includes a purpose statement. However, section 4 of the Act describes the legal framework of the Act,<sup>2</sup> not the outcomes the Act seeks to achieve.
- 4.1.14 We agree that a purpose statement can be included in the new Part 16A of the Code to clarify what it intends to achieve. We consider that this is a minor and non-controversial change. The purpose statement in new Part 16A will not place an obligation on any participant and will not change the meaning of any of the other Code amendments.

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<sup>2</sup> Section 4 of the Act states:

*The purpose of this Act is to provide a framework for the regulation of the electricity industry.*

- 4.1.15 We disagree that each auditable participant class should have its own purpose statement. Each participant is audited in the context of its role in the accurate settlement of the wholesale electricity market.

**Table 2: The Authority's decisions and reasons for A.1.1 – Purpose of the audit regime**

Decision	Reason
<p>State the purpose of the audit regime as:  <i>The purpose of the audit regime is to:</i></p> <ul style="list-style-type: none"> <li><i>evaluate participants' compliance with the Code and to help ensure the ongoing accurate and efficient operation of the wholesale electricity market settlement process</i></li> <li><i>enable the Authority to make an informed decision regarding the certification, approval, and audit frequency of participants.</i></li> </ul>	<p>The proposed purpose addresses the issues with the existing purpose of the audit regime as identified in the consultation paper.</p>
<p>The purpose will be incorporated into guidelines, not the Code.</p>	<p>The purpose does not place an obligation on participants, so has no additional standing in the Code.</p>
<p>The audit provisions will be included in a dedicated part of the Code, Part 16A.</p>	<p>Placing the audit provisions at the end of Part 15, as Part 15A could create the misperception that the audit provisions are solely related to reconciliation obligations contained in Part 15.</p>
<p>Part 16A will include a new clause to state the part's purpose.</p> <p>16A.2 Purpose of this part  <u><i>The purpose of this Part is to require the performance of <b>audits</b> to support the accurate settlement and operation of the wholesale electricity market</i></u></p>	<p>Clause 16A.2 will clarify the purpose of the new Part 16A of the Code, addressing concerns raised regarding comparisons to purpose statements made in other legislation.</p>
<p>Revoke clause 11.10(3)</p>	<p>The reason for incorporating distributor audits into clause 11.10(3) is no longer appropriate because the audit regime will have a wider purpose statement that encompasses all audit types.</p>

Source: Electricity Authority

## 4.2 Area B: to align the audit regime with auditing best practice

- 4.2.1 The Authority proposed to improve the governance of the audit regime, and better align it with international audit best practice, by:
- (a) setting formal auditor assurance standards
  - (b) adopting a risk-based audit planning procedure
  - (c) more directly managing auditor objectivity and conflicts of interests.

### B.1.1 Governance of the audit regime

- 4.2.2 The Authority proposed to address issues with the governance of the audit regime by prescribing assurance requirements that auditors must follow and be assessed against.
- 4.2.3 These assurance requirements were based on the ISAE (NZ) 3000 standard, and a draft auditor protocol was provided in an appendix to the consultation paper.

### Submissions generally supported use of auditor standards and proposed auditor protocol

- 4.2.4 Submissions generally supported the use of auditor standards such as the proposed auditor protocol (appendix D of the consultation paper).
- 4.2.5 Key points raised by submitters were:
- (a) the need to test the auditor protocol prior to fully implementing it
  - (b) concern regarding the auditor protocol's reference to risk-based planning, when risk-based planning principles were in the draft stage
  - (c) auditors should be required to meet the full auditor standard, either ISAE (NZ) 3000 or ISO 19011:2011.
- 4.2.6 The Authority agrees that testing the auditor protocol before implementation is sensible and it will be included as part of the implementation of the changes to the audit regime.
- 4.2.7 The Authority does not agree with concerns regarding the reference to risk-based planning when the risk-based planning procedure has not been fully developed. The development of these risk-based planning documents is staged to allow for comments on the higher level principles to be considered before the detail of the risk planning procedure is referenced in the protocol. The implementation phase will consider the timing and order required to effectively deliver on changes.
- 4.2.8 The Authority does not agree that ISO 19011:2011 is a suitable alternative standard that should be adopted. This standard focusses on the auditing of risk management systems, not compliance with legislative obligations (such as the Code). However, there are aspects of this standard that are relevant and can be incorporated into the auditor protocol.
- 4.2.9 The Authority does not agree that requiring auditors to meet the full ISAE (NZ) 3000 standard is a solution that will deliver the most benefits to consumers. ISAE (NZ) 3000 requires monitoring of a firm's quality control system to determine compliance. Larger firms have internal auditors who monitor compliance with such internal policies. Requiring smaller firms to comply would impose undue costs on the audit regime without delivering additional benefits.

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**Table 3: The Authority's decisions and reasons for B.1.1 – Governance of the audit regime**

Decision	Reason
Retain the auditor protocol as the standard for auditors to adhere to.	The tailored auditor protocol provides the best balance of assurance against costs incurred by existing and potential auditors in meeting governance requirements..
Amend the auditor protocol based on feedback, including incorporating relevant aspects of ISO 19011:2011.	Submissions have identified a number of improvements to the draft auditor protocol.
Test the auditor protocol prior to implementation.	To provide the opportunity to identify potential operational issues with the protocol that were not found during consultation.

Source: Electricity Authority

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### **B.2.1 Approach used to focus effort**

4.2.10 The Authority proposed to expand its role in audit planning to:

- (a) specify the scope and focus areas for audits based on a risk assessment of participants
- (b) specify materiality levels to be used to report audit findings.

4.2.11 This would be achieved through risk-based planning procedures.

4.2.12 A copy of the risk-based planning principles on which a risk-based planning procedure would be based was included as supplementary information to the consultation paper.

### **Submissions very supportive of the use of risk-based planning procedures to focus effort**

4.2.13 Submissions were very supportive of the use of risk-based planning procedures to focus effort, with all submissions supporting the concepts behind the proposal.

4.2.14 Submissions focussed on the details surrounding the proposed risk-based planning procedures with the key points focussing on:

- (a) the need for further consultation on the content of the risk-based planning procedures prior to finalisation
- (b) the need to define a materiality threshold to ensure time and effort is not wasted on low risk areas
- (c) the need to include a forward looking assessment of risk and to consider materiality in terms of ongoing historical impact as well as future impact of any issue.

4.2.15 The Authority agrees that there should be further consultation on the detail within the risk-based planning procedures prior to finalisation. The procedures will be based on

the risk-based planning principles included as supplementary information to the consultation paper. Consultation on the details within the risk-based planning principles will be included as part of implementing the changes to the audit regime.

- 4.2.16 The Authority agrees that time should not be wasted on low risk areas; however there is a need to consider the ongoing nature of any issue. A small issue left unaddressed for a long time will still impact the market negatively over time.
- 4.2.17 The Authority agrees that risk and materiality needs to be viewed in terms of both historical and future risks and impacts.

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**Table 4: The Authority's decisions and reasons for B.2.1 – Approach used to focus audit effort**

Decision	Reason
Retain the risk and materiality guidelines for use in audits	Considering risk and materiality when approaching audits will deliver efficiency benefits and allow more focus to be placed on high risk and high materiality areas.
Consult on the risk and materiality guidelines prior to implementation	To improve the draft risk and materiality guidelines based on submissions.

Source: Electricity Authority

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### B.3.1 Appointment of auditors

- 4.2.18 The Authority proposed to better align the appointment of auditors with audit best practice by:
  - (a) requiring participants to change auditors every two audits
  - (b) approving the nomination of an auditor by a participant
  - (c) amending the terms and conditions of auditor approval to require auditors to undergo further training where appropriate.

### Submissions were split on the proposals surrounding the appointment of auditors

- 4.2.19 Submissions were split, with five submissions not supporting the proposals.
- 4.2.20 Key points from submissions were:
  - (a) most submitters preferred to retain the choice of auditor (one submitter proposed that the Authority should assign auditors)
  - (b) confusion by submitters about whether the proposal was to change auditor, or audit company
  - (c) concerns around the timeframes for a participant to obtain an audit if its choice of auditor is declined

- (d) concerns that the number of available auditors may make auditor rotation impractical
  - (e) concerns that the two year time period for auditor rotation is overly restrictive
  - (f) a suggestion that if the Authority rejects an auditor's appointment, the Authority should provide its reason for the rejection.
  - (g) if the Authority rejects an auditor's appointment, the Authority should provide a list of auditors that it will not reject
  - (h) provide an 'unless agreed otherwise' clause to allow a participant to use an auditor more times than allowed by the Code.
- 4.2.21 The Authority agrees that audited participants should retain choice of auditor. As discussed in the consultation paper, assignment of auditors by the Authority is unlikely to deliver any additional benefits and will add administrative costs.
- 4.2.22 The potential for confusion regarding whether the proposal was intended to require the change of auditor or audit company is acknowledged. For clarity the proposal was to change auditor at least every two years, but not necessarily the audit company.
- 4.2.23 We agree that there is no need for the participant to notify the Authority of the nomination of their auditor or for the Authority to approve or decline the nomination. There should be no need for the Authority to decline the appointment of auditors that has been approved to perform audits.
- 4.2.25 The Authority believes that the number of auditors is sufficient to support auditor rotation and that opportunities exist for further auditors to enter the market if necessary.
- 4.2.26 The two year time period for auditor rotation was reflected in the Code as being a two audit time period. we agree that there may be some confusion from participants that are audited annually as to the difference and that a two audit time period is overly restrictive. The Code will be amended to require auditor rotation after two audits or two years (whichever is the latter).
- 4.2.27 We agree that Authority should provide a reason if it rejects the appointment of an auditor. However we agree that there should be no need for the Authority to decline the appointment of auditors that has been approved to perform audits.
- 4.2.28 We disagree that the Authority should provide a list of suitable auditors. However we agree that there should be no need for the Authority to decline the appointment of auditors that has been approved to perform audits.
- 4.2.29 The Authority agrees that there should be a provision to account for extreme circumstances in which the same auditor may need to be used more than the Code allows.

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**Table 5: The Authority's decisions and reasons for B.3.1 – Auditor appointment**

Decision	Reason
Proceed with the Code amendments to require participants to change auditors.	<p>This amendment will:</p> <ul style="list-style-type: none"> <li>• mitigate threats to auditor independence</li> </ul>

Decision	Reason
	<ul style="list-style-type: none"> <li>align the current regime with auditing best practices</li> <li>enhance the credibility and quality of audits.</li> </ul>
Amend the Code to require participants to change auditors the greater of every 2 years or two audits.	This will allow the same auditor to be retained if more frequent audits are required, and for the same auditor to be used for more than 2 years when audits are less frequent.
Remove the requirement for participants to notify the Authority of their auditor and ability to reject the use of an auditor.	<p>Authority has approved auditors to conduct audits. This should be sufficient to consider the auditor competent enough to conduct the audit.</p> <p>In the event of a conflict of interest or poor quality audit a shorter next audit date can be set to enable the audited participant to provide a good quality audit that is free from any conflicts of interest.</p>
Proceed with the proposal to amend the terms and conditions of auditor approval to require auditors to undergo further training where appropriate	Will support consistent auditing practice.

Source: Electricity Authority

### 4.3 Area C: to improve the operational efficiency of the audit regime and better align it with the Authority's statutory objective

4.3.1 The Authority proposed changes to the audit regime in order to improve the operational efficiency of the audit regime.

4.3.2 These proposals were separated into the following categories:

C.1: Decision-making

C.2: Transparency

C.3: Education

C.4: Manual Processes

C.5: Quality Certification

C.6: New entrant retailers

C.7: Distributed unmetered load.

#### C.1 Decision-making

4.3.3 The Authority makes decisions based on the content of the audit reports.



- 4.3.4 Decisions are likely to be high quality decisions when:
- (a) the information in the audit report is clear
  - (b) there is no uncertainty about the actions required as a result of the audit.
- 4.3.5 The Authority identified the following areas where changes could be made to improve the decision-making process:
- C.1.1: clarify the actions taken as a result of the audit
  - C.1.2: clarify if an alleged breach is a wider industry issue
  - C.1.3: clarify definition of material change
  - C.1.4: clarify definition of next audit date
  - C.1.5: better decisions regarding the frequency of audits
  - C.1.6: standardise the timing requirements for agent audits
  - C.1.7: flexibly auditor approval terms
  - C.1.8: requirement for participants to provide auditor and Authority with information
  - C.1.9: standardise allocation of payment of auditor costs.

#### **C.1.1 Clarify the actions taken as a result of the audit**

- 4.3.6 The Authority proposed to clarify the actions taken as a result of the audit by amending the Code to require the participant to submit a compliance plan, with its audit report, to the Authority.

#### **Submissions generally supported the compliance plan**

- 4.3.7 Key points from the submissions included:
- (a) uncertainty around if the auditor was required to submit a draft audit report
  - (b) non-material non-compliances should not be part of the compliance plan
  - (c) concerns regarding the compliance plan as an evolving document that may change over time.
- 4.3.8 The Authority notes that the proposal did not include the requirement for the auditor to submit a draft audit report, while the proposed Code amendments did include this requirement. The finalised Code amendment does not include this requirement and reflects the proposal that was consulted on.
- 4.3.9 The Authority disagrees that non-material non-compliances should not be part of the compliance plan. Compliance with the Code is not optional and where there is a breach information needs to be provided to assess how this is being addressed.
- 4.3.10 The intention is for the compliance plan to be a snap-shot of planned actions as a result of the audit. This is a similar, but more formal version of the information some participants are choosing to provide in their audit reports.

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**Table 6: The Authority's decisions and reasons for C.1.1 – Compliance plan**

Decision	Reason
Amend the Code to require each audited participant to submit a compliance plan.	A compliance plan will provide the Authority with information in a standardised format that can be used to support more informed decisions.
Amend clause 16A.12 to remove requirement for submission of a draft audit report.	Submission of a draft audit report would result in double handing of audits.

Source: Electricity Authority

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### **C.1.2 Clarify if an alleged breach is a wider industry issue**

- 4.3.11 The Authority proposed to clarify if an alleged breach is a wider industry issue by creating an issues register for all issues where action taken is not specific to the participant.

#### **Submissions generally supported the issues register**

- 4.3.12 Key points from the submissions included:
- (a) auditors are a better source of knowledge than a register of issues
  - (b) concerns that an issues register would not be effectively managed or maintained
  - (c) a working group should formally review and respond to industry level issues identified by auditors
  - (d) items on the issues register should not result in alleged Code breaches.
- 4.3.13 The Authority disagrees that auditors are a better source of knowledge than the issues register. Auditors have insights based on the different participants they audit. Keeping this information 'siloe'd' within each auditor is unlikely to deliver system benefits or enable fully informed decisions to be made.
- 4.3.14 Concerns regarding management and maintenance of issues register are noted. Details regarding how the issues register will fit into the operational functions of the Authority will be considered as part of implementation of the changes to the audit regime.
- 4.3.15 The Authority disagrees that a working group is the best solution to review and respond to issues on the issues register. It is the Authority that needs to decide if an issue warrants further action or should be referred back to an individual participant for resolution. The Authority can also establish ad hoc or more formal working groups in the event that an issue or issues on the register merit such an approach.
- 4.3.16 The Authority disagrees that items on the issues register should not result in alleged Code breaches. The Code imposes legal obligations on participants. Participants are still in breach of the Code, even if the issue is listed on an issues register.

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**Table 7: The Authority's decisions and reasons for C.1.2 – Issues register**

Decision	Reason
Create an issues register for breaches or issues where the action taken is not specific to the participant being audited.	An issues register will allow the Authority to identify and collate industry-wide issues.

Source: Electricity Authority

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### C.1.3 Definition of material change

- 4.3.17 The Authority proposed to clarify what constituted a material change and to standardise the requirement for material change audits across all audited participants.

#### Submissions generally did not support the amended material change definition

- 4.3.18 Key points from the submissions included:
- (a) concerns that current wording is broad and may have unintended consequences that means minor changes are subject to a material change audit
  - (b) concerns that introducing audit requirements will delay implementation of unaudited changes
  - (c) a third party such as the Authority should make a determination for each change to decide if it is material
  - (d) the status-quo should be retained.
- 4.3.19 The Authority agrees that the proposed wording may have unintended consequences. The intention was not for minor changes to be subject to a material change audit.
- 4.3.20 Concerns regarding delay are noted. However if a change is significant enough to be material (for instance it involves planning, testing and a controlled deployment to production) then the audit requirement can be planned as part of the testing and deployment phases.
- 4.3.21 The Authority disagrees that a third party should make a determination for each change to decide if it is material. This would add unnecessary cost for minor changes, as changes could only be deemed minor if determined by the third party.

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**Table 8: The Authority's decisions and reasons for C.1.3 – Material change**

Decision	Reason
Revise the wording of clause 16A.11 to describe a material change in terms of a change that is likely to affect the ability of the participant to comply with the Code	Supports efficient decision making by defining materiality in terms of the likelihood of a change impacting the participant's ability to comply with the Code.

Decision	Reason
Update participant audit guidelines and auditor guidelines to provide guidance on how to assess whether a change is likely to be material.	Will support consistent assessment of when a change should be considered material.

Source: Electricity Authority

#### C.1.4 Definition of next audit date

- 4.3.22 The Authority proposed to standardise the terminology regarding audit timeframes to reference a next audit date.
- 4.3.23 The purpose of this change was to ensure that it was clear the timeframes for audit regardless of the participant being audited.

#### Submissions generally supported the clarification of next audit date

- 4.3.24 Most submissions supported the clarification of next audit date with the only key point raised being to introduce an additional requirement that audits be completed within 2 months of the next audit date.
- 4.3.25 While we can understand the reasoning behind requiring audits to be completed within two months of the next audit date, we do not believe that this requirement should be adopted. The timeframes for audit are a maximum, not a target. We do not want to prevent audited entities from conducting and submitting audits earlier than the next audit date.

**Table 9: The Authority's decisions and reasons for C.1.4 – Next audit date**

Decision	Reason
Retain the proposal to standardise the next audit date.	Will introduce administrative efficiencies and remove ambiguity as to when an audit is considered complete.

Source: Electricity Authority

#### C.1.5 Variable audit period

- 4.3.26 The Authority proposed to extend the ability to determine the next audit date to all audited participants.
- 4.3.27 This change sought to deliver efficiency benefits by allowing the Authority to increase the period between audits for participants that are a low risk to the market, and by reducing the period between audits for participants that have a higher risk of adversely impacting market settlement.

### Submissions were mixed on the variable audit period

- 4.3.28 Submissions were mixed on the proposal of a variable audit period with some submitters objecting to the proposal and preferring a fixed 12 monthly audit cycle, while other submitters strongly supported the initiative.
- 4.3.29 Key points from submissions were:
- (a) all audited participants should be audited annually; additional audits can be enforced via the Authority's compliance team
  - (b) audit periods of less than 12 months are inefficient
  - (c) the Authority should consult with participants prior to setting criteria for variable audits.
- 4.3.30 We disagree that all participants should be audited annually. The cost-benefit analysis demonstrates that there is expected to be a benefit to audited entities and, ultimately, consumers by shifting to a variable audit regime.
- 4.3.31 We disagree that audit periods of less than 12 months are inefficient. Audit periods of less than 12 months have been successfully applied to metering equipment providers and reconciliation participants. More frequent audits can help provide transparency and opportunities for clarification and further action while audited participants manage issues impacting the market.
- 4.3.32 The Authority agrees that any criteria for variable audits should be consulted on. This is consistent with the approach taken to setting the criteria for variable audits for metering equipment providers.

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**Table 10: The Authority's decisions and reasons for C.1.5 – Frequency of audits**

Decision	Reason
Retain the proposal to introduce variable audits for all audited entities.	Will deliver efficiency benefits in the form of less frequent audits for participants that comply with the Code and manage their compliance risk

Source: Electricity Authority

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### C.1.6 Timing of agent audits

- 4.3.33 The Authority proposed to require agent audits to have been conducted within seven months of the participant audit in order to be used by the participant auditor.
- 4.3.34 This change sought to remove the issues associated with participant audits, where the participant's agent is audited for a different period than the participant. Information in the agent audit is used to assess compliance for the participant over the participant audit period.

**Submissions were silent on or did not support the changes to the timing of agent audits.**

- 4.3.35 Of the 18 submissions received, 13 did not directly address the proposed changes affecting the timing of agent audits. Five submissions did directly address the proposed changes to the timing of agent audits and all five did not support the proposal.
- 4.3.36 Some of the lack of support was due to misunderstanding around what an agent is and their role in the electricity industry.
- 4.3.37 Key points from submissions were:
- (a) classify agents as an industry participant and include them in the audit regime
  - (b) participants should be audited for compliance with the Code, not agents
  - (c) agent audits should be conducted within the previous calendar year
  - (d) agent audits should clearly identify the participants in breach
  - (e) the lead (participant) audit should be required to evaluate samples of work carried out by agent.
- 4.3.38 Section 7 of the Act sets out who are "industry participants" for the purposes of the Act and the Code. As currently worded, the Act does not include agents in the meaning of "industry participants". Additionally agents act on behalf of a participant, so it is the participant who ultimately has responsibility for meeting their obligation under the Code.
- 4.3.39 Participants are audited for compliance with the Code. Where more than one participant discharges their obligations through the same agent it can be cost effective for the agent to produce one audit rather than for the agent to be audited as part of each participant audit.
- 4.3.40 The proposal for agent audits to be conducted within the previous calendar year is noted. However, agent audits this old are unlikely to fully inform decisions made as a result of the audit. For example if a participant is audited in December 2015, the participant will commonly be assessed for its activities between January 2015 and December 2015. For an agent that is audited in January 2015 whose audit was included in that participant's audit, they would be assessed for their activities between February 2014 and January 2015. It is difficult to make a fully informed decision regarding the participant's next audit date, when compliance with the Code is being assessed on information that is up to 23 months old (ie, the information dates back to February 2014).
- 4.3.41 The Authority agrees that agent audits should identify participants in breach. The audit guidelines will be updated to include this requirement.
- 4.3.42 The proposed requirement for the lead audit to evaluate samples of the agent's work will be considered during the development of the audit guidelines.

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**Table 11: The Authority's decisions and reasons for C.1.6 – Agent audits**

Decision	Reason
Retain the proposal to require agents to be audited within seven months of the relevant participant audit.	Will help ensure the agent audit is relevant to the period the participant is being audited for.
Update guidelines to include requirements for evaluating agent audits and to clarify requirements to clearly identify participants in breach.	Will support consistent evaluation of agent audits and provide improved clarity regarding participants in breach due to agent actions

Source: Electricity Authority

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### **C.1.7 Fixed auditor approval term**

- 4.3.43 The Authority proposed a Code amendment that would allow the Authority to approve auditors for a period of up to 36 months. This replaces the existing Code which requires approval to be for a fixed period of 24 months.

#### **Submissions generally supported shifting to a variable auditor approval term.**

- 4.3.44 All apart from one submission supported the proposed changes to the auditor approval period.
- 4.3.45 The only objection focussed on the concern that reducing the timeframe for approval could be seen as a lack of confidence in the auditor.
- 4.3.46 The Authority agrees that there is a risk that parties may perceive a shorter approval period as a lack of confidence in the auditor. However there are administrative impracticalities in requiring a fixed approval term. Additionally it means that auditors that may not be approved under a fixed 24 month period could be approved for a shorter period to allow them to demonstrate they meet the auditor approval criteria.

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**Table 12: The Authority's decisions and reasons for C.1.7 – Fixed audit approval term**

Decision	Reason
Retain the proposal to amend the Code to allow the Authority to approve auditors for a period of up to 36 months.	Provide administrative flexibility for the approval of auditors.

Source: Electricity Authority

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### **C.1.8 Access to information**

- 4.3.47 The Authority proposed a Code amendment that would require participants to provide the Authority and auditors access to information for the purposes of conducting an audit.

Most submissions supported proposal to require participants to provide access to information.

- 4.3.48 Most submissions supported or conditionally supported requiring participants to provide the Authority and auditors access to information for the purposes of conducting an audit. One submitter did not support the proposal.
- 4.3.49 Key issues raised were:
- (a) access rights should be reciprocal and auditors should provide full disclosure regarding their analysis, particularly where their analysis determines a breach has occurred
  - (b) the Code should include a caveat regarding information that can be reasonably provided to avoid difficult to fulfil or onerous requests
  - (c) the clause should not apply to the Authority, who already has powers to request information under the Act.
- 4.3.50 The Authority agrees that auditors should provide information regarding the analysis that has been conducted. This should be covered by the terms for engagement between the auditor and participant, rather than the Code.
- 4.3.51 The Authority agrees the requests for information should be 'reasonable'. However it is not necessary to expressly include the term "reasonable" because it is inherent. The Code is delegated legislation that sits within an administrative law framework. A fundamental principle of administrative law is the requirement for such requests to be reasonable.
- 4.3.52 The Authority disagrees that the clause should not extend to Authority audits. By including this provision it is clear that the participant is required to provide the information for the purpose of the audit, rather than having to refer to the wider legislation and powers under the Act.

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**Table 13: The Authority's decisions and reasons for C.1.8 – Provision of information**

Decision	Reason
Retain the proposal to require participants to provide information requested for the purpose of the audit.	Expected to improve the quality of audits by removing barriers to the access to information.

Source: Electricity Authority

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### C.1.9 Standardise payment of auditor costs

- 4.3.53 The Authority proposed a Code amendment that would standardise the payment of auditor costs across all audit regimes. This would allow the Authority to apply one clause across all audited participants, in place of the multiple and different clauses that currently exist.



### Most submissions supported standardisation

- 4.3.54 Most submissions supported standardisation. However, not all submissions supported the standardised wording which would allow the Authority to determine the allocation of costs in the instance where a participant is not found to be in breach of the obligations as alleged by the alleging party.
- 4.3.55 The Authority considers that retaining the ability to allocate costs will enable it to consider any mitigating circumstances surrounding the allegations and circumstances that resulted in the Authority agreeing that an audit was necessary. The option still remains for the Authority to allocate all costs to the alleging party.

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**Table 14: The Authority's decisions and reasons for C.1.9 – Payment of auditor costs**

Decision	Reason
Retain the proposal to standardise the wording of the Code regarding how costs should be allocated following an Authority or participant requested audit.	Delivers a standard process that is consistent with the existing wording of the Code.

Source: Electricity Authority

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## C.2 Transparency and accountability

- 4.3.56 The Authority identified that it is not clear:
- (a) on what basis the Authority makes decisions regarding certification, approval or next audit date
  - (b) which issues are widespread and which are isolated to a small number of parties
  - (c) what actions have been taken by other participants to successfully address compliance issues
  - (d) how other auditors are assessing similar issues.

### C.2.1 Publication of audit reports and audit information

- 4.3.57 The Authority proposed a Code amendment to require the Authority to publicise:
- (a) a copy of the lead audit report submitted
  - (b) a copy of the compliance plan (if available)
  - (c) each participant's 'next audit date'.
- 4.3.58 The Authority proposed to revoke the requirement to publish a summary of the audit report.
- 4.3.59 The Authority proposed a process change that would mean the issues register (proposed in C.1.2) would also be publicised.
- 4.3.60 One reason for publicising the information is that the Official Information Act already requires the Authority to provide copies of audit reports on request.

- 4.3.61 While the proposal was part of the consultation held between 10 November 2015 and 22 December 2015, there were no questions in the paper that sought feedback for this proposal. Additional questions were raised and there was an opportunity to provide feedback on the proposal between 12 January and 16 February 2016.

**There was mixed support for the publication of audit reports**

- 4.3.62 Six out of 12 submitters did not support the publication of audit reports. A further three submitters supported the publication of audit reports but did not support the publication of additional information, including compliance plans.
- 4.3.63 One submission proposed the Authority publish an informative summary of the Authority's decision.
- 4.3.64 There was no direct opposition to the proposal to publish a participant's next audit date.
- 4.3.65 Key reasons for opposing publication of information were:
- (a) publication of follow-up questions would affect the way in which participants respond
  - (b) compliance plans contain detailed commercially sensitive information that prevents publication
  - (c) publication of audit reports creates a risk that the information could be misinterpreted by parties not familiar with the electricity sector
  - (d) publication of audit reports creates a risk that other participants will use the information for commercial gain
  - (e) audit reports include intellectual property, such as business processes; this intellectual property needs to be protected.
- 4.3.66 We agree that transparency and accountability is just as important for the Authority as it is for participants. Options for how to clearly communicate reasons for decisions made by the Authority as a result of the audit will be considered as part of the implementation of proposed changes to the Audit regime.
- 4.3.67 The Authority agrees that follow-up questions should not be published, and there is no intention to mandate that this information is made available to the public.
- 4.3.68 The Authority notes the concerns regarding compliance plans. The intention of the compliance plan is to understand what the participant plans, or has done, to achieve compliance. The intention is not to publish detailed information such as installation control point (ICP) numbers. Where required, detailed information could be supplied to the Authority in a separate document, not in the compliance plan
- 4.3.69 The Authority notes the concerns about commercially sensitive information contained in audit reports being made available. We note that this risk exists under the current audit regime as the Authority must consider whether to make audit reports available under the Official Information Act 1982 (OIA), if requested. The OIA provides grounds to withhold any commercially sensitive content from audit reports. Additionally, experience from other audit regimes, such as the gas industry audit regime, has not found any evidence of the risk manifesting.
- 4.3.70 The OIA includes provisions regarding the publication of trade secrets. Processes to protect information under the OIA will be adopted for any publication of audit reports and associated information.

**Table 15: The Authority's decisions and reasons for C.2.1 – Provision of information**

Decision	Reason
<p>Proceed with the proposal to amend Code to require the Authority to publicise:</p> <ul style="list-style-type: none"> <li>• a copy of the lead audit report</li> <li>• the compliance plan</li> <li>• each participant's next audit date.</li> </ul> <p>Proceed with the proposal to publicise a register of reported issues.</p> <p>Develop a mechanism that will allow participants to notify the Authority of any items in the audit report or compliance plan that meet the OIA criteria for withholding the item. Details regarding the reason the information has been withheld can then be made available in place of the information.</p> <p>Publicise a brief summary of the reasons for any decision made by the Authority.</p>	<p>This solution is consistent with the conditions under which information is required to be released under the OIA. These conditions include provisions to protect trade secrets and to not unreasonably prejudice the commercial position of the organisation that supplied the information.</p> <p>It is expected that publication will provide qualitative benefits in the form of improved compliance and learnings from other participants. This supports the purpose of the audit regime and the efficient operation of the wholesale electricity market.</p>

Source: Electricity Authority

### C.3 Education

- 4.3.71 The current audit regime does not consistently provide enough information to effectively audit participants. Some participants do not understand the audit process and what is required of them when being audited.
- 4.3.72 The Authority identified the following areas where changes could be made to improve the decision-making process:
- C.3.1 redefine breach materiality ratings
  - C.3.2 setting the scope of audit or level of investigation required
  - C.3.3 create participant audit guidelines.

#### C.3.1 Redefine breach materiality

- 4.3.73 The Authority proposed to redefine breach materiality ratings. The proposed change shifts from an assessment of financial impact in dollar terms to an assessment of the risk and impact in relation to the size of the affected party, taking into consideration both financial and non-financial impacts.

- 4.3.74 The breach materiality ratings were included in the auditor protocol attached as an appendix to the consultation paper.

**Submissions generally supported clearer breach materiality ratings**

- 4.3.75 Submissions generally supported clearer breach materiality ratings.

- 4.3.76 Key points raised by submitters were:

- (a) a better solution to all proposed education initiatives would be to set up a working group of all approved auditors to manage the audit regime
- (b) the materiality ratings should undergo further consultation.

- 4.3.77 The Authority disagrees that setting up a working group of all approved auditors is a better alternative. The Authority has the responsibility to manage the audit regime and make informed decision as a result of audits. Auditors are commercially driven and are unlikely to volunteer their time and effort to manage the operations aspects of the audit regime, including education of participants.

- 4.3.78 The Authority notes that the materiality ratings were clearly labelled in the appendix to the consultation paper. The Authority will consider consulting further on the materiality ratings as part of the implementation of the proposed changes.

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**Table 16: The Authority's decisions and reasons for C.3.1 – Breach materiality ratings**

Decision	Reason
Retain existing proposal to redefine breach materiality ratings.	This solution aligns with audit best practice and can be used to feed into the risk-based audit planning and decision-making.

Source: Electricity Authority

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**C.3.2 Authority involvement in setting scope and level of investigation of audit**

- 4.3.79 The Authority proposed to amend the Code to allow the Authority to require an individual audit to have a particular emphasis on any areas of concern.

**Submissions generally supported Authority involvement in setting scope and level of investigation of audit**

- 4.3.80 Submissions generally supported clearer Authority involvement. However the following key points were raised:

- (a) the Authority should only be able to set scope and level of investigation at a global 'industry' level, not individual audits
- (b) it is unclear what factors may cause the Authority to require an audit to focus on a specific area.

- 4.3.81 The Authority believes that setting the scope and level of investigation at an individual audit level is useful. Where there are concerns regarding a specific participant's actions

in one area or an individual audit has previously lacked clarity, requesting the individual audit has emphasis on that area is an efficient way of obtaining that information.

- 4.3.82 Factors that may cause the Authority to require an audit focus on a specific area may include:
- (a) a lack of clarity from a previous audit in that area
  - (b) a known or suspected issue with the audited participant that needs verification or monitoring by an auditor
  - (c) any industry level issues that could benefit from a general increase in the level of assessment by the auditor.

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**Table 17: The Authority's decisions and reasons for C.3.2 – Authority involvement in setting scope and level of investigation of audit**

Decision	Reason
Retain existing proposal to allow the Authority to require an individual audit to have particular emphasis on any area(s) of concern.	This will ensure the audit covers any areas of concern and support informed decision-making regarding the next audit date.

Source: Electricity Authority

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### C.3.3 Participant audit guidelines

- 4.3.83 The Authority proposed to produce a guideline for participants that describes the audit and audit review process. No proposed guideline was included in the consultation.

#### Submissions generally supported the creation of guideline

- 4.3.84 Submissions generally supported the proposal to create an audit guideline for participants, However submitters have requested that the guidelines be consulted on prior to finalisation.
- 4.3.85 The Authority agrees that consultation will support the creation of guidelines that clearly communicate the audit and audit review process to audited participants.

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**Table 18: The Authority's decisions and reasons for C.3.3 – Participant audit guidelines**

Decision	Reason
Retain existing proposal to create participant audit guidelines.	Provides transparency of the audit process for audited entities.

Source: Electricity Authority

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### C.3.4 Agent audit requirements

- 4.3.86 The Authority proposed to amend the Code to clarify that agent audits should be of the same quality as the participant audit and should be incorporated into the participant audit.

#### Most submissions supported the proposal for agent audit requirements

- 4.3.87 Most submissions supported the changes to agent audit requirements. However there was some confusion regarding the existing agent audit arrangements. The following key points were raised:
- (a) agents should be defined as participants under the Code and regulated directly
  - (b) disagree that agents should be audited, as it is the participant that is responsible under the Code
  - (c) audit requirements are unclear, particularly on whether a different auditor can be appointed for an agent audit.
- 4.3.88 The Code can only impose obligations on "participants" which, as defined in section 7 of the Act, does not include the agents of participants. For this reason, the Authority cannot impose obligations on agents.
- 4.3.89 If a participant is being audited directly for its obligations then there is no need to audit its agents. Where a participant is discharging its obligations through an agent (for example reading NHH metering installations) it can be more efficient to audit the agent once for all participants the agent provides services to.
- 4.3.90 Audit guidelines will be updated to clarify audit requirements. However, the Code makes it clear that it is the participant auditor's responsibility to ensure that the agent is audited to a standard that would have been required if the participant performed the obligation itself.

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**Table 19: The Authority's decisions and reasons for C.3.4 – Agent audit requirements**

Decision	Reason
Retain existing proposal to amend the Code to clarify agent audit requirements.	Will ensure the agent audit is treated the same way as participant audits.

Source: Electricity Authority

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### C.4 Manual processes

- 4.3.91 The current audit regime includes a number of manual processes.
- 4.3.92 The Authority identified the following areas where automation may deliver benefits to the industry:
- C.4.1 analysis of registry information
  - C.4.2 automation of the prescribed form for audit reports.

### C.4.1 Analysis of registry information

- 4.3.93 The Authority proposed to improve the manner in which registry information is analysed through enhancing the registry to produce a suite of compliance information from it.

#### Submissions supported analysis of registry information

- 4.3.94 Submissions supported the analysis of registry information. However the following points were raised:
- (a) audits should not be required to assess the performance of Code obligations that can be monitored through automation
  - (b) provide unrestricted access to the registry for all auditors.
- 4.3.95 The Authority disagrees with the proposal to remove areas that can be automatically monitored from the audit regime. Automated monitoring provides an assessment of compliance, but does not provide an appropriate level of detail into why any breach occurred and what actions are being taken to address it.
- 4.3.96 The Authority disagrees with the proposal to provide unrestricted access to the registry for all auditors. Auditors already have access to information, including the proposed additional compliance reports, through the participants they are auditing. This access has been strengthened through the introduction of the requirement for participants to provide full access to all information required for carrying out an audit.

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**Table 20: The Authority's decisions and reasons for C.4.1 – Analysis of registry information**

Decision	Reason
Retain existing proposal to enhance the registry to allow participants to receive a suite of compliance information from the registry.	Efficiency benefits in standardising the availability of information for auditors.

Source: Electricity Authority

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### C.4.2 Automation of audit creation

- 4.3.97 The Authority proposed to improve the audit creation process by providing an online report tool for auditors accessible via the audit portal.

#### Submissions supported creation of online audit creation tool

- 4.3.98 Submissions supported the concept of the online tool. Most submissions to the Authority provided limited input and focussed on the technical detail of the tool.
- 4.3.99 Key submissions about the proposal for the online tool were:
- (a) the audit and compliance databases should be combined
  - (b) this proposal contradicts an earlier proposal to deliver a compliance plan to the Authority (C.1.1).

- 4.3.100 The proposal for the audit and compliance databases to be combined appears to continue one submitter's theme regarding combining the operational decision-making and compliance functions of the Authority. As noted previously in this discussion paper the Authority believes that the audit regime should support the Authority in its role in providing assurance and operation of the electricity market, not its role of enforcement and compliance.
- 4.3.101 The Authority disagrees that the use of an online audit tool contradicts the proposal to deliver a compliance plan. This proposal focusses on the mechanism and establishes a standardised format for delivery of information, not the content of that information.

**Table 21: The Authority's decisions and reasons for C.4.2 – Online audit reporting tool**

Decision	Reason
Retain existing proposal to update the existing audit database to allow auditors to populate the information directly into the database.	Deliver more consistent reports and reduce the risk of the auditor missing key obligations.

Source: Electricity Authority

## C.5 Quality Certification

- 4.3.102 The current audit regime requires certified reconciliation participants, dispatchable load purchasers, and approved test houses to hold quality certification.
- 4.3.103 The review of the audit regime identified the following inefficiencies in the way quality certification is managed:
- C.5.1: quality certification scope not defined
  - C.5.2: quality certification requirements not aligned to Code requirements
  - C.5.3: no explicit Code obligation for reconciliation participants and dispatchable load purchasers to hold quality certification
  - C.5.4: approved test house ISO requirements out of date.

### C.5.1 Quality scope not defined

- 4.3.104 The Authority proposed to clarify the scope of quality certification through working with quality certification auditors to develop examples of minimum quality certification scope statements. The proposal also included training with quality certification auditors to help them understand the Authority's requirements for participants holding quality certification.

### Submissions supported alternative proposal to remove requirement for reconciliation participants to hold quality certification

- 4.3.105 Most submissions did not directly address the proposal to clarify the scope. Submissions focussed on an alternative solution of removing the requirement to hold quality certification from reconciliation participants and dispatchable load purchasers.



- 4.3.106 One submission did directly address this proposal. The submitter disagreed with the problem definition on the basis that the audit scope can already be defined through the quality management framework.
- 4.3.107 One submitter did not directly address the proposal but did alert us to an organisation JASANZ<sup>3</sup> that approves agencies and manages the quality certification regime. This organisation is a more appropriate place to handle issues with scope statements for quality certification.
- 4.3.108 The Authority notes this disagreement with the problem definition. The problem had been identified both internally and externally and the purpose of consultation was to both help ascertain if the problem exists as well as the options to resolve the issue.
- 4.3.109 We agree that the Authority should not regulate quality certification auditors, particularly where another organisation exists that address this.
- 4.3.110 The decision in C.5.2. (see Table 23) to remove the requirement to hold quality certification results in this proposal no longer being required.

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**Table 22: The Authority's decisions and reasons for C.5.1 – Define quality certification scope**

Decision	Reason
No further action to be taken regarding scope of quality certification.	Decision in C.5.2 to remove requirement for quality certification results in this proposal no longer being required.

Source: Electricity Authority

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### **C.5.2 Quality certification audits not aligned to Code requirements**

- 4.3.111 The Authority proposed to improve the alignment of quality certification audits to Code requirements through holding training sessions with quality certification auditors to clarify our expectations.
- 4.3.112 The Authority also proposed to investigate opportunities for existing Code audits to be accredited to audit to AS/NZS ISO 9001 standards.

### **Submissions supported alternative proposal to remove requirement for quality certification**

- 4.3.113 Most submissions that directly addressed this section supported alternative 2 – remove requirements for reconciliation participants and dispatchable load purchasers to hold quality certification.
- 4.3.114 Four reconciliation participants, and all three approved auditors that submitted on the proposal, supported the alternative proposal to remove the requirement to hold quality certification.
- 4.3.115 The reasons for removing requirement to hold quality certification included:

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<sup>3</sup> Joint Accreditation System of Australia and New Zealand (<http://www.jas-anz.com.au/>)

- (a) quality certification is a cost that is not adding value to auditor or customer experience
  - (b) ISO certification does not assist in compliance with the Code
  - (c) the requirement for ISO certification is no longer relevant; it was introduced prior to the existing audit guidelines and framework.
- 4.3.116 One submitter supported the retention of quality certification and stated it would be difficult to operate a consistent and effective business without it.
- 4.3.117 The Authority has considered the alternative to remove the requirement for reconciliation participants to hold quality certification from the Code. A cost-benefit analysis has been conducted and it is estimated that there would be a net benefit of between \$529,000 and \$1,263,000 NPV over 10 years in removing the requirement for reconciliation participants to hold quality certification and replacing it with guidelines that auditors could follow to assess what framework is in place to ensure the quality of the outputs and ability to meet Code obligations.
- 4.3.118 The Authority notes that even if the requirement to hold quality certification is removed from the Code, the decisions around next audit date will consider several factors, including the risk the participant poses to the future accurate settlement of the market. Holding quality certification and having robust controls in place will help support a decision for a longer audit period.

**Table 23: The Authority's decisions and reasons for C.5.2 – Quality certification alignment with Code requirements**

Decision	Reason
Remove the requirement for reconciliation participants and dispatchable load purchasers to hold quality certification.  Amend audit guidelines to include requirement for auditors to look at the controls and framework in place to support ongoing accurate settlement of the wholesale market.	Benefits of replacing requirement for quality certification with a guideline for auditors is estimated to deliver efficiency benefits of between \$583,000 and \$1,271,000 NPV over 10 years.  This supports the Authority's statutory objective of promoting the efficient operation of the electricity industry for the longer term benefit of consumers.

Source: Electricity Authority

### **C.5.3 Explicit requirement for reconciliation participant and dispatchable load purchasers to hold quality certification**

- 4.3.119 The Authority proposed amendment to the Code to require reconciliation participants and dispatchable load purchasers to hold quality certification.
- 4.3.120 This is because under the existing Code there is no requirement to hold quality certification. However in order for the Authority to grant certification the participant must hold quality certification.

### No substantive submissions were received on this proposal

- 4.3.121 No substantive submissions were received on this proposal. One submission directly addressed the proposal and expressed support for it. We consider that the reasons for the lack of substantive submissions were likely due to:
- (a) the proposal was technical and non-controversial, however has been included in the consultation on the changes to the audit regime for completeness
  - (b) submitters expressing a preference to remove the requirement to hold quality certification, making this proposal redundant.

**Table 24: The Authority's decisions and reasons for C.5.3 – Explicit requirement to hold quality certification**

Decision	Reason
No further action to be taken to make requirement to hold quality certification explicit in the Code.	Decision to remove requirement to hold quality certification for reconciliation participants and dispatchable load purchasers makes this proposal redundant.

Source: Electricity Authority

### C.5.4 Updating requirement to ensure approved test houses hold latest version of quality certification

- 4.3.122 The Authority proposed to amend the Code to require approved test houses to hold the latest version of quality certification (AS/NZS ISO 9001:2016).
- 4.3.123 This would replace the current requirement to hold AS/NZS ISO 9001:2000.

### No substantive submissions were received on this proposal

- 4.3.124 No substantive submissions were received on this proposal. One submission directly addressed the proposal and expressed support for it.
- 4.3.125 The lack of substantive submissions were likely due to the proposal being technical and non-controversial, however it was included in the consultation on the changes to the audit regime for completeness.

**Table 25: The Authority's decisions and reasons for C.5.4 – Amend the Code to reflect requirement for approved test houses to hold latest version of ISO 9001**

Decision	Reason
Proceed with Code amendment to require approved test houses to hold latest version of AS/NZS ISO 9001.	This proposal is expected to deliver a positive NPV benefit while retaining the underlying requirement for participants to have documentation and controls the enable the participant to consistently comply with the Code.

## C.6 New entrant retailers

4.3.126 New entrant retailers are confronted with many complex issues with trading to establish trading processes, including the requirement to be audited under the Code

4.3.127 The current audit regime does not:

- (a) recognise the challenges that a new entrant retailer faces in establishing a business
- (b) consider the timeframes required to obtain quality certification
- (c) consider the level of risk a small new entrant retailer poses to the market.

4.3.128 The review of the audit regime identified the following areas where improvements could be made to support new entrant retailers:

C.6.1: Clearer initial audit requirements

C.6.2: Improve quality certification timeframes

C.6.3: Alternative timeframes for audit and certification of small new entrant retailers.

### C.6.1 Clearer initial audit requirements

4.3.129 The existing initial audit requirement is for new reconciliation participants to hold certification within three months and submit and audit two months prior to certification. The Authority proposed to replace this with a requirement for prospective reconciliation participants to obtain approval before accessing market systems.

4.3.130 The requirement to be audited and hold certification would remain and is covered by the proposal under C.6.3.

### Submission supported the proposal to require Authority approval before accessing market systems

4.3.131 Submissions supported the proposal that new entrant retailers obtain Authority approval prior to accessing market systems. The only key point raised in submissions was the need to undertake a robust assessment of the retailer's knowledge and readiness for market participation.

4.3.132 We agree that the Authority needs to be satisfied that the new entrant meets the criteria set out in clause 2B(3) of Schedule 15.1, however there is no intention to formalise this beyond meeting that clause

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**Table 26: The Authority's decisions and reasons for C.6.1 – Initial audit requirements**

Decision	Reason
Proceed with Code amendment to replace the existing audit and certification requirements with the requirement to obtain Authority approval if a reconciliation participant intends to	This change will deliver qualitative benefits through clarifying what is required of reconciliation participants before they perform functions under clause 15.38(1) without holding

Decision	Reason
perform functions requiring certification, without first holding certification.	certification.

Source: Electricity Authority

### C.6.2 Initial quality certification timeframes

- 4.3.133 The Authority proposed to replace the existing requirement to hold quality certification in order to be certified with a requirement to obtain quality certification at least two months prior to intending to become certified.
- 4.3.134 This was intended to address the issue that reconciliation participants need to hold quality certification before reconciling volumes in the market. However the associated processes need to be operational in order for quality certification to be granted.
- 4.3.135 The consultation paper noted that this amendment was dependent on the outcome of the proposal regarding wider certification requirements.

### No substantive submissions were received on this proposal

- 4.3.136 No substantive submissions were received on this proposal. Two submissions directly addressed the proposal. One expressed support and one questioned the need to hold quality certification in the first place.

**Table 27: The Authority's decisions and reasons for C.6.2 – Initial quality certification timeframes**

Decision	Reason
No further action will be taken on this proposal.	Decision to remove requirement to hold quality certification in C.5.3 means this change is no longer required.

Source: Electricity Authority

### C.6.3 Timeframes for holding certification

- 4.3.137 The Authority proposed to amend the Code to allow new entrant retailers to operate without certification for up to 12 months under certain conditions and up to six months in all other cases.
- 4.3.138 This change was intended to:
- (a) allow initial audits to be conducted based on the participants use of market systems and actual outputs
  - (b) enhance the functionality of the Code to replicate the conditions under which several new entrant retailers have applied for an exemption from the audit requirements.

**Submissions were mixed on the proposal and raised concerns regarding the risks new entrant retailers pose to the market**

- 4.3.139 Submissions were mixed with some submitters, including auditors and distributors disagreeing with the proposal.
- 4.3.140 Key points raised by submitters were:
- (a) the thresholds are too risky for the market; additional thresholds should be included to limit a new entrant retailers market share per NSP, limit the volume of energy purchased and impose additional switching timeframe requirements
  - (b) a 12 month period is too long if the new entrant retailer has issues that will affect the wash-up cycle
  - (c) the reason for the exemption is because the requirement to be audited within the first month of trading is too short.
- 4.3.141 The Authority considers that the thresholds are appropriate. The thresholds restrict the trader to only category 1 metering, and only 100 ICPs. This sets limits on the volume (capacity of individual category 1 metering ICPs is low compared to total NSP volumes) and number of customers (100 customers). This is able to be easily monitored through the registry. Limiting market share is impractical and does not change the overall market impact. Additional limits on switching timeframes create an unnecessary barrier that does address where we believe the risks lie. Should the new entrant retailer not switch within the timeframes specified by the Code, this is a Code breach that can be addressed through the breach allegation process. Further reducing the risk is the new requirement (see Table 26) for new entrant retailers to be approved by the Authority before accessing the market systems.
- 4.3.142 The Authority agrees that the 12 month period is very close to the 14 month revision period; however the audit needs to be completed prior to the 12 month revision. New entrant retailers will have at least two months, and more likely four months to pursue remedial action and correct any errors that affect reconciliation.
- 4.3.143 The Authority disagrees that the reason for exemptions was because of the requirement to be audited within the first month of trading. One of the reasons exemptions were approved for a period of up to 12 months, rather than a shorter timeframe was to allow the new entrant retailer to establish their business and trial their operation under a limited scope to generate enough data and process history to allow a meaningful audit.

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**Table 28: The Authority's decisions and reasons for C.6.3 – Timeframes for holding certification**

Decision	Reason
Proceed with the proposal to amend the Code to allow new entrant retailers who have been approved to access market systems to obtain certification within six months, or 12 months under certain conditions.	This proposal is expected to deliver efficiency benefits and reduce barriers to entry for new entrant retailers.

Source: Electricity Authority

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## C.7 Distributed unmetered load

- 4.3.144 The Authority proposed changes to the distributed unmetered load (DUML) audit requirements that will make the context of DUML audits with the audit regime clear and aligned with the proposed purpose of the audit regime.
- 4.3.145 The Authority proposed the following changes:
- C.7.1: clearer DUML audit frequency and timing requirements
  - C.7.2: clearer DUML audit requirements
  - C.7.3: improve transparency of compliance of DUML databases
  - C.7.4: use of more consistent streetlight data.

### C.7.1 Clearer DUML audit frequency and timing requirements

- 4.3.146 The Authority proposed Code amendments that would:
- (a) separate the DUML audit requirements from the reconciliation participant audit requirements
  - (b) require separate field audits of all items of load
  - (c) allow the Authority to specify the frequency of DUML audits and field audits.
- 4.3.147 DUML is one of the largest sources of inaccurate submission information. Separating out DUML audits will allow for better decisions to be made regarding reconciliation participant next audit dates.

### Submissions raised concerns regarding proposal to clarify DUML audit frequency and timing requirements

- 4.3.148 Submissions raised concerns regarding the DUML audit frequency. A strong theme from submissions was that the requirement for a full field audit of load was impractical and would impose cost on the industry.
- 4.3.149 Two submitters proposed that parties other than reconciliation participants (such as distributors or the end consumer) should be responsible for the DUML database and DUML audits.
- 4.3.150 Concerns were also raised regarding the introduction of variable DUML audits and ability for reconciliation participants to arrange for their DUML databases to be audited.
- 4.3.151 One submission proposed a working group be established to work through DUML audit issues.
- 4.3.152 The Authority agrees that full field audits may involve higher costs than included in the cost-benefit analysis of the proposed changes to the audit regime. The Authority considers that requiring statistically significant sampling to demonstrate database accuracy is a suitable alternative. Further cost-benefit analysis has been conducted to determine the estimated costs of requiring a statistically significant sample. This analysis can be found in Appendix B.
- 4.3.153 The Authority disagrees that other parties should be responsible for DUML databases and DUML audits. Reconciliation participants are responsible under the Code for the accurate quantification of electricity consumed at each ICP, and reconciliation participants have the contractual relationship with the DUML customer. DUML is one of



several options to available to reconciliation participants in order to quantify electricity and comply with the Code.

- 4.3.154 The ability for reconciliation participants to manage their agents is a contractual issue between the reconciliation participant and its agent. The Code does not specify how to manage the database or who should hold it, only that the database needs to exist, the criteria for the database and requirements to be accurate. Variable DUMML audits will allow the Authority to better recognise the varying levels of risk associated with each database.
- 4.3.155 The Authority disagrees that a DUMML working group to look at DUMML audit issues will be effective and it is likely that this approach would delay the benefits from the changes proposed. The Authority agrees that a working group to look at wider DUMML issues (not limited to DUMML audits) may be beneficial and will be considered for future work programme initiatives.

**Table 29: The Authority's decisions and reasons for C.7.1 – Independent DUMML audits**

Decision	Reason
<p>Will proceed with the proposal to amend the Code to require retailers to arrange for independent DUMML audits and allow for the Authority to determine the frequency of DUMML audits.</p> <p>The Code will not be amended to require full field audits, rather the DUMML audit guidelines will include a requirement for statistically significant sampling to demonstrate the expected level of accuracy of the database.</p>	<p>This proposal will achieve similar benefits to what was consulted on, however is expected to reduce the costs compared to those resulting from full field audits.</p>

Source: Electricity Authority

### **C.7.2 Clearer DUMML audit requirements**

- 4.3.156 The Authority proposed to produce DUMML audit guidelines that would provide a clear set of expectations for auditor to follow.

#### **Submissions support DUMML audit guidelines**

- 4.3.157 Submissions supported the creation of DUMML audit guidelines.
- 4.3.158 One submitter asserted that proposed DUMML audit guidelines already exist. We believe the submitter is referring to a guideline developed independently of the Authority which has not been formally endorsed by the Authority.



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**Table 30: The Authority's decisions and reasons for C.7.2 – DUML audit guidelines**

Decision	Reason
Will proceed with the proposal to create DUML audit guidelines	Guidelines will provide a clear set of expectations for auditors to following when auditing DUML and DUML databases.

Source: Electricity Authority

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### C.7.3 Publication of DUML audit and next audit dates

- 4.3.159 The Authority proposed to publicise a copy of the DUML audit report and the DUML next audit date.

#### Submissions were mixed on publication of DUML audit reports

- 4.3.160 Submissions were mixed on the publication of DUML audit reports. Key points raised were:

- (a) publication of DUML audit reports is unnecessary
- (b) it is impractical to impose an audit timeframe on a gaining trader.

- 4.3.161 The Authority disagrees that publication of DUML audit reports are unnecessary. When a DUML ICP is switching, the gaining trader needs to be able to determine the risk the ICP poses to the trader's operation and compliance with the Code. Publication will allow traders to make informed switching decisions regarding willingness to take on the costs associated with inaccurate (and accurate) DUML ICPs and their databases.

- 4.3.162 The Authority disagrees that it is impractical to impose an audit timeframe on a gaining trader. Publication of information means the gaining trader will be aware of the audit timeframe prior to switching and can consider the audit timeframes and requirements when contracting with the customer.

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**Table 31: The Authority's decisions and reasons for C.7.3 – DUML audit and next audit date publication**

Decision	Reason
Proceed with the proposal to publish DUML audits and DUML next audit dates.	Publication of audits and next audit dates will allow potential gaining traders to know what issues exist with the DUML database and when the next audit is due prior to becoming responsible for the DUML ICP.

Source: Electricity Authority

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### C.7.4 Publication of standardised table of wattages

- 4.3.163 The Authority proposed to publicise a standardised table of streetlight wattages. This will ensure consistent assessment of the consumption associated with each type of streetlight.

### Submissions generally supported publication of standard table of wattages

- 4.3.164 Submissions generally supported publicising a standardised table of streetlight wattages.
- 4.3.165 One submitter did not support the proposal on the basis that the wattages for databases they are associated with are already accurate.
- 4.3.166 The Authority considers that unless there is a central source of information regarding accuracy of streetlight wattages, it will not be possible to determine if the wattages used in each DUML database should be considered accurate.

**Table 32: The Authority's decisions and reasons for C.7.4 – Standardised table of wattages**

Decision	Reason
Proceed with the proposal to publicise a standardised table of wattages.	Will provide a single source of information for determining the expected consumption of commonly used streetlight fittings.

Source: Electricity Authority

## 5 Other issues raised during consultation

- 5.1 The following two other issues were raised by submitters as part of the consultation that do not directly affect decisions made as a result of the consultation:

**Table 33: Other issues raised during consultation**

Issue	Action
Removal of requirement to hold certification: Following the separation of next audit date and certification period, some submitters questioned the need for reconciliation participants to hold certification.	The Authority will consider the role of certification during the implementation of changes to the audit regime.
National DUML database: One proposal in response to the DUML audit issues was to have a single DUML database that all participants must use to populate DUML information.	This can be considered in a proposed wider review of DUML. However, this issue needs to be considered in light of the Authority's preference to specify outcomes rather than specify solutions.

Source: Electricity Authority

## Glossary of abbreviations and terms

Act	<b>Electricity Industry Act 2010</b>
CBA	<b>cost-benefit analysis</b>
DUML	<b>distributed unmetered load</b>
NPV	<b>net present value</b>
OIA	<b>Official Information Act 1982</b>