

Our Reference: DMS# 3681622
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19 March 2014

Mr Paul Reid
Assistant Director, Licensing,
Economic Regulation Authority
PO Box 8469
Perth Business Centre
PERTH WA 6000

Dear Mr Reid

DRAFT AUDIT AND REVIEW GUIDELINES: ELECTRICITY AND GAS LICENCES

I refer to the Economic Regulation Authority's (**Authority**) notice dated 25 February 2014 seeking submissions in relation to the "draft audit and review guidelines: electricity and gas licences" (**guidelines**). The conduct of a performance audit involves significant organisational effort and cost, therefore Synergy is appreciative of the opportunity to review and provide this submission to the Authority. This submission has been prepared from a Synergy retail, generation and internal audit perspective.

Purpose of these Guidelines

Section 1 amongst other matters, states "The Authority intends to reduce the frequency of audits and reviews for licences that can demonstrate consistent and effective compliance with licence requirements" however, the guidelines provide no baseline as to what the Authority considers to be "consistent and effective compliance". It would be useful to licensees if the guidelines could clarify the matter.

Frequency of audit reviews (section 6.4)

Synergy notes where an audit period has been reduced this is typically due to a small number of material incidents of non-compliance in the previous audit. In other words there are situations where the overall compliance framework is compliant but with certain elements materially deficient.

In Synergy's experience the Authority's current approach is to require all licence obligations to be tested during the shortened audit period including the majority of licence obligations previously found to be fully compliant. Such an approach involves significant resources and cost to both the licensee and the Secretariat.

A more pragmatic approach is to audit or review the areas of non-compliance in isolation at a shorter interval than those matters found to be compliant. Synergy recommends section 6.4 address this matter.

Auditor selection (section 8)

Footnote 9 states “The Secretariat can request changes to an auditor’s audit procedures at the draft audit/review stage if deemed necessary by the Secretariat. Licensees may wish to consider this possibility during contract negotiations with potential auditors. For further details refer section 10.3.2.2.”

Synergy could not find a reference to section 10.3.2.2 in the guidelines.

The guidelines do not substantiate what circumstances the Secretariat would seek to exercise this significant power. Without clarification a licensee cannot reasonably reflect the matter in any request for tender as it is not aware of the circumstances the Secretariat deems such powers necessary. Synergy recommends the guidelines clarify the matter.

Auditor rotation (section 8.4)

The Authority is proposing to reduce its auditor rotation requirement from three consecutive audits or reviews conducted by the same auditor to two. Synergy does not support this change on the basis:

- there is a limited pool of auditors in Perth that can perform such performance audits and asset management reviews to the scale required by Synergy recognising its significant customer base and generation portfolio;
- it limits a licensee’s ability to obtain economies of scale for auditor procurement; and
- there is considerable investment by a licensee in terms of educating a new auditor with respect to their business operations as part of an audit. Having to do this after every second audit imposes a too onerous workload and cost on a licensee for little public benefit.

Performance audit compliance summary (section 11.4.1)

It is common for a licensee to experience a situation where it has strong controls in place such as standard operating procedures (**SOP**) but due to human error the SOP has not been followed and a breach occurs. This can result in a non-compliance audit finding but with no recommendation for improvement. This scenario is not reflected in the proposed new audit ratings in Table 6. Consequently, Synergy recommends the following new category for inclusion.

B	Adequate controls in place – no improvement needed	2	Non-compliant – minor impact on customers or third parties
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In addition, the compliance rating scale should reflect a ‘not applicable’ situation. For example, a large number of gas trading licence obligations relate to residential customers which currently do not apply to Synergy.

The introduction of the rating against controls appears to be moving further away from a risk based approach and will lead to more onerous, time consuming (and therefore more costly) performance audits. It is not clear to Synergy why this assessment is required given the control outcome is assessed in terms of a breach/non breach finding.

The guidelines state on page 32 state:

“Consistent with the objective of the audit, any evidence that a licence condition has been contravened during the audit period should result in the auditor rating the licence condition as non-compliant. This includes the situation where the auditor needs to assess a large number of manual or electronic records to determine a licensee’s compliance with a particular licence condition, and only a small number (including single occurrences) of contraventions are identified by the auditor.

Synergy has previously advised the Secretariat of its significant concern with respect to this proposal and reiterates that position for the following reasons:

- It is not clear from the guidelines what problem the Authority is seeking to solve or address by adopting this practice. For a mass retailer such as Synergy that performs millions of transactions each year, it is reality breaches will occur. For this reason volume and materiality must be taken into consideration. This should be left to the auditor’s professional judgement as to do otherwise can result in unintended consequences detailed below.
- The requirement will detrimentally affect an organisation’s culture of compliance. It sends the wrong message to employees that a minor breach in a situation where thousands of transactions are performed outweighs compliance in the mass majority of tasks performed. For a mass retailer such as Synergy it is akin to achieving a test score of 99% but failing the exam. Synergy is concerned the proposal will result in a negative culture of “why does it matter if further breaches occur, as we have already breached on one occasion”.
- An individual instance of human or system error should not automatically result in a non-compliance rating. The audit finding should reflect an informed decision by the independent auditor whether a single occurrence out of tens or hundreds of thousands or millions of transactions or tasks performed reflects the actual licensee’s performance or control system effectiveness against standards prescribed in the licence throughout the audit period. The basis of an informed decision is consideration by the auditor of materiality and frequency of incident occurrence.
- A requirement that a single instance of non-compliance automatically results in a non-compliant rating is inconsistent with the current audit guidelines and Australian audit standards which require the auditor to exercise their professional judgement and requires a risk based approach to the audit. Such an outcome is not consistent with good audit industry practice.

- There would be diminished value in the audit process if materiality were not attributed to the compliance status in qualitative as well as quantitative terms. If a purely quantitative “pass/fail” approach were to be adopted then the outcome would be solely determined by the binary results of output compliance alone. This would preclude the application of professional audit judgment and risk reporting infrequent, inconsequential or explicable justifiable non-conformances as being indicative of significant systemic weaknesses, which may not be the reality and could therefore risk publicly misrepresenting a licensee’s actual performance. Such a public outcome would negatively affect a licensee’s legitimate business interests.

Other

Regulation should be imposed only when it can be shown to offer overall net benefit. In order to assess net benefit every substantive regulatory policy change should be subject of a regulatory impact statement. The guidelines propose substantive change and will have a significant impact on Synergy’s business but do not include any supporting evidence that the changes will result in overall societal net benefit. Consistent with best practice regulation Synergy considers it appropriate for the Secretariat to publish alongside its proposal for change evidence that the benefits of the change outweigh the cost.

Synergy would like to reiterate its appreciation of being able to provide feedback on the audit guidelines. Please contact me should you wish to discuss any aspect of this submission.

Yours sincerely

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