

AUDIT GUIDELINES: ELECTRICITY, GAS AND WATER LICENCES

DRAFT – MAY 2009

Economic Regulation Authority

 WESTERN AUSTRALIA

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A full copy of this document is available from the Economic Regulation Authority web site at www.era.wa.gov.au.

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1 Purpose of the guidelines

The purpose of the guidelines is to inform electricity, gas and water service providers licensed by the Economic Regulation Authority (Authority) and external auditors about the Authority's requirements regarding the conduct of performance/operational audits and asset management system reviews of licensees.

The guidelines are designed to promote consistency of performance/operational audits and asset management system reviews through:

- informing licensees and auditors about the legislative framework applicable to auditing licensee's compliance with licence conditions;
- describing a framework for the conduct of audits/reviews based on Australian Auditing and Assurance Standards;
- adopting a risk based approach to planning audits/reviews using the risk assessment process in AS/NZS 4360:2004;
- promoting consistency of reporting on the performance/operational audit by mandating a 7-point compliance rating scale;
- promoting consistency of reporting on the effectiveness of asset management processes by mandating separate adequacy and performance rating scales; and
- providing a framework for:
 - the criteria the Authority will consider when approving auditors;
 - the format and content of audit plans;
 - the conduct of the audit/review with reference to the Australian Auditing and Assurance Standards; and
 - the format and content of the audit/review report to be provided to the Authority.

The use of common rating scales to measure compliance with licence conditions and effectiveness of asset management processes enables the Authority to benchmark individual licensees and groups of licensees over time. The Authority intends to reduce the frequency of audits and reviews for licensees that can demonstrate consistent and effective compliance with licence requirements. This approach will benefit the licensee through reducing the costs and resources needed for audit activities over time.

2 Implementation of these guidelines

Licence audits and reviews that commence on or after 1 January 2010, that is the auditor nomination is received from this date onwards, are to be conducted in accordance with the requirements set out in these guidelines. However, licensees and auditors may elect to apply these guidelines voluntarily to audits and reviews that are conducted between the date that these guidelines are published by the Authority and 1 January 2010. The licensee is required to inform the Authority that this is the case at the time that they nominate an auditor to the Authority for its approval.

3 Mandatory auditing requirements

In order to promote consistency of reporting on performance/operational audits and asset management system reviews the Authority has identified a number of mandatory requirements in respect of:

- adopting a risk based approach to auditing with a preference for the risk evaluation model set out in AS/NZS 4360:2004;
- the compliance rating scale to be used to assess compliance with licence conditions;
- the effectiveness rating scale to be used to assess effectiveness of asset management processes;
- the terms and conditions of engagement for auditors employed to undertake audits/reviews of licensees;
- the format and content of an audit plan for audits/reviews;
- the format and content of the auditor's report; and
- the format and content of the post-audit implementation plan.

The Authority has identified the mandatory requirements through the use of the words “must” and “requires” in the text.

4 The licensing framework for electricity, gas and water licences

4.1 *The role of the Authority*

Under the provisions of the *Economic Regulation Authority Act 2003* (ERA Act) section 25, it is a requirement that the Authority administers the licensing schemes for the provision of electricity services, gas services and water services.

In performing its functions, the Authority, under section 26 of the ERA Act, must have regard to:

- promoting regulatory outcomes that are in the public interest;
- the long-term interests of consumers in relation to the price, quality and reliability of goods and services provided in the relevant markets;
- encouraging investment in relevant markets;
- the legitimate business interests of investors and service providers in relevant markets;
- promoting competitive and fair market conduct; and
- preventing abuse of monopoly or market power.

Licences are granted subject to conditions intended to promote the objectives of the legislation including supply quality (public health and safety issues), supply reliability (connections and supply), consumer protection (customer service levels and prices) and

regulatory compliance (compliance with legislation and standards). These conditions are supported by various technical and industry codes and standards.

The Authority has the responsibility for granting licences with appropriate conditions, monitoring compliance, reviewing performance reports from the licensees and enforcing compliance or revoking licences.

The Governing Body of the Authority is assisted by the Secretariat, which consists of a Chief Employee and public service officers appointed or made available under Part 3 of the *Public Sector Management Act 1994*. Secretariat staff are the initial point of contact in the Authority's day-to-day dealings on matters relating to gas, electricity, rail and water regulation. While Secretariat staff may provide assistance on these matters, it is the Governing Body that has ultimate responsibility for regulatory and inquiry functions.

4.2 Legislation governing electricity, gas and water licensing

The legislation (Industry Acts) that governs the licensing of providers of electricity services, gas services and water services respectively is:

- *Electricity Industry Act 2004 (WA) (Electricity Act)*
- *Energy Coordination Act 1994 (WA) (Gas Act)*
- *Water Services Licensing Act 1995 (WA) (Water Act)*

There are two types of audits prescribed under the Industry Acts (refer to sections 13-14, 11Y & 11ZA and 36-37 of the Electricity, Gas and Water Acts, respectively) that impose the following obligations on licensed service providers:

- provide the Authority with a performance/operational audit conducted by an independent expert acceptable to the Authority not less than once in every 24 month period (or such longer period as the Authority allows); and
- provide the Authority with a report by an independent expert acceptable to the Authority as to the effectiveness of the asset management system not less than once in every 24 month period (or such longer period as the Authority allows).

Regular audits of a licensee by independent auditors/experts provide the Authority with a level of assurance that the licensee is complying with its obligations with regard to supply quality, supply reliability, consumer protection and regulatory compliance.

Conditions in respect of audits/reviews are included in all licences, except electricity retail licences and gas trading licences, which are not subject to conditions regarding the review of asset management systems.

4.3 Licence conditions related to audits and reviews

The Authority has developed licences for electricity, gas and water services that are consistent with the corresponding legislation. There are some differences in the structure of these licences, particularly electricity licences, which reflect the structure and content of the corresponding legislation. However, the licence conditions dealing with the conduct of an audit in respect of the appointment of auditors and the frequency of audits are the same for electricity, gas and water licences.

The reader is referred to the Authority's web site (www.era.wa.gov.au) for more information on licence conditions.

5 Australian audit standards

The following sections of the guidelines refer to the principles outlined in the Australian Auditing Standards and Standards on Assurance Engagements (the Standards) issued by the Auditing and Assurance Standards Board¹. While the Standards have been developed by the accountancy profession, the audit principles in the Standards apply equally well to operational/performance audits and asset management system reviews of licensees.

The Authority acknowledges that the audits/reviews of smaller licensees may sometimes be undertaken by specialist engineering consultants rather than professional auditors. However, auditors conducting audits/reviews of a licensee's compliance with licence conditions are advised to familiarise themselves with the standards that are identified in these guidelines.

The Authority expects the audits/reviews of licensees to be conducted in accordance with the principles described in the standards that are identified in these guidelines. However, it is left to the professional judgement of the auditor to determine how to apply the principles to a particular audit.

6 Audit/review purpose, scope and frequency

Section 4.2 identified two types of audits: operational/performance audits and asset management system reviews. Each type of audit has a separate and distinct purpose and scope, as described below.

6.1 *Operational/performance audit*

The purpose of the operational/performance audit is to assess the effectiveness of measures taken by the licensee to meet the obligations of the performance and quality standards referred to in the licence.

The audit focuses on the systems and effectiveness of processes used to ensure compliance with the standards, outputs and outcomes required by the licence. The audit should identify areas where improvement is required and recommend corrective action as necessary.

The scope of the audit must include the adequacy and effectiveness of performance against the requirements of the licence by considering:

- **process compliance** - the effectiveness of systems and procedures in place throughout the audit period, including the adequacy of internal controls;
- **outcome compliance** – the actual performance against standards prescribed in the licence throughout the audit period;

¹ Available on the Auditing and Assurance Standards Board (AUASB) website: www.auasb.gov.au

- **output compliance** – the existence of the output from systems and procedures throughout the audit period (that is, proper records exist to provide assurance that procedures are being consistently followed and controls are being maintained);
- **integrity of reporting** – the completeness and accuracy of the compliance and performance reports provided to the Authority; and
- **compliance with any individual licence conditions** - the requirements imposed on the specific licensee by the Authority or specific issues that are advised by the Authority.

6.2 *Asset management system review*

The purpose of the asset management system review is to assess the measures taken by the licensee for the proper management of assets used in the provision and operation of services and, where appropriate, the construction or alteration of relevant assets.

The asset management system review focuses on the asset management system, including asset management plans, which set out the measures that are to be taken by the licensee for the proper operation and maintenance of assets. The plans must convey the licensee's business strategies to ensure the effective management of assets over at least a five year period.

The scope of the asset management system review must include an assessment of the adequacy and effectiveness of the asset management system by evaluating the 12 key processes of:

- asset planning
- asset creation/acquisition
- asset disposal
- environmental analysis
- asset operations
- asset maintenance
- asset management information system
- risk management
- contingency planning
- financial planning
- capital expenditure planning
- review of the asset management system

The effectiveness criteria that are to be used in the review is described in section 2 of Appendix 3.

6.3 *Risk based approach to audits & reviews*

The primary purpose of an audit/review is to assess the effectiveness of measures taken by the licensee to ensure compliance with licence conditions or effective management of

assets. These guidelines incorporate a risk-based approach to assessing the appropriate risk factors in order to focus the audit/review on higher risk areas, with less intensive coverage of medium and lower risk areas. The Authority requires all audit/reviews to utilise a risk based approach to planning and conducting the audit/review.

In order to obtain greater consistency of risk assessment across the different utility sectors and licensees, detailed guidelines (refer to Appendix 1) have been included on the Authority's preferred risk evaluation model, which is based on Australian/New Zealand Standard 4360:2004 (Risk Management). Applying this methodology results in audits/reviews providing a greater focus and depth of testing for higher risk areas compared to medium and lower risk areas. There should be more extensive audit testing of higher risk areas to provide sufficient assurance of compliance or the presence of effective controls.

The auditor has scope to evaluate risk using an alternative approach to that set out in Appendix 1. If this is the case, the auditor is required to specify the risk evaluation method in the audit report. The auditor is also required to map the audit priority ratings derived from their method onto the 5-point scale identified in Table 14 (Appendix 1) in the audit plan that is submitted to the Authority for approval.

6.4 Frequency of audits & reviews

The Industry Acts prescribe a minimum interval of time between audits and reviews of 24 months, commencing from the date that the licence is granted (see section 4.2). However, the Industry Acts also include provision for the Authority to extend the interval between audits/reviews from the standard 24 month period at its discretion.

Audits and reviews impose direct and indirect costs on the licensee and the Authority. The Authority's policy is to minimise the cost of regulation on licensees, subject to maintaining an appropriate level of oversight of the licensee's compliance with its regulatory obligations under the licence. For audits and reviews, the cost of regulation may be reduced if the interval between audits/reviews is increased. Hence, the Authority is prepared to, within reasonable bounds, extend the interval between audits/reviews for low risk licensees, i.e. those licensees who are demonstrating high levels of compliance or asset management effectiveness.

Licensees who are assessed as:

- having a strong compliance framework that is achieving a high level of compliance with the licence; or
- operating an effective asset management system that has strong controls to maintain a high level of effectiveness,

may be rewarded with an increased interval between audits/reviews.

Conversely, licensees who are assessed as:

- having a weak compliance framework that is achieving an inadequate level of compliance with the licence; or
- operating an ineffective asset management system,

may have the interval between audits/reviews reduced. It may be the case that in some, but not all, situations where the audit/review period is reduced the Authority will also serve a notice of contravention on the licensee under the applicable legislation.

7 The audit & review process

Please refer to the flowchart in Appendix 3 for an overview of the process for conducting operational/performance audits and asset management reviews. The following sections discuss each stage of the process in more detail.

8 Auditor selection

The audit framework contemplated by the Industry Acts places the onus on the licensee to demonstrate compliance with the conditions of their licence by engaging independent experts (auditors) to conduct audits/reviews and report to the licensee and the Authority.

Under the Industry Acts, the Authority must approve the auditor nominated by the licensee prior to their appointment by the licensee to undertake the audit/review. The Authority must be satisfied that an auditor nominated by a licensee has the required expertise and experience to conduct the audit/review to an acceptable standard. The Authority must also give consideration to the independence of the auditor in relation to the licensee. The remainder of this section sets out the criteria that the Authority will consider when determining the suitability of an auditor to conduct an audit/review.

It is anticipated the licensee will undertake a selection/tendering process to identify an auditor that is able to conduct the audit/review to a satisfactory standard in a cost effective manner. The licensee, in seeking the Authority's approval of their nominated auditor, must provide the Authority with a copy of the auditor's submission/tender², which should address the criteria set out in the remainder of this section.

8.1 *Competence and capacity of an auditor to perform the audit/review*

8.1.1 Operational/Performance Audits

In determining the suitability of an auditor to conduct an operational/performance audit, the Authority will give consideration to the following factors:

- The experience of the audit company in performance and compliance auditing. It is desirable for the audit company to demonstrate experience of undertaking regulatory audits or non-financial assurance audits of utilities or other regulated businesses within the previous 3 years.
- The audit skills and experience of each member of the audit team. The Authority will give particular consideration to:

² It is left to the discretion of the licensee whether they provide the financial and pricing component of the submission/tender.

- each audit team member’s audit expertise and audit experience; and
- the lead auditor’s (e.g. partner, manager, senior engineer or similar) knowledge and experience of conducting regulatory audits or non-financial audits of utilities or other regulated businesses.

8.1.2 Asset management effectiveness reviews

In determining the suitability of an auditor to conduct an asset management effectiveness review, the Authority will give consideration to the following factors:

- The experience of the audit company in asset management practice. It is desirable for the audit company to demonstrate relevant asset management experience in utilities or other regulated businesses within the previous 3 years. Relevant experience might include asset management system development, asset valuations, asset performance reviews, asset project management or strategic asset planning.
- The engineering and technical expertise of each member of the review team. The Authority will give particular consideration to:
 - each review team member’s professional qualifications;
 - each review team member’s knowledge of asset management practice in the relevant utility sector; and
 - the lead auditor’s (e.g. partner, manager, senior engineer or similar) knowledge and experience of conducting reviews of asset management systems or asset management practices of utilities or other regulated infrastructure businesses.

8.2 Auditor independence

During the appointment process consideration will be given to the professional independence of the auditor in relation to the licensee and any related entity³, particularly where the auditor undertakes other professional work for the licensee or a related entity.

Auditor independence requires that the auditor and the licensee take appropriate measures to avoid conflict of interest situations in respect of the audit/review. Section 324CD of the *Corporations Act 2001 (Cth)* (Corporations Act) states that:

“a conflict of interest situation exists in relation to an audited body at a particular time if, because of circumstances that exist at that time:

- the auditor, or a professional member of the audit team, is not capable of exercising objective and impartial judgement in relation to the conduct of the audited body; or
- a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that the auditor, or a professional member of the audit team, is not capable of exercising objective and impartial judgement in relation to the conduct of the audit of the audited body.”

³ A related entity has the same meaning as in section 9 of the Corporations Act 2001 (Cth)

Section 324 of the Corporations Act includes a comprehensive framework for identifying circumstances that give rise to conflicts of interest. The Authority notes that the professional codes of conduct for audit and assurance practitioners are broadly consistent with the Corporations Act, but may be less prescriptive in their approach to resolving conflicts of interest. The Authority expects that auditors who are members of a professional accounting body will be governed by the code of ethics of that body when determining whether they meet the minimum standards for professional independence in relation to an audit/review of a licensee. However, the Authority also recognises that some audits and reviews are conducted by auditors who may not be members of a professional accounting body. The remainder of this section outlines the factors, drawn from the Corporations Act and APES 110⁴, that the Authority requires all auditors to take into account when assessing whether they meet the minimum standards for auditor independence.

All auditors will be required to provide to the Authority a declaration of independence in relation to the audit/review (see section 8.4).

8.2.1 Threats to independence

When nominating an auditor for the Authority's approval, a licensee and the auditor should satisfy themselves that there are no conflicts of interest that might give rise to an independence threat. Of particular interest are independence threats due to:

- self-interest – occurs when an audit company or a member of the audit team could benefit from a financial or non-financial interest in a licensee or a related entity;
- self-review – occurs when:
 - the audit company or a member of the audit team has undertaken other non-audit work for the licensee that is being evaluated in relation to the audit/review; or
 - when a member of the audit team was previously an officer or director of the licensee; or
 - where a member of the audit team was previously an employee of the licensee who was in a position to exert direct influence over material that will be subject to audit during an audit/review.

Auditors are encouraged to assess the risk of a self-review threat based on work that:

- has been undertaken by the auditor, or a member of the audit/review team, for the licensee within the previous 24 months; or
- the auditor is currently undertaking for the licensee; or
- the auditor has submitted an offer, or intends to submit an offer, to undertake for the licensee within the next 6 months; and
- familiarity – occurs when, by virtue of a close family relationship with a licensee, its directors, officers or employees, an audit company or a member of the audit team is or is perceived to be too sympathetic to the licensee's interests.

⁴ Accounting and Professional Ethical Standards Board, Compiled APES 110 Code of Ethics for Professional Accountants (February 2008).

These, and other, independence threats are discussed in more detail in sections AUST290.41.2 – 290.41.7 of APES 110.

Auditors are required to consider a number of relevant relationships when assessing whether circumstances exist that might create an independence threat. These relationships are considered in more detail in Appendix 1.

8.3 Auditor rotation

8.3.1 Consecutive audits/reviews conducted by the same auditor

There is a self-review or familiarity threat to auditor independence where the same auditor conducts consecutive audits of the same business. To mitigate against this risk, auditor rotation is common practice for other types of statutory audit⁵.

The Authority's policy with respect to auditor rotation is to limit the number of consecutive audits/reviews that can be conducted by the same auditor to a period of time not greater than 6 years in aggregate. This means that the same auditor can conduct either 2 (audit period is 3 years) or 3 (audit period is 2 years) consecutive audits/reviews. Where an auditor is unable to conduct an audit/review because of the rotation criterion, at least one audit/review must be conducted by another auditor before that auditor is eligible to conduct a subsequent audit/review.

8.3.2 Application of the auditor rotation policy to audits/reviews

The auditor rotation policy outlined in section 8.3.1 applies to persons who play a significant role in the audit/review. A person who plays a significant role in an audit/review includes:

- if the person is appointed as an individual auditor:
 - the person; and
 - a service company, or similar, through which the auditor provides the audit service; or
- if an audit company is appointed as the auditor:
 - the lead auditor, i.e. the person who is primarily responsible to the audit company for the conduct of the audit/review⁶; and
 - the review auditor, i.e. the person who is primarily responsible to the audit company for reviewing the conduct of the audit.

⁵ The Corporations Act (section 324DA), and the professional codes of conduct for auditors and assurance practitioners set limits on the number of consecutive audits that can be undertaken by an auditor. The Corporations Act also prohibits an auditor from conducting financial audits of the same business for more than 5 out of 7 successive years.

⁶ The Authority will apply this test to persons, other than the person who approves the audit report, if it considers that this person will have a direct influence over the development of the opinion of the audit company in relation to an audit/review.

8.4 Declaration of independence

The Authority requires auditors to provide to the Authority a declaration of independence to accompany the auditor nomination documents provided by the licensee.

The declaration is to include a statement that the individual auditor or audit company will be able to comply with the Authority's independence criteria set out in these guidelines at the time that the audit/review is to be conducted. The Authority has left it to the discretion of the auditor to determine the format of the declaration. However, the Authority notes that some professional bodies have developed their own declaration templates, which can be used in relation to audits and reviews at the discretion of the auditor. Should this be the case the declaration should include specific reference to the requirements set out in these guidelines.

8.5 Summary of required documents for auditor approval

The following documents/information must be submitted to the Authority when seeking approval of the proposed auditor:

- a formal request (i.e. letter or email) from the licensee requesting the Authority to approve the nominated auditor;
- a copy of the Curriculum Vitae for each audit/review team member demonstrating their skills and experience relevant to the audit/review;⁷
- for audit companies, a business profile, or similar, demonstrating their capability to undertake the audit/review;
- a document containing the following information:
 - facilities to be visited – for those licensees who have business operations over a number of sites, the Authority is particularly interested in details of the sites that will be visited during the audit/review;
 - functions to be audited and individuals, or office holders, to be interviewed; and
 - approximate timeline for the above activities – the Authority requires a high level work program and confirmation that the audit/review report will be provided to the Authority by the due date⁸;
- a declaration of independence prepared by the auditor.

⁷ If at any time a new member is added to the audit/review team, the auditor is required to provide a copy of the new member's Curriculum Vitae to the Authority.

⁸ The Authority notes that the responsibility for the timely delivery of the audit/review jointly rests with the auditor and the licensee.

9 Audit plan approval

9.1 Responsibility for developing the audit plan

The auditor is responsible for developing the audit plan. However, the Industry Acts do not include explicit provision for auditors to submit audit plans directly to the Authority.

The Authority requires either:

- with the licensee's consent, the auditor submit the audit plan to the Authority for its approval with a copy provided to the licensee; or
- the audit plan to be submitted to the Authority by the licensee on behalf of the auditor.

9.2 General requirements for audit plans

ASAE 3000 states that an engagement plan should consist of “a detailed approach for the nature, timing and extent of evidence-gathering procedures to be performed and the reasons for selecting them.”⁹ ASAE 3000 also provides a list of examples of the main matters to be considered in the engagement plan:

- the terms of the assurance engagement;
- the characteristics of the subject matter and the identified criteria;
- the assurance engagement process and possible sources of evidence;
- the assurance practitioner's understanding of the entity and its environment, including the risks that the subject matter information may be materially misstated;
- identification of intended users and their needs, and consideration of materiality and the components of assurance engagement risk;
- personnel and expertise requirements, including the nature and extent of experts' involvement.

The remainder of this section outlines the Authority's requirements in respect of an audit plan for audits/reviews.

9.2.1 Audit objectives

The audit plan must include a statement setting out the objectives and purpose of the audit/review. Inclusion of an audit objectives statement enables the Authority to confirm that the audit/review is being undertaken in accordance with the regulatory framework prescribed in the Industry Acts.

⁹ ASAE 3000, paragraph 26

9.2.2 Scope of work

The scope of work comprises a number of components:

- facilities that will be visited by the auditors during the audit/review – this enables the Authority to determine whether the audit will examine an appropriate proportion of the licensee’s business operations, particularly where these operations are geographically distributed;
- for each facility, details of the business functions that will be audited, the key personnel who will be interviewed and the documentation that will be examined¹⁰;
- a review of the actions taken to address the recommendations of the previous audit/review – the audit plan should include a copy of the recommendations from the previous audit/review; and
- work schedule – details of the key activities that will be performed during the audit (including report preparation), the audit/review team members who will be undertaking the activities and the amount of time that has been allocated to each activity.

9.2.3 Reporting

The audit plan should confirm that the audit/review report will comply with the format prescribed in these guidelines, see section 11.

9.3 Risk based approach to auditing

The audit plan for audits and reviews must apply the Authority’s mandatory methodology for assessing risk, which is based on Australian/New Zealand Standard 4360:2004. The methodology is described in more detail in Appendix 2. The output of the risk assessment process is the determination of an audit priority for each licence compliance obligation or asset management component. The calculated audit priority determines the nature and extent of audit testing for each compliance obligation or asset management component.

9.4 Specific requirements for operational/performance audit plans

The primary objective of an operational/performance audit is to provide to the Authority an independent assessment of a licensee’s compliance with all of the relevant obligations under the licence¹¹. Consequently, the Authority requires the auditor to undertake a comprehensive review of the licensee’s compliance with the licence, which requires an examination of each and every applicable compliance obligation during the audit. The risk based audit approach, described in Appendix 2, enables auditors to adjust the amount of audit examination and testing in line with the calculated risk of non-compliance. Licence

¹⁰ The Authority acknowledges that the auditor may not wish to disclose details of the sampling processes that will be applied during the audit/review. Should the Authority require further information regarding these matters then it will contact the auditor directly.

¹¹ The Authority also requires licensees to provide an annual, exception based, compliance report, which is a self-assessment of the licensee’s compliance with the licence. Auditors are required to review the compliance reports that have been provided to the Authority by the licensee since the previous audit.

obligations that are higher risk will be subjected to more detailed examination compared to lower risk licence obligations.

The remainder of this section details two possible approaches to determining the audit priority for the compliance obligations:

- application of an audit priority to each compliance obligation: or
- aggregate similar compliance obligations with similar audit priorities.

9.4.1 Singular audit priority assessment

The singular approach is where the auditor uses the compliance obligation framework in the relevant compliance manual¹² to identify the licence obligations¹³ applicable to a licence, and calculates an audit priority for each obligation. This is the most granular approach to calculating audit priorities.

9.4.2 Aggregated audit priority assessment

Auditors may elect to apply the audit priority assessment framework at a level that captures more than one compliance obligation. Common approaches to aggregation include calculating an audit priority for:

- each licence clause;
- a component part of a legislative instrument such as acts, regulations and codes¹⁴; or
- a group of compliance obligations that map onto the licensee's business processes (e.g. a common manager or business function is responsible for complying with the obligations).

Where aggregation has been applied to determining audit priority, the Authority will assume that stated audit priority applies to each and every applicable compliance obligation, as defined in the relevant compliance manual, unless otherwise stated. Also, where the auditor has selected the third option in the above list, the audit plan should explicitly detail the obligation numbers that are included in the aggregated group of compliance obligations.

9.4.3 Presentation of audit priority in the audit plan

The final draft of the audit plan must include for each compliance obligation, licence clause, legislative instrument, or group of compliance obligations, a table that identifies the risk assessment and audit priority rating. Table 1 provides an example based on licence clauses.

When developing the audit plan, the auditor may identify that one or more licence clauses/obligations do not apply to the licensee's business operations. Should this be the

¹² Electricity Compliance Reporting Manual, Gas Compliance Reporting Manual or Water Compliance Reporting Manual.

¹³ Each compliance obligation is given a unique number in the relevant compliance manual.

¹⁴ For example, a single audit priority might be applied to whole part of a code or a regulation, including sub-regulations.

case, the auditor is required to identify the clauses/obligations in the audit plan and briefly explain why these obligations are being excluded from the audit.

Table 1: Presenting audit priority ratings in operational/performance audit plans

Operating area	Operating Licence reference (Cl.=clause, Sch.=schedule)	Consequence (1=minor, 2=moderate, 3=major)	Likelihood (A=likely, B=probable, C=unlikely)	Inherent Risk (Low, Medium, High)	Adequacy of existing controls (S=strong, M=moderate, W=weak)	Audit Priority (Refer to Table 15 for audit priority ratings)					
						1	2	3	4	5	N/A
SERVICE DELIVERY						1	2	3	4	5	N/A
Water services in designated areas	Cl.2(b), Sch.1	1	C	Low	Strong					✓	
Availability / connection of services	Cl.12(b)	2	C	Medium	Strong				✓		
etc											

9.5 Specific requirements for asset management system review audit plans

The primary objective of an asset management effectiveness review is to provide to the Authority an independent assessment of the effectiveness of the licensee's asset management system in delivering the services covered by the licence.

To assist licensees and auditors, the Authority has developed a framework comprising 12 asset management processes, that is to be used to assess asset management effectiveness. Each asset management component includes details of the desired outcome and a minimum set of effectiveness criteria. Refer to Appendix 4 for more information.

The Authority requires auditors to base their assessment of asset management effectiveness on the mandatory framework described in Appendix 4. By applying the risk based audit approach described in Appendix 2, auditors are able to determine the amount of audit examination and testing that is to be applied to each asset management component. Higher risk asset management components will be subjected to more detailed examination compared to lower risk components.

As a minimum, the Authority requires auditors to state an audit priority for each of the 12 asset management components described in Appendix 4. However, auditors may optionally choose to break down an asset management component into sub-components and assign an audit priority to each sub-component.

9.5.1 Presentation of audit priority in the audit plan

The final draft of the audit plan should include for each component or sub-component of the asset management system, as applicable, a table that identifies the risk assessment

and review priority rating. Table 2 provides an example based on asset management component assessment.

Table 2: Asset management system review plan

Asset management system components	Consequence (1=minor, 2=moderate, 3=major)	Likelihood (A=likely, B=probable, C=unlikely)	Inherent Risk (Low, Medium, High)	Adequacy of existing controls (S=strong, M=moderate, W=weak)	Review Priority (Refer to Table 15 for audit priority ratings)					
					1	2	3	4	5	N/A
Asset planning	1	C	Low	Strong					✓	
Asset creation and acquisition	2	C	Medium	Strong				✓		
etc										

In undertaking the development of the audit plan, the auditor may identify that one or more asset management components/sub-components do not apply to the licensee's business operations. Should this be the case, the auditor is required to identify the asset management components/sub-components in the audit plan and briefly explain why they are being excluded from the review.

9.6 Assistance to be provided by the Authority

Following the appointment of the auditor by the licensee, the auditor may obtain a copy of the licensee's previous audit/review report from the Authority's web site (www.era.wa.gov.au).

The Authority may also, upon request from the licensee or the auditor, meet with the auditor to discuss any specific issues related to the audit/review planning process.

10 Conducting the audit/review

This section outlines some general principles to be followed by the auditor and the licensee to ensure the audit/review is conducted in a thorough and timely manner. These principles are discussed in the following sections.

10.1 Assistance to be provided by the licensee

The Authority requires licensees to facilitate the audit/review process by providing to the auditor, as needed and in a timely manner:

- access to the facilities and business premises identified in the audit plan;

- access to required materials and information sources that the auditor needs to conduct the audit/review, including data, performance reports, records and any other relevant information;
- access to the relevant person(s) in each of the licensee's business units that are being audited; and
- introductions to persons, other than employees of the licensee, who are relevant to the audit/review.

10.2 Deviation from the approved audit plan

When the audit plan has been finalised the auditor will then conduct the audit/review in accordance with the audit plan. However, as the audit/review progresses there may be a need to revise the audit plan based on the findings of the audit/review to date. The Authority requires that revisions to an audit plan that result in a higher or lower audit priority being assigned to a compliance obligation or asset management component, as applicable, be identified in the audit/review report along with a brief explanation of the reason for increasing/decreasing the audit priority.

10.3 Fieldwork

During the audit/review, the auditor is required to undertake one or more visits, as needed, to the licensee's organisation to access information, make enquiries and interview key personnel. The auditor should assess compliance with the requirements of the licence through assessing and testing:

- **the control environment** – licensee's management philosophy and operating style, organisational structure, assignment of authority and responsibilities, the use of internal audit, the use of information technology and the skills and experience of the key staff members;
- **the information system** – the appropriateness of the licensee's information systems to record the information needed to comply with the licence, accuracy of data, security of data and documentation describing the information system;
- **control procedures** – the presence of systems and procedures to monitor compliance with the licence or the effectiveness of the licensee's asset management system and to detect and correct non-compliance or under-performance;
- **compliance attitude** - the action taken by the licensee in response to any previous audit/review recommendations, and an assessment of the licensee's attitude towards compliance; and
- **outcome compliance** – the actual performance against standards prescribed in the licence throughout the audit period.

10.4 Audit evidence

ASAE 3000 (para 56-67) provides guidance on the quantity and quality of audit evidence to be obtained when conducting an audit/review. The standard states an auditor "*shall obtain sufficient appropriate evidence on which to base the conclusion*".

It is left to the auditor to use their professional judgement to determine what constitutes sufficient audit evidence for the audit/review they are conducting. However, the Authority requires the auditor to develop a comprehensive set of working papers throughout the audit/review. The working papers need to be sufficiently detailed to provide a high standard of evidence to support the auditor's opinions and recommendations that are included in the audit report. The auditor is required, upon request, to provide the Authority with access to the working papers.

10.4.1 Specific requirements for testing output compliance

There are licence conditions and obligations arising under the legislation, regulations and codes that require licensees to develop processes to ensure that benchmarks and milestones are achieved within prescribed timeframes. Examples include responding to customer complaints, connecting and re-connecting customers and providing annual compliance and performance reports to the Authority. The Authority expects auditors to undertake appropriate testing to determine whether a licensee has complied with the obligation. The level of testing will be guided by the licensee's control environment. If a licensee has a strong control environment with high level of visibility of the required compliance outcomes, then it may be appropriate for the auditor to rely on the available data provided by the licensee to assess compliance. However, if the licensee has a weak control environment, then the Authority expects the auditor to undertake more detailed testing, including sampling, to assess the level of compliance.

10.5 Professional scepticism

The auditor is expected to adopt an attitude of professional scepticism throughout the audit/review. ASAE 3100 (para 11(a)) states that having an attitude of professional scepticism "*means the assurance practitioner makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents and responses to enquiries and other information obtained from management and the responsible party*".

11 Audit/review reporting

The auditor is required to provide a comprehensive report to the licensee and the Authority that clearly expresses the opinion of the auditor in respect of the findings of the audit/review. AUS 810 provides a useful reference framework of the structure and content of reports on the effectiveness of control procedures.

The remainder of this section sets out the minimum set of information to be included in an audit/review report provided to the Authority for approval. This does not preclude the auditor from including other information in the report that they deem relevant to the audit outcomes.

11.1 *Executive summary*

11.1.1 **Operational/Performance audits**

The executive summary must include:

- a statement that the audit has been conducted in order to assess the licensee's level of compliance with the conditions of its licence;
- brief description of the type of licence held by the licensee and the business that is the subject of the licence and any major changes to either since the previous audit;
- summary of issues and recommendations arising from the current audit in a tabular form (licence condition reference, issue, recommendation and post-audit action plan by the licensee) and a review of the actions taken by the licensee in response to the previous post-audit plan;
- summary opinion of the auditor on the control environment operated by the licensee;
- overall assessment of compliance with the licence including the identification of any significant non-compliance events and the integrity of the licensee's reporting to the Authority and other statutory organisations; and
- any other information the auditor considers relevant to the audit.

11.1.2 **Asset management system reviews**

The executive summary must include:

- brief description of the assets that have been reviewed and any major changes to those assets since the previous review;
- summary of issues and recommendations arising from the current review in a tabular form (asset management system component, issue, recommendation and post-audit action plan by the licensee) and a review of the actions taken by the licensee in response to the previous post-audit plan;
- summary opinion of the auditor on the control environment operated by the licensee;
- overall assessment of the asset management system effectiveness; and
- any other information the auditor considers relevant to the review.

11.2 *Audit/review scope*

The audit/review scope must include:

- description of the audit/review objectives, scope and methodology used to conduct the audit/review;
- time period covered by the audit/review and the previous audit/review;
- the time period over which the audit/review has been conducted;

- details of the licensee's representatives participating in the audit/review;
- details of key documents and other information sources examined by the auditor during the course of the audit/review;
- details of the audit/review team members and hours utilised by each member; and
- any other information the auditor considers relevant to the audit/review scope.

11.3 Licensee's response to previous audit recommendations

The report must provide a tabular summary of:

- the recommendations from the previous audit report;
- action taken by the licensee to address the recommendations;
- whether the issue(s) that gave rise to the recommendations have been resolved; and
- any further action needed to address the issues identified in recommendations that have not been satisfactorily resolved.

The auditor is required to provide an assessment of the licensee's overall response to the recommendations in the previous audit report.

11.4 Performance summary

As discussed in section 6, the purpose and scope of operational/performance audits is different to those of an asset management system review. The performance summary of the audit/review report must report according to the appropriate rating framework described in the following sections.

11.4.1 Operational/performance audit compliance summary

The operational/performance audit report must provide a table that summarises the compliance rating for each licence condition using the 7-point rating scale described in Table 3.

Table 3: Operational/performance compliance rating scale

Compliance status	Rating	Description of compliance
COMPLIANT	5	Compliant with no further action required to maintain compliance
COMPLIANT	4	Compliant apart from minor or immaterial recommendations to improve the strength internal controls to maintain compliance
COMPLIANT	3	Compliant with major or material recommendations to improve the strength of internal controls to maintain compliance
NON-COMPLIANT	2	Does not meet minimum requirements
SIGNIFICANTLY NON-COMPLIANT	1	Significant weaknesses and/or serious action required
NOT APPLICABLE	N/A	Determined that the compliance obligation does not apply to the licensee's business operations

NOT RATED	N/R	No relevant activity took place during the audit period, therefore it is not possible to assess compliance
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The overall compliance rating applied to each licence condition is left to the judgement of the auditor. However, the auditor is required to tabulate the risk ratings and the overall compliance rating for each licence condition in a single table.

Table 4 provides an example of an operational/performance audit compliance summary table that must to be used in audit reports. The auditor is required to replicate this table in order to facilitate comparison and benchmarking of audit outcomes.

Table 4: An example of an operational/performance audit compliance summary

Operating area	Operating Licence reference (Cl.=clause, Sch.=schedule)	Consequence (1=minor, 2=moderate, 3=major)	Likelihood (A=likely, B=probable, C=unlikely)	Inherent Risk (Low, Medium, High)	Adequacy of existing controls (S=strong, M=moderate, W=weak)	Compliance Rating (Refer to the 7-point rating scale in Table 3 for details)							
						1	2	3	4	5	N/A	N/R	
SERVICE DELIVERY													
Water services in designated areas	Cl.2(b), Sch.1	1	C	Low	Strong				✓				
Availability / connection of services	Cl.12(b)	2	C	Medium	Strong			✓					
etc													

The auditor may include additional information in the observations section of the audit report (see section 11.6) that is considered relevant to the audit findings.

The Authority expects auditors who have rated compliance obligations as 1, 2, or 3 to also make recommendations to address the issue(s) that have resulted in that rating. Auditors may also include recommendations to address opportunities for improvement (for items rated 4 or 5) in the audit report.

11.4.2 Asset management review effectiveness summary

The asset management review report must provide a table that summarises the auditor's assessment of both the process and policy definition rating and the performance rating for each key process in the licensee's asset management system using the scales described in Table 5 and Table 6. It is left to the judgement of the auditor to determine the most appropriate rating for each asset management process.

Table 5: Asset management process and policy definition adequacy ratings

Rating	Description	Criteria
A	Adequately defined	<ul style="list-style-type: none"> Processes and policies are documented. Processes and policies adequately document the required performance of the assets. Processes and policies are subject to regular reviews, and updated where necessary The asset management information system(s) are adequate in relation to the assets that are being managed.
B	Requires some improvement	<ul style="list-style-type: none"> Process and policy documentation requires improvement. Processes and policies do not adequately document the required performance of the assets. Reviews of processes and policies are not conducted regularly enough. The asset management information system(s) require minor improvements (taking into consideration the assets that are being managed).
C	Requires significant improvement	<ul style="list-style-type: none"> Process and policy documentation is incomplete or requires significant improvement. Processes and policies do not document the required performance of the assets. Processes and policies are significantly out of date. The asset management information system(s) require significant improvements (taking into consideration the assets that are being managed).
D	Inadequate	<ul style="list-style-type: none"> Processes and policies are not documented. The asset management information system(s) is not fit for purpose (taking into consideration the assets that are being managed).

Table 6: Asset management performance ratings

Rating	Description	Criteria
1	Performing effectively	<ul style="list-style-type: none"> The performance of the process meets or exceeds the required levels of performance. Process effectiveness is regularly assessed, and corrective action taken where necessary.
2	Opportunity for improvement	<ul style="list-style-type: none"> The performance of the process requires some improvement to meet the required level. Process effectiveness reviews are not performed regularly enough. Process improvement opportunities are not actioned.
3	Corrective action required	<ul style="list-style-type: none"> The performance of the process requires significant improvement to meet the required level. Process effectiveness reviews are performed irregularly, or not at all. Process improvement opportunities are not actioned.
4	Serious action required	<ul style="list-style-type: none"> Process is not performed, or the performance is so poor that the process is considered to be ineffective.

The overall effectiveness rating for an asset management process is based on a combination of the process and policy adequacy rating and the performance rating.

Table 7 provides an example of a summary table that is to be used to report effectiveness in asset management review reports. The auditor is required to replicate this table in order to facilitate comparison and benchmarking of review outcomes.

Table 7: An example of an asset management effectiveness summary

ASSET MANAGEMENT SYSTEM	Asset management process and policy definition adequacy rating	Asset management performance rating
Asset planning	B	3
Asset creation/ acquisition	A	2
Asset disposal	C	4
Environmental analysis		
Asset operations		
Asset maintenance		
Asset Management Information System		
Risk management		
Contingency planning		
Financial planning		
Capital expenditure planning		
Review of AMS		

The auditor may include additional information in the effectiveness assessment section of the audit report (see section 11.6) that is considered relevant to the review findings.

The Authority expects auditors who have rated:

- the adequacy of the process and policy definition process as C or D; or
- the asset management performance as 3 or 4,

to also make recommendations to address the issue(s) that have resulted in that rating.

Auditors may also include recommendations to address opportunities for process improvements (for items rated A, B, 1 or 2) in the review report.

11.5 Recommendations

The auditor is required to provide detailed recommendations on the actions to be taken by the licensee to address non-compliance (operational/performance audits) or process deficiencies (asset management system reviews).

The Authority prefers the presentation of the recommendations to be tabular in format with each entry in the table including:

- reference to the compliance obligation/asset management process that the recommendation relates to; and
- the recommended action(s) to be taken to address the non-compliance or process deficiency.

11.5.1 Operational/performance audit

The recommendations must identify:

- the licence condition;
- the compliance rating;
- the issue(s) identified that have resulted in the nominated compliance rating; and
- the recommended action(s) to improve compliance to an acceptable level.

11.5.2 Asset management system review

The recommendations must identify:

- the asset management process;
- the effectiveness rating;
- the issue(s) identified that have resulted in the nominated effectiveness rating; and
- the recommended action(s) to improve the effectiveness of the asset management process to an acceptable level.

11.6 Observations

The observations section of the audit/review report expands on the findings presented in the compliance summary (operational/performance audits) or effectiveness summary (asset management reviews). The observations should be detailed enough to inform the Authority of the basis for the auditor arriving at the findings and recommendations contained in the report including:

- key findings of the audit fieldwork;
- sources of information used to assess compliance/effectiveness;
- tests undertaken to assess compliance/effectiveness;
- review of systems and/or procedures;
- interviews with licensee's staff and/or external experts; and
- the overall level of compliance/effectiveness demonstrated by the licensee during the time period covered by the audit/review.

To facilitate cross-referencing, the use of a tabular format to present the observations and recommendations with linkages to the summary findings is preferred but other methods of presentation are also acceptable.

11.7 Changes to the licence

Where the auditor is of the opinion the existing licence conditions do not adequately address risks that are identified in the compliance summary, the report may recommend changes to the licence conditions. The recommendation should clearly identify the licence

condition(s) affected and nominate alternative wording for an existing condition or nominate a new condition.

11.8 Post-audit implementation plan

The licensee must include a post-audit implementation plan in the audit/review report for the Authority to approve. The post-audit implementation plan must identify for each of the recommendations (refer to section 11.5) made by the auditor:

- the action(s) to be taken to address the auditor's recommendations;
- the position(s) or business function(s) in the licensee's organisation that will be responsible for undertaking the nominated action(s); and
- the date by which the nominated action(s) will be completed.

The post audit implementation plan can be either a separate document attached to the audit/review report or incorporated into the report as an appendix.

It is mandatory that the post-audit implementation plan include actions to address audit non-compliances (rated 1 – 3) or asset management process deficiencies (rated C, D, 3 or 4). It is left to the discretion of the licensee to determine whether to also include in the post-audit implementation plan actions to address recommendations made by the auditor that represent opportunities to improve licence compliance (rated 4 or 5) or asset management effectiveness (rated A, B, 1 or 2).

It is the responsibility of the licensee to develop the post-audit implementation plan. When submitting the plan to the Authority, it needs to be made clear that it does not form part of the final audit report. Whether this distinction is achieved by providing two separate documents, or by the auditor including a caveat in the final report stipulating that the plan does not form part of their opinion, is left to the discretion of the auditor and licensee. The Authority will not commence the audit/review report approval process until both the report and the post-audit implementation plan have been received.

11.9 Signature of the auditor

The auditor is required to confirm their approval of the content of the audit/review report by:

- including a statement to the effect that the audit/review report is an accurate presentation of their findings and opinions;
- attaching the signature of a person authorised to make the above statement on behalf of the auditor;
- the date on which the signature was attached to the report; and
- the address of the auditor.

Alternatively, the above information may be provided in a dated covering letter bearing the auditor's signature.

11.9.1 Disagreement between the auditor and the licensee

There may be circumstances where the auditor and licensee are not able to agree on either the audit/review findings or the auditor's recommendations. Should this situation arise, the auditor and licensee are encouraged to take all reasonable steps to resolve the issue. If it is not possible for the auditor and licensee to reach a resolution, then the auditor is required to include details of the points of disagreement in the audit report. This section must identify:

- the auditor's original opinion and/or recommendation;
- the licensee's response to the auditor's opinion and/or recommendation; and
- if applicable, the amendment to the audit report requested by the licensee.

11.10 Reporting to the Authority

The auditor or the licensee may elect to forward a draft report for comment to the Authority prior to submitting the final report to the Authority for its approval. However, the Authority will not commence the approval process until it has received the final audit report and the post-audit implementation plan (see section 11.8).

The auditor is responsible for producing the audit/review report. The report is to be submitted to the Authority for approval in both electronic and printed formats as follows:

- an electronic copy of the report in both Microsoft Word¹⁵ and Adobe Acrobat format on a CD-ROM or transmitted by email; and
- 3 printed, bound copies of the report delivered to the Authority's postal address or delivered in person to Level 6, Governor Stirling Tower, 197 St Georges Terrace, Perth WA 6000. Auditors are required to ensure that at least 1 of the bound copies is bound in a way that enables it to be easily disassembled and scanned into the Authority's electronic document management system.

11.11 Repeat audit

The Authority may require the licensee to repeat the audit/review using the same auditor, or an alternative auditor of the Authority's choosing, in the event that one or more of the following occur:

- the auditor has not conducted the audit/review in accordance with the approved audit plan, subject to reasonable variation based on audit/review findings;
- the audit team is changed during the course of the audit/review in a way that, in the view of the Authority, unacceptably compromises the conduct of the audit/review;
- the auditor has not observed its responsibility to the Authority by withholding relevant information in the audit report; or

¹⁵ The Word version of the document will be used solely for the purpose of extracting information for inclusion in documents prepared within the Authority and to prepare a version of the audit report in Adobe PDF format for publication on the Authority's website. At no time will the Word document be circulated to parties external to the Authority.

- the audit/review report does not comply with the mandatory components of these guidelines or the report is deemed to be of an unacceptable quality by the Authority.

12 Reporting on the audit/review by the Authority

When the Authority has approved the audit/review report, it will:

- provide a copy of the report to the relevant Minister within 1 month of the receipt of the final report for water licences and within 2 months of the receipt of the final report for electricity and gas licences; and
- subsequent to the report being provided to the Minister, the Authority will publish a copy of the audit/review report on its web site: www.era.wa.gov.au

13 Commercial confidentiality

In performing its licensing functions under the Industry Acts, the Authority has an obligation to promote transparent decision making functions and public consultation. Consistent with these aims, the Authority will publish on its web site each audit/review report received from a licensee.

Where, in the licensee's reasonable opinion, the audit/review report contains confidential or commercially sensitive information, the licensee should clearly identify the information that is claimed to be confidential or commercially sensitive. "Confidential or commercially sensitive information" is information of the type that would ordinarily be covered by the *Freedom of Information Act 1992* Schedule 1, clause 4. That is, information such as trade secrets or sensitive commercial information that would cause detriment to the organisation if disclosed.

A licensee must not make a blanket claim of confidentiality or commercial sensitivity in relation to an audit/review report, but clearly state the exact information claimed to be confidential and the reasons for the claim. Where, in the Authority's view, a claim is excessive or not justified, the Authority may request the licensee to review the claim. Accordingly, licensees are encouraged to carefully review any claim of confidentiality or commercial sensitivity before submitting it to the Authority.

14 Amendments

The Authority may amend or revoke these guidelines.

Any significant amendments will be made available to licensees and interested parties for comment prior to their release by the Authority.

Appendix 1 – Relevant Relationships for Assessing Auditor Independence

Section 324CH of the *Corporations Act 2001 (Cth)* describes a number of relevant relationships that need to be considered by auditors for the purposes of determining whether a conflict of interest situation may exist in respect of the proposed audit/review of the licensee. These relationships are reproduced in this Appendix to clarify the extent to which the Authority requires auditors to examine the potential for a conflict of interest situation in respect of the audit/review.

Table 8: Relevant relationships applicable to assessing auditor independence

Relevant Relationships
The following relationships apply to a person (or, if applicable, an audit company) at a particular time that the person (or audit company):
Is an officer of the licensee
Is an audit-critical employee of the licensee
Is a partner of: <ul style="list-style-type: none"> • an officer of the licensee; or • an audit-critical employee of the licensee.
Is an employer of: <ul style="list-style-type: none"> • an officer of the licensee; or • an audit-critical employee of the licensee.
is an employee of: <ul style="list-style-type: none"> • an officer of the licensee; or • an audit-critical employee of the licensee.
Is a partner or employee of an employee of: <ul style="list-style-type: none"> • an officer of the licensee; or • an audit-critical employee of the licensee.
Provides remuneration to: <ul style="list-style-type: none"> • an officer of the licensee; • an audit-critical employee of the licensee, for acting as a consultant to the person.
Was an officer of the licensee at any time during: <ul style="list-style-type: none"> • the period to which the audit/review relates; or • the 12 months immediately preceding the beginning of the period to which the audit/review relates; or • the period during which the audit/review is being conducted or the audit/review report is being prepared.
Was an audit-critical employee of the licensee at any time during: <ul style="list-style-type: none"> • the period to which the audit/review relates; or • the 12 months immediately preceding the beginning of the period to which the audit/review relates; or • the period during which the audit/review is being conducted or the audit/review report is being prepared.
Has an asset that is an investment in the licensee.
Has an asset that is a beneficial interest in an investment in the licensee and has control over that asset.
Has an asset that is a beneficial interest in an investment in the licensee that is a material interest.
Has an asset that is a material investment in an entity that has a controlling interest in the licensee.

Has an asset that is a material beneficial interest in an investment in an entity that has a controlling interest in the licensee.
Owes an amount to: <ul style="list-style-type: none"> • the licensee; or • a related entity; or • an entity that the licensee controls.
Is owed an amount by: <ul style="list-style-type: none"> • the licensee; or • a related entity; or • an entity that the licensee controls.
Is liable under a guarantee of a loan made to: <ul style="list-style-type: none"> • the licensee; or • a related entity; or • an entity that the licensee controls.
Is entitled to the benefit of a guarantee given by: <ul style="list-style-type: none"> • the licensee; or • a related entity; or • an entity that the licensee controls.

Notes to Table 8:

1. An officer is a person who is:

- a partner in a partnership; or
- an office holder in an unincorporated association; or
- a person who:
 - makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the entity; or
 - who has the capacity to affect significantly the licensee's financial standing.

2. An entity can be any of the following:

- a body corporate;
- a partnership;
- an unincorporated body;
- an individual;
- for a trust that has only 1 trustee--the trustee; or
- for a trust that has more than 1 trustee--the trustees together.

3. Audit company means:

- an individual auditor; or
- a service company or trust acting for, or on behalf of, an individual auditor, or another entity serving a similar function; or
- a body corporate; or
- a partnership; or
- an unincorporated body.

4. Where the person referred to in Table 8 is a member of the audit team then the personal relationship tests should be applied to that person and their immediate family members, which includes:

- the person's spouse, *de facto* or partner; or
- a person who is wholly or partially dependent on the person; or
- the person's parents (including parents-in-law); or
- a child who is not a dependent; or
- a sibling.

5. An audit-critical employee is a person who is in a position to exert influence over the matters being audited or the conduct of the audit.

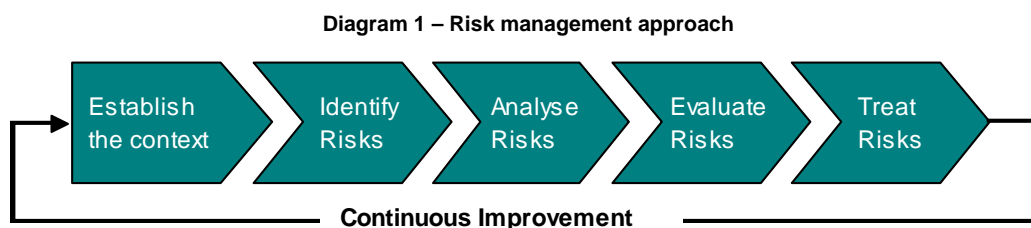
Appendix 2 – Risk based approach to audits and reviews

1 Assessing risk

The first stage of an audit or review is to conduct a preliminary assessment of the risks of non-compliance with the licence conditions or ineffective management of assets respectively in order to identify higher risk areas for testing and focus the audit/review accordingly.

The preliminary risk assessment is to be documented in the audit plan, which is then presented to the Authority and the licensee for approval prior to the fieldwork commencing. The risk assessment should be reviewed during the fieldwork phase of the audit/review and may need to be updated in accordance with the audit/review findings.

The risk assessment approach to the conduct of audits and reviews is based on the Australian/New Zealand Standard AS/NZS 4360:2004 Risk Management as shown in Diagram 1.



The main elements of the risk assessment process relevant to an audit/review are described below.

2 Establish the context

The context is:

- the business objectives of the licensee;
- the relevant legal and regulatory environment that applies to the particular industry;
- industry codes;
- the licence conditions;
- the Authority's regulatory functions and objectives; and
- for reviews, effective asset management practice.

3 Identify risks

For audits, review the licence conditions and identify the risks that may affect compliance with these conditions. Consider where, when, why and how events could prevent, degrade or delay compliance with the licence obligations.

For reviews, review the asset management processes and identify the risks that may adversely impact on the process and result in ineffective asset management.

The following steps in the risk evaluation process are common to audits and reviews. It is left to the auditor to apply the principles to the audit/review based on their knowledge of the licensee's business and the relevant regulatory framework. For the purposes of illustration the remainder of this appendix focuses on audits, but the processes leading to the calculation of audit priorities can be equally applied to determining the audit priority for asset management processes in a review.

Licences are granted by the Authority subject to conditions intended to promote the objectives of the legislation governing the Authority. The conditions relevant to the licensing of service providers have been used to frame the types of risk as shown in Table 9.

Table 9: Types of compliance risk

Type of Risk	Examples
Non-compliance with supply quality	Public health and safety issues, quality not fit-for-purpose.
Non-compliance with supply reliability	Delays in new connections, disruptions to supplies, insufficient supplies.
Non-compliance with consumer protection	Customer service levels not met, higher prices charged.
Non-compliance with legislation/licence	Breach of industry Acts and regulations, other licence conditions not met eg, performance reporting to the Authority.

4 Analyse risks

An approach to analysing the compliance risks involves a two-stage process:

- 1) Identify the consequences and likelihood of the inherent risks to give an overall inherent risk rating.
- 2) Identify and assess the strength of the existing internal controls that mitigate the inherent risks.

These steps are explained in more detail below.

1. Identify the consequences and likelihood of the inherent risks to give an overall inherent risk rating

An "inherent risk" is the risk of an event assuming there are no effective controls. It is similar to the concept of materiality as set out in the audit standards. For example, the inherent risk if water quality standards are not met is higher for a potable water supplier than an irrigator due to the potential direct impact on public health of supplying potable water.

The consequences of the risk occurring is assessed using the 3-point rating scale described in Table 10. The examples indicate that the consequences of 'supply quality' and 'supply reliability' would generally be rated higher than 'consumer protection' and 'breaches of legislation' because of the risk to public safety and health.

Table 10: Consequence ratings

	Rating	Examples of non-compliance			
		Supply quality	Supply reliability	Consumer protection	Breaches of legislation or other licence conditions
1	Minor	Minor public health or safety issues. Breach of quality standards minor - minimal impact on customers.	System failure or connection delays affecting only a few customers. Some inconvenience to customers.	Customer complaints procedures not followed in a few instances. Nil or minor costs incurred by customers.	Licence conditions not fully complied with but issues have been promptly resolved.
2	Moderate	Event is restricted in both area and time eg, supply of service to one street is affected for up to one day. Some remedial action is required.	Event is restricted in both area and time eg supply of service to one street is affected for up to one day. Some remedial action is required.	Lapse in customer service standards is clearly noticeable but manageable. Some additional cost may be incurred by some customers.	Clear evidence of one or more breaches of legislation or other licence conditions and/or sustained period of breaches.
3	Major	Significant system failure. Life-threatening injuries or widespread health risks. Extensive remedial action required.	Significant system failure. Extensive remedial action required.		

The next step towards assessing inherent risk is to determine the likelihood of the risk occurring. This likelihood is assessed using the 3-point rating scale described in Table 11.

Table 11: Likelihood ratings

	Level	Criteria
A	Likely	Non-compliance is expected to occur at least once or twice a year
B	Probable	Non-compliance is expected to occur once every three years
C	Unlikely	Non-compliance is expected to occur once every 10 years or longer

The combination of consequence rating and likelihood rating is used to arrive at an overall inherent risk rating using a 3-point rating scale, which is quantified in Table 12.

Table 12: Inherent risk rating

Likelihood	Consequence		
	1. Minor	2. Moderate	3. Major
A. Likely	Medium	High	High
B. Probable	Low	Medium	High
C. Unlikely	Low	Medium	High

The 3 inherent risk ratings, low, medium and high, are described in Table 13.

Table 13: Description of inherent risk ratings

Level	Description
High	Likely to cause major damage, disruption or breach of licence obligations
Medium	Unlikely to cause major damage but may threaten the efficiency and effectiveness of service
Low	Unlikely to occur and consequences are relatively minor

2. Identify and assess the strength of the existing internal controls that mitigate the inherent risks

Once the inherent risks have been identified and classified, it is important to assess the strength of the existing internal controls that mitigate each inherent risk. Licensees who have recognised risk events that carry a high inherent risk and put in place appropriate controls to mitigate these risks carry a lower risk of the event being realised than licensees that have not. There are a number of internal control components that need to be examined to assess the licensee's ability to manage its risks. Internal control,¹⁶ as it applies to a licensee, consists of the following components:

- Control environment (corporate governance, organisation structure, assignment of authority and responsibility, documentation of policies and procedures, human resource practices, records management, etc).
- Licensee's risk assessment process.
- Information systems, including the related business processes relevant to the licence conditions.
- Control activities (authorisation, segregation of duties, physical controls and security, etc).
- Monitoring of controls (management review, internal audit, other audits, etc).

The adequacy of controls is assessed using the 3-point rating scale described in Table 14.

Table 14: Adequacy ratings for existing controls

Level	Description
Strong	Strong controls that are sufficient for the identified risks
Moderate	Moderate controls that cover significant risks; improvement possible
Weak	Controls are weak or non-existent and have minimal impact on the risks

A preliminary assessment of controls is usually made during the planning stage of the audit. The risk assessment is revised during the audit as evidence is gathered on the effectiveness of the controls in place, with the updated assessment forming part of the final audit report.

5 Evaluate risks

The next stage in the audit planning process is to evaluate the depth of audit of each licence condition based on the combined rating for inherent risk and control adequacy. Table 15 identifies a 5-level audit priority scale to inform the audit testing process.

¹⁶ Auditing and Assurance Standard AUS 402 February 2004, Auditing and Assurance Standards Board.

Table 15: Assessment of audit priority

		Adequacy of existing controls		
		Weak	Moderate	Strong
Inherent Risk	High	Audit priority 1	Audit priority 2	
	Medium	Audit priority 3	Audit priority 4	
	Low	Audit priority 5		

The assessment of audit priority is used to determine the audit objectives, the nature of the audit testing and the extent of audit testing required.

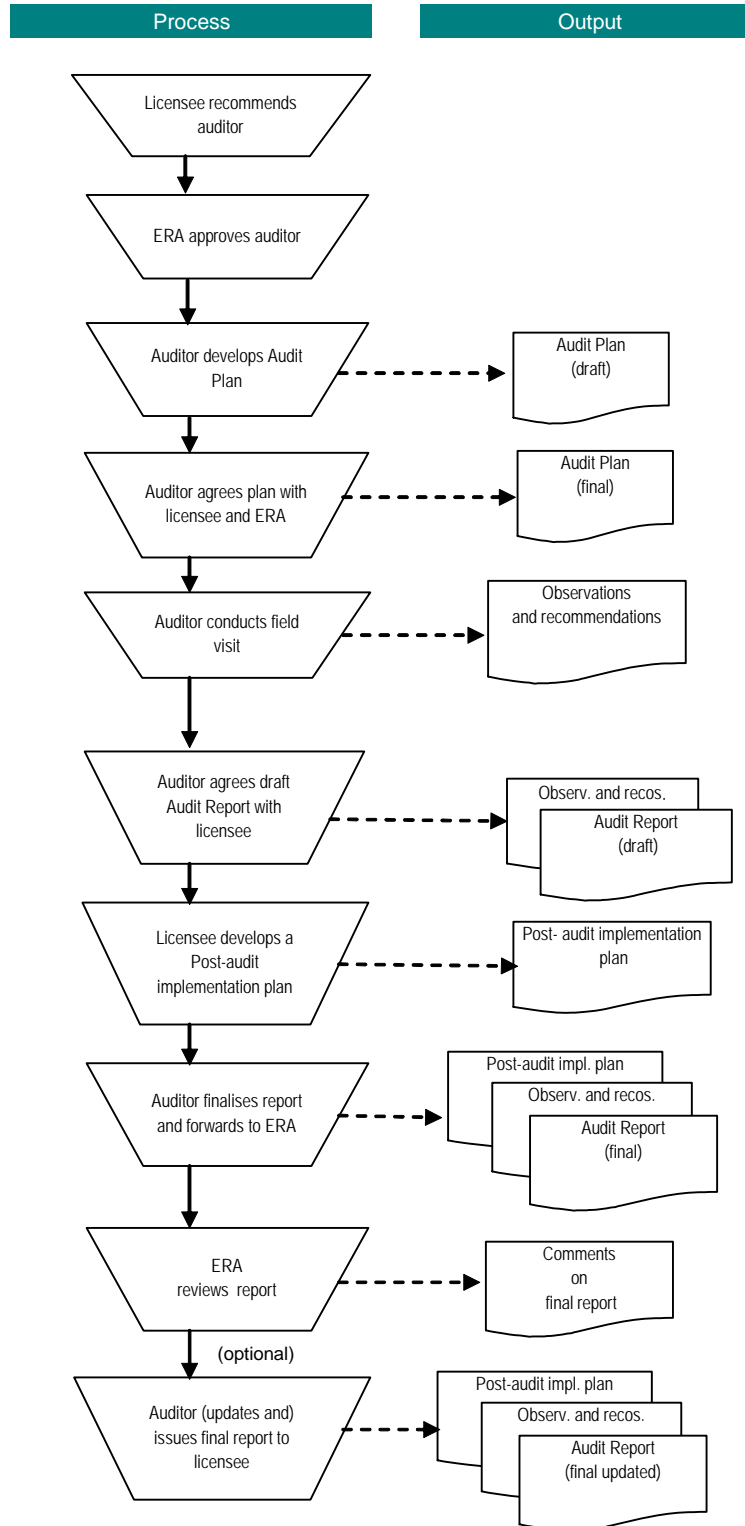
It is left to the professional judgement of the auditor to determine the testing requirements for each of the licence conditions, but it is anticipated an Audit Priority 1 is a 'high risk' area and would usually require extensive controls and/or substantive testing to provide adequate assurance that no major breaches of the relevant licence obligation had occurred during the audit period. Conversely, an Audit Priority 5 is a 'low risk' area and would only require confirmation by discussion and desktop review of documented procedures to confirm that adequate controls exist to comply with the licence obligation.

6 Treat risks

The auditor will assess compliance with the licence obligations and recommend any corrective action or improvements required to minimise risk. The auditor is expected to include recommendations in the audit report to address each risk item that requires corrective action or improvement.

In extreme cases where significant risk issues are identified the Authority may seek a direct response from the management and/or Board of the licensee.

Appendix 3 – Process flowchart for performance/operational audits and asset management system reviews



Appendix 4 – A Guide to the AMS Effectiveness Framework

An asset management system comprises the processes and plans needed to ensure the physical assets continue to provide a specified level of service in a cost-effective manner throughout their useful life.

Assets should only exist to support service delivery objectives. When a service is in the planning stage it is necessary to identify the assets that are needed to meet a specified level of service. The extended life of assets involved in the delivery of electricity, gas and water services requires the decisions involving asset acquisition to take account of the full operating costs over the asset's design life. It is therefore essential to consider the asset life-cycle.

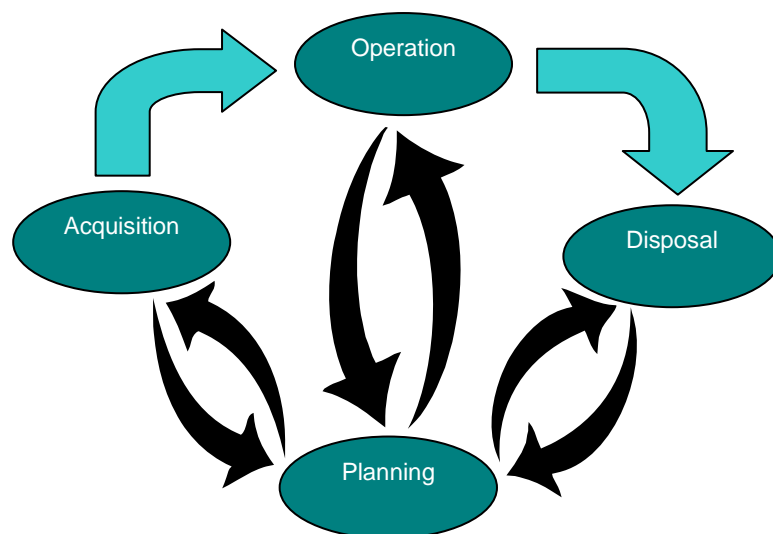
1 Asset life-cycle

The fact that assets have a life-cycle distinguishes them from other program resource inputs. The life-cycle of an asset or group of assets has three distinct phases - acquisition, operation and disposal.

Typically, those responsible for acquisition decisions in an organisation differ from those responsible for operating and maintaining assets, and these groups often differ from those responsible for their disposal. Problems may arise as a consequence of this fragmentation of management over the asset life-cycle.

A fourth phase, planning, is a continuous process where the information outputs from each phase are used as an input to planning. The four phases are shown in Diagram 1.

Diagram 1 - Asset Life Cycle



Source: Better Practice Guide – Asset Management Handbook June 1996, Australian National Audit Office

2 Asset management system key processes

The key processes in the asset management life-cycle are:

- 1) Asset planning (including development and maintenance of an asset management plan).
- 2) Asset creation and acquisition.
- 3) Asset disposal.
- 4) Environmental analysis (all external factors that affect the system).
- 5) Asset operations.
- 6) Asset maintenance.
- 7) Asset management information system.
- 8) Risk management.
- 9) Contingency planning.
- 10) Financial planning.
- 11) Capital expenditure planning.
- 12) Review of AMS.

Table 15 examines each of these asset management processes in more detail and provides auditors and licensees with guidance on each process with regard to the desirable outcomes, effectiveness criteria and an approach to reviewing the effectiveness. The suggested review approach is intended to provide an example only and should be adapted to each review by the auditor based on their professional judgement.

Table 16: Asset management system key processes and effectiveness criteria

Key process	Outcome	Effectiveness criteria	Example of review approach
<p>1. Asset planning</p> <p>Asset planning strategies are focused on meeting customer needs in the most effective and efficient manner (delivering the right service at the right price).</p>	<p>Integration of asset strategies into operational or business plans will establish a framework for existing and new assets to be effectively utilised and their service potential optimised.</p>	<ul style="list-style-type: none"> ▪ Planning process and objectives reflect the needs of all stakeholders and is integrated with business planning ▪ Service levels are defined ▪ Non-asset options (eg demand management) are considered ▪ Lifecycle costs of owning and operating assets are assessed ▪ Funding options are evaluated ▪ Costs are justified and cost drivers identified ▪ Likelihood and consequences of asset failure are predicted ▪ Plans are regularly reviewed and updated 	<ul style="list-style-type: none"> ▪ Assess the adequacy of the asset planning process ▪ Assess the adequacy of the asset management plan ▪ Assess whether the asset management plan is up-to-date and implemented in practice ▪ Assess whether the plan clearly assigns responsibilities and whether these have been applied in practice
<p>2. Asset creation and acquisition</p> <p>Asset creation/acquisition means the provision or improvement of an asset where the outlay can be expected to provide benefits beyond the year of outlay.</p>	<p>A more economic, efficient and cost-effective asset acquisition framework which will reduce demand for new assets, lower service costs and improve service delivery.</p>	<ul style="list-style-type: none"> ▪ Full project evaluations are undertaken for new assets, including comparative assessment of non-asset solutions ▪ Evaluations include all life-cycle costs ▪ Projects reflect sound engineering and business decisions ▪ Commissioning tests are documented and completed ▪ Ongoing legal/environmental/safety obligations of the asset owner are assigned and understood 	<ul style="list-style-type: none"> ▪ Assess the adequacy of policies and procedures covering the creation and acquisition of assets ▪ Select a sample of creations/ acquisitions over the review period and confirm that adequate procedures have been followed and actual costs are as predicted
<p>3. Asset disposal</p> <p>Effective asset disposal frameworks incorporate consideration of alternatives for the disposal of surplus, obsolete, under-performing or unserviceable assets. Alternatives are evaluated in cost-benefit terms.</p>	<p>Effective management of the disposal process will minimise holdings of surplus and under-performing assets and will lower service costs.</p>	<ul style="list-style-type: none"> ▪ Under-utilised and under-performing assets are identified as part of a regular systematic review process ▪ The reasons for under-utilisation or poor performance are critically examined and corrective action or disposal undertaken ▪ Disposal alternatives are evaluated ▪ There is a replacement strategy for assets 	<ul style="list-style-type: none"> ▪ Assess the adequacy of policies and procedures covering the identification of under-performing assets, disposal of assets and replacement strategy ▪ Determine whether a regular review of the usefulness of assets is performed ▪ Select a sample of disposals over the review period and confirm that adequate procedures

Key process	Outcome	Effectiveness criteria	Example of review approach
			have been followed
<p>4. Environmental analysis</p> <p>Environmental analysis examines the asset system environment and assesses all external factors affecting the asset system.</p>	<p>The asset management system regularly assesses external opportunities and threats and takes corrective action to maintain performance requirements.</p>	<ul style="list-style-type: none"> ▪ Opportunities and threats in the system environment are assessed ▪ Performance standards (availability of service, capacity, continuity, emergency response, etc) are measured and achieved ▪ Compliance with statutory and regulatory requirements ▪ Achievement of customer service levels 	<ul style="list-style-type: none"> ▪ Review achievement of performance and service standards over the audit period ▪ Investigate any breaches and assess corrective action taken ▪ Review the adequacy of reporting and monitoring tools
<p>5. Asset operations</p> <p>Operations functions relate to the day-to-day running of assets and directly affect service levels and costs.</p>	<p>Operations plans adequately document the processes and knowledge of staff in the operation of assets so that service levels can be consistently achieved.</p>	<ul style="list-style-type: none"> ▪ Operational policies and procedures are documented and linked to service levels required ▪ Risk management is applied to prioritise operations tasks ▪ Assets are documented in an Asset Register including asset type, location, material, plans of components, an assessment of assets' physical/structural condition and accounting data ▪ Operational costs are measured and monitored ▪ Staff receive training commensurate with their responsibilities 	<ul style="list-style-type: none"> ▪ Assess the adequacy of policies and procedures covering operations functions ▪ Assess the adequacy of staff resourcing and training ▪ Confirm the policies and procedures have been followed during the review period by testing of asset register, observation of operational procedures, analysis of costs, etc ▪ Assess the significance of exceptions identified and whether adequate corrective action has been taken
<p>6. Asset maintenance</p> <p>Maintenance functions relate to the upkeep of assets and directly affect service levels and costs.</p>	<p>Maintenance plans cover the scheduling and resourcing of the maintenance tasks so that work can be done on time and on cost.</p>	<ul style="list-style-type: none"> ▪ Maintenance policies and procedures are documented and linked to service levels required ▪ Regular inspections are undertaken of asset performance and condition ▪ Maintenance plans (emergency, corrective and preventative) are documented and completed on schedule ▪ Failures are analysed and operational/maintenance plans adjusted where necessary 	<ul style="list-style-type: none"> ▪ Assess the adequacy of policies and procedures covering maintenance functions ▪ Confirm the policies and procedures have been followed during the review period by testing of maintenance schedules, analysis of costs, etc ▪ Assess the significance of exceptions identified and whether adequate corrective action has been taken

Key process	Outcome	Effectiveness criteria	Example of review approach
		<ul style="list-style-type: none"> Risk management is applied to prioritise maintenance tasks Maintenance costs are measured and monitored 	
<p>7. Asset Management Information System (MIS)</p> <p>An asset management information system is a combination of processes, data and software that support the asset management functions.</p>	<p>The asset management information system provides authorised, complete and accurate information for the day-to-date running of the asset management system.</p> <p>The focus of the review is the accuracy of performance information used by the licensee to monitor and report on service standards.</p>	<ul style="list-style-type: none"> Adequate system documentation for users and IT operators Input controls include appropriate verification and validation of data entered into the system Logical security access controls appear adequate, such as passwords Physical security access controls appear adequate Data backup procedures appear adequate Key computations related to licensee performance reporting are materially accurate Management reports appear adequate for the licensee to monitor licence obligations 	<ul style="list-style-type: none"> Assess the adequacy of policies and procedures covering the general control and security of the computer systems used to provide management information on service standards/licence obligations Confirm that management reports on service standards/licence obligations are being reviewed and significant exceptions to service standards are promptly followed up and actioned
<p>8. Risk management</p> <p>Risk management involves the identification of risks and their management within an acceptable level of risk.</p>	<p>An effective risk management framework is applied to manage risks related to the maintenance of service standards</p>	<ul style="list-style-type: none"> Risk management policies and procedures exist and are being applied to minimise internal and external risks associated with the asset management system Risks are documented in a risk register and treatment plans are actioned and monitored The probability and consequences of asset failure are regularly assessed 	<ul style="list-style-type: none"> Assess the adequacy of policies and procedures covering risk management and contingency planning Assess whether the risk management policies and procedures have been applied in practice Assess the adequacy of staff understanding and training on risk management
<p>9. Contingency planning</p> <p>Contingency plans document the steps to deal with the unexpected failure of an asset.</p>	<p>Contingency plans have been developed and tested to minimise any significant disruptions to service standards.</p>	<ul style="list-style-type: none"> Contingency plans are documented, understood and tested to confirm their operability and to cover higher risks 	<ul style="list-style-type: none"> Determine whether contingency plans have been developed and are current Determine whether contingency plans have been tested. If so, review the results to confirm that

Key process	Outcome	Effectiveness criteria	Example of review approach
			any improvements identified have been actioned.
<p>10. Financial planning</p> <p>The financial planning component of the asset management plan brings together the financial elements of the service delivery to ensure its financial viability over the long term.</p>	<p>A financial plan that is reliable and provides for the long-term financial viability of the services.</p>	<ul style="list-style-type: none"> ▪ The financial plan states the financial objectives and strategies and actions to achieve the objectives ▪ The financial plan identifies the source of funds for capital expenditure and recurrent costs ▪ The financial plan provides projections of operating statements (profit and loss) and statement of financial position (balance sheets) ▪ The financial plan provide firm predictions on income for the next five years and reasonable indicative predictions beyond this period ▪ The financial plan provides for the operations and maintenance, administration and capital expenditure requirements of the services ▪ Significant variances in actual/budget income and expenses are identified and corrective action taken where necessary 	<ul style="list-style-type: none"> ▪ Obtain an understanding of the financial planning, budgeting and reporting process and assess its effectiveness ▪ Obtain a copy of the current financial plan (including budget/actual) and assess whether the process is being followed
<p>11. Capital expenditure planning</p> <p>The capital expenditure plan provides a schedule of new works, rehabilitation and replacement works, together with estimated annual expenditure on each over the next five or more years.</p> <p>Since capital investments tend to be large and lumpy, projections</p>	<p>A capital expenditure plan that provides reliable forward estimates of capital expenditure and asset disposal income, supported by documentation of the reasons for the decisions and evaluation of alternatives and options.</p>	<ul style="list-style-type: none"> ▪ There is a capital expenditure plan that covers issues to be addressed, actions proposed, responsibilities and dates ▪ The plan provide reasons for capital expenditure and timing of expenditure ▪ The capital expenditure plan is consistent with the asset life and condition identified in the asset management plan ▪ There is an adequate process to ensure that the capital expenditure plan is regularly updated and actioned 	<ul style="list-style-type: none"> ▪ Obtain an understanding of the capital expenditure planning process and assess its effectiveness ▪ Obtain a copy of the capital expenditure plan for the current year and assess whether the process is being followed

Key process	Outcome	Effectiveness criteria	Example of review approach
<p>would normally be expected to cover at least 10 years, preferably longer. Projections over the next five years would usually be based on firm estimates.</p>			
<p>12. Review of AMS The asset management system is regularly reviewed and updated.</p>	<p>Review of the Asset Management System to ensure the effectiveness of the integration of its components and their currency.</p>	<ul style="list-style-type: none"> ▪ A review process is in place to ensure that the asset management plan and the asset management system described therein are kept current ▪ Independent reviews (eg internal audit) are performed of the asset management system 	<ul style="list-style-type: none"> ▪ Determine when the asset management plan was last updated and assess whether any significant changes have occurred ▪ Determine whether any independent reviews have been performed. If so, review results and action taken ▪ Consider the need to update the asset management plan based on the results of this review ▪ Determine when the AMS was last reviewed.

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