



**JOINING THE AUDIT PANEL**  
**ELECTRICITY AND GAS INDUSTRIES**

**December 2013**

**ELECTRICITY AND GAS INDUSTRIES REGULATORY AUDITS**

**JOINING THE AUDIT PANEL**

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**AMENDMENT RECORD**

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## CONTENTS

1.	INTRODUCTION	1
2.	AUDIT DEED	2
3.	CONDUCTING THE AUDIT	2
4.	AUDIT INDEPENDENCE	2
5.	ADDITION TO OR REMOVAL FROM THE AUDIT PANEL	3
6.	APPLICATION	4
7.	KEY PERFORMANCE INDICATORS (KPIS)	4
8.	APPOINTMENT TO THE PANEL	5
	APPENDIX 1: QUALIFICATIONS, SKILLS, EXPERIENCE & KNOWLEDGE	6
	APPENDIX 2: ASSESSING AND REPORTING ON COMPLIANCE	8



## 1. INTRODUCTION

This document should be read in conjunction with Energy Industries Guideline No. 22 – Regulatory Audits of Energy Businesses published by the Essential Services Commission (the Commission).

### Purpose

The Commission seeks applications from suitably qualified organisations for appointment to the Commission’s Audit Panel.

The Commission is the independent economic regulator established by the Victorian Government to regulate prescribed essential utility services, including electricity, gas, water, ports and rail freight industries.

One of the Commission’s statutory functions is to administer the licensing of electricity distribution and retailing activities under the *Gas Industry Act 2001* (the Gas Act) and the *Electricity Industry Act 2000* (‘the Electricity Act’). As a condition of their licences, the Commission may require licensed energy retailers (‘retailers’) and licensed energy distribution businesses (‘distributors’) to undertake audits of their compliance with applicable legislative and regulatory obligations, and of the quality of regulatory data such as performance indicators that the licensees report.

Audits requested under retailers’ or distributors’ licenses are assurance services, unless otherwise specified in the Commission’s Minimum Audit Scope issued for an engagement. Assurance services involve the auditor’s objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system, or other subject matter.<sup>1</sup> The nature and scope of the assurance engagement are set out in the Commission’s Minimum Audit Scope. There are generally three parties involved in assurance services:

- the process owner, person or group directly responsible for the entity, operation, function, system, or other subject matter under review- the licensee;
- the person or group making the assessment - the auditor;
- the person or group using the assessment - the Commission.

Licensees are expected to select auditors to perform the audit from the Audit Panel. Where a business fails to nominate an auditor or the Commission decides not to approve the auditor, the Commission may (but is not obliged to) appoint an auditor from its audit panel.

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<sup>1</sup> Definition of “assurance services” is taken from the International Standards for the Professional Practice of Internal Auditing.

## **Audit Panel Expectations**

In order to be appointed to the Commission's audit panel, firms will need to satisfy specified criteria. The initial term of appointment will be for a period greater than one year but not more than three years. In order to remain on the panel and/or be re-appointed, auditors will have to demonstrate compliance to set key performance indicators ('KPIs').

### **2. AUDIT DEED**

The auditor and the licensee must enter into a tripartite deed (Audit Deed) with the Commission in the form of the Commission's standard Audit Deed, or in such other form as the Commission may require. The Audit Deed sets out the obligations the auditor has to the licensee and the Commission.

### **3. CONDUCTING THE AUDIT**

To ensure that audits are performed to achieve their purpose as stated in Guideline 22, the methodology employed must comply with the general principles of the Standard on Assurance Engagements ASAE 3100 Compliance Engagements and the generic minimum requirements specified in the Audit Deed or such other requirements specified by the Commission.

Notwithstanding the requirements of any standard, as a minimum the Commission requires the auditor to:

- analyse documented procedures;
- interview responsible staff;
- analyse information systems;
- analyse quality controls;
- identify changes in systems and documented procedures;
- analyse relevant data;
- analyse a sample of cases or data; and
- in cases where significant non-compliance or significant information defects is established, assess the licensee's plan to remedy the non-compliance.

Refer to Appendix 2 for details on how the Commission expects compliance to be assessed and reported.

### **4. AUDIT INDEPENDENCE**

Audits requested under retailers' or distributors' licenses are assurance services, unless otherwise specified in the Commission's Minimum Audit Scope. Assurance services involve the auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system, or other subject matter

Independence is the freedom from conditions that threaten objectivity or the appearance of objectivity.<sup>2</sup> Objectivity is an unbiased mental attitude that allows auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made.<sup>3</sup> Objectivity requires auditors not to subordinate their judgement on audit matter to that of others.

A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively. In identifying conflict of interest situations, the auditor may refer to the Accounting Professional and Ethical Standards (APES) 110 Code of Ethics for Professional Accountants issued by the APES Board. The auditor and any sub-contractors may be placed in a position where their duty to another and their duty to the Commission conflict and in such an event, the primary duty must be to the Commission. The Audit Deed elaborates on conflicts, duty of care and a procedure for addressing conflicts of interest.

## **5. ADDITION TO OR REMOVAL FROM THE AUDIT PANEL**

### **Addition to the Audit Panel**

The audit panel may be added to from time to time where the Commission is satisfied that a firm meets the specified criteria in terms of experience, expertise, independence and capability to perform the audits.

### **Removal from the audit panel**

The Commission may remove a firm from the audit panel after:

- (a) the expiry of the appointment term;
- (b) a failure by the auditor to comply with any obligation owed to the Commission under an Audit Deed;
- (c) a representation and warranty made by the auditor under an Audit Deed is, or proves to be, false;
- (d) there is a change in the composition of the staff available to perform audits which, in the opinion of the Commission arrived at in good faith, results in an unacceptable reduction in the level of competence of the audit firm;
- (e) a failure by the audit firm to maintain the necessary level of experience, expertise or capability to perform the audits; or
- (f) a failure to follow Guideline 22 or observe the necessary level of independence in performing an audit.

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<sup>2</sup> Definition of “independence” is taken from the International Standards for the Professional Practice of Internal Auditing.

<sup>3</sup> Definition of “Objectivity” is taken from the International Standards for the Professional Practice of Internal Auditing.

The Commission reserves the right not to form an audit panel or not make appointments to the panel. Additionally the Commission reserves the right to disband the panel.

## **6. APPLICATION**

### **Selection Criteria**

In selecting successful audit panel members, the Commission will consider the criteria detailed in Appendix 1, the auditor's agreement to the terms and conditions of the Audit Deed and whether the auditor has the required level of insurance coverage.

### **Responses**

In expressing interest to be appointed to the Commission's audit panel, a firm's submission will need to:

- identify the firm's field of work, core expertise, relevant work experience and corporate business structure;
- identify staff to be made available to lead the audits and act as audit team members, with brief resumes;
- demonstrate that they are able to satisfy the selection criteria requirements in terms of experience and expertise;
- outline any conflicts of interest or potential conflicts of interest and the manner in which the potential or perceived conflict of interest is proposed to be managed;
- demonstrate the resource capacity to undertake more than one audit during an audit cycle, including the ability to maintain availability, continuity and skill level of key staff;
- identify that they have the required level of insurance coverage;
- indicate your acceptance of the terms and conditions of the Audit Deed or identify any concerns with the Audit Deed; and
- provide referees and list examples of relevant audit work previously undertaken.

## **7. KEY PERFORMANCE INDICATORS (KPIs)**

The performance of panel auditors will be measured by a series of KPIs, and will influence their ability to remain or be reappointed to the panel. KPIs will include: the ability of the auditors to meet the prescribed timeframes; acceptance and compliance with the Audit Deed; management of conflicts of interest; and quality of the outputs.



## **8. APPOINTMENT TO THE PANEL**

### **Term of Appointment**

*The Commission proposes that the initial term of appointment to the audit panel will be for a period greater than one year but no more than three years. At the expiry of this term the audit firm may be reappointed from the audit panel.*

### **Application Address**

Applications to become a member of the panel can be sent to:

Energy Group  
Essential Services Commission, Victoria  
37/2 Lonsdale Street  
Melbourne 3000

OR

[energy.submissions@esc.vic.gov.au](mailto:energy.submissions@esc.vic.gov.au)

## **APPENDIX 1: QUALIFICATIONS, SKILLS, EXPERIENCE & KNOWLEDGE**

### **1.1 SKILLS & EXPERIENCE**

The auditor and the audit team must be able to demonstrate:

- a) skill and proven experience in, and a detailed knowledge of, quality assurance, including operational or compliance auditing;
- b) where relevant, skill and proven experience in, and detailed knowledge of, science or engineering, asset management, information systems and customer service;
- c) detailed knowledge of the electricity or gas industry (as the case requires); and
- d) compliance with the Institute of Internal Auditors International Standards for Professional Practice of Internal Auditing and Code of Ethics.

The audit team must be directed by a partner (or equivalent) of the auditor. Partners and individuals who are to act on-site during an assignment as lead auditors must be identified.

### **1.2 EVIDENCE OF KNOWLEDGE OF ELECTRICITY INDUSTRY ACT, GAS INDUSTRY ACT AND RELEVANT CODES AND GUIDELINES**

The auditor and the audit team must provide appropriate evidence to the Commission that:

- a) demonstrates that the auditor and the audit team has knowledge of the Electricity Act, Gas Act and relevant codes and guidelines;
- b) sets out details of how the knowledge was obtained including, if relevant, details of the following:
  - i) previous experience in assisting a licensed energy business to comply with its regulatory obligations;
  - ii) training in the Electricity Act, Gas Act and relevant codes and guidelines;
  - iii) experience in participating in regulatory audits; and
- c) sets out any other information that the auditor and the audit believe is relevant to demonstrate their knowledge of the Electricity Act, Gas Act and relevant codes and guidelines.

### **1.3 EVIDENCE AND KNOWLEDGE OF AUDITING – EXPERIENCE AND KNOWLEDGE**

The auditor and the audit team must provide appropriate evidence to the Commission that:

1. the audit team leader has adequate experience in the last five years as an audit team leader or a member of an audit team in auditing and preparing audit reports in one or more of the following types of audits:
  - a. an audit carried out with reference to AS 3806-2006 Australian Standard Compliance Programs or AS 31000 Risk Management or AS ISO 1002-2006 Customer Satisfaction – Guidelines for Complaints Handling;
  - b. an assurance engagement carried out in accordance with Standard on Assurance Engagement ASAE 3100 Compliance Engagements or its equivalent.
2. the experience is equivalent to, or sufficiently relevant for, conducting an audit under the Commission’s Guideline 22 - Regulatory Audits of Energy Businesses;
3. sets out any other information that the auditor and the audit team believe to be relevant to demonstrate their experience and qualifications an auditing.

The Commission may from time to time seek evidence that the auditor and audit team continue to have recent experience in relevant audit practice.

#### **1.4 QUALIFICATIONS – NOMINATED LEAD AUDITOR**

The nominated Lead Auditor must provide details of qualifications and training relevant to their role as Lead Auditor. Specifically, the Nominated Lead Auditor must provide details of:

1. Tertiary Qualifications;
2. Auditor Certification; and
3. Other qualifications or training, relevant to the conduct of reasonable assurance audits, for which the Lead Auditor received accreditation.

#### **1.5 INSURANCE**

Audit Panel Members must hold:

- public liability insurance of \$5 million for any one or more claims arising out of the same set of circumstances; and
- a policy of professional indemnity insurance with a reputable insurer which meets the Commission’s requirements (which is currently \$1 million for technical services and \$5 million for audit services).

## APPENDIX 2: ASSESSING AND REPORTING ON COMPLIANCE

It is important that compliance is rated using standard grades, thereby maximising the comparability of the results reported to the Commission. The Commission uses a specific grading system in order to assess compliance. Auditors must use the prescribed standard grades for the regulatory information and compliance with licence obligations.

### REGULATORY INFORMATION

The grades used to assess regulatory information focus on the reliability of the licensee's procedures for generating the information and the quality of the data produced by those procedures.

The auditor must determine the data quality by having regard to:

- a) the systems and processes used to generate the data;
- b) the methods used, if any, to extrapolate or estimate data; and
- c) the way in which reports are prepared and the extent to which reports are communicated, reviewed and acted upon.

The auditor must assign a two-part grade (e.g. B2, DX) to each category of information in the audit scope as follows:

<i>Grade</i>	<i>Reliability assessment</i>
<b>A</b>	<p>All data is based on robust information systems that support the compliance program, and documented policies, practices and procedures, which are:</p> <ul style="list-style-type: none"><li>• updated as required and endorsed by the licensee's management;</li><li>• consistent with the Commission's information specifications;</li><li>• communicated and readily available to all staff; and</li><li>• fully understood and followed by staff to support compliance outcomes and acted upon at all levels of the organisation, including the Board and senior executive management.</li></ul>
<b>B</b>	<p>Most data conforms with Grade A. Data integrity is compromised due to minor compliance failures and inadequate controls over information systems. For example, a minority of data may be based on:</p> <ul style="list-style-type: none"><li>• information specifications that are different to those published by or reported to the Commission;</li></ul>

- outdated policies and procedures;
- inconsistent compliance practices;
- minor deviations from documented operating policies and procedures;
- policies and procedures that are not properly communicated or that are misunderstood by staff;
- system upgrades and changes that have resulted in loss of data; or
- estimation or extrapolation of data that conforms with Grade A.

**C** In many cases, but not all, data does not conform with Grade A. Data integrity is significantly compromised due to compliance failures and lack of controls over information systems. For example, the majority of the data may be based on:

- information specifications that are materially different to those published by or reported to the Commission;
- policies and procedures that are not documented and endorsed by the licensee’s management;
- documented operating policies and procedures that are significantly out of date, incomplete or not followed;
- policies and procedures that are not communicated to staff or fully understood;
- processes that do not retain source documentation for verification purposes;
- processes that increase the risk of manual intervention or data that is manually managed outside a major system; or
- estimation or extrapolation of data that conforms with Grade A or B.

**D** Data is not relevant, suitable or adequate to form an objective determination regarding its quality.

<i>Grade</i>	<i>Accuracy</i>
<b>1</b>	± 1%
Where a performance indicator is relevant to operations in principle but no data exists and none is reported in the audit period, this should be graded <b>1</b> .	
<b>2</b>	± 5%
<b>3</b>	± 10%
<b>4</b>	± 25%
<b>5</b>	± 50%
<b>6</b>	± 100%
<b>X</b>	For small samples where an error would be more than 100%, or data that is not relevant, suitable or adequate.

## COMPLIANCE WITH LICENCE OBLIGATIONS





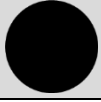
Most audits will include in their scope an assessment of the licensee’s compliance framework and its demonstrated capacity to identify its regulatory obligations, comply with them, monitor its compliance and report breaches. On occasion, the scope may require the auditor to assess compliance against each of the 12 principles of AS 3806-2006 Australian Standard Compliance Programs. Otherwise, the auditor must assess compliance using the following two-step grading system.

### Step One

To assess if compliance is reliable and demonstrable, the following control areas may be considered:




- Policies / procedures;
- Skills / training;
- Systems / maintenance;
- Monitoring / feedback;
- Culture / practices.

A separate Harvey Ball symbol is to be used to indicate the existence and adequate operation of each of these five control areas. Each Harvey Ball indicator can show one of five grades. For the purposes of illustration, the following example refers only to ‘**Policies / procedures**’ but similar consideration needs to be given, and a Harvey Ball grade applied, to each of the other four control areas as relevant.

<i>Grade</i>	<i>Description</i>	<i>Required Action</i>
	Non-Compliance	Full revision or development of processes and controls is required in the area of <b>Policies / procedures</b> ; specifically <auditor’s comments>.
	Non-Compliance	Significant revision or development of key processes and controls is required in the area of <b>Policies / procedures</b> ; specifically <auditor’s comments>.
	Non-Compliance	Revision of some key processes and controls is required in the area of <b>Policies / procedures</b> ; <auditor’s comments>.
	Needs Improvement	Improvement opportunities exist in some processes and controls in the area of <b>Policies / procedures</b> ; specifically <auditor’s comments>.
	General Compliance	Minimal or no action required in the area of <b>Policies / procedures</b> .

## Step Two

A traffic light system must be used to indicate overall compliance with an obligation, taking into account all five control areas for which the separate Harvey Balls have been given.

<i>Grade</i>	<i>Description</i>	<i>Definition</i>
	Non-Compliance	The requirements of the condition have not been met, or adequate, relevant and suitable information to form an objective determination on compliance was not available to demonstrate compliance. Findings noted are considered material in nature and require urgent remedial action.
	Partial Compliance	Key requirements of the condition have been met but only minor achievements in compliance have been demonstrated. Findings noted are considered significant and require substantial effort to correct.
	General Compliance	Most requirements of the condition have been met with some minor failures or breaches. Findings noted are considered minor and require routine efforts to correct in the normal course of business.