

6 May 2013

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**Commission Draft Decision
Guideline 22 – Regulatory Audits of Energy Businesses
SP AusNet Submission**

Thank you for the opportunity to contribute to the consideration of a renewed audit approach for Victorian distributors. SP AusNet has a number of concerns and uncertainties regarding the Commission's proposal to commence renewed audit activities with respect to distributors and their obligations under their licenses.

1 Compliance Regime Uncertainties

SP AusNet understand that regulatory oversight of distributor's activities have largely passed to the AER. This handover was notionally of the economic regulation matters, however it has to date essentially been accepted by the two regulators and the industry that the AER role extended largely across the whole range of distributor obligations. This is consistent with the interpretation that all these obligations ultimately are related to economic considerations. That is, to levels of resourcing, expenditure on systems and facilities, etc. Under the understood arrangements, whereas the current regulatory instruments developed by the Commission (eg EDSC, GDC, etc) would remain under the Commission's "ownership", the compliance regime for these was to be managed by the AER. Further, once the NECF was in place in Victorian, and the related Victorian subordinate instruments established to provide coverage of matters in the current Commission instruments not in the NECF, that even this document management role of the Commission with respect to energy would fall away. This is consistent with the broad thrust of the national regulatory framework approach which aims to increase the effectiveness and efficiency of energy regulation by moving to a single energy regulator (regulating as much as possible against nationally consistent obligations).



Hence whereas the EIA , GIA and the ESCA may well, as stated in the Draft Decision Paper, require the Commission to ensure ongoing distributor compliance with their broad license obligations, the understanding is that any such requirement is being met through the compliance regime being maintained by the Commission's fellow regulatory, the AER. ¹

We understand that recently there has been some debate with respect to the AER assuming as expected the regulatory oversight of some aspects of the Victorian smart meter regime. We further understand that as this debate is not yet finalised, and to ensure that there are no associated regulatory oversight "holes", that the recent legislation to establish the flexible tariff regime in Victoria gives the Victorian Government the power through an Ministerial Order to assign the regulatory role for any matter to the AER or the Commission. Potentially this may specifically assign the Commission as the regulator for certain obligations. Whilst it is not entirely clear, we assume that the AER will not have a parallel regulatory role for these specified obligations. We assume but again it is not clear, that ultimately the broad policy approach of a single national regulator will prevail and at a point in the future all Distributor regulation will be by the AER.

Can the Commission please provide detail of the overall distribution obligations compliance regime and the relative roles of the Commission and the AER.

2 Basis of need for Commission compliance regime

Since the regulatory role of the Commission was passed to the AER, SP AusNet has been subject to, and contributed to the AER's regulatory regime. This regime is consistent with the compliance approach as defined in the AER "Compliance and Enforcement Statement of Approach". The AER approach with respect to their NECF compliance role (not yet applicable in Victoria) is fundamentally the same, and hence their more comprehensive "Statement of Approach" and "AER Compliance Procedure and Guidelines" applicable to their NECF serves to expand and define in more detail their general compliance regime.

This regime has specifically consisted of:

- 1 the annual reporting of key service and performance standards through the AER's Electricity Network Service Provider Performance Reports.
- 2 reporting of compliance using an approach consistent with the requirements and the obligation classifications as defined and detailed in the Commission's "Compliance Reporting Manual (Energy Distribution and Retail Businesses)". This involves compliance reporting against more than 135 nominated separate obligations on a six monthly or 12 monthly basis. Whilst this is not a mandated part of the AER regime, it does serve to provide the AER with an understanding of the distributor compliance issues and hence serves as part of the AER's mechanism for understanding areas of compliance risk.
- 3 being subjected to the monitoring regime as detailed in the AER "Compliance and Enforcement Statement of Approach". SP AusNet has been subject of a number of reviews across a wide range of distributor obligations, based on the AER's identification from their various market intelligence and information sources of areas of potential risk and concerns. These reviews have included:
 - meter upgrades on large customers;
 - market (MSATS) standing data update timeframes;
 - current transformer testing requirements;
 - interval meter reversion issues;

¹ We note that it is of ongoing concern that the above is based largely on a number of understandings and considerations of the broad policy positions, and that the relative regulatory roles of the Commission and the AER for the full range of distributor regulatory obligations is not clearly and formally defined in the necessary detail.

- Solar generation installations;
- connection charges;
- planned outages;
- ring fencing; and
- GSL's.

Whilst no specific formal compliance audits have been conducted on, or requested from SP AusNet, these remain as options in the AER's regime.

As outlined above apart from potentially some aspects of smart meter obligations for which the AER may not, at least in the shorter term have the regulatory role, there is an understanding that the AER has the regulatory role and there is a compliance regime in place and compliance actions are being undertaken.

If the Commission are seeking assurance that License obligations are being met, then it is our view that the Commission could approach the AER to obtain details of the compliance monitoring framework in place under the AER, and copies of the various reviews and input undertaken under this framework. If the Commission have concerns with respect to certain aspects of the distributors' obligations then surely there are mechanisms between the Commission and the AER for these matters to be agreed and for them to be incorporated into the AER's ongoing compliance plan.

SP AusNet would be concerned if the proposed audits by the Commission were going to introduce a second "parallel" distributor obligations compliance regime with a different approach. This does not appear to meet the generally accepted criteria for an effective and efficient compliance regime. It would have the potential to introduce confusion within distribution business internal groups due to different approaches and to uncoordinated time scheduling, including possibly producing unintentional peaks in compliance review/audit activity. Further there is the possibility of duplication of regulatory compliance activity against specific distributor obligations. As well as the concerns expressed immediately above this also introduces the very undesirable potential for differences in interpretation of specific instrument clauses and outcomes which then has fundamental compliance issues for distributors (and the regulators).

Can the Commission please provide some understanding of the perceived need for Commission audits of Distributor obligation to be undertaken.

3 Commission compliance approach alignment with AER approach

The AER compliance approach as defined in their compliance regime documents is based around using targeted reviews wherever possible, and the previous Commission approach of externally conducted annual audits, are both legitimate compliance assurance approaches. However unless there is a fundamental change of policy with respect to compliance management, in the medium term it will be the AER's regime which will be applied as they will be the single national regulator .

To reintroduce routine compliance audits will require the re-establishment within SP AusNet of the processes for the creation of audit arrangements and for the management of audits within the business. This is a considerable undertaking given the break in time since the last Commission audit and the considerable churn of personnel who would have previous experience of the audit process.

On this basis it is difficult to understand the justification for the Commission's compliance approach to be reapplied in the short term.

Hence if there is a real need for the Commission to undertake compliance activities again, it is suggested that consideration should be given to utilising an approach better aligned to that

established by the AER and as defined in considerable detail in their NECF compliance framework documents.

Can the Commission please provide some understanding why a compliance regime more closely aligned to the AER approach cannot be used for the distributor compliance obligations to be regulated by the Commission?

4 Envisaged scope of Commission distributor audits

Whereas in Section 1.1 p2 of the Draft Decision Paper the Commission states “References will be made in this paper to those issues where the Commission will undertake audits in relation to distribution”, the Paper does not actually specify the obligations for which the Commission is to be required under Ministerial Order, or under some other Commission decision process, to resume regulatory oversight and hence potentially request distribution audits.

Can the Commission please make it clear what aspects of the Distributor’s obligation will be subject to Commission audit.

5 Timing of Commission audits

In Section 1.3.2 p5 of the Draft Decision, it is stated that “the proposed planwill be communicated to the relevant licensed businesses in a timely manner, for example in the fourth quarter of the preceding year”. Given the need for work planning and co-ordination, internal financial provisions, etc this would appear to be a reasonable approach.

However it is stated in Section 2.1.2 p8 of the Draft Decision that “it is expected that some or all Victorian distributorswill be required to undertake regulatory audits in the first half of 2013”.

This would not appear to give sufficient lead time for the necessary finalisation of the Guideline and for the distributors to consider this and put in place workplans for the establishment of auditor arrangements and for the internal management of the audit process

Can the Commission please make it clear what timeframe it is considering for distributor audits, taking into account that any audit would be the first under the Guideline for some time.

6 Comments regarding the proposed Guideline 22 Audit Process

Whilst as outlined above SP AusNet have a number of concerns with the broad concept of Commission audits of distributor obligations, we have carried out some assessment of the details of the audit approach as drafted into the revision of Guideline 22. We raise the following issues or uncertainties with respect to the process defined in the Guideline:

i. Audit panel

SP AusNet understand the Commission’s proposed strategy of establishing an audit panel. However we make the following comments:

- The concept of having an audit panel places the establishment of this panel on the critical path to undertaking audits.
- There is a need for consideration when establishing the annual audit program, of the number of audit teams required for an audit round compared with the number of teams available across the panel members.
- Further consideration should be taken of the need to maintain continuity on the panel as this reduces costs in second and subsequent audits.
- Having an audit panel of selected recognised competent and Commission outcome aligned audit companies, should streamline the auditor selection

process by reducing the need for the Commission's detail approval of the auditor selected. The Guideline approval detail appears excessive given the pre-approval through the panel appointment process.

ii. Scope

In Section 5.1.2 p8 of the Guideline it is stated that the audit scope will specify "obligations and any other matters". What are potentially the "other matters" to which this refer.

iii. Harvey Balls

SP AusNet find the concept of use of Harvey Balls is unclear.

- Is it for each obligation there are 5 areas of assessment of processes and controls with one ball for each area? ie One ball indicating whether policies/procedures are satisfactory; a second ball for skills/training; etc.
- There is no Harvey Ball requirements (nor traffic light system) for measured compliance just the two part confidence grade?
- Do each of the balls for license obligation compliance then have 5 grades of compliance?
 - 1 General compliance
 - 2 Needs improvement
 - 3 Non compliance – some revisions needed
 - 4 Non compliance – significant revisions needed
 - 5 Non compliance

Whilst this appears consistent with 7.5.1, the details in the table in 7.4.1 suggest otherwise. Eg in the third row with half shaded ball labelled Non Compliance, the detailed comment is "Revision of some key processes and controls is required in the area of Culture/practices..." Whereas the second row example refers to monitoring/feedback. If the assumption above is correct then it would be clearer if all rows in the example referred to the one area.

iv. Audit completion concepts and timelines

Some of the concepts and timelines with respect to audit completion are unclear:

The Final Report is delivered to the Commission 5 bus days before Closing Meeting. (It is assumed that this is the meaning of "within 15 business days before the closing meeting"?), and the Draft Report is delivered no later than 15 bus days before Closing Meeting

- In the ten days between these two submissions, the distributor must negotiate any accuracy issues revisions with the auditor and get Board endorsement - this is very tight!
- What is the Commission going to do with the draft audit report? Why is it required by the Commission?
- Is actual Board endorsement required or can this be endorsed by an executive??

SP AusNet assess that further consideration needs to be given to the Guideline to improve the workability and the clarity of the Commission's requirements.

If you require further detail on any of the matters above, please contact myself on 9695 6629.

Yours Sincerely,

A handwritten signature in black ink that reads "Peter Ellis". The signature is written in a cursive style with a large, stylized 'P' and 'E'.

Peter Ellis
Network Market Services Manager