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Submissions  
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## Proposed changes to participant audit regime

We welcome the opportunity to submit on the Electricity Authority's consultation paper *Proposed changes to participant audit regime* published 10 November 2015.

Our submission focuses on three areas and we have answered the questions at Appendix A.

- We agree with some of the issues raised during the Authority's review but consider many could be addressed through improvements to existing mechanisms instead of creating new obligations
- The costs analysis is detailed but we are not convinced it supports the case for much of the proposed new Code requirements
- The Authority is able to be an auditor but it is not clear how the costs of this function would be funded (i.e. whether it can 'charge' for audit services).

## AGREE THAT THERE ARE SOME ISSUES WITH THE REGIME

We welcome the Authority's review of the audit regime given the necessary role audit procedures play in the assurance of operational processes and outputs in the high-value electricity market. We consider that an effective audit regime that promotes certainty in the accuracy of market measurements will lead to greater confidence and efficient decisions by market participants.

We understand the Authority surveyed participants at an early review stage but decided to not publish survey responses. This is disappointing for a policy development process because it ultimately has hindered ours and perhaps other participants' ability to respond.

We agree with the Authority's review that opportunities exist for improvement to the governance and scope of audits for parts 10, 11 and 15 compliance. We support the actions for introducing risk-based approaches to audit scope which can be achieved through guidelines for each audited area. We encourage the Authority to advance its work on assessing audit scope through risk-based planning as this will be fundamental to understanding the likely costs of each audit type.

We support changes to the Code to improve accessibility and clarity and suggest the audit regime could be better served by its own part of the Code with the guidelines as the main vehicle for the detail. We did however find it difficult to follow in the consultation paper which of the Code changes are simply parts that have been moved, or are new, or are removed, and annotation of the Code changes to this effect would be most helpful.

Overall however we have reservations about and do not support new Code obligations for most of the audit process matters outlined.

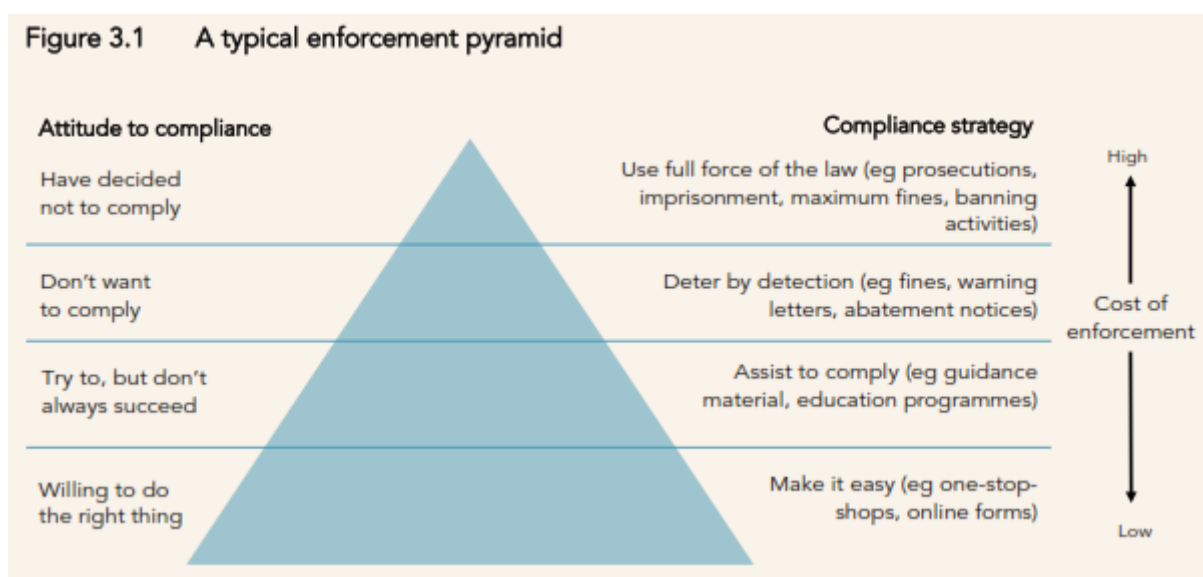
## RESERVATIONS ABOUT MOST NEW CODE OBLIGATIONS

It is not clear from the consultation paper whether the current audit practice is revealing a level of non-compliance that could be considered unsatisfactory (e.g. sufficient to require substantial rework or undermine confidence) in market measurement and reconciliation processes. In other words, we do not believe that the Authority has demonstrated that there is a problem that warrants the proposed level of regulatory intervention.

Rather than increased prescription and regulatory intrusion, which inevitably imposes additional costs, we consider the aims of improved governance and targeted (risk-based) audit scope would be better met by working with guidelines, increasing education about the regime, and attention to the Authority's approval process.

In this regard we note the Productivity Commission's report *Regulatory Institutions and Practice*<sup>1</sup> which outlines a framework for compliance that starts with the assumption that a party wants to comply and using actions to help them to comply for example, providing guidance material or education programmes. Enforcement processes such as detection start when there is evidence that parties do not want to comply. We have copied the framework diagram below for completeness.

Figure 1 Ayres and Braithwaite (1992) Responsive Regulation<sup>2</sup>



## COST BENEFIT OF 'REGIME CHANGE'

We acknowledge the effort and attention that has gone into identifying the costs of the proposed changes. We found this helpful in understanding the Authority's approach to the cost-benefit analysis required to support a Code amendment.

We consider the benefits of system and governance improvements to the audit regime is to reduce the risk of inaccurate market measurements and the checking, rework and rebilling (etc.) that

<sup>1</sup> Available at <http://www.productivity.govt.nz/sites/default/files/regulatory-institutions-and-practices-final-report.pdf> Page 56

<sup>2</sup> Ditto

measurement uncertainty entails. We suggest the correct starting point for the CBA is to articulate and quantify how the costs under the changes (which include the audit costs) create market operation benefits that are greater than those from the current regime. We accept a changed framework will make for a more challenging CBA. Care should also be taken not to unnecessarily erode competition for provision of audit services.

Overall we are not persuaded that the cost benefit analysis supports new Code. We consider the bulk, if not all, of the potential efficiency gains may be achieved by improving existing non-Code approaches, for example, by guidelines and via education; and consistent with the philosophy that participants seek to comply with their obligations.

#### **AUTHORITY AS AUDITOR**

If the Authority decides to undertake the audit function itself, as is contemplated by proposed Code clause 15A.2, then we understand this could mean that the audited participant would not need to pay directly for the audit as the Authority's functions are funded by levy.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Micky Cave', with a stylized, cursive script.

Micky Cave

**Senior Regulatory Analyst**

## APPENDIX A QUESTIONS

#	Question	Comment
Question 1	Do you agree the opportunities to improve the audit regime identified by the Authority are worthy of attention?	Yes.
Question 2	Do you agree that the problems identified with the existing purpose of the audit regime are correct? If not, why not?	We agree with the Authority's conclusions.
Question 3	Do you agree with the proposed purpose of the audit regime? If not, why not?	No, we consider the current compliance focus is appropriate with an audit report providing the assurance of that extent. The additional 'purposes' or 'objectives' may be better framed as ex-post Authority processes that attach to the results of the independent audit.
Question 4	Do you agree with the proposed purpose of the audit regime being incorporated into guidelines but not the Code? If not, why not?	No. We consider that the audit purpose statement should sit at the head of a dedicated Code part for audit processes e.g. 'Part 16'.
Question 5	Do you agree with the problems identified with the governance arrangements of the audit regime? If not, why not?	We consider the problems presented could be managed by the Authority in its role in approval.  What is not clear is whether the current audit practice is revealing a level of non-compliance that is creating problems (a lack of confidence) in market measurements and reconciliation processes.
Question 6	Are there any other gaps in auditing best practices not identified here that should be addressed as part of this review?	No comment.

#	Question	Comment
Question 7	Do you agree with the proposed used of tailored Auditor Protocol? If not, why not?	The protocol may be an effective tool for setting expectations for Authority appointment of auditors. However it cannot be viewed as a tool for 'compliance' (guidelines are not legally binding) and nor should it be.
Question 8	Do you have any feedback on the proposed tailored Auditor Protocol attached as Appendix D?	We could not find any Code direction for the Authority's approval process to have regard to / take into account the protocol.
Question 9	Do you agree with the proposal for the Authority to set audit scope, focus and materiality levels through risk-based planning? If not, why not?	<p>Yes we support the concept for audit scope to focus more on those aspects where non-compliance produces the largest impact.</p> <p>This approach should be developed in advance of any Code amendments to better understand costs and compliance risk.</p>
Question 10	Do you agree with the proposed changes to auditor appointment? If not, why not?	<p>There may be merit in rotation of the same company's auditors but every two years for different companies would seem far too frequent for operational efficiency and learning from repeat processes to be obtained. This aspect should remain flexible consistent with the objective for less frequent audit.</p> <p>We consider the argument for expanding the Authority's role in auditor appointment is not persuasive and no evidence has been presented for the issues outlined under 4.5.2. We do not support the Authority making decisions on who the auditor is for any particular participant.</p>

#	Question	Comment
Question 11	Do you agree with the proposed Code amendments? If not, why not?	<p>No, see above. Guidelines are more flexible for setting expectations, providing for differing scope and risk levels.</p> <p>We do support a structural tidy up of the currently fragemented audit requirements into a dedicated part.</p>
Question 12	Do you agree with the issues identified in this section and that the proposed solutions adequately address the issues?	<p>We accept that there are issues but these do not seem sufficiently material to warrant new Code obligations as their solution. It may be more efficient to rely on non-Code approaches such as Authority's governance at approval and improvements to the nature of the reports expected from the audit process. The Authority also has existing powers under section 45 of the EIA to make closer enquiries of participants where any issues lie.</p>
Question 13	Are there any other solutions that the Authority should be considering in relation to the decision-making process?	<p>Yes, that guidelines and education can ensure audit reports provide sufficient information for the Authority to act effectively. We note the existing guidelines could be a starting point.</p>
Question 14	Do you agree there is a need for improving education within the audit regime and has the issue been correctly identified?	<p>Yes, education is a primary function of the Authority and could be an appropriate mechanism for ensuring effective and efficient audit processes including for agent audits.</p>
Question 15	What other improvements do you believe the Authority should consider?	<p>Wrt section 5.3 we agree with the principle of transparency and the discussion that audit reports be made public (assume by the Authority on its site).</p>

#	Question	Comment
Question 16	Do you agree with the issues leading to the requirement to automate systems?	<p>We assume that is is not a new Code obligation( although the use of the word 'requirement' suggests otherwise).</p> <p>We can see the benefit of the Authority in assiting audit efficiency by creating a standardised registry report. We assume the costs of the registry upgrade will be funded by the Authority.</p> <p>There may also be efficiency benefits from making auditors submit online and the search function sounds useful. There would need to be provision for this information to be read offline by a wide audience. Again we would expect this cost to be met by the Authority.</p>
Question 17	Do you agree with the requirement to automate systems? If not, why not?	If the Authority wishes to fund the automation of systems to assist its own compliance monitoring function we have no problem with that.
Question 18	Apart from the proposed solutions given in the table, are there any other improvements that the Authority should consider?	No comment.
Question 19	Do you agree with the issues identified in this section?	We support the use of guidelines to convey scope statements along with the and the timely use of (likely to be repeated) training .
Question 20	Are there other possible solutions that the Authority should consider in regards to the requirements to hold quality certification?	MEPs appear to not be bound by the quality standards desired and we are unclear if this is deliberate or an oversight.
Question 21	Do you agree with the proposed solutions to assist new entrants? If not, why not?	No comment.

#	Question	Comment
Question 22	Are there other possible solutions that the Authority should consider?	No comment, other than to recognise that this issue seems to be a real candidate for Code Change as it has arisen from the evidence of the number of exemptions being applied for.
Question 23	Do you agree with the issues identified in this section for DUMML?	As a reconciliation participant we agree that DUMML is a significant source of error in the settlement process.
Question 24	Are there other possible solutions that the Authority should consider in regards to DUMML audits?	We suggest a variation of 'alternative 1' which is to treat DUMML the same as any other type of unmetered load. This would ensure that all physical connections to a network are identified and have an appropriate capacity applied (essentially what the DUMML should be doing). ICPs could be set to "reconciled elsewhere" and the volumes consolidated and reconciled using the existing pseudo ICPs. The parties that currently maintain the DUMML databases could be provided with the ability to maintain capacities on the registry and run reports. ICPs could be selected at random and capacities verified in the field.
Question 25	Do you agree with the objectives of the proposed amendment? If not, why not?	On the whole we do not support a reach for new Code when there are already established avenues to manage the issues such as improvements to the Authority's approval process and applying a risk-based lens to audit scope. We do support improving structure and location of the currently fragmented provisions, and creating consistency across all participant types.
Question 26	Can you see any options or implications that have not been considered as part of this consultation paper? If so please elaborate.	No comment.



#	Question	Comment
Question 27	Do you consider that the Authority has captured all the costs of the proposed changes? If not, what other costs to you expect will be incurred due to the proposed changes?	Suspect underplayed the costs of change especially in upskilling and automation of systems, and not included that variable frequency audits may be more inefficient (more costly) than regular frequency audits.
Question 28	Do you consider that the Authority has captured all the benefits of the proposed amendment? If not, what other benefits do you expect the proposed changes to lead to?	<p>We do not consider that the 'benefits' are an assumption in an overall reduction in the cost of audits, we view these as still 'costs' under the new regime.</p> <p>The purpose of audit is assurance of compliance and that assurance provides benefits in the confidence of market participants that the processes and numbers are accurate. It is unclear whether the changes being made seek to achieve improvements to compliance as it is not clear whether there is any 'cost' from non-compliance currently as the problem has not been framed that way.</p>
Question 29	Do you agree the benefits of the proposed changes outweigh the costs? If not, why not?	<p>No we do not consider the CBA has been appropriately framed</p> <p>The costs of the new regime are all the new costs including the (albeit reduced) costs of the actual audits. The benefits of the proposed audit process changes should be that the higher cost (higher quality) audits improve compliance assessments with flow-on assurances for market accuracy and reduced costs of re-work, checking, disputes etc. (as outlined under 6.4.51)</p> <p>We also have reservations about claiming any cost reductions from 'variable frequency' audits. Repeatable, planned audits provide for opportunities to obtain operational efficiencies bought by 'repeat game' learning.</p> <p>It is not clear how the current audit regime is creating cost in the market.</p>

#	Question	Comment
Question 30	Do you agree the proposed changes are preferable to the other options? If you disagree, please explain your preferred option in terms consistent with the Authority's statutory objective in section 15 of the Electricity Industry Act 2010.	No. Make better use of the processes in place such as tidy up guidelines according to intent for use of audit e.g. scope and where risk lies.
Question 31	Do you agree the Authority's proposed amendment complies with section 32(1) of the Act?	<p>We are not persuaded that the new Code that creates more obligations will promote efficient operation and could even have negative effects on competition for provision of audit services.</p> <p>We consider consider postive efficiency changes can be made through proposed Authority actions on approval, education and improvements to audit scope.</p>
Question 32	Do you have any comments on the drafting of the proposed amendment?	<p>Audit procedures could have a dedicated Code part.</p> <p>Further we suggest a tidy up of provisions with an objective for consistency between audited participants (unless there is good reason for inconsistent requirements between audited participants) e.g. 15A.18 is not necessary given proposal for guidelines or a negotiation process to convey scope.</p>