

18 December 2015

Submissions
Electricity Authority
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by email: submissions@ea.govt.nz

SUBMISSION ON PROPOSED CHANGES TO PARTICIPANT AUDIT REGIME

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the “Proposed changes to participant audit regime” consultation paper (the **paper**) released by the Electricity Authority (Authority) in November 2015.

Introduction

- 2 Our submission is in two parts:
 - (a) General comments on the paper, and
 - (b) Responses to the specific questions as an appendix.

Areas where we agree with the Authority

- 3 We agree in principle with the Authority that the audit regime can be improved by creating an auditor protocol with professional and ethical requirements. However we would suggest that a more efficient alternative would be to encourage existing financial auditors to undertake these assurance engagements.
- 4 The use of standard financial auditors has a number of advantages:
 - (a) they are already familiar with the internal control systems of companies;
 - (b) they already have professional accreditation;
 - (c) they are familiar with auditing complex requirements.

- 5 We also suggest that rather than develop specific professional standards the Authority should consider that all of the EA's authorised auditors should be subject to XRB standards.
- 6 We agree with the Authority's proposal that auditors should be changed at regular intervals, but would suggest that this should be no more frequently than every three years as there is a cost overhead for a business (and auditors) in this change.
- 7 We also suggest that an alternative to changing the auditors completely is that the director of the audit is rotated every three years. This is the approach taken by auditors globally to reduce the risk of director "capture" and to ensure that a fresh view is taken on a regular basis.
- 8 A key area we believe that can substantially enhance the audit process is a focus on identifying and reporting areas of the Code that result in ongoing trivial Code breaches or requires inefficient work-arounds, or where ambiguities in the Code are identified. If these were identified then appropriate Code changes can be consulted on.
- 9 The Authority's suggestion of an issues register could help facilitate improved regulation or removal of inappropriate regulation by identifying Code that is causing multiple different parties to breach. This will reduce costs that ultimately will fall to end use customers and therefore promote long term benefits to customers.

Areas where we disagree with the Authority

- 10 We are concerned about the proposal to carry out audits of internal EDB's process changes prior to their implementation. We consider that such a change will inhibit /delay our introduction of changes. Auditors who review financial information systems as part of statutory audits do not typically review the process changes at point of implementation – rather, a significant change is a key area of audit focus during the next cyclical audit. At that time the auditor will review the system change, the transfer of data, and the quality of the implementation. We support the retention of the status quo on this issue.
- 11 We are concerned about the proposal to have short time spans between audits (3 months). We consider that any audit period of less than 12 months is inappropriate and inefficient. We question whether any participant's miss-behaviour could be so serious that it would be allowed to continue to participate if it required an audit every 3 months. We consider that in such a case other more immediate action would be required rather than a 3 monthly audit. It is also unclear for how long 3 monthly audits would be required before other action is taken. We consider that the alternative to amend the Code to require all participants to be audited at fixed yearly intervals is a better solution. In addition should the Authority proceed with automation of compliance information as outlined in section C.4.1 of the paper then reduction of the frequency of audits to every two or three years may be appropriate.

Concluding remarks

- 12 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email dennis.jones@oriongroup.co.nz.

Yours sincerely

A handwritten signature in black ink that reads "D. L. Jones". The letters are cursive and slightly slanted to the right.

Dennis Jones
Industry developments Manager

Appendix: Response to specific questions

Submitter	Orion NZ
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#	Question	Comment
Question 1	Do you agree the opportunities to improve the audit regime identified by the Authority are worthy of attention?	<p>The Authority considers that the following opportunities exist to improve the audit regime:</p> <ul style="list-style-type: none"> (a) the purpose of the audit regime has not been clearly conveyed to stakeholders (b) opportunities exist to improve the governance of the audit regime and better align it with international audit best practice (c) opportunities exist to improve the operational efficiency of the audit regime and better align it with the Authority's statutory objective. <p>We agree that opportunities exist to improve:</p> <ul style="list-style-type: none"> the governance of the audit regime and better align it with international audit best practice the operational efficiency of the audit regime and better align it with the Authority's statutory objective <p>We disagree that the purpose of the audit regime has not been clearly conveyed to stakeholders, however that is not to say that further clarity of the purpose cannot be achieved.</p>

<p>Question 2</p>	<p>Do you agree that the problems identified with the existing purpose of the audit regime are correct? If not, why not?</p>	<p>The Authority considers that the current focus of the audit regime to assess whether an audited party has complied with the Code is problematic because the Authority considers this current focus does not fully satisfy the Authority’s statutory objective. We disagree.</p> <p>We consider that the problem with the current focus of the audit regime “<i>to assess whether an audited party has complied with the Code</i>” is that it does not identify whether the Code itself fully satisfies the Authority’s statutory objective. For example, a party may breach the Code because it is in the best long term interests of the consumer, or because it is more efficient to do so. In these cases the appropriate response could be a Code amendment.</p> <p>We believe that the Audit process can be enhanced if an additional focus of the audit process is to identify and report areas of the Code that are resulting in ongoing trivial Code breaches or require inefficient work-arounds, or ambiguities in the Code.</p> <p>We do however consider that to assist the Authority in determining if a participants non-compliance with the Code is a result of poor (outdated) Code or some other reason, that access by the Authority to addition of information such as:</p> <ul style="list-style-type: none"> (a) the reasons for any non-compliance (b) action being taken by the audited entity to address the non-compliance (c) action being taken by the audited entity to prevent future non-compliance (d) timeframes for resolution; <p>may be useful.</p> <p>The Authority has effectively identified at para 3.1.6 that the purpose of the audit regime may be different for different participants i.e those that require to have certification and/or approval and those that don’t. It is unclear whether this difference in purpose requires different consideration of the audit process and therefore, the Authority, if it decides to alter</p>
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#	Question	Comment
		the purpose, may require more than one purpose statement or at least a qualified purpose statement.
Question 3	Do you agree with the proposed purpose of the audit regime? If not, why not?	<p>No. We consider that the purpose of the Audit process can be enhanced if an additional focus of the audit process is to identify and report areas of the Code that are resulting in ongoing trivial Code breaches or require inefficient work-arounds, or ambiguities in the Code.</p> <p>Due to the different purpose requirements regarding participants that require certification and those that don't, we consider that the purpose statement may need to be split to cover the different purposes that apply to different participants this may require more than one purpose statement or at least a qualified purpose statement. We do not consider that the purpose statement needs to consider the frequency of audits.</p>
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?	We consider that the purpose of the audit regime should be incorporated in Code, not into guidelines. As with other legislation/regulation there may be an over-riding purpose such as that set out in the Act for the Electricity Authority and this may well be the purpose of the Code, but different parts of the Code could have their own purpose statement which guides the interpretation of the relevant part. We consider that if the purpose statement is incorporated in guidelines it loses its impact and standing.

#	Question	Comment
Question 5	Do you agree with the problems identified with the governance arrangements of the audit regime? If not, why not?	<p>We agree that the problems with the current governance arrangements are problematic. The Authority has identified the following problems. The Authority:</p> <ul style="list-style-type: none"> (a) has limited control over the scope, direction, and outputs of audits (b) does not have the ability to prescribe formal assurance requirements. (c) risk and materiality are not considered by the auditor or Authority when setting the scope of an audit, the focus of audit activities, or when reporting audit findings. (d) cannot appoint auditors or require an audited participant to rotate the auditor it engages.
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 7	Do you agree with the proposed use of tailored Auditor Protocol? If not, why not?	We suggest that rather than develop specific professional standards the Authority should consider that all of the EA's authorised auditors should be subject to XRB standards. This could facilitate the use of financial auditors that already meet appropriate standards rather than having an Authority specific arrangement. Financial auditors, if they are willing to take on this work, have an advantage in that they will be familiar with the individual companies systems.

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#	Question	Comment
Question 8	Do you have any feedback on the proposed tailored Auditor Protocol attached as Appendix D?	
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?	We agree with the proposal for the Authority to set audit scope, focus and materiality levels through risk-based planning. This is a familiar process for EDB's who use it for their asset management practices.

#	Question	Comment
Question 10	Do you agree with the proposed changes to auditor appointment? If not, why not?	<p>We agree with the Authority’s suggestions that it should:</p> <p>(a) Require participants to change auditors at regular intervals. We would suggest that this should be no more frequently than every three years as there is a cost overhead for a business (and auditors) in this change. We also suggest that an alternative to changing the auditors completely is that the director of the audit is rotated every three years. This is the approach taken by auditors globally to reduce the risk of director “capture” and to ensure that a fresh view is taken on a regular basis.</p> <p>(b) Approve or decline the nomination of an auditor by a participant.</p> <p>(c) Require auditors, at time of initial appointment to the auditor pool and prior to starting any audit, to:</p> <p>(i) declare any conflicts of interests or other threats that may impact on their objectivity</p> <p>(ii) disclose any procedures they have to identify and address conflicts of interest and other threats.</p> <p>As noted in response to Q7 above we also consider that the Authority should consider approaching financial auditors.</p>

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#	Question	Comment
Question 11	Do you agree with the proposed Code amendments? If not, why not?	We have not commented on the detailed Code drafting as we consider that this should be considered in a separate technical drafting consultation following the Authority's decision on this consultation round. The current process pre supposes an outcome from the consultation that may not eventuate. We consider that it is inefficient for us to look at detailed code drafting which may change as a result of the Authority's decisions on the consultation.

<p>Question 12</p>	<p>Do you agree with the issues identified in this section and that the proposed solutions adequately address the issues?</p>	<p>C.1.1: It is unclear what actions have been taken as a result of the audit.</p> <p>We agree that it may be unclear what actions have been taken as a result of the audit. We agree that the preferred solution to require participants to submit a compliance plan is appropriate. We consider that the compliance plan should include timeframes for completion. However in some cases it will be issues with the Code that are the problem and a Code amendment required. While the participant could include as part of its compliance plan that it would be applying for a Code amendment within a certain timeframe, we consider that a better approach is that the Authority takes a pro-active role via its issues register in facilitating corrections and improvements to the Code.</p> <p>We do not consider that the proposed alternative 1 is appropriate. The Authority should be receiving the Audit report and the auditor should identify in that report areas where more information is required.</p> <p>C.1.2: Participants do not always know if an alleged breach is isolated or part of a wider industry discussion.</p> <p>We agree that participants do not always know if an alleged breach is isolated or part of a wider industry discussion. We agree with the proposal to create an issues register. We consider that where an issue has been identified and is on the register then auditors should be made aware of these issues and their audits should not result in an alleged breach of the Code. Rather they would be required to provide additional evidence to the Authority.</p> <p>We disagree with (C.1.3) definition of material change insofar as it impacts on a distributor's ability to introduce changes to their own systems.</p> <p>We consider that such a change will inhibit /delay our introduction of changes. Auditors who review financial information systems as part of statutory audits do not typically review the process changes at point of implementation – rather, a significant change is a key area of audit focus during the next cyclical audit. At that time the auditor will review</p>
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		<p>the system change, the transfer of data, and the quality of the implementation. We support the retention of the status quo on this issue.</p> <p>C.1.4: Definition of a next audit date</p> <p>We agree that there should be a definition of a next audit date and suggest that an improvement would be to add a requirement that the audit must be completed within 2 months of that date.</p> <p>C.1.5: Frequency of audits</p> <p>We disagree with the Authority's preferred solution to have a variable audit period for all participants. We consider that any audit period of less than 12 months is inappropriate and inefficient. We question whether any participant's miss-behaviour could be so serious that it would be allowed to continue to participate if it required an audit every 3 months. We consider that in such a case other more immediate action would be required rather than a 3 monthly audit. It is also unclear for how long 3 monthly audits would be required before other action is taken.</p> <p>We consider that the alternative to amend the Code to require all participants to be audited at fixed yearly intervals is a better solution. In addition should the Authority proceed with automation of compliance information as outlined in section C.4.1 of the paper then reduction of the frequency of audits to every two or three years may be appropriate.</p> <p>C.1.6: Timing of agent audits</p> <p>We disagree with the requirement to audit distributor's agents. It is the participant processes and results that are being audited. The appropriate audit would be to ensure that the participant had an appropriate contract with the agent and that the outcomes of the agent's actions on behalf of the participant comply with the rules. The onus is on the participant to make sure its methods and processes are robust whether in-house or if it</p>
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#	Question	Comment
		<p>chooses to use an agent, and it is up to the participant to ensure that its agents provide a quality service and quality data.</p> <p>C.1.7: Fixed auditor approval term</p> <p>We agree with the Authority's preferred solution to amend the Code to allow the authority to approve auditors for up to 36 months.</p> <p>C.1.8: Limited access to information to enable audit to be conducted</p> <p>We partially agree with the preferred solution. We agree to the requirement to provide auditors full access to information that may be required to carry out the audit. We already expect this from our financial auditors, who carry out their obligations in line with the International Standards on Auditing – which includes confidentiality. Further, in a letter of representation to the auditor, directors certify that all relevant information has been made available to the audit team, unrestricted access and that any known instances of non-compliance have been disclosed. We do not consider that this access should be conferred on the Authority who already have extensive information gathering powers for the purpose of monitoring compliance with the Act (including Part 3), the regulations, and the Code; under s46 of the Act.</p> <p>C.1.9: Inconsistent allocation of payment of auditor's costs for Authority and participant requested audits</p> <p>No Comment</p>

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#	Question	Comment
Question 13	Are there any other solutions that the Authority should be considering in relation to the decision-making process?	See our response to Q12 which includes some alternative solutions.

<p>Question 14</p>	<p>Do you agree there is a need for improving education within the audit regime and has the issue been correctly identified?</p>	<p>C.3.1: Breach materiality classification is not practical</p> <p>We agree in principle with the preferred solution to redefine the breach materiality criteria in terms of the action or potential impact the breach has on the participants or other participants.</p> <p>We consider that Authority needs to provide further information on the detail of how this may work. This is potentially a difficult area as the magnitude and risk are not necessarily the issue but the size of the participant. For example a small retailer with \$2m turnover getting a \$100k wrong could be material but a large retailer with \$100m turnover getting a \$100k wrong would not be material.</p> <p>C.3.2: Authority not involved in setting the scope of the audit or level of investigation</p> <p>We agree in principle that the Authority should be involved in setting the scope and level of investigation required for each audit. In the same way that we would expect the office of the auditor general to instruct all the auditors it appoints to undertake EDB audits to have particular areas of focus in a given year.</p> <p>Therefor we consider that the Authority should be able to set the focus of an audit. We have concerns about the proposed ability to require an individual audit to have a particular emphasis on any particular concern. We consider that the authority should have the ability to require auditors (all auditors) to have a particular emphasis on an industry issue.</p> <p>C.3.3: The audit and audit review process is not always clear</p> <p>We agree with the preferred solution to develop a guideline for participants who are audited. We note that the Authority has not developed a guideline that describes the audit and audit review process as the content is dependent on the outcome of the consultation. We consider that this same principle should apply to any Code amendments as these too are dependent on the outcome of the consultation process.</p>
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#	Question	Comment
		<p>C.3.4: Agent audit requirements are unclear</p> <p>As noted in response to C.1.6: Timing of agent audits. We disagree with the requirement to audit distributor's agents. It is the distributor that is being audited and the way that we request our contractors should be audited together with information that we receive and accept from our contractors, but not the contractor.</p> <p>We consider that an alternative is to update guidelines to clarify that while the agent is acting on behalf of a distributor it is the distributor that is subject to the audit.</p>
Question 15	What other improvements do you believe the Authority should consider?	No Comment

#	Question	Comment
Question 16	Do you agree with the issues leading to the requirement to automate systems?	<p>C.4.1: Inconsistent analysis of registry information by auditors</p> <p>We are not aware of any inconsistent analysis of registry information by auditors but the Authority is in a better position than participants to obtain the information to judge this. We consider that a suite of compliance information received from the registry on a regular basis could enhance the information currently provided in exception reports. It is imperative however that this information is correct and cannot be misinterpreted resulting in extensive manual checking to ascertain the issue. We consider that improved clarity and precise definitions would improve compliance, also it is important that the registry correctly reflects the Code and it would be useful if it had some built in checking to prevent incorrect information being entered. We agree that Alternative 2 and 3 should be rejected.</p> <p>C.4.2: Unclear prescribed form for audit reports</p> <p>We agree in principle with this proposal but consider that there needs to be a process to change/correct the information if required. Possibly the Authority would approve any such changes/corrections.</p>
Question 17	Do you agree with the requirement to automate systems? If not, why not?	See our response to Q16
Question 18	Apart from the proposed solutions given in the table, are there any other improvements that the Authority should consider?	We consider that cost-benefit should always be a consideration in any move towards automation

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#	Question	Comment
Question 19	Do you agree with the issues identified in this section?	No Comment
Question 20	Are there other possible solutions that the Authority should consider in regards to the requirements to hold quality certification?	No Comment
Question 21	Do you agree with the proposed solutions to assist new entrants? If not, why not?	<p>C.6.1: Initial audit requirements</p> <p>We consider that the preferred solution to obtain Authority approval before accessing market systems. We agree with the rationale the paper puts forward to support this proposal. We consider that the preferred solution is superior to the other two options.</p> <p>C.6.2: Quality certification requirement and timeframes</p> <p>No Comment</p> <p>C.6.3: Timeframes for holding certification</p> <p>We disagree with this proposal. We consider that for the same reasons that the Authority is requiring Authority approval and an ability to demonstrate an understanding and use market systems in a manner that complies with the Code a new entrant retailer should apply for certification in the first month of trading and hold certification before 3 months (i.e the status quo).</p>

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#	Question	Comment
Question 22	Are there other possible solutions that the Authority should consider?	

<p>Question 23</p>	<p>Do you agree with the issues identified in this section for DUMML?</p>	<p>C.7.1: Code Requirements for DUMML audits unclear</p> <p>We do not consider that the Authority has produced any evidence that separating the audit of the DUMML database from the audit of the participant will improve the accuracy of the DUMML data. We would have considered that if the participant’s certification was at risk then this would be a significant incentive to ensure that there were no issues with their DUMML data base.</p> <p>It is also unclear on how extensive the requirements for a full field audit will be. We suggest that the Authority should provide guidance on sample size.</p> <p>We do not consider that alternative 1 to remove DUMML as an option for the quantification of electricity is a practical solution to the issues raised. We also consider that if the Authority did consider continuing with this approach then an appropriate cost benefit analysis would need to be carried out and the issue separately consulted on.</p> <p>C.7.2: Audit requirements</p> <p>We agree that the Authority should publish guidelines for auditors of DUMML databases to follow.</p> <p>C.7.3: Level of compliance of DUMML customers not transparent</p> <p>We consider that the preferred option or a summary would be an improvement on the status quo.</p> <p>C.7.4: Use of consistent and accurate streetlight data</p> <p>We do not consider that the introduction of a standardised table of wattages for use by all participants would provide any improvement to the DUMML database that we administer. We also consider that the potential for a rapid uptake and replacement to LED lighting will improve the accuracy of any historic information and also reduce the impact of any errors.</p>
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#	Question	Comment
Question 24	Are there other possible solutions that the Authority should consider in regards to DUML audits?	
Question 25	Do you agree with the objectives of the proposed amendment? If not, why not?	<p>We agree with the objectives of the proposed amendment</p> <ul style="list-style-type: none"> (a) to ensure the purpose of the audit regime is clear, well-defined, and aligned with the Authority's statutory objective (b) to improve participants' compliance with the Code (c) to increase the operational efficiency of the audit regime. <p>We consider that a number of the proposals will help achieve these objectives while a few will not as discussed above. We do not consider that the Authority should have proposed Code at this stage of the consultation as it could be seen as pre-empting the outcome of the consultation.</p>
Question 26	Can you see any options or implications that have not been considered as part of this consultation paper? If so please elaborate.	

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#	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?	
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?	
Question 29	Do you agree the benefits of the proposed changes outweigh the costs? If not, why not?	
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.	We do not agree will all the proposed changes as noted in our responses to the various individual questions above. However in summary our concerns are that a number of the proposals in our opinion introduce further inefficiencies which would not be in the long term interest of consumers.

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#	Question	Comment
Question 31	Do you agree the Authority's proposed amendment complies with section 32(1) of the Act?	See our response to Q30
Question 32	Do you have any comments on the drafting of the proposed amendment?	We consider that the Authority is in danger of pre-empting the consultation process. As we have noted in response to earlier questions the Authority has not developed a guideline that describes the audit and audit review process as the content is dependent on the outcome of the consultation. We consider that this same principle should apply to any Code amendments as these too are dependent on the outcome of the consultation process.