



Independent Pricing and Regulatory Tribunal

Audit Guideline

Public Water Utilities

Water — Guideline

June 2015

© Independent Pricing and Regulatory Tribunal of New South Wales 2015

This work is copyright. The *Copyright Act 1968* permits fair dealing for study, research, news reporting, criticism and review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgement of the source is included.

Inquiries regarding this document should be directed to a staff member:

Erin Cini (02) 9113 7778

Jessica Hanna (02) 9113 7715

Amendment Record

Issue No	Date Issued	Reason/s for Amendment
Revision 1	February 2012	Release of draft guidelines for comment
Revision 2	March 2012	Release of guidelines for 2011-12 audits
Revision 3	May 2012	Revised compliance grades for 2011-12 audits
Revision 4	May 2013	Revised guidance for site visits, opportunities for improvement, panel classifications and categories, and report template for 2012-13 audits
Revision 5	July 2014	Minor editorial Updated audit report template Addition of management system reviews
Revision 6	May 2015	Editorial changes Addition of escalation of issues process

Independent Pricing and Regulatory Tribunal of New South Wales

PO Box K35, Haymarket Post Shop NSW 1240

Level 15, 2-24 Rawson Place, Sydney NSW 2000

T (02) 9290 8400 F (02) 9290 2061

www.ipart.nsw.gov.au

Contents

1	Introduction	1
1.1	Purpose	1
1.2	Structure of the guideline	1
1.3	Changing the guideline	2
1.4	Auditor or utility feedback	2
1.5	National Water Initiative audits	2
2	Operational Audit Procedure	4
2.1	Introduction	4
2.2	Matters outside the scope	6
2.3	Steps for an audit	7
2.4	Escalation of issues	15
2.5	A summary of major milestones for an operational audit	17
3	Audit Panel	18
3.1	Panel classifications	18
3.2	Panel categories	19
3.3	Auditor training	20
	Appendices	21
A	Statement of compliance	23
B	Questionnaire template	25
C	Compliance grades	27
D	Audit report template	28
E	Audit standards and principles	30
F	Audit methods	31

1 | Introduction

1.1 Purpose

The purpose of this Audit Guideline (the guideline) is to set out IPART's expectations regarding the conduct of operational audits of public water utilities. It provides a framework to help auditors and public water utilities to prepare for and conduct operational audits efficiently and effectively, and provides a guide to assist with documenting the audit findings. It also informs public utilities of the audit process and the requirements of the operational audits.

IPART audits the Operating Licences of the following public water utilities:

- ▼ Sydney Water Corporation
- ▼ Hunter Water Corporation, and
- ▼ Water NSW (including both the Sydney Catchment Authority Operating Licence and the State Water Corporation Operating Licence).

We have drawn on our experience in managing operational audits to provide guidance on common areas of confusion.

This document is only a guideline and does not provide guidance in all circumstances. Where the guideline is unclear, auditors and utilities should seek clarification from IPART. In these cases, we will provide specific advice on the application of the guidelines or appropriate departures from the guidelines where necessary.

1.2 Structure of the guideline

The guideline is structured into the following chapters:

Operational Audit Procedure

This chapter includes:

- ▼ audit steps – details of the steps in the audit process, including actions, responsibilities and outputs
- ▼ escalation of issues – details the process for the escalation of issues, and
- ▼ audit milestone – details of the timing of the steps.

Audit Panel

This chapter includes:

- ▼ panel classifications – classifies lead auditors, auditors and area specialists
- ▼ panel categories – defines the disciplines of the auditors, and
- ▼ auditor training.

1.3 Changing the guideline

We may change this guideline to:

- ▼ reflect changes in the legislation or licence conditions
- ▼ amend the audit information that must be provided to IPART, and
- ▼ improve the audit process.

Before we change the guideline significantly, we will consult relevant utilities, audit panel members and other interested stakeholders. We will then notify stakeholders of the changes to the guideline and the start date for any new auditing arrangements. In determining the start date, we will consider the time required for utilities to implement new arrangements.

1.4 Auditor or utility feedback

Over time, auditors and public water utilities are likely to identify opportunities for improving the audit framework, or other aspects of the audit process. We encourage auditors and utilities to provide feedback on any issues, and submit recommendations to make the audit process or the licensing framework more efficient and effective.

1.5 National Water Initiative audits

The Bureau of Meteorology produces an annual National Performance Report as part of the National Water Initiative. The purpose of the report is to publicly and independently report on the performance of water utilities across Australia. The National Performance Report is based on data from performance indicators about customers, health, water resources, assets, environment, pricing and finances.

The National Water Initiative audits are undertaken as part of operational audits. However, this audit guideline does not apply to the National Water Initiative component of the operational audits.

The National Performance Framework outlines the auditing requirements and provides an audit report template. We use this framework for National Water Initiative audits, rather than this audit guideline. For further information on these audits, please contact us and we can provide the latest National Performance Framework.

2 | Operational Audit Procedure

2.1 Introduction

Operational audits of all major public water utilities are conducted annually to review their compliance in the past financial year. We engage independent consultants to audit each utility.

The objective of the audit is to minimise the likelihood of non-compliance by checking the utility's compliance with:

- ▼ operating licence conditions
- ▼ the relevant Act(s), and
- ▼ Ministerial recommendations from previous operational audits.

In particular, the audit assesses whether the utilities provide services to the standards set out in the Operating Licence.

Auditors are engaged to assess compliance against quantitative and objective criteria or to exercise their professional opinion as an experienced industry member. Auditors must remain independent at all times during the audit process.

Risk-based approach

We use a risk-based approach to the operational audits, in order to minimise the regulatory burden while meeting the objectives outlined above.

Risk is a function of both consequence and likelihood. The audit itself reduces the likelihood of non-compliance. In a risk-based approach, it is appropriate to focus on those conditions that have the highest consequences of non-compliance.

For this reason, we do not require all clauses in the utility's licence to be audited every year. The audit frequency of a clause will depend on the consequence that a non-compliance poses, as well as the utility's previous performance (which is also an indicator of likelihood of non-compliance). Our approach will ensure auditing reflects the type, size, complexity and consequences of non-compliance. Further, when combined with likelihood, our approach determines the level of risk associated with the utility's activities.

For example, a non-compliance in the area of water quality is more likely to present significant consequences to human health than the consequences of late reporting about customer complaints. Hence, we audit water quality performance every year and retail clauses less frequently.

Most clauses will be audited at least once during a 5-year licence period. The audit of the first year of a new licence is likely to be more comprehensive in order to help identify any areas that we should focus on through the licence period.

All licence obligations are also subject to a statement of compliance from the public utility (see Appendix A for a template). The utility is to complete the Statement of Compliance to the best of its knowledge and have it signed by the CEO (Managing Director or equivalent) and Chairman of the Board or otherwise an authorised Board Director.

Stakeholder consultation

IPART engages with stakeholders during the operational audit process. For example, we are also required to advertise the audits in relevant newspapers and invite submissions from the public. This allows the public to contribute to the operational audits if they have particular issues they wish to raise regarding the audits or utility performance. In determining the audit scope (see Step 1 in Section 2.3), we consider issues identified by the public in our public consultation process.

Further, prior to finalising the audit scope, IPART will seek feedback from relevant government agencies regarding the performance of the utility (see Step 3 in Section 2.3).

Overlap with other audits

Utilities may have parts of their operation audited under other frameworks, such as certification schemes or other legislation. An example may be a document control system audited under ISO9001 accreditation.

We will adjust our operational audit scopes to take account of these other audits. We encourage our auditors to use the data and audit opinion from other relevant audits rather than duplicating the audit effort.

Utilities should inform IPART of any upcoming audits. This will allow IPART to provide input or attendance at an audit where the utility is seeking consideration of audit results.

Implementation of Management Systems

Licences now include systems-based conditions, many of which contain transitional periods for implementation. Systems-based licence conditions relate to requirements to have certain Environmental Management Systems, Asset Management Systems and Quality Management Systems in place. Management systems to be reviewed will be identified in the audit scope.

Where a system is required to be developed and/or implemented by a date outside of the audit period, we require the audit to consider the progress towards the date(s).

The utility is to provide a verbal update on progress during the audit interviews. The purpose of the update from the utility is to inform IPART and the auditor of progress that has been made in developing an effective management system by the due date required in the licence. It is anticipated that this will be a verbal update. However, the utility may choose to provide a visual presentation as well.

The auditor is requested to provide a summary of this update and whether, in the auditor's opinion, sufficient progress has been made to meet the future licence requirement. The summary should not be included in the audit report. Rather, it should form an attachment to the cover note to the audit report. A draft attachment should be prepared and submitted at the first draft report stage to enable review by the utility and IPART.

2.2 Matters outside the scope

In general, auditors are required to stay within the scope of the audit. However, occasionally the auditor may identify issues that may pose a significant risk to public health or the environment which falls outside the scope of the audit. These out of scope issues may or may not relate to licence conditions.

In these circumstances, the auditor may continue the investigation of the "out of scope" issue with the concurrence of the IPART representative in attendance.

The auditor should detail any out of scope findings in a covering letter attached to the audit report. The letter may also include any specific concerns the auditor has relating to trends in performance that may lead to potential future non-compliance. The auditor should consult with IPART about where and how to document out of scope findings.

2.3 Steps for an audit

This section of the guideline outlines the steps involved in the audit process. We have adopted a systematic audit method to promote consistency across auditors and over time. There are nine steps to an audit, and each of the parties (the utility, auditor and IPART) is responsible for completing some of the steps. Table 2.1 below lists the steps. The requirements for each are outlined in the sections that follow.

Table 2.1 Audit steps

Step	Description	Responsibility
Step 1	Audit scoping	IPART
Step 2	Appointment of the auditor	IPART
Step 3	Audit preparation	Auditor/Utility/IPART
Step 4	Audit interview	Auditor/Utility (IPART observer)
Step 5	Field verification site visits	Auditor/Utility (IPART observer)
Step 6	Wrap up and close out sessions	Auditor/Utility (IPART observer)
Step 7	Audit assessment and reporting	Auditor/Utility/IPART
Step 8	Report to the Minister	IPART
Step 9	Report on audit recommendations	Utility

Step 1: Audit scoping

The scope of the audit is determined by IPART and demonstrates to both the auditor and the utility which clauses in the licence will be audited. It determines the scope of the auditor's contract, and shows the utility which parts of their business will be covered in the audit.

To determine the scope of an audit, IPART uses a risk-based approach (described in Section 2.1) and considers issues identified by the public during our consultation process. All licence obligations are also subject to a statement of compliance from the public utility (see Appendix A for a template).

Step 2: Appointment of the auditor

IPART has a panel of accredited auditors that is regularly updated (see Section **Error! Reference source not found.** for details). We invite quotes from auditors on our panel and select auditors based on criteria including relevant team experience, technical and audit expertise, resource availability and cost.

IPART requests quotes from at least three auditors on our panel for each audit of a public water utility. This gives us a good understanding of the market rate, and ensures we are able to appoint quality auditors.

Where possible, we do not intend to use the same auditor for a utility's operational audit more than three times in a 5-year period. Larger audit firms may be able to rotate auditors to satisfy this requirement.

After engaging the auditors, IPART sets the initial schedule for audit milestones. To ensure the appropriate utility staff members are available for the audit, we will consult the utility and auditor about the initial schedule of the milestones. This schedule can be adjusted to make sure we get the best outcome from the audit. In general, the final schedule is consistent with the milestones outlined in Section 2.5.

Following this, IPART will hold a briefing meeting with the appointed auditor. The meeting will cover the expectations of IPART, locations for field verification site visits and any concerns raised by stakeholders.

Step 3: Audit preparation

The auditor and utility will exchange information to ensure the audit interview is as efficient and effective as possible. In addition, the auditor and IPART will consult with other government agencies and the public. Activities undertaken in this step include the preparation of the audit questionnaire, stakeholder consultation, scheduling of interviews and the field verification site visit(s). Contact details of all relevant staff will also be provided by IPART to each party.

Audit questionnaire

The auditor will prepare a **questionnaire** based on the scope of the audit. The utility will **answer the questionnaire** and provide a **statement of compliance**. All these documents will be posted to a confidential data upload point on IPART's website before the audit interviews. Only the auditor, the utility and IPART will have access to this information on the website. For more detail on the content of the questionnaire and appropriate answers to the questionnaire, please see **Appendix B**. The statement of compliance template is in **Appendix A**.

Evidence provided by utilities should be well referenced, clearly identifying relevant page numbers and/or paragraphs of long documents.

The auditor must read the answers and evidence provided before the interview. This allows for an efficient interview process (ie, in the interview, the auditor should only need to test and validate evidence, clarify any uncertainties and ask for information to fill gaps, rather than covering all the evidence provided in the response to the audit questionnaire). The auditors may still request additional information or ask additional questions during the interviews.

Stakeholder consultation

IPART will contact relevant government agencies prior to finalising the scope of the operating licence audit. We will seek formal feedback on the utility's performance during the audit period for the functions where the agency works with or regulates the utility. The auditor should confirm the relevant agencies with IPART before consultation. The auditor must follow up with the relevant government agencies in regard to submissions received by IPART. Agencies might include the NSW Health, Environment Protection Authority, Office of Environment and Heritage, NSW Office of Water and/or the Dam Safety Committee.

At a minimum, the auditor will be required to liaise with NSW Health. **Any requests should be made in writing and addressed to the Chief Health Officer at NSW Health.**

Scheduling of interviews and field verification site visit

The auditor and utility will organise an **interview timetable**. The auditor will indicate how many interview hours are needed for each licence category. The utility will identify which business functional areas will be interviewed for these clauses, and will draft the timetable accordingly. After the audit interviews and field verification, a period of time (eg, half a day) should be set aside to review and clarify any outstanding matters or conduct additional interviews that were not able to be held in the scheduled interview times.

During the audit, IPART requires at least one field verification site visit. We will determine together with the auditor what type of facilities will be inspected and will notify the utility at this time. Facilities include assets, property or physical elements related to the utility's operations, such as catchment areas or waterways. Any facility relevant to the licence obligations being audited may be selected for the site visit. To inform the selection of facilities, we will provide the lead auditor with a list of facilities visited in the previous five years. We anticipate that at least one day should be set aside for field verification site visits depending on what facilities are to be inspected.

It is helpful to schedule site visits on the second day of an interview program in order to allow time in the office on the days before and after to discuss any matters arising from the previous interview and the site visit itself. A short (30 minute) session should be scheduled on day one to outline the field verification site visits (see Step 5 for more details).

The utility and auditor are to discuss with IPART as early as possible whether there will be multiple interviews run in parallel or a single interview. Multiple interviews running in parallel are often more time efficient. However, auditors and utilities must be able to resource the interviews effectively, including a requirement to ensure the interviews are appropriately transcribed. IPART considers that it may be necessary for an auditor to have an assistant or junior colleague available to take notes of the interviews, especially where large more complex clauses are being audited.

Step 4: Audit interview

The interview covers the meetings at the utility's offices and facilities. Both IPART staff and auditors should be present at all interviews. Utilities are responsible for ensuring the most appropriate staff members attend the relevant interviews.

There will be an **opening meeting** to establish the protocols for the audit¹ and ensure that all necessary arrangements are in place and agreed. The meeting will cover the audit approach and the timelines for undertaking the audit. This meeting is usually the first interview session on the first day.

Utilities may wish to start each interview on a specific part of the licence with a brief **presentation** outlining how the business operates in this area. This will help set the scene for the auditor and also help the utility ensure the right staff members are present and are prepared. The utility should discuss this approach with the auditor before the interviews, to see if it is suitable for the audit team.

Through the interviews and field verification site visits, auditors must obtain sufficient evidence to be able to provide an audit opinion in accordance with an adopted audit standard. It is the responsibility of the auditor to determine the level of sufficient evidence required. **Appendix E** discusses appropriate audit standards.

Auditors will conduct the interviews by using the audit methods outlined in **Appendix F**. Lead auditors must use their professional judgement to determine the mix of audit methods needed to get sufficient evidence to support an opinion on each item within the scope.

We require auditors to maintain an accurate record of documents sighted. Auditors do not need to submit this record with the final audit report; however, records of audits must be maintained for a reasonable period (ie, seven years), securely and confidentially, given the sensitivity of the material.

¹ For example, the process for managing any disagreements between the auditor and the utility.

Step 5: Field verification site visits

The purpose of a field verification site visit is for the auditor to verify how effectively the requirements of the operating licence are met in practice.

The field verification site visit is part of the audit. As such, it is appropriate for the auditor to include questions about implementation of management systems, plans and procedures at the sites in the questionnaire.

It is also an opportunity for the utility to demonstrate its compliance with the operating licence in the course of its everyday operations. This may include identifying how management systems, plans and procedures are implemented under actual working conditions. As part of this process, any gaps in implementation will be noted. The field verification site visit must be linked back to one or more sections of the Operating Licence that is being audited. Site visit facilities will be selected by the auditor in consultation with the utility and IPART, having regard for relevance to the audit scope, asset classes of previous site visits, and practical and safety aspects (such as travel or a high risk site) as advised by the utility.

Before the field verification site visit, a short session should be scheduled during the interviews to introduce and familiarise the participants with the site(s), and explain how the site visit will demonstrate compliance with the operating licence. In doing so the utility should cite documentary evidence already provided for the relevant part of the operating licence audit. This session should provide the necessary context for the auditor, so system schematics, maps, technical specifications, design drawings, guidance to the auditor regarding personal protective equipment (PPE) required or other necessary information should be presented in the session, prior to the site visit.

During a field verification site visit, the auditor will review aspects of the utility's operations and consider compliance with the operating licence using the audit methods outlined in **Appendix F**. The auditor is expected to ask a utility's operational staff about the operation of the system and application of management systems, plans or procedures while on site. Utilities are responsible for ensuring the appropriate operational staff members are available during a site visit and access to an agreed site is secured. This includes sites that are managed by contractors or other third parties.

During a field verification site visit, the auditor may identify issues that pose a significant risk to public health or the environment but are outside the scope of the audit. If this occurs, the auditor will notify the utility and IPART at the time of the observation. Section 2.2 of this Guideline contains further details on "out of scope" issues and findings.

Step 6: Wrap up and close out sessions

The final session of the audit interview process should involve the following:

- ▼ A **final wrap up**. This item is to cover any outstanding matters. For example, to discuss any concerns from the site verification visits, to answer any questions taken on notice or complete any interviews that ran over time or where staff were not available when required. It is anticipated that this extra step allocated to the audit interviews will save time and improve the outcomes of the audit reporting step. **This wrap up may not be required if both the utility and the auditors are satisfied there are no outstanding issues to be covered.**
- ▼ A **close out meeting**. It is recommended that auditors, senior management from the utility and IPART staff are present. The auditor will flag any clauses where full compliance may not be awarded. Ways of achieving compliance should be discussed and form part of the auditor's recommendations (see Step 7). The auditor should also summarise any outstanding information required or identify any other actions for the utility or IPART to complete prior to finalising the audit reports.

The two items can be held as one session. However, it is important that suitable personnel are present for the close out meeting.

Step 7: Audit assessment and reporting

After the audit interview and field verification site visits, the auditor will continue to assess the evidence provided at the interview. Throughout this step, there may be further communication between the auditor and utility. IPART should be copied in on all correspondence for document control purposes. Should any meeting or teleconferences take place, IPART should be invited to participate, and if IPART is unable to attend the auditor is responsible for advising IPART of the meeting outcomes. All additional evidence supplied should be uploaded to the IPART issued data transfer site used for the audit.

The auditor is to assess the compliance that a utility has achieved during the audit period. The auditor must prepare a report that addresses all of the elements identified in the audit scope. The required level of detail and format of the report are presented in the audit report template in **Appendix D** of this document.

When preparing the audit report, the auditor should use language that is appropriate for a public document. Language should be objective and factual, and should not be overly complex or unnecessarily emotive or alarming, and should not include names or other personal details (emails, etc) of utility or IPART staff members. The report should not contain any specific material that could pose security issues for the utility. However, this should be balanced with the need to provide enough detail to support the awarding of an audit grade.

The auditor is to write up the assessment in the **first draft audit report**. **This report must be complete** – ie, no sections should be left for completion in the second draft. Should further evidence be provided after the first draft, details in the report may change. Where full compliance was not awarded, the auditor should identify what is needed for full compliance to be achieved. If further evidence has been requested but not supplied, the auditor should make an assessment based on the information/evidence already provided.

Compliance grades are defined in **Appendix C**. Details of the other parts of the report are in the audit report template in **Appendix D**.

Commenting on draft reports

Both the utility and IPART will **comment** on the first draft audit report, including providing further evidence and clarification if needed using the issues register process (see Box 2.1).

Box 2.1 **Comments register process**

Comments on the draft report must be made in the register template provided by IPART. This allows comments to be compiled into a central location, as the auditor will need to respond to them and submit it with the second draft report. **Comments by the utility disputing the opinion of an audit grade, need to be accompanied by supporting evidence. It is not sufficient to make comments such as “we strongly disagree...”** without substantiating evidence.

Auditors must respond to all comments using the comments register procedure, explaining whether comments were or were not incorporated and considering new evidence. Using this register it is clear that all issues raised were considered, even if there was no obvious change to the report.

It is the utility’s responsibility to identify any factual errors, omissions, or required clarifications in the first draft audit report. **This is the last opportunity** for the utility to attempt to provide more evidence or clarify information that may influence the compliance grade. If the parties do not agree on the grade or evidence required, we require the utility and the auditor to discuss with us what **additional evidence** is required to revisit a compliance grade before the utility’s comments on the first draft report are finalised. The utility must initiate this discussion with the nominated IPART representative assigned to the audit.

In our comments, we may clarify the intention of licence clauses or audit procedures. We will not make comments that compromise the independent assessment of the auditor. Comments from IPART and the utility should focus on the report content, rather than spelling or typographical mistakes. The report will be subject to quality assurance by the audit team to address these issues prior to issuing the final report.

After receiving comments, the auditor will write the **second draft audit report**. The second draft audit report must be accompanied by the completed issues log which includes responses to all utility and IPART comments. This report will reflect the new evidence and clarification and include the final compliance grades. All the changes to the report from this point should be editorial only.

The utility and IPART may **comment** on the second draft audit report, but comments should be limited to matters of fact only. There is no opportunity to provide further evidence or dispute opinion at this stage. The process for escalation of issues outlined in Section 2.4 should be followed if an issue relating to the audit arises which cannot be resolved through the normal audit process.

The auditor will compile the **final report** and provide it to us by the milestone date agreed in the contract between IPART and the auditor. At the same time IPART receives the final report, the public water utility will also receive a copy. All final audit reports will be provided to the Minister and be publically available on IPART's website. The final report must be quality assured by an appropriately qualified person, with the relevant experience necessary to undertake this task.

Step 8: Report to the Minister

IPART must report to the relevant Minister on the utility's compliance throughout the year. We will use the auditor's findings in our report and include the auditor's report as an appendix. If we are aware of other non-compliances throughout the year, either through our regulatory relationship, the statement of compliance, out of scope audit findings or other methods, these will also be reported to the Minister in our report.

Upon reviewing the audit findings, audit evidence and any other relevant performance information, audit grades reported to the Minister in our report may differ from those reported by the auditor. If IPART decides to depart from audit grades of the auditor, we will write to the utility as soon as possible to explain the reason for the difference.

If relevant, we will make recommendations to the Minister that the utility improves its operational systems, programs and/or procedures as a result of the compliance grades awarded. Where possible, our recommendations will be outcomes focused to allow the utility to determine the most efficient way to achieve compliance. Our recommendations may also differ from those made by the auditor to balance service standards with our understanding of customers' willingness and ability to pay. This means our recommendations may not reflect the specific recommendations or opportunities for improvement made by the auditor. Where our recommendations differ from those of the auditor, we will inform the utility prior to finalising the audit report.

We may identify opportunities for improvement in our report as well as recommendations. We do not require the utility to report back on opportunities for improvement. For more information on auditor's recommendations and opportunities for improvement see **Appendix D**.

Utilities will receive a copy of IPART's Report to the Minister in parallel with its submission to the Minister.

The Minister responsible for Sydney Water and Water NSW (formerly the Sydney Catchment Authority and State Water Corporation) must table the reports on their performance in parliament within a month of receiving the report(s).

IPART's report to the Minister and appendices (including the auditor's report) will be posted on our website after they have been sent to the relevant Minister (for all public water utilities) and tabled in parliament (for Sydney Water and Water NSW only).

Step 9: Report on audit recommendations

Utilities are to report to IPART on the status of recommendations identified in IPART's report to the Minister by 31 March in the following year. In some cases, we may require a different reporting date for specific recommendations if there is a higher or lower risk posed.

The report must include a:

- ▼ progress report on implementation of recommendations from IPART's report to the Minister, and
- ▼ status update on any outstanding audit recommendations or accepted improvement opportunities from previous years.

2.4 Escalation of issues

The audit process requires auditors, utilities and IPART analysts to communicate on numerous complex issues relating to a utility's operations and management.

From time to time there will be differences in opinion or understanding regarding aspects such as adequacy of information, interpretation of obligations or audit grades. This is a normal part of the audit process. The audit process and these guidelines have been written with this in mind. To afford the audit team every opportunity to present the information, IPART requires a variety of communication steps within the audit process, including:

- ▼ written questionnaires
- ▼ file transfer capabilities
- ▼ audit interviews

- ▼ site visits
- ▼ two draft reports, and
- ▼ a comments register.

Each audit will be assigned a nominated IPART representative overseeing the audit. The nominated IPART representative should attend the audit interviews and is familiar with the utility and the scope of the audit.

Where an issue relating to the audit arises that cannot be resolved through the normal audit process, it should always be raised in the first instance with the nominated IPART representative, as early as possible. An issue may be escalated by either a utility or an auditor.

Box 2.2 Content or Process?

An issue of content is an issue relating to a difference of opinion regarding technical issues. These could be a difference of opinion about an obligation, application of drinking water or recycled water management guidelines, or best practice in asset management. These issues usually relate to provision of specific evidence which could be used to support an argument for or against a given audit grade.

An issue of process relates to the conduct of the audit. Behaviours of auditors, IPART or utility staff, and deviations from the audit guidelines or wording of reporting might be examples of process issues.

IPART will decide if the issue is an issue of content or an issue of process.

In the first instance, correspondence should be made by email to the nominated IPART representative, clearly setting out the issue, the attempts already taken within the audit process to resolve it, and indicating that this is an escalation of the issue. The Director, Licensing and Compliance at IPART should be copied for information. Once the nominated IPART representative has an email outlining the issue, we will call or meet with the notifier to discuss the issue.

The only exception to this is where the issue relates to the behaviour of IPART staff, whereby the Director, Licensing and Compliance should be emailed directly with the General Manager, Licensing and Compliance copied in for information. From there the Director will arrange a meeting.

All parties should endeavour to keep content issues (see Box 2.2) at an officer level (the nominated IPART representative). It is not appropriate for senior levels of management who were not present at the audit or involved in reviewing evidence and reporting to be discussing technical details of content. If the independence of the auditor is in question, IPART will consider appropriate action. IPART could consider a range of measures including suspension of the audit.

Importantly, auditors have been engaged to exercise their professional opinion as an experienced industry member. Auditors must remain independent at all times during the audit process. Escalation of issues should only be raised with IPART, and should not be used in any way to influence the auditor. Communication with the auditor must always occur within the audit process described (comments register – see Box 2.1) or with IPART copied in.

2.5 A summary of major milestones for an operational audit

Each audit is for the financial year just completed. The following schedule outlines the timeframes in which each of the steps will happen for an operational audit. The exact dates of when outputs are due will vary from year to year and the dates will be set during Step 2 and Step 3 of the process.

Table 2.2 Audit Schedule

Audit Step	Output	Responsibility	Timing
Step 1 – Audit scoping	Audit scope	IPART	April - June
Step 2 – Appointment of the auditor	Letter of appointment	IPART/Auditor	June - July
Step 3 – Audit preparation	Questionnaire	Auditor	July - September
	Stakeholder consultation letters	Auditor	
	Answer to questionnaire	Utility	
	Statement of compliance Advertisement	Utility IPART	
Step 4 – Audit interview		Auditor/Utility	September
Step 5 – Field verification site visits		Auditor/Utility	September
Step 6 – Wrap up and close out sessions		Auditor/Utility	September
Step 7 – Audit assessment and reporting	First draft audit report	Auditor	October - November
	Comments on first draft	Utility / IPART	
	Second draft audit report	Auditor	
	Utility and IPART response	Utility / IPART	
	Final audit report	Auditor	
Step 8 – Report to Minister	IPART report to Minister	IPART	November/ December
Step 9 – Reporting on recommendations	Utility report on recommendations	Utility	March

3 | Audit Panel

The Water Licensing Audit and Technical Services Panel (the panel) operated by IPART is a panel of approved auditors and area specialists. The panel was developed to identify pre-approved auditors to make the auditor selection process simpler.

To find out how to apply to be listed on the panel, or to see the list of approved auditors on the panel, go to our website at: www.ipart.nsw.gov.au.

3.1 Panel classifications

There are three classifications on the Panel:

1. **Area Specialists** are senior technical professionals with specific skills, competencies and experience in their industry fields. An Area Specialist may not have the necessary skills and experience to conduct audits.

We may engage Area Specialists to provide specialist water industry advice, or assist Lead Auditors and Auditors, if required and if approved by us.

2. **Lead Auditors** are recognised as competent to undertake audits independently (although they are required to be part of a project team to comply with quality assurance and peer review requirements), or to lead an audit team. Only Lead Auditors can direct and supervise audit teams, and sign written reports submitted by a Panel Member.
3. **Auditors** are recognised as competent to undertake audits as a member of an audit team. Auditors may not have sufficient experience to lead an audit.

Any other staff, employees or contractors may only help the audit team in areas such as administrative support and/or auditor training. All work by non-Panel Members must be undertaken within the direct control and supervision of the Lead Auditor.

Box 3.1 Conflict of interest

Licensees, auditors and area specialists need to be conscious of the need to ensure that conflict of interest issues are managed appropriately for the engagement of audit panel members (as individuals or as organisations) for both audit and non-audit purposes.

For the purpose of undertaking audits of public utilities, a conflict of interest is defined as any actual, potential or perceived conflict of interest (including, but not limited to, any past, present, or anticipated agreement, arrangement, understanding or activity) which may affect the panel member's ability to objectively perform any audit service.

IPART takes a conservative approach to assessing conflicts of interest. In assessing whether a conflict of interest exists, we will be guided by whether:

- ▼ The auditor has assisted the utility in preparing any of the plans, procedures or systems required as a licence condition – either directly or indirectly.
- ▼ A high proportion of the auditor's firm's revenue is derived from the utility (or a related entity).
- ▼ The audit firm is the incumbent internal auditor to the utility or a related entity.

Full details of the requirement to disclose conflicts of interest are contained in the Water Licensing Audit and Technical Services Panel Agreement, which is available on our website (www.ipart.nsw.gov.au).

3.2 Panel categories

We have established eight categories based on the audit requirements in the *Water Industry Competition Act 2006* and the legislation for public water utilities. Only five of the categories are relevant to the public water utilities and are explained below.

Audit personnel may only conduct audits within the categories for which they are listed for the Audit Panel.

3.2.1 Infrastructure performance

Auditors in this category will assess the adequacy of infrastructure to achieve safe, reliable and continuous performance. It may also include assessing the adequacy of:

- ▼ infrastructure performance
- ▼ infrastructure management, and
- ▼ monitoring.

3.2.2 Drinking water quality

Auditors in this category will assess how adequately a utility implements the *Australian Drinking Water Guidelines*. It may also include assessing the adequacy of:

- ▼ any risk assessment
- ▼ the measures adopted to control risks, and
- ▼ the water quality supplied, ie, that it is fit-for-purpose.

Auditors in this category will also assess the adequacy of catchment management practices, including the adequacy of relevant risk assessments and their outcomes.

3.2.3 Recycled water quality

Auditors in this category will assess how adequately a utility implements the *Australian Guidelines for Water Recycling*. It may also include assessing the adequacy of:

- ▼ any risk assessment
- ▼ the measures adopted to control risks, and
- ▼ the water quality supplied, ie, that it is fit-for-purpose.

3.2.4 Retail supply

Auditors in this category will assess the adequacy of the utility's systems developed to manage proposed customer interactions. This includes:

- ▼ complaint handling procedures
- ▼ dispute resolution processes, and
- ▼ hardship and debt management.

3.2.5 Environmental management

Auditors in this category will assess the adequacy of environmental management practices including the adequacy of relevant risk assessments.

3.3 Auditor training

We may require all auditors to undertake training on our expectations of auditors using this guideline. We will provide the guideline training periodically, at no cost to the auditors, in the Sydney central business district. The training is intended to help auditors comply with the audit guideline, and to effectively plan, execute and report on audits.



Appendices

A Statement of compliance

Statement of compliance *[Insert Year]*

For 20_/_/_

Submitted by *[utility]*

To: The Chief Executive Officer
Independent Pricing and Regulatory Tribunal of NSW
PO Box K35
Haymarket Post Shop NSW 1240

[utility] reports as follows:

1. This statement documents compliance during *[financial year]* with all obligations to which *[utility]* is subject by virtue of its operating licence.
2. This report has been prepared by *[utility]* with all due care and skill to the best of our knowledge of conditions to which it is subject under the *[utility legislation]*.
3. Schedule A provides information on all obligations with which *[utility]* did not comply during *[financial year]*.
4. Other than the information provided in Schedule A, *[utility]* has complied with all conditions to which it is subject.
5. This compliance report has been approved by the Chief Executive Officer (or equivalent) and the Chairman of the Board of Directors of *[utility]*/ Duly authorised Board Member of *[utility]*.

DATE:	DATE:
Signed	Signed
Name:	Name:
Designation:	Designation:

Schedule A Non Compliances²

Table #	List clauses breached, including a brief description of each licence clause	Describe:
		<ul style="list-style-type: none">i Date or period of non-complianceii Nature and extent of non-compliance (including whether and how many customers have been affected)iii Results of any monitoring (where applicable)iv Reasons for non-compliancev Remedial action takenvi Actual/anticipated date of full compliance

² Utilities should report only non-compliances that were identified during the reporting period.

B Questionnaire template

Table B.1 is a template for the auditor's questionnaire and the utility's response, to be used before the audit interview. The auditor will prepare a questionnaire based on the scope of the audit for the utility. The utility will then answer the questionnaire before the audit interviews.

The evidence the utility provides will be in separate documents and systems. The questionnaire answer must reference the evidence clearly – including, where relevant, chapter numbers or page numbers. All referenced documents must be provided with the completed questionnaire. All referenced systems must be available in the interview period for the auditor to test. Reports can be provided as evidence, however, information contained in the reports should be referenced (chapter and page numbers) in the questionnaire.

The completed questionnaire and referenced documents will be large and may be difficult to transmit to multiple parties. We have set up a data upload facility, which all three parties can use to upload and see the documents. We will send details of the facility to each party when the auditor is appointed.

The auditor must read the answers and evidence provided before the interview. This method allows for efficient interviews, as the auditor sees much of the evidence before the interview. Then, in the interview, the auditor can test and verify the evidence provided, clarify any uncertainties and ask for information to fill gaps, rather than covering all the content from the beginning.

Table B.1 Questionnaire template






Auditor Questionnaire			Utility Response	
Licence Clause	Questions	Type of evidence	Discussion	Evidence
	Questions that detail what the auditor expects to see to show compliance with the licence clause	Documents or systems which might answer the question	Discussion of how the evidence answers the question	<p>Hyperlinks to documents or systems, or detailed naming of documents.</p> <p>To improve audit efficiency, chapter or page numbers for references should be included, where relevant.</p> <p>Providing unreferenced information can increase time and cost of audits.</p>

C Compliance grades

An auditor is to assess the adequacy or level of compliance that a licensee has achieved for each requirement, and award grades for each requirement. The grades are to be awarded at the clause level. For example, if the clause is 3.2.1 (a)-(d), the grade would be awarded at the level of 3.2.1 and not at a lower sub-clause level. All letter and Roman numeral clauses are considered sub-clauses.

The proposed grades for all audits are shown in Table C.1. The grades are a traffic light approach.

Table C.1 Compliance grades for public utilities

Grades of compliance	Description
 Full Compliance	Sufficient evidence to confirm that the requirements have been fully met.
 High Compliance	Sufficient evidence to confirm that the requirements have generally been met apart from very few minor shortcomings which do not compromise the ability of the utility to achieve defined objectives or assure controlled processes, products or outcomes.
 Adequate Compliance	Sufficient evidence to confirm that the requirements have generally been met apart from a number of minor shortcomings which do not compromise the ability of the utility to achieve defined objectives or assure controlled processes, products or outcomes.
 Non compliant	Sufficient evidence has not been provided to confirm that all major requirements are being met and the deficiency adversely impacts the ability of the utility to achieve defined objectives or assure controlled processes, products or outcomes.
 No Requirement	The requirement to comply with the licence condition does not occur within the audit period or there is no requirement for the utility to meet this assessment criterion.

D | Audit report template

Report content and layout

The following pages are a template outlining what we require in an audit report as a minimum. Auditors do not have to use the formatting of the template, as we expect they will use their company's formatting protocols. The template only provides the content and layout of what is required.

The report should include a chapter for each licence obligation category (ie, Water Quality, Asset Management, Customers, etc.), and a separate chapter addressing previous IPART recommendations. Each chapter should clearly state compliance grades for each clause and include a summary of findings, including a brief discussion as to why a compliance grade was awarded.

The first draft report must be complete: ie, no sections should be left for completion in the second draft.

Where the auditor is waiting on further information, an assessment should be made based on information available to the auditor at the time of finalising the first draft audit report.

Report writing style

The final audit report will be attached to our report to the Minister and so will be publically posted on our website. When preparing the audit report, the auditor should use language that is appropriate for a public document. Language should be objective and factual, and should not be overly complex or unnecessarily emotive or alarming, and should not include names or other personal details (emails, etc) of utility or IPART staff members. The report should also not contain any specific material that could pose security issues for the utility. However, this should be balanced with the need to provide enough detail to support the awarding of an audit grade.

We acknowledge that the audit report will be prepared by more than one auditor. However, we expect that a consistent approach to formatting, language, referencing and abbreviations be applied when preparing the audit reports.

Recommendations

Auditors are to make recommendations as to how the utility could improve its compliance with each clause where full compliance was not awarded. The recommendations should address the gaps found in the evidence and help the utility identify ways to rectify these gaps. The only exception to this requirement is where compliance is dependent on someone or something that is out of the utility's control. In this event, the auditor should state this in the recommendations column of the template. Where full compliance is awarded, an auditor should not make a recommendation, as we want to balance performance and the investment required to improve it. That is, we want to consider the pricing implications of continual improvement and value for money to the customer before recommending that utilities implement improvements.

Opportunities for improvement

In addition to recommendations, if the auditor sees an area where an improvement could be made to the operation of the utility's activities and functions, the auditor can identify this as an "opportunity for improvement". The auditor may identify an opportunity where full compliance or less than full compliance is awarded. The opportunity for improvement may not have an impact on compliance, but may contribute the overall improvement the utility operations. The utility can decide whether to implement an opportunity, based on their own assessment of whether the improvement is a prudent and efficient way to achieve its outcomes.

If we adopt the opportunity for improvement in our report to the Minister, the utility can decide whether or not it will report on implementation. Any information provided by the utility on their response to the opportunity for improvement will be provided to the auditor prior to the next audit. However, we will not follow up the opportunity for improvement in subsequent audits.

E | Audit standards and principles

No specific auditing standard is required for the audits. We require all auditors to use a systematic approach to:

- ▼ planning the audits
- ▼ interpreting licence conditions
- ▼ collecting audit evidence
- ▼ objectively assessing the evidence, and
- ▼ reporting in a clear and accurate manner.

Acceptable standards that may help auditors with this approach include: ISAE 3000, Australian Auditing Standards (AUS 108, AUS 110) or ISO 19011.

Auditors must identify the standard they will use in the tender. These standards can be adapted, if appropriate, for the audit. The final report must state the audit was done according to the identified standard.

Auditors are responsible for ensuring the audit procedures they use meet the following audit principles:

- ▼ Faithful representation - information should faithfully represent the outputs and outcomes of the audit. Uncertainties should be minimised, identified and quantified where possible.
- ▼ Completeness - information should be as complete as possible, such that information is not misleading or unreliable.
- ▼ Consistency - consistent methods should be used so comparative assessments can be made over time.
- ▼ Reliability - information and source data should be free of material mis-statement and able to be relied upon by users of the information.
- ▼ Transparency - data shall be capable of replication by a third party through adequate record keeping. Reference sources, methodologies and approaches to data generation shall be clearly documented. Changes to data and methodologies over time shall be clearly documented.

F | Audit methods

Table F.1 Audit methods

Principle	Definition	Example of method
Inspection	Examining records, documents or physical assets. The auditor must consider the source of the documentation for differing degrees of reliability.	Obtain a summary of licensee water supply main breaks and customers affected and trace figures back to source documentation, and reconcile to the participant's internal record keeping system.
Observation	Looking at a process or procedure being performed by the participant. Generally, this audit procedure is conducted when the particular process ordinarily leaves no audit trail.	Observe the record keeping process and documented procedures in operation.
Inquiry and confirmation	Seeking appropriate information of knowledgeable persons inside or outside the organisation. The response to an inquiry to corroborate information contained in the records.	Inquire how the field work crews collect data and how this data is logged into the data collection system. Confirm data recording is accurate.
Computation	Checking the accuracy of source documents and accounting records, or of performing independent calculations.	Consider sampling of customer property numbers for several main failures via alternative computation methods.
Analytical procedures	Investigation and analysis of data fluctuations and relationships to determine whether there are inconsistencies with other relevant information, or deviations from predicated amounts.	Confirm interpretations of definitions and compare with other interpretations, for example counting of flats and units in customer property numbers. Consider errors and confidence limits.

A variety of factors will affect the reliability of audit evidence, including:

- ▼ independence of evidence - evidence from outside the organisation is generally considered more reliable than evidence generated internally
- ▼ knowledge and lack of bias of the person providing the evidence to the auditor, and the attention paid to the auditor's request for evidence
- ▼ the directness in which it is obtained - evidence received directly by the auditor is generally considered to be more reliable than evidence received indirectly, and
- ▼ control systems - evidence prepared by utilities under systems of strong internal control is considered more reliable than evidence prepared under systems of weak internal controls.

Auditors should adopt an attitude of professional objectivity throughout the audit in order to ensure information provided is accurate and complete.