

Submission to the Independent Pricing and Regulatory Tribunal

Review of Audit Guidelines for Public Water Utilities

May 2018



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1. Introduction

WaterNSW welcomes the Independent Pricing and Regulatory Tribunal's (IPART) decision to review its Public Water Utilities (PWUs) Audit Guidelines, and appreciates the opportunity to provide input into this process. WaterNSW supports the intent of the review to improve the efficiency of the audit process, better align the guidelines with recent changes made to our operating licence, and to clarify IPART's approach to checking compliance with our licence conditions.

The key areas discussed in this response relate to various components in section two of the guidelines "Audit Fundamentals" and section three "Operation Audit Procedure", being:

- Overlap with other audits
- Matters outside of the audit scope
- The 'three in five' rule
- Peer review
- Application of auditing standards
- Audit grades

2. Overlap with other audits

Under the terms of its Operating Licence, WaterNSW must at all times maintain its Asset and Environmental Management Systems consistent with *AS ISO 55001:2014* and *AS/NZS ISO 14001:2016* respectively.

WaterNSW believes that IPART should only subject a management system to an operational audit where surveillance or (re)certification audits have identified issues or areas of concern. The scope of the management system audit should comprise of the activity undertaken in order to rectify any identified issues and/or areas of concern.

System surveillance and (re)certification audits are available to IPART as evidence of system effectiveness and should be used to provide assurance regarding system effectiveness.

The proposed audit guidelines potentially create audit duplication. IPART has progressively shifted the operating licence towards system-based licence conditions on the premise that this reduces audit cost and resource burden on both WaterNSW and IPART, as well as gaining process efficiency and better price outcomes for WaterNSW customers.

3. Matters outside of the audit scope

WaterNSW in general agrees with the procedure for matters outside of the audit scope. However, greater clarity is needed regarding the process following the auditor's covering letter submission to IPART in relation to out of scope findings. It is not clear how or to whom these findings will be reported, whether they are made publicly available, and how they will be addressed.

WaterNSW suggests that any out of scope issues identified are addressed through the annual audit recommendations status report, due to IPART 31 March each year.

4. The ‘three in five’ rule

WaterNSW agrees with IPART’s approach, however we are concerned that the same auditors will be used more than three times, as this is only IPART’s “preferred and general approach”, with the ability to “approve an exemption to this rule”. We would encourage IPART to commit to the ‘three in five’ rule, with no capacity to use auditors more than three in five years in the proposed audit guidelines.

5. Peer review

We suggest that IPART consider requiring the peer reviewer to demonstrate the same level of independence as the auditors i.e. “sufficient independence and without actual or potential conflicts of interest”.

6. Application of auditing standards

Auditors are required to securely and confidentially retain audit records for no less than seven years. We encourage IPART to ensure that effective controls are in place and assurance is provided by the auditors.

7. Audit grades

The proposed audit grading system is a significant step change from the current grading system. WaterNSW does not support the proposed audit grades, in particular the grade and description for compliant and non-compliant (non-material).

The proposed audit grades remove the former compliant grades of “High” and “Adequate”, with a single “Compliant” grade remaining. The proposed compliance grade uses the terms “fully or substantially met” in the description. There is no guidance as to what constitutes “substantially met”.

Unless awarded full compliance for a clause, the auditor will be required to default to non-compliant. The description for the grade “non-compliant (non-material)” is very similar to the definition of high compliance under the current grade system, but would be interpreted as a failure rather than acknowledging that WaterNSW is essentially performing effectively. The proposed grades also encourage an auditor to grade as non-compliant (non-material) in order to make an audit recommendation.

WaterNSW is concerned that the proposed grades and their description do not match the public’s perception of what constitutes compliant and non-compliant. We are keenly aware that the results of operational audits are tabled in Parliament. Consequently, there is greater risk by the public of misinterpretation regarding the term of ‘non-compliant’ (non-material). Even though WaterNSW’s ability to achieve defined objectives or assure controlled processes may not have been compromised, for these reasons the term attracts unwarranted risk to our credibility and reputation.

WaterNSW suggests two alternatives to the audit grades for IPART’s consideration in preferred order.

- **Option One:** Retain the current audit grade system.
 - Full Compliance

- High Compliance
 - Adequate Compliance
 - Non-Compliant
 - No Requirement
- **Option Two:** Replace compliant with compliant (full) and remove “substantially” from the definition. Change the label non-compliant (non-material) to compliant (high), and retain the grade’s description. These labels better reflect utility performance. Insert an additional compliance grade titled non-compliant (technical) that would address non-compliance with licence clauses due to new or changed government directive, policy or initiative, regulation or legislation and other water industry factors that directly affect the public water utilities.
 - Compliant (full)
 - Compliant (high)
 - Non-Compliant (technical)
 - Non-Compliant (material)
 - No Requirement

Audit grades are again discussed in section three – operational audit procedure. The current audit guidelines state under “risk-based approach”, that water quality is to be audited every year. The proposed audit guidelines provide more detail on auditing of water quality management systems (WQMS).

We agree with IPART’s assessment that the grade should not be the grade of the lowest element, but a result that balances the relative significance of the individual element grades. However, not all elements of the Australian Drinking Water Guidelines (ADWG) are audited each year, and the elements against which a utility is usually awarded a higher level of compliance are less likely to be audited (based on IPART’s risk-based approach). To avoid a skew towards lower compliance, performance of the WQMS should be assessed as a whole; assuming unaudited elements are fully compliant.

8. Figures, tables and appendices

The following sets out specific concerns regarding the figures, tables and appendices in the proposed guidelines:

- **Figure 3.1 Public water utility process:** the box “provide resources and personnel for interview” is not linked to the rest of the process. We suggest linking it to Step 4. Also, the last step proposed in the process, “Evaluation: feedback from auditors and PWUs” is not included in this figure.
- **Table 3.2 Indicative audit schedule:** we note that indicative dates have been removed. However, the timeline proposed is very confusing and not helpful as a ‘timeline’. We recommend IPART review how this information is displayed. It is stated that “dates will set during Step 2 and Step 3 of the process”. It would be helpful to include at Step 3 a requirement to consult with the utility on the timing of the audit to ensure availability of relevant staff. Also, the timing of stakeholder consultation differs to the audit process in Figure 3.1. In Figure 3.1 stakeholder consultation occurs after Step 2 Appoint Auditor, where as in Table 3.2 it occurs after Step 1 Audit Scoping. We suggest IPART retain the timing outlined in Table 3.2, to undertake stakeholder consultation before the appointment of the auditor and

amend Figure 3.1.

- **Appendix D Audit grade decision tree:** we suggest the removal of the decision tree. We believe that it does not add any value or clarity to the audit grade process. There are a number of deficiencies in the decision tree process and it does not directly relate to the audit grades and their descriptions. For example, compliant states that “sufficient evidence to confirm that the requirements have been fully or substantially met”. However, the decision tree states “Can the auditor judge that the requirements have been fully met?” Based on this, it’s a ‘no’ if not fully met. Also, if the shortcoming “doesn’t affect water quality, public health, safety or the environment”, then it’s a ‘yes’, but any other aspect of the utility is ‘no’.
- **Appendix F Audit report template:** The appendix begins with a section that has been copied from the current guidelines – Appendix D Report Content and Layout, but the first paragraph and a half have been omitted, which leaves the first paragraph starting with half a sentence. We recommend the removal of the first paragraph as this is covered in more detail on pages 35-37.

Under the heading “Recommendations”, we suggest the removal of the first sentence. The second last sentence of this paragraph should end at ‘recommendation’ and remove the rest of the sentence. The last sentence of this paragraph we recommend moving and incorporating into the section below on “Opportunities for improvement”.