



Independent Pricing and Regulatory Tribunal

Compliance and Performance Monitoring Strategy

Energy Savings Scheme — Compliance
February 2015

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

Christine Allen (02) 9290 8412

David Pryor (02) 9113 7731

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Independent Pricing and Regulatory Tribunal of New South Wales
Energy Savings Scheme Administrator and Scheme Regulator

PO Box K35, Haymarket Post Shop, NSW 1240

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

T (02) 9290 8452

F (02) 9290 2061

ess@ipart.nsw.gov.au

www.ess.nsw.gov.au

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Contents

1	Introduction	1
1.1	What is the status of the Compliance and Performance Monitoring Strategy (CPMS)?	1
1.2	What does the CPMS cover?	1
2	Tools used to monitor, assess and manage compliance and performance	3
2.1	Regular compliance reporting	3
2.2	Audits	5
2.3	ESC creation limits	6
2.4	Set-aside agreements with ACPs	7
3	Approach for setting audit requirements for ACPs	11
3.1	Approach for setting initial audit regime	13
3.2	Approach for setting ongoing audit regimes	14
4	Managing compliance	17
4.1	Managing performance by Scheme Participants	17
4.2	Managing performance by ACPs	18
	Appendices	21
A	Risk Assessment Framework	23
B	Treatment of errors and sampling during audit	24
C	Application risk factors	30
D	Legislative framework	33

1 Introduction

The Compliance and Performance Monitoring Strategy (CPMS) provides guidance on the approach taken by the Independent Pricing and Regulatory Tribunal (IPART)¹ in managing the compliance and performance of Accredited Certificate Providers (ACPs) and Scheme Participants under the Energy Savings Scheme (ESS).

Publishing the CPMS ensures that all stakeholders – particularly Scheme Participants and ACPs – have clear, consistent information on our expectations regarding compliance in the Scheme.

1.1 What is the status of the Compliance and Performance Monitoring Strategy (CPMS)?

IPART sets compliance requirements for the ESS as both Scheme Administrator and Scheme Regulator. The CPMS explains how we monitor and manage compliance in most situations; however there may be occasions when particular circumstances establish specific requirements for an individual Scheme Participant or ACP that differ from those outlined in this strategy.

1.2 What does the CPMS cover?

The main sections of the CPMS:

- ▼ describe the four general tools we use to monitor, assess and manage the compliance and performance of Scheme Participants and ACPs
- ▼ explain how we use audits for ACPs in more detail, including how we determine the specific audit requirements of individual ACPs or Recognised Energy Saving Activities
- ▼ outline our approach and the mechanisms available to us to manage compliance issues.

The appendices of the CPMS are:

- ▼ Appendix A – Risk assessment framework
- ▼ Appendix B – Treatment of errors and sampling during audits
- ▼ Appendix C – the risk factors we assess during the application process to establish an ACP's initial audit requirements, and
- ▼ Appendix D – Legislative framework of the ESS.

Box 1.1 provides general definitions of key terms used in the CPMS.

¹ IPART is the Scheme Administrator and Scheme Regulator for the ESS.

Box 1.1 General definitions

Category	Definition
Accredited Certificate Provider (ACP)	ACPs are voluntary participants in the ESS. They are parties that are accredited to create Energy Savings Certificates (ESCs) from carrying out Recognised Energy Savings Activities (RESAs) which increase the efficiency of electricity consumption or reduce electricity consumption.
Annual Energy Savings Statement (AESS)	The Annual Energy Savings Statement (AESS) is used annually by Scheme Participants to self-assess the amount of ESCs they are required to surrender, and any liability for an energy savings shortfall penalty that may be required.
Audit limit	Sets the maximum number of ESCs that may be created before an audit is required.
Compliance	Compliance means the extent to which an ACP or Scheme Participant meets the requirements of the Act, Regulation, ESS Rule and Accreditation Conditions. This is established mainly through auditing, annual reporting and controls on the ESS Registry (the Registry).
Energy Savings Certificates (ESCs)	A transferable certificate under Part 9 of the <i>Energy Supply Act 1995</i> (the Act), which is created in accordance with the <i>Energy Savings Scheme Rule of 2009</i> (ESS Rule). A certificate represents the Energy Savings associated with the abatement of one tonne of carbon dioxide equivalent (tCO ₂ -e).
Invalid ESCs	The creation of ESCs must be carried out in a way that meets the requirements of the Act, Regulation, ESS Rule and any Accreditation Conditions imposed by IPART. If the ESCs are found by the Scheme Administrator, or through audit, to have been created in a way that does not meet those requirements, they are considered to be invalid ESCs.
Performance	Performance means the ongoing compliance of the ACP or Scheme Participant for the duration of its involvement with the ESS. This is the track record that an ACP or a Scheme Participant builds up over time, as well as the body of knowledge built up around the compliance performance of similar RESAs.
Recognised Energy Savings Activity (RESA)	The ESS Rule specifies a number of Recognised Energy Savings Activities (RESAs) as eligible activities for the creation of ESCs. ACPs are accredited to carry out these activities at a single site, or multiple sites as a program of energy savings activities.
Scheme Participant	Scheme Participants are mandatory participants in the ESS. They are primarily electricity retailers, but also include some market customers. They are required to meet their individual energy savings targets (based on the size of their share of the NSW electricity market) through the surrender of ESCs.

2 Tools used to monitor, assess and manage compliance and performance

In general, we use four tools to monitor, assess and manage the compliance and performance of ACPs and Scheme Participants. These include:

1. regular compliance reporting
2. audits
3. ESC creation limits
4. set-aside agreements with ACPs.

2.1 Regular compliance reporting

2.1.1 ACPs

We require ACPs to submit regular reports on their compliance and the activities that have been undertaken. This reporting enables us to monitor when and where RESAs are taking place. When submitting reports, ACPs declare that all the information provided is correct and complete.

What ACPs are required to report

The reporting requirements are listed in the Accreditation Notice for each RESA. In general, these include requirements to report on their ESC creation activity, and on any changes the ACP has made to:

- ▼ its record keeping arrangements or systems for the RESA
- ▼ the scope of its RESA and the business models used for delivering the RESA, and
- ▼ the equipment used to deliver energy savings (if applicable).

ACPs are required to report on the implementation of audit recommendations or other Scheme Administrator requirements.

How often they are required to report

The required frequency of compliance reporting depends on the scope of the RESA. In general:

- ▼ If the RESA takes place at multiple sites, we generally require **quarterly reports**. These are template reports, and must be accompanied by supporting calculations. They must list all ESCs registered in the previous quarter.
- ▼ If the RESA takes place at a single site, we generally require **annual reports**. These are template reports, and must be accompanied by supporting calculations.
- ▼ If the RESA involves one-off certificate creation, or all the ESCs to be created by the project are assessed at the time of application, we may not require subsequent reporting.

Templates for quarterly and annual compliance reports are provided on the ESS website. ACPs must use the appropriate template for all reporting.

2.1.2 Scheme Participants

Scheme Participants are required to submit an Annual Energy Savings Statement (AESS) by the compliance deadline each year.² This report is a self-assessment of the Scheme Participant's compliance for the reporting year. It must include:

- ▼ the calculation of its individual energy savings target for the year
- ▼ the extent to which it met the target by surrendering ESCs
- ▼ any energy savings shortfall it is carrying forward
- ▼ any penalty it is required to pay, and
- ▼ the particulars of its liable acquisitions and any deductions in respect of partially exempt loads.

The Scheme Participant is also required to ensure that this report is correct and complete.

² The AESS is available on the ESS website at http://www.ess.nsw.gov.au/For_Liable_Entities

2.2 Audits

2.2.1 ACP audits

ACPs are required to have their RESA audited in line with the specific audit requirements we set in the Accreditation Notice. These are reasonable assurance audits and must be conducted by independent third party Auditors on the ESS Audit Services Panel (Auditors). The audits include:

- ▼ validating information supplied as part of an application for accreditation
- ▼ verifying the ongoing eligibility of RESAs, and
- ▼ verifying calculations supporting ESC creation.

The Auditors must conduct audits in accord with the Audit Panel Agreement.³ The Audit Panel Agreement sets out the roles and responsibilities of the Auditors. It ensures they comply with our guidelines and policies and use qualified, competent staff. Auditors are bound by confidentiality obligations and our conflict of interest requirements.

Section 3 and below provide information on our approach for setting the audit requirements for ACPs. If audits identify a material error of improper ESC creation, those invalid ESCs must be voluntarily forfeited. The resulting non-compliances are addressed using the methods described in Section 4. A material error can be quantitative or qualitative and is described in Box 2.1.

The Audit Guideline has been developed for use by Auditors and provides more detailed information about our approach to auditing, including the process for engaging audits, sampling, reporting of audit findings and the requirements for joining the Audit Services Panel.⁴

³ Audit firms on the panel can be found on the ESS website at http://www.ess.nsw.gov.au/For_Auditors/List_of_Auditors

⁴ The Audit Guideline will be updated from time to time to incorporate relevant material from the CPMS. It is available on the ESS website at www.ess.nsw.gov.au/forAuditors.

Box 2.1 Materiality: ESC creation

The **materiality threshold for the creation of ESCs is 5%**. If the rate of material misstatement exceeds 5%, Auditors should not issue a finding of reasonable assurance and the audit will be considered a Failed Audit. The Auditor may however provide a qualified opinion, with assurance provided over a reduced number of ESCs.

In making materiality judgements, Auditors consider both quantitative and qualitative factors. When assessing the results of an audit they consider:

- ▼ the significance of an individual misstatement to the creation of ESCs
- ▼ whether the misstatement is one-off or symptomatic of a control or system weakness, which would have routine effects on figures being reported to IPART, and
- ▼ the effect of the potential misstatement that would result from an unrecorded audit difference on the number of ESCs created (taken as a whole).

More information on materiality and error is described in detail in Appendix B.

2.2.2 Scheme Participant audits

Scheme Participants are required to lodge an independent audit report with their completed AESS each year. To meet this requirement, a Scheme Participant must have its completed AESS audited before submitting to IPART. The audit must be conducted by an Auditor. It must be a reasonable assurance audit focussed on ensuring that the AESS is free of material misstatement or error. This is important to ensure that the correct numbers of ESCs are surrendered in compliance with the legislated Energy Savings Target.

However, where Scheme Participants:

- ▼ did not purchase any electricity in the compliance year (ie, are submitting a nil return that takes account of any non-NEM electricity), they are exempt from this requirement, or
- ▼ purchased only a very small amount of electricity in the compliance year, they may seek an exemption for that year, by writing to IPART as Scheme Regulator.

2.3 ESC creation limits

As Scheme Administrator, we determine the number of ESCs that the ACP may register from a RESA either:

- ▼ prior to requiring an audit (audit limit), or
- ▼ in an annual period (nominated ESC limit).

This is done to manage the risk to the integrity of the scheme by unaudited ESCs. Audit limits do not stop ACPs from creating valid ESCs, as:

- ▼ an ACP can apply for an amendment to these limits when required,⁵ or
- ▼ they may conduct voluntary pre-registration audits to allow the creation of further ESCs outside of these limits.

For RESAs subject to periodic audits, the nominated ESC limits set by the Scheme Administrator are based on the number of ESCs the ACP proposes to create per year. They are typically expressed as an annual limit on ESC creation.

For RESAs subject to volumetric audits, the audit limits set the maximum number of ESCs that can be created between commissioning and completion of audits.

Both of these ESC creation limits are managed in the ESS Registry. The ESS Registry is an online database of information about ACP's activities including the creation, ownership and surrender of certificates under the ESS.

2.4 Set-aside agreements with ACPs

We may ask an ACP to enter into an agreement with IPART to set-aside ESCs in the Registry. These 'set-aside agreements' allow us to manage the risk of invalid ESC creation while still allowing an ACP to actively create and trade ESCs. They are commonly used throughout the Scheme.

Where the ACP has a good compliance record, the number of ESCs to be set aside may be reduced.

Set-aside agreements (in the form of a legally binding deed) are used in a variety of situations, such as when:

- ▼ new participants enter the ESS and are yet to establish a compliance record
- ▼ an audit has identified a material error that requires a large number of invalid ESCs to be voluntarily forfeited⁶
- ▼ audits of other ACPs carrying out similar RESAs or using a similar business model have identified widespread compliance issues, with the result that a large number of invalid ESCs have been created, or
- ▼ we have identified areas of the Scheme where additional compliance measures are required to balance increased flexibility in the operation of a RESA. For example, allowing the use of extended operating hours procedures instead of requiring the approval of hours at each site.

⁵ More information about RESA amendments is available on the ESS website.

⁶ See Appendix B for details on how material error rates are applied to determine the number of ESCs to be forfeited.

The terms and conditions of set-aside agreements vary to reflect individual circumstances, but generally they require an ACP:

- ▼ to set aside a certain proportion of ESC creation in the lead up to its next audit, and
- ▼ to forfeit any invalidly created ESCs identified by the Auditor from the set-aside amount.

These ESCs are placed on 'administration hold' in the ESS Registry until the audit findings are released.

More specifically, set-aside agreements are typically required for:

- ▼ all new participants that enter the ESS and do not have a compliance record
- ▼ all Commercial Lighting RESAs
- ▼ all new RESAs accredited under the Deemed Energy Savings Method, and
- ▼ RESAs that receive a material error finding at audit (regardless of the ESS Rule method).

The use of set-aside agreements are described below and illustrated in Figure 2.1. Where set-aside agreements are in place, ESCs are automatically set aside in the Registry as the certificate creation takes place.

For new accreditations

- ▼ Where an applicant has agreed to enter into a set-aside agreement, 10% of ESC creation is to be set-aside following Accreditation, remaining at 10% for the first 2 successful audits,⁷ then either:
 - reducing to 5% of ESC creation for the 3rd audit and reducing to 0% thereafter if audits have no material error (see Figure 2.1.A), or
 - increasing to 20% of ESC creation if material errors are found in either of the first 2 audits, reducing to 10%, 5% and 0% thereafter if each subsequent audit has no material error (see Figure 2.1.B and 2.1.C).
- ▼ For subsequent audits after the first two audits, if material errors are found and the audits are failed, the set-aside amount increases to 10% of ESC creation (see Figure 2.1.D).

⁷ Audits are generally considered successful if reasonable assurance is provided and no material errors are found.

For existing accreditations

- ▼ Where an ACP has not entered into a set-aside agreement that ACP will be requested to enter into a set-aside agreement if material errors are found in any audits, initially setting aside 10% of ESC creation then reducing to 5% and 0% thereafter if each subsequent audit has no material error (see Figure 2.1.D).

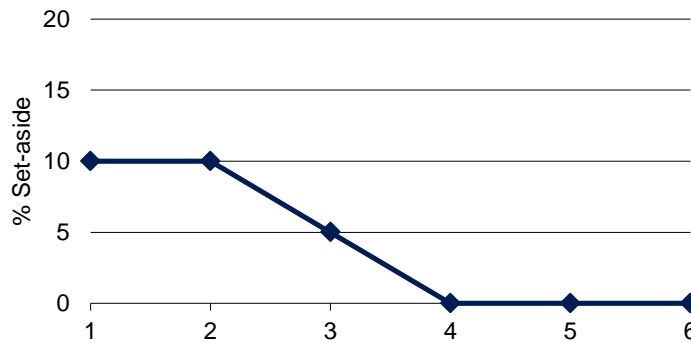
Figure 2.1 illustrates the use of set-aside agreements as described above for a new RESA. The treatment of the set-aside amount is the same for new and existing accreditations, from the 3rd audit onwards.

If the number of ESCs to be forfeited is less than the number set aside, any remaining ESCs are released to the ACP for trading. If additional ESCs are required to make up the invalid amount, the ACP will be asked to voluntarily forfeit those additional ESCs.

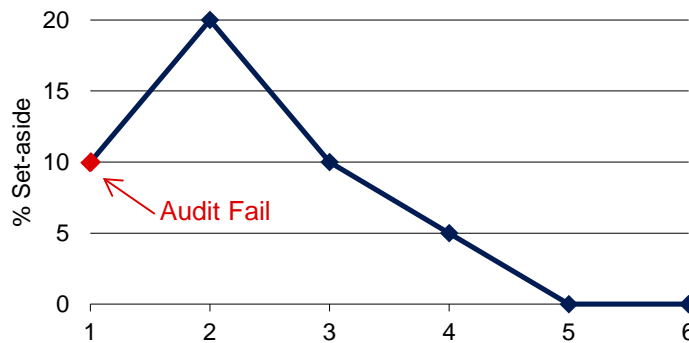
Where an ACP or applicant does not agree to enter into the set-aside agreement, we may consider reassessing the risk of ACP's RESA. As a result, audit limits may be reduced (i.e. the maximum number of ESC creation between audits is reduced) or pre-registration audits may be required before ESCs can be registered.

Figure 2.1 Use of set-aside agreements for a new RESA

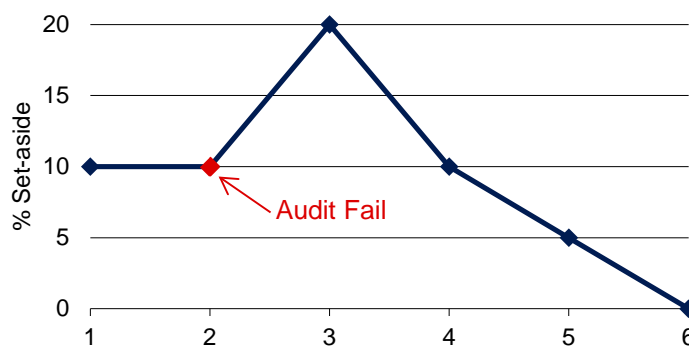
A. Successful Audits with No Material Errors:
Reduce % of ESCs set-aside prior to audit to zero



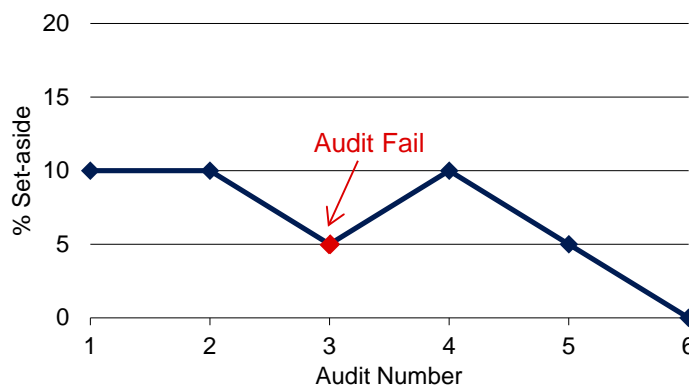
B. Fail 1st Audit:
Increase % of ESCs set-aside prior to audit from 10% to 20%



C. Fail 2nd Audit:
Increase % of ESCs set-aside prior to audit from 10% to 20%



D. Fail an Ongoing Audit (from Audit 3 onwards): Increase % of ESCs set-aside prior to audit



3 Approach for setting audit requirements for ACPs

We set the specific audit requirements for each RESA by:

- ▼ assessing the risk of non-compliance based on the application for accreditation and assigning a risk rating of satisfactory, moderate or high
- ▼ establishing an initial audit regime based on this risk rating, and
- ▼ establishing the ongoing audit regime based on the audit results and adjusting this regime over time to reward good compliance and to respond promptly and fairly to compliance issues.

Audit requirements are specified in the Accreditation Notice. The different types of audits we may require are outlined in Table 3.1.

Table 3.1 Audit types for ACPs

Audit type	Description
Spot	Spot audits are minimum requirements included in all accreditation conditions. The Scheme Administrator has the right to request a spot audit at any time. These audits may be initiated whenever we believe an audit is required, for example if we identify changes in the risk profile of an ACP or a RESA, or we require increased certainty of ongoing ESC creation from a RESA.
Single	May be specified at the time of accreditation if we consider audit confirmation of ESC creation is necessary after a certain period of time, but there is no need for ongoing audits. Depending on the results of the audit, the ACP may be moved onto a spot, periodic or volumetric audit regime.
Periodic	ESC creation is controlled by an annual limit determined by the Scheme Administrator, based on ACP projections of ESC creation. Generally, audits are required in the year following accreditation. If a biennial audit regime is set, it may be 2 years after accreditation before the initial audit is undertaken. Following an initial audit, the frequency of audits is set based on the proposed number of ESCs to be created per year.
Volumetric	ESC creation is determined by the Scheme Administrator and is limited by the number of ESCs registered between audits (the 'audit limit'). Audits are required once the audit limit is reached, but may be done early to aid business continuity. The number of ESCs permitted to be created between audits typically increases with good audit performance and reduces with poor performance.
Pre-Registration (Voluntary)	ACPs may choose to commission a pre-registration audit if, for example they have large numbers of verifiable records to support ESC creation. These audits are outside the audit limits set in the Accreditation Notice.
Pre-Registration (Mandatory)	May be required before an ACP is able to create ESCs from a RESA. This is the highest level of risk mitigation under the ESS, as ESCs can only be registered following satisfactory completion of an audit.
Pre-Accreditation	This one-off audit may be required to confirm an applicant's eligibility for accreditation. It is used when the ESC creation methodology is very complex, or if the Scheme Administrator has significant concerns about an application. We note this type of audit is rarely required.

Most RESAs will require either Volumetric or Periodic audits, however in specific circumstances Spot audits are also common.

Volumetric Audits are typically required:

- ▼ where the RESA delivery model means the RESA takes place at multiple sites, or involves multiple Energy Savers, thereby increasing the complexity of RESA delivery
- ▼ for RESAs with frequent, high volume ESC creation, and
- ▼ where periodic auditing is considered too infrequent to capture potential invalid ESC creation in a timely manner.

Periodic Audits are typically required:

- ▼ where RESAs take place at a single site, or where a simple delivery model is used for multiple site RESAs
- ▼ for RESAs with a regular pattern or low frequency of ESC creation. This is usually annual or biennial, and
- ▼ where measurement and verification techniques are used to calculate ESCs.

Spot Audits are typically required:

- ▼ where the ACP is the original energy saver
- ▼ for RESAs where energy savings are small, and
- ▼ where all energy savings from the RESA occur at a single site, or a defined list of sites.

Single Audits are typically required in the same circumstances as for Spot Audits, but where energy savings are larger.

The relationship between different calculation methods in the ESS Rule and typical audit regimes is shown in Table 3.2 below.

Table 3.2 Typical Audit types for ESS Rule methods and RESA delivery models

ESS Rule Method and RESA delivery model	Audit type		
	Spot/Single	Periodic	Volumetric
Deemed Energy Savings Method			
Single Site or Defined Sites	✓	✓	
Multiple Sites			✓
Project Impact Assessment Method			
Single Site or Defined Sites	✓	✓	
Multiple Sites		✓	✓
Metered Baseline Method			
Single Site or Defined Sites	✓	✓	
Multiple Sites		✓	✓

3.1 Approach for setting initial audit regime

We use the information provided during the accreditation application process to assess the risk associated with the RESA, particularly the likelihood of invalid ESC creation. We consider a range of application risk factors, relating to both new applicants and existing ACPs, including:

- ▼ Application quality
- ▼ Operation of systems and quality assurance
- ▼ Number of RESAs
- ▼ General compliance record under the ESS, and
- ▼ Compliance record under other schemes.

We may also consider whether the ACP agrees to enter into a set-aside agreement as outlined in Section 2.4.

Each application risk factor is scored against defined criteria described in Appendix C - Table C.1, with the final score providing a risk rating of satisfactory, moderate or high. If the risk rating is high or moderate, we set more conservative requirements for the first audit (see Table 3.3). The difference between Volumetric and Periodic audits and when they are typically applied is described in the previous section. Table 3.3 also shows when a new accreditation starts in terms of the 'audit step' (described in section 3.2.1).

Table 3.3 Examples of initial audit regimes based on different risk ratings

Risk rating	Volumetric audit	Periodic audit
High	Pre-registration ¹ (Audit step 0 in Table 3.4)	Pre-registration ^a
Moderate	First audit after a maximum of 5,000 ESCs are registered (Audit step 0 in Table 3.4)	Annual audit
Satisfactory	First audit after a maximum of 10,000 ESCs are registered (Audit step 1 in Table 3.4)	Annual Audit if ≥ 20,000 ESCs/year proposed Biennial Audit if < 20,000 ESCs/year proposed

^a Minimum number of ESCs/sites audited needs to be determined as part of the application assessment. It is likely to be in the range of 1,000 ESCs, or between 1-10 sites depending on the RESA.

Appendix A provides more information on our overall risk assessment framework. Appendix C provides more detail on the application risk factors we consider in setting initial audit regimes, and how we score these factors to determine the risk rating.

3.2 Approach for setting ongoing audit regimes

After a RESA's first audit, we set the ongoing audit regime based on the results of this audit. We may adjust this regime over time as ACPs establish a compliance record. If an ACP demonstrates good compliance – ie, through audit findings of no material errors over a period of time – we may vary the requirements so that:

- ▼ periodic audits become less frequent, or
- ▼ volumetric audit limits are increased (so a larger number of ESCs can be registered between audits).

If an ACP demonstrates poor compliance – ie, through an audit finding of 'Audit fail with no assurance opinion' or if material errors are found – we may vary the audit requirements so that:

- ▼ periodic audits become more frequent, or pre-registration audits are required, or
- ▼ volumetric audit limits are decreased (so a smaller number of ESCs can be registered between audits).

Audit reports often contain recommendations,⁸ made by the Auditor to help mitigate problems with future ESCs creation. Where the Scheme Administrator considers audit recommendations to be significant, ACPs will be notified as part

⁸ Auditors may also suggest opportunities for improvement, which are similar to recommendations, but are less likely to cause problems with future ESC creation.

of the process of finalising audits. Failure to implement significant audit recommendations in a timely manner may result in a change to the audit regime.

Where ACPs have a number of RESAs in a ‘portfolio’, the audit performance of each individual RESA may influence the audit requirements across the portfolio.

3.2.1 Ongoing volumetric audits

Table 3.4 provides guidance on our general process for adjusting volumetric audit limits to reward good compliance. It shows that if the first audit of the RESA finds no material errors, the number of ESCs that can be registered between audits is increased (by one audit step). This is also shown graphically in Figure 3.1.

The actual number of ESCs that may be registered between audits will be determined by the Scheme Administrator on a case by case basis.

Table 3.4 Adjusting volumetric audit limits to reward good compliance

Audit step	Successful audits required to progress to the next audit step	Number of ESCs that can be registered between audits (per audit)	Minimum number of ESCs to be audited (per audit step) ^a
0	1	Pre-registration or 5,000	2,500
1	1	10,000	5,000
2	2	25,000	25,000
3	2	50,000	50,000
4	2	75,000	75,000
5	ongoing	100,000 (maximum)	n/a

^a For example, when the limit is 75,000 ESCs, a minimum of two audits are required on that audit step before a further increase is considered. More audits can be conducted at each audit step, but for a request to increase a limit to be considered, the sum of all ESCs audited at that limit must be equal to or greater than the minimum number required in column four above – being 75,000 ESCs in this example, which could be 40% and 60% of the limit for the two audits.

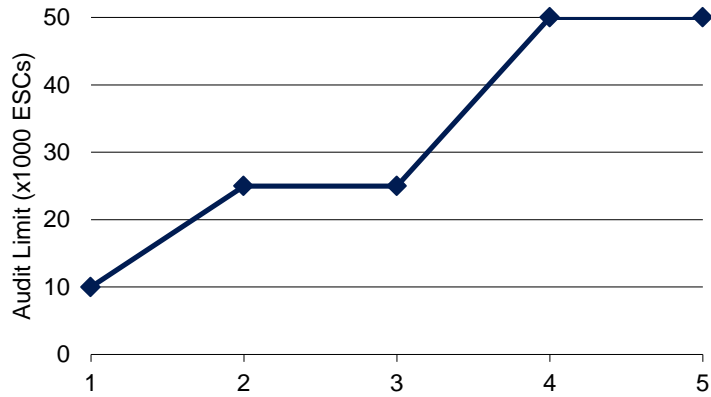
For example, if the RESA is assessed as ‘Moderate Risk’ and has a successful first audit at 5,000 ESCs, the next audit would likely be at audit step 1, with an audit of 10,000 ESCs. If a RESA is assessed as ‘Satisfactory Risk’ and has a successful first audit at 10,000 ESCs, the next audit would likely be at audit step 2, with an audit of 25,000 ESCs.

If subsequent audits also find no material errors, and the ACP builds up a record of good compliance in respect of that RESA, the number of ESCs that can be registered between audits continues to increase (audit steps 2 on).

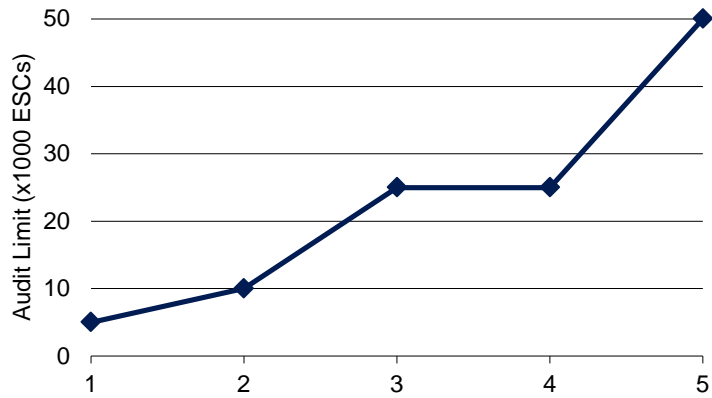
How volumetric audit limits are adjusted as a consequence of compliance issues is discussed in Section 4.

Figure 3.1 Increasing volumetric audit limits using Table 3.3, for new accreditations with different risk profiles

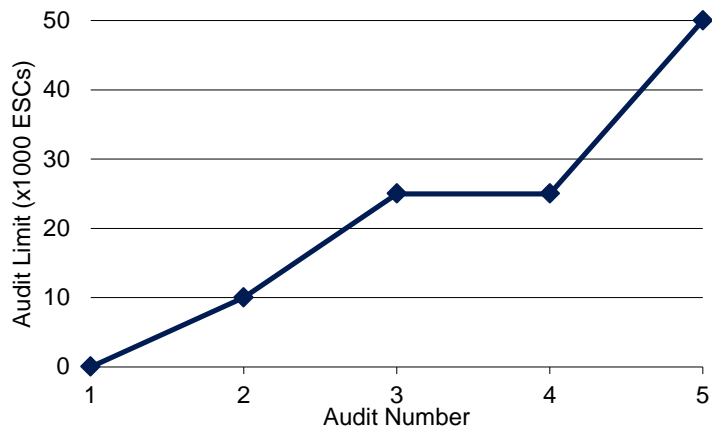
Satisfactory Risk:
The 1st audit is a prior to the registration of 10,000 ESCs.



Moderate Risk:
The 1st audit is a prior to the registration of 5,000 ESCs.



High Risk:
The 1st audit is a pre-registration audit



3.2.2 Ongoing periodic audits

Periodic audits are not adjusted in the same way as volumetric audits, as they typically cover RESAs with more predictable ESC creation.

If a RESA/ACP receives 3 annual audits findings of no material error, the audit frequency may be reduced from once a year to once every 2 years if requested, however this will be at the discretion of the Scheme Administrator. However, if the RESA/ACP subsequently receives a finding of 'audit fail' its audit frequency is likely to revert to annual.

3.2.3 Ongoing audits of RESA portfolios

If an ACP is accredited for a portfolio of RESAs, and receives 2 or more findings of 'audit fail' across the portfolio, we may require pre-registration audits:

- ▼ for the next audits of the RESAs receiving the 'audit fail' finding, and
- ▼ for the next audits of all RESAs in the portfolio if there is significant concern over continued ESC creation.

4 Managing compliance

Wherever an ACP or Scheme Participant fails to meet the requirements of the Act, Regulation, ESS Rule or Accreditation Conditions, it is considered a non-compliance. We generally consider any non-compliance as serious.

Non-compliances can occur at any time, and in particular include failure to comply with accreditation requirements by:

- ▼ not maintaining eligibility for accreditation (including not complying with Accreditation Conditions), and
- ▼ not creating ESCs in accordance with requirements of the Act, Regulation, ESS Rule and Accreditation Conditions (see Appendix D).

4.1 Managing performance by Scheme Participants

A Scheme Participant's compliance is based on whether it has surrendered sufficient ESCs to meet its Individual Energy Savings Target. If it does not surrender the required number of ESCs, it is required to pay a financial penalty as set out in the Regulation.

Audits assess whether the AESS is complete and correct – that it includes the Scheme Participant's calculation of its individual energy savings target, including:

- ▼ the particulars of its liable acquisitions and any deductions in respect of partially exempt loads
- ▼ the extent to which it met the target by surrendering ESCs, and
- ▼ any energy savings shortfall it is carrying forward and any penalty it is required to pay.

4.2 Managing performance by ACPs

In considering an ACP's performance, we consider its regular compliance reports and history of audit findings. We also consider any relevant complaints we receive as Scheme Administrator and its performance in other schemes.

If we consider the compliance and performance of the ACP/RESA is poor, we will attempt to manage it through different mechanisms including:

- ▼ adjusting audit requirements such as volumetric audit limits (discussed below)
- ▼ establishing and adjusting set-aside agreements (discussed below)
- ▼ requesting voluntary forfeiture of invalidly created ESCs
- ▼ issuing notices of apparent contravention
- ▼ amending accreditation conditions – to require that audit recommendations or other specific issues are implemented
- ▼ suspending or cancelling accreditations, and/or
- ▼ initiating a prosecution.

If we decide to use one of these mechanisms, we will notify the ACP of the reasons for this. The ACP will have an opportunity to make a submission in response to this notification, which we will consider before taking further action.

Note that all non-compliances are reported in our Annual Report to the Minister. This report is publicly available on our website.

4.2.1 Volumetric audit limits and set-aside agreements

The Scheme Administrator may adjust the limit on ESC creation before audits are required (the 'audit limit'), and the proportion of ESCs which are to be put on administrative hold pending an audit, to respond to non-compliances. The volumetric audit limits are set out in the Accreditation Notice and the proportion of ESCs on administrative hold are set out in the set-aside agreement.

Table 4.1 provides our general process for adjusting these limits as a consequence of audit results and non-compliance. In limited circumstances the Scheme Administrator may deal with audit outcomes on a case by case basis instead of

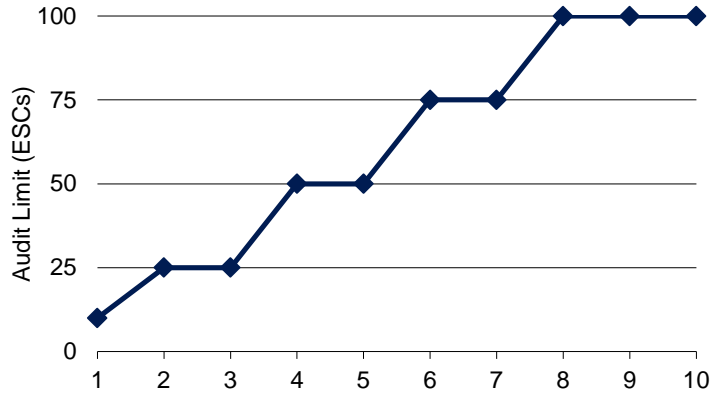
the process outlined here. Examples of the operation of Table 4.1 are shown in Figure 4.1.

Table 4.1 Adjusting Volumetric audit limits in response to non-compliance

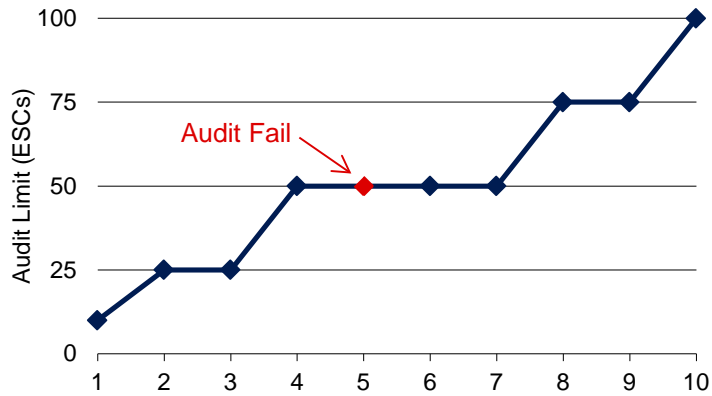
Audits findings	Response
Failed Audit: for the First or Second Audit	<ul style="list-style-type: none"> ▼ Remain at current audit step ▼ The number of ESCs subject to the set-aside agreement is raised to 20%
Failed Audit: for subsequent audits	<ul style="list-style-type: none"> ▼ Remain at current audit step ▼ The count of audits on the audit step is reset to zero, and ▼ The number of ESCs subject to the set-aside agreement is reset to 10%
Failed Audit after a previous failed audit	<ul style="list-style-type: none"> ▼ Pre-registration audit required and other compliance actions considered by the Scheme Administrator ▼ Following the Pre-registration Audit: <ul style="list-style-type: none"> – the audit step is reduced by one, – The count of audits on the (new) audit step is reset to zero, and – The number of ESCs subject to the set-aside agreement is reset to 10%
Qualitative errors found to be material	<ul style="list-style-type: none"> ▼ The count of audits on the audit step is reset to zero ▼ Audit limits are not adjusted
Significant audit recommendations not addressed	<ul style="list-style-type: none"> ▼ The count of audits on the audit step is reset to zero ▼ Audit limits are not adjusted

Figure 4.1 Audit progression for Volumetric audits, with the First Audit required prior to the creation of 10,000 ESCs, using Table 4.1

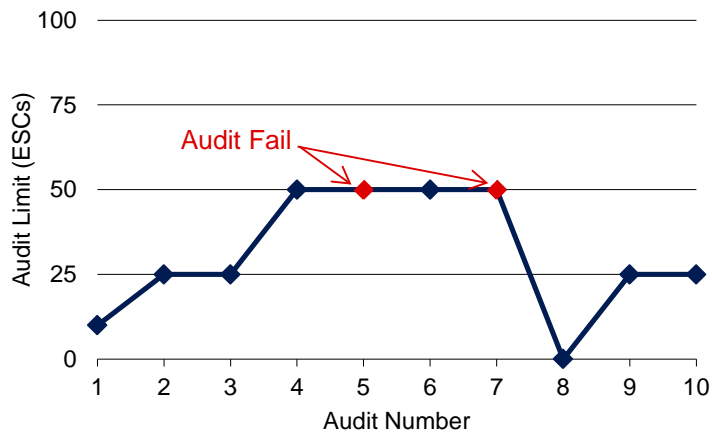
Audits with No Material Errors



Failed Audit 5:
Restart the count of audits on an audit step



Failed Audit 5 and Audit 7:
Pre-registration audit required for Audit 8, then restart volumetric audits on a lower audit step





Appendices

A Risk Assessment Framework

For the purposes of the CPMS, we are concerned primarily with risks relating to:

- ▼ the likelihood of errors in ESC creation, and
- ▼ the impact of those errors on ESC creation.

The risk types related to ESS audits are listed in Table A.1.

Table A.1 Risk Types

Risk Type	Description
Inherent	The susceptibility of data to material misstatement, assuming there are no related internal controls.
Control	The risk that a material misstatement could occur and not be prevented or detected on a timely basis by the entity's internal controls. This risk is a function of the effectiveness of the design and operation of internal controls. Some control risk may always exist because of the inherent limitations of internal controls.
Detection	The risk that the Auditor may not detect a material misstatement that exists. This risk is a function of the effectiveness of the procedures performed in an audit. It arises when less than 100% of the data is examined.

The treatment of risk types in different sections of the CPMS is shown in Table A.2.

Table A.2 Treatment of risk types in the CPMS

Risk Type	CPMS Treatment	Risk Treatment
Inherent	▼ Initial audit type	Inherent risks are managed by requiring different audit types (ie, volumetric or periodic) based on the likelihood of errors from calculation methods in the ESS Rule.
Control	▼ Application risk factors ▼ Initial audit frequency	The likelihood of control risks are considered by the assessment of application risk factors The consequences of control risks are limited by setting thresholds for the frequency of periodic audits and audit limits for volumetric audits (ie, number of ESCs that can be created before an audit is required).
Detection	▼ Ongoing audit frequency ▼ Audit sampling	The consequence of detection risks (invalid ESC creation) is managed through ongoing frequency and audit sampling requirements.

B Treatment of errors and sampling during audit

This section describes our general approach to addressing the errors identified in audits. Further guidance on how Auditors determine sample sizes, and treat and report on errors in audits, is provided in the Audit Guideline.⁹

B.1 Materiality

We expect Auditors to identify errors (misstatements) and assess the materiality of these errors during audits.

Errors are considered to be material to the ESS if the omission or misstatement of information could adversely influence:

- ▼ the acceptance of an AESS
- ▼ decisions relating to the accreditation of a RESA, or
- ▼ the number of ESCs registered, or proposed to be registered, by an ACP.

Material errors can be both quantitative and qualitative.

When considering audit results, along with quantitative and qualitative material errors, we consider the following factors:

- ▼ the significance of an individual misstatement to the AESS, or the proposed or actual creation of ESCs, and
- ▼ whether misstatements are one-off or symptomatic of a control or system weakness, which would have repeated effects on ESC creation or AESS reporting.

B.1.1 Quantitative errors

Quantitative errors are clearly identifiable errors, such as factual or calculation errors. They can be quantified as a percentage error rate and their impact on the ESC claim (or Individual Energy Savings Target) can be directly measured.

For ACPs, we have specified that quantitative errors are material if the calculated 'absolute error rate' (see Box B.1) is greater than 5%. If an Auditor finds an error rate above this materiality threshold, the audit is considered to be a fail.

The Auditor will identify a number of ESCs over which they can provide reasonable assurance, and will list the under-creation and the over-creation of ESCs. Error rates and materiality are based on the total number of ESCs listed in the detailed scope of works.

⁹ The Audit Guideline will be updated from time to time to incorporate relevant material from the CPMS. It is available on the ESS website at www.ess.new.gov.au/forAuditors.

We note that in some cases, ACPs may deliberately under-create ESCs to be conservative. This is not considered to be an error. If this type of under-creation is identified by the Auditor, it can be listed in the audit report and not included in the absolute error rate (after discussion with IPART).

Box B.1 Calculating the error rate and invalid ESCs

To determine the materiality of quantitative errors, the Auditor calculates the **absolute error rate**. This rate is the gross number of all relevant misstatements (including under and over creation of ESCs), divided by the number of ESCs in the sample.

An absolute error rate $\geq 5\%$ is considered to be a material error. It affects the audit opinion and the progression of volumetric audits. It may also have an effect on set-aside agreements.

To determine the number of invalid ESCs, the Auditor calculates the **net over-creation error rate**. This rate is the difference of all identified misstatements (over creation minus under creation of ESCs), divided by the number of ESCs in the sample. We only apply it in the case of a net over-creation of ESCs.

- ▼ If the net over-creation error rate is $\geq 5\%$, this error rate may be applied to the total population of ESCs being audited to give the total amount of ESCs that should be voluntarily forfeited.
- ▼ If the net over-creation error rate is $< 5\%$, the actual number of invalid ESCs identified in the audit is the amount that should be voluntarily forfeited.

Example 1. An Auditor identifies 800 over-created ESCs and 1,000 under-created ESCs in an audit sample of 14,000 ESCs (from a total of 50,000 ESCs being audited). In this case the absolute error rate of the audit sample is $(800+1,000)/14,000 = 13\%$ - a material error, affecting the overall audit result and treatment of ongoing audits. There is no net over-creation of ESCs, so no ESCs should be forfeited. The 200 ESCs identified as under-creation could be registered.

Example 2. An Auditor identifies 2,000 over-created ESCs and 1,000 under-created ESCs in an audit sample of 14,000 ESCs (from a total of 50,000 ESCs being audited). In this case, for the audit sample:

- ▼ the absolute error rate = $3,000/14,000 = 21\%$, and
- ▼ the net over-creation error rate = $(2,000-1,000)/14,000 = 7.15\%$.

The Auditor finds that the errors are systemic, and the audit sample is representative of the entire population of ESCs being audited. As a result, the 7.15% net error is applied to the 50,000 ESCs subject to audit, so we request that 3,575 ESCs are voluntarily forfeited.

Example 3. An Auditor identifies 1,200 over-created ESCs and 1,000 under-created ESCs in an audit sample of 14,000 ESCs (from a total of 50,000 ESCs being audited). In this case for the audit sample, the absolute error rate is 16%, while the net over-creation error rate is only 1.5% (200 ESCs). In this case we request that the 200 ESCs (net) identified as invalid are voluntarily forfeited.

B.1.2 Qualitative errors

Qualitative errors are less clearly identifiable. Typically, they are issues identified by the auditor that reduce its confidence that the applicant or ACP has adequate systems in place to support ESC creation. The materiality of these errors is largely a matter of the auditor’s judgement.

One example of material qualitative error might be the failure of an ACP’s quality assurance systems to ensure all information required to support ESC creation is adequate prior to ESCs creation. This might be identified during an audit if the ACP is not able to locate all required records on request.

Where qualitative errors are identified, ACPs will be asked to update procedures and respond to audit recommendations by a certain date. Where issues do not have the potential to impact ESC creation, the auditor may identify opportunities for improvement. These would not usually result in a material qualitative error being identified.

B.1.3 Treatment of material errors and their effect on audit results

The relation between audit results and material errors is shown in Table B.1.

Table B.1 **Audit results and material errors**

Audit result	Material errors identified in the audit report	Error Type	
		Quantitative error rate (absolute)	Qualitative errors
Reasonable assurance	No material error	< 5%	None – all errors dealt with through recommendations
Failed audit with qualified assurance	Material error (quantitative OR qualitative error)	> 5%	Auditor identifies significant qualitative errors
Failed audit with no assurance	Material error (quantitative AND qualitative error)	> 5%	Auditor identified significant qualitative error

Where material errors are identified, we may:

- ▼ Allow additional audit sampling to increase the sample size of the audit to allow for a higher confidence factor to be applied to the results. This is done through an audit variation.¹⁰
- ▼ Request voluntary forfeiture of invalid ESCs at the identified error rate, if no further auditing is possible. For instance if audit sample sizes are already at their maximum and the Auditor has identified systemic errors.
- ▼ Apply the identified error rate only to a particular site or sites if there are mitigating circumstances, such as the errors applying to a discrete sample.
- ▼ Request an ACP to voluntarily forfeit all invalid ESCs and commission a second audit (at the ACP's expense) over a larger sample size once the ACP is confident the errors have been rectified.

Auditors are asked to provide an opinion on whether the material error is systemic or 'one-off'. This will inform our decision about the treatment of the error. Where the errors are systematic, the error rate is typically applied to the whole population of ESCs being audited in order to determine the total number of invalid ESCs.

We may amend the Accreditation Notice to reflect important audit recommendations following audits where material errors are identified, or audit recommendations are not addressed in subsequent audits.

B.1.4 Non-material errors

Where an audit identifies non-material quantitative errors (ie, an error rate of <5%), the Auditor is able to issue a reasonable assurance opinion. We request that the ACP voluntarily forfeit all invalid ESCs identified.

For example, if an over-creation of 8 ESCs is found in an audit sample 400 ESCs, the error rate is 2%. As the error rate is <5% and not considered material, we would ask the ACP to forfeit the 8 ESCs identified by the Auditor as invalid.

¹⁰ Audit variations are required if the audit scope is changed and additional audit procedures are required. They are typically required where the Auditor is unable to provide an audit opinion, and they allow the Auditor to establish updated costs for carrying out extra work. Audit variations should not be used as a way to include missing information, as ESCs should only be registered when all quality assurance procedures have taken place.

B.1.5 Pre-registration audits

For pre-registration audits, the Auditor will examine the total number of ESCs the ACP proposes to create. The Auditor will identify the number of ESCs it considers can be validly created with reasonable assurance. If it considers that some of the proposed ESC creation is invalid, this must be shown in the audit report and an error rate determined.

Following the successful completion of the audit, the ACP will be able to register the number of ESCs the Auditor found can be validly created with reasonable assurance.

Our auditing requirements apply for pre-registration audits in the same way as for audits of ESCs that have already been registered. For instance, if audit sampling is used to determine the audit outcome, the results are applied to all sites included in the audit population. This means that there is no opportunity after the audit is completed to include additional information or to 'fix' records that are part of the audit.

B.2 Audit Sampling

B.2.1 Sample selection

Audit sampling is at the Auditor's discretion and must be clearly explained in the detailed scope of works for an audit. Auditors must sample a sufficient amount of supporting evidence to give the Auditor confidence that no material misstatements exist and that certificate creation meets all regulatory requirements.

To provide a reasonable assurance opinion, Auditors are not required to review every piece of evidence. Rather, they take a risk-based approach to audits. This is especially the case for multi-site RESAs, where this evidence is collected at a large number of sites. To adequately assess the materiality of quantitative errors, a statistically significant sample of ESC creation is required based on the number of sites, or discrete project locations, subject to the audit.

We require audits to satisfy an overall assurance with 95% confidence and a maximum confidence level $\pm 5\%$. We consider this a reasonable level of accuracy to allow us to extrapolate the results of an audit sample to the entire population of ESCs being audited when the materiality threshold is breached. Auditors should apply a risk based approach when selecting samples. This may include random sampling, or in some instances stratifying the population based on:

- ▼ technology and calculation type (especially for lighting technologies)
- ▼ location (regional/metropolitan sites)
- ▼ size of sites (large/small sites)

- ▼ differing installers or RESA delivery models (contractor/employees).

Auditors should also have regard to any specific advice we publish for audits of different RESAs. This can be found in updated ‘detailed scope of works’ templates available on our website.

B.2.2 Audit tiers

To account for the large volume of information an Auditor needs to consider, we suggest splitting the overall sampling requirements for different audit activities into 3 tiers. Table B.2 lists the characteristics of each audit tier.

The sample size is reduced from Tier 1 to Tier 3 (higher for desktop audits and lower for site visits) in order to allow for a staged approach to audits. Each smaller sample (in Tier 2 and Tier 3) is a subset of a larger sample. In this way the records for each site visit will have had both detailed and desktop reviews.

Bigger sample sizes are required for the desktop component of audits (Tier 1), to allow for review of statistically significant samples.

Table B.2 Levels of auditing activity and sampling requirements

Tier	Audit activity	Description
1	Desktop Review	Desktop review to ensure significant documentation is available, complete and correct, including: <ul style="list-style-type: none"> ▼ Document Pack and required supporting information, or ▼ Original energy saver nomination, electricity account details and evidence to support ESC calculations
2	Detailed review	Detailed review to validate all records supporting ESC creation
3	Site visits	Site visit to ‘ground truth’ the evidence provided

The detailed review of documentation allows for an in-depth analysis of all records supporting ESC creation at a site (Tier 2). A smaller sample is used, to account for the increased information required of this level of review.

Site visits provide a higher level of assurance resulting from the physical inspection of energy savings activities shown in the detailed records (Tier 3). It is not practical to visit every site, so this component of the audit is used to ‘ground truth’ a small selection of the sites for which more detailed reviews have taken place.

C Application risk factors

Application risk is an indicator of the likelihood of invalid ESC creation based on the information provided in the application for accreditation.

When we assess applications for accreditation, we consider the sufficiency of the information provided, and the proposed operation of the systems and processes supporting ESC creation. As Section 3.1 discussed, we consider a range of application risk factors, depending on whether the application is from a new applicant or an existing ACP. These factors described in Table C.1.

Table C.1 Application risk factors considered

Application risk factors	Description
Overall application quality	We consider the sufficiency of an application against our published requirements and the ability and responsiveness of applicants to provide additional information.
Operation of systems and quality assurance	We assess the errors and misstatements in the information provided to support the application, to test: <ul style="list-style-type: none"> ▼ The systems used to collect the required information (at multiple sites if required, and ▼ The quality assurance processes used to ensure records are complete, accurate and reliable.
Number of RESAs	We consider that applicants get a better understanding of the ESS and its legal framework as more RESAs are accredited.
General compliance record	We consider the applicant's entire track record in the ESS. This relates to satisfactory performance in audits and reporting, as well as other factors such as complaints received and responsiveness to ongoing information requests.
Compliance record under other schemes	We consider the applicant's compliance in other schemes from time to time. This relates to all aspects of 'general compliance record' as listed above.

We assign each application risk factor to a risk category (low, medium or high), using the defined criteria shown in Table C.2.

We then score and weight these categories as shown in Table C.3 to determine the application's overall score.

Table C.4 shows the overall scores associated with each risk rating (satisfactory, moderate or high).

Table C.2 Criteria used to assign application risk factors to a risk category

Application risk factors	Risk categories		
	High	Medium	Low
Overall application quality	Multiple information requests required as a result of partial responses, or no response, to information requests	Further information requested and complete response provided within allocated time	All requirements are satisfied as part of the application, with no further information requested
Operation of systems and quality assurance	Application has significant errors and requires significant reworking or assistance to: <ul style="list-style-type: none"> ▼ describe the systems used to collect evidence of ESC creation, and ▼ demonstrate the quality assurance processes used to ensure records are complete, accurate and reliable. 	Application has some errors and some inadequate information to: <ul style="list-style-type: none"> ▼ describe the systems used to collect evidence of ESC creation, and ▼ demonstrate the quality assurance processes used to ensure records are complete, accurate and reliable. 	Application is free from errors and all requirements are addressed to: <ul style="list-style-type: none"> ▼ describe the systems used to collect evidence of ESC creation, and ▼ demonstrate the quality assurance processes used to ensure records are complete, accurate and reliable.
Number of RESAs	≤ 1	2 ≤ x ≤ 5	> 5
General compliance record	<ul style="list-style-type: none"> ▼ No compliance record, or ▼ Non-compliances as notified in writing from time to time and material errors in any previous audit. 	Minor non-compliances as notified in writing from time to time	No issues
Compliance record under other schemes	<ul style="list-style-type: none"> ▼ No compliance record, or ▼ Non-compliances as notified in writing from time to time and material errors in any previous audit 	Minor non-compliances as notified in writing from time to time	No issues

Table C.3 Scores and weightings used to determine an applications overall risk score

	Application Quality	Operation of Systems and Quality Assurance	Number of RESAs	General compliance Record	Compliance Record under other Schemes
Low risk	1	1	1	1	1
Medium risk	2	2	2	2	2
High risk	3	3	3	3	3
Weighting	2	3	1	2	1
Maximum Score	6	9	3	6	3
Total					27

Table C.4 Application risk ratings and scores

Rating	Score (/27)
Satisfactory	≤ 15
Moderate	$16 \leq x \leq 22$
High	≥ 23

D Legislative framework

The ESS is established through a package of NSW legislation, including:

- ▼ the *Electricity Supply Act 1995* (the Act)
- ▼ the *Electricity Supply (General) Regulation 2014* (the Regulation) and
- ▼ the *Energy Savings Scheme Rule of 2009* (the ESS Rule).

This legislation sets out the legal and technical framework for the scheme, describes its operation, and governs the calculation and creation of ESCs. It also sets out the functions and responsibilities of the Scheme Administrator and Scheme Regulator.

D.1 Compliance requirements for ACPs

As the Scheme Administrator, IPART accredits ACPs to undertake RESAs under the scheme. We also set the conditions of this accreditation.

For each RESA, we set the conditions of accreditation in line with the Act, the Regulation and the ESS Rule, and with the approaches set out in the CPMS. We provide the ACP with an Accreditation Notice that lists these conditions, as well as a statement of reasons for imposing such conditions.

The ACP must comply with obligations under the Act, the Regulation, the ESS Rule and all the accreditation conditions in the Accreditation Notice. For example, they must ensure that all ESCs created reflect energy savings and are created in accordance with the provisions of this legal framework and any accreditation conditions. If it breaches any of its obligations, it may be guilty of an offence under the Act.

We may amend the accreditation conditions over the life of the RESA. If we do so, we provide a statement of reasons for the changes to the conditions. An ACP may also apply to us in writing to amend its accreditation conditions, and must submit its request using the Amendment Application Form available from the ESS website.

D.2 Compliance requirements for Scheme Participants

As the Scheme Regulator, IPART monitors Scheme Participant compliance with their legislative requirement to meet annual individual energy savings targets.¹¹

¹¹ These targets are based on the size of their share of liable electricity acquisitions in NSW.

The Act and the Regulation set out the obligation for Scheme Participants to comply with their annual target and specify other compliance requirements. The Regulation provides principles that govern our assessment of their compliance.

If a Scheme Participant breaches its compliance obligations, it may be liable to pay an energy savings shortfall penalty.

D.3 Powers to deal with non-compliance events

The legislative framework gives IPART, as the Scheme Administrator and Scheme Regulator, broad discretion to deal with non-compliance events by ACPs and Scheme Participants. For example, we have explicit powers to:

- ▼ require the provision of documents
- ▼ require audits
- ▼ amend, suspend or cancel an ACP's accreditation
- ▼ assess and determine an energy savings shortfall penalty payable by Scheme Participants
- ▼ prosecute an ACP or Scheme Participant under certain circumstances
- ▼ require the surrender and cancellation of ESCs following a successful prosecution.

Where non-compliance events are minor or the ACP or Scheme Participant has already taken action to remedy the non-compliance, we may decide to take no further action.

However, all non-compliance events are noted in Annual Report to the Minister, which is published on the ESS website. The companies and activities associated with these non-compliance events are named in the report.

D.4 Right to seek review

ACPs and Scheme Participants have the right to make an application for internal review of reviewable decisions made by IPART as Scheme Administrator or Scheme Regulator within 28 days after the date of the decision. The application must be in writing, lodged at our offices and specify an address to which a notice of the result of the review can be sent.

D.5 Further information

For further information about the ESS, including the legislative framework, liable parties, the accreditation process and other detailed information, please refer to the ESS website, www.ess.nsw.gov.au.