IPART
New South Wales

Independent Pricing and Regulatory Tribunal

Compliance and Performance Monitoring Strategy

Energy Savings Scheme
November 2016

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This document has been prepared for information purposes only. The contents of this document are not intended to constitute legal advice and any person who requires legal advice should obtain it themselves.

While this document provides general guidance as to IPART's expectations and practice, IPART may amend or depart from any procedure, practice or guideline referred to in this document at any time.

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V2.0	Changes to: ▾ Accredited Certificate Providers (ACPs) are no longer required to submit quarterly or annual reports. ▾ setting the initial audit types for ACPs and new applicants (Section 3), and ▾ other minor changes to the structure of the document including the removal of appendices A and C. (Note: the above Table 3.4 is now Table 3.11).	August 2015
V2.1	Inclusion of new section 3.2.3, applicable to the Home Energy Efficiency Retrofits method.	April 2016
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1 Introduction

The NSW Energy Savings Scheme (**ESS**) seeks to reduce energy consumption in NSW by creating financial incentives for organisations to invest in energy saving projects.

The other objects of the ESS are to:

- assist households and businesses to reduce energy consumption and energy costs
- make the reduction of greenhouse gas emissions achievable at a lower cost, and
- reduce the cost of, and need for, additional energy generation, transmission and distribution infrastructure.

Electricity retailers and other mandatory participants (**Scheme Participants**) are obliged to meet energy saving targets. Energy savings can be achieved by installing, improving or replacing energy saving equipment. Persons that become Accredited Certificate Providers (**ACPs**) can create energy savings certificates (**ESCs**) by carrying out these activities and then sell those ESCs to Scheme Participants. The Independent Pricing and Regulatory Tribunal of NSW (**IPART**) is both the Scheme Administrator and Scheme Regulator of the ESS.[1]

As part of this role, we aim to:

- protect the integrity of the ESS by monitoring and managing compliance with the requirements of the ESS, and
- ensure that every ESC represents genuine energy savings because the cost of the ESS is ultimately borne by consumers through the price they pay for electricity.

This *Compliance and Performance Monitoring Strategy* (**CPMS**) informs stakeholders how we do this.[2] It is structured as follows:

- Section 2 describes general tools we use to monitor, assess and manage the compliance and performance of Scheme Participants and ACPs
- Section 3 explains our general approach for setting and adjusting ACPs' audit regimes, including how we determine the specific audit requirements for individual ACPs, and
- Section 4 outlines our general approach for managing non-compliance.

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1 *Act*, sections 153(2) and 151(2)

2 We update our CPMS from time to time.

1.1 Legislative requirements

This document is a guide only and is not legal advice. The legal requirements for ACPs participating in the ESS are set out in:

- Part 9 of the *Electricity Supply Act 1995* (**Act**)
- Part 6 of the *Electricity Supply (General) Regulation 2014* (**Regulation**)
- the *Energy Savings Scheme Rule of 2009* (**ESS Rule**), and
- the *Energy Savings Scheme – Scheme Regulator Exemptions Rule No. 1 of 2009* (**Exemptions Rule**).

ACPs are also required to meet any additional conditions as set out in their Accreditation Notice.

2 Tools for monitoring, assessing and managing compliance and performance

In general, we use three tools to monitor, assess and manage the compliance and performance of ACPs:

- audits of their compliance with the Act, Regulation, ESS Rule and any accreditation conditions
- limits on the number of ESCs that ACPs can create between audits or in a specified period, and
- agreements with ACPs to set aside a portion of the ESCs they register until the validity of the ESCs is confirmed through audit.

For Scheme Participants we require an audit of their self-reporting in certain circumstances.

2.1 Audits of compliance

Audits are one of our main tools for monitoring and assessing compliance in the ESS. We use audits to obtain independent advice on whether:

- Scheme Participants have correctly calculated their individual energy savings target and any energy savings shortfall penalty they may have for a compliance year
- ESCs have been (or are likely to be) properly calculated and created in accordance with the Act, the Regulation, the ESS Rule and any accreditation conditions, and
- ACPs are compliant with the legislative requirements.

We only use audit firms that are members of our Audit Services Panel.[3] These auditors must conduct audits in accordance with the *Audit Panel Agreement*, which sets out their roles and responsibilities. This ensures they comply with our guidelines and policies and use qualified, competent staff. Auditors are bound by confidentiality obligations and must appropriately manage any conflicts of interest that may arise.

We have developed an *Audit Guideline*[4] for use by auditors. This document provides more detailed information about our approach to auditing, including the process for engaging auditors, the three audit rule, sampling, reporting of audit findings and the requirements for joining the Audit Services Panel.

2.1.1 Scheme Participant audits

Scheme Participants are required to submit an Annual Energy Savings Statement (**AESS**) by the compliance deadline each year.[5] An AESS 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 offering ESCs for surrender)
- 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.[6]

Scheme Participants are responsible for ensuring that the AESS is correct and complete. In some cases, they are also required to lodge an independent audit report with their completed AESS. Where an audit of the AESS is required, it must be completed by a member of the Audit Services Panel before submitting it to IPART.[7] The audit must be conducted in accordance with the *Audit Guideline*.[8]

Scheme Participants must have their AESS audited before submitting it to IPART if it includes either of the following:[9]

1. data relating to non-market purchases (field 2(d) in the inputs sheet of the AESS template), or
2. data relating to exempt electricity loads (field 2(e) in the inputs sheet).

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3 Refer: www.ess.nsw.gov.au/For_Auditors/List_of_Auditors

4 The *Audit Guideline* is updated from time to time. Refer: www.ess.nsw.gov.au/Audits_and_Compliance

5 Refer: www.ess.nsw.gov.au/Liable_Entities

6 *Act*, sections 107 (liable acquisitions) and 119(6) (partially exempt loads)

7 Refer: www.ess.nsw.gov.au/Audits_and_Compliance/List_of_Auditors

8 Refer: www.ess.nsw.gov.au/Audits_and_Compliance/Audit_and_compliance_guides

9 *Act*, section 152(1)(c)

An AESS that includes this data will not be considered complete[10] unless an audit report is attached.

Scheme Participants should ensure they commence preparation of their AESS with enough time to have it audited, if required. In some cases a Scheme Participant may not determine that they need to have their AESS audited until they have collected all relevant data for the AESS (eg, data from small-scale photovoltaic generation).

2.1.2 ACP audits

ACPs are required to undergo audits in line with the audit regime and audit requirements specified in their accreditation notice. As noted above, we use these audits to establish whether ESCs have been (or are likely to be) calculated and properly created in accordance with the Act, Regulation, ESS Rule and any accreditation conditions. If an audit identifies improperly created ESCs, the ACP will be asked to voluntarily forfeit them. More detailed information on materiality and error is provided in Appendix A and may also be found in the *Audit Guideline*.[11]

We also use audits to establish whether ACPs are compliant with legislative requirements, including record keeping requirements.[12] We consider audit findings in making decisions about managing the ongoing compliance of individual ACPs. We may also consider these findings as part of the accreditation process (where the application is from an ACP that already has a compliance history under the scheme).

Our approach for setting and adjusting the audit regimes for ACPs is discussed in section 3 below. The mechanisms we may use to manage compliance issues are outlined in section 4.

2.2 Controls on number of ESCs that can be created

In setting an ACP's accreditation conditions, we may limit the number of ESCs it can apply to register by either:

- setting the number of ESCs that can be created between audits through a volumetric audit limit, or
- limiting the number of ESCs that can be created in a period (nominated number of ESCs) in the form of an annual ESC creation limit, or total for the life of the RESA.

10 *Act*, section 123(5)
11 Refer: www.ess.nsw.gov.au/Audits_and_Compliance
12 Refer: www.ess.nsw.gov.au/Accredited_Certificate_Providers/Record_keeping_arrangements

The type of limit applied to an ACP's accreditation depends on the nature of the RESA being undertaken (eg, multi-site or single site), calculation method being used and the expected volume and frequency of ESC creation.

For an ACP with a volumetric audit regime, we set an audit limit that is typically expressed as the maximum number of ESCs that can be created between audits. For an ACP with a periodic audit regime, we set a nominated ESC limit that is typically expressed as an annual limit on ESC creation. Section 3 of this document outlines the basis on which we set these limits.

These ESC creation limits manage risk to the integrity of the scheme posed by unaudited ESCs. However, they do not prevent the ACP from creating valid ESCs in addition to the limits, as the ACP may:

- apply for an amendment to the limits,[13] or
- conduct voluntary audits of ESCs before they are registered (pre-registration audits).[14]

We monitor and manage ACPs' compliance with their ESC creation limits in the ESS Registry.[15] The ESS Registry is an online database of information about ACPs' activities, including the registration, ownership and surrender of ESCs under the ESS.

2.3 Agreements with ACPs to set aside a portion of ESCs registered

In some cases we will ask an ACP to enter into an agreement with IPART (as Scheme Administrator) to set aside a portion of the ESCs they register at one time until the validity of those ESCs is confirmed through audit. These set-aside agreements take the form of a legally binding deed. They allow us to manage the risk of invalid ESC creation while still allowing the ACP to actively register and trade ESCs. In general, we may initiate a set-aside deed in situations such as when:

- the ACP is new to the ESS and does not have a compliance record
- a previous audit of the ACP identified a material error that resulted in it invalidly creating a large number of ESCs
- audits of other ACPs carrying out similar RESAs have identified widespread compliance issues that resulted in the creation of a large number of invalid ESCs, or
- we have identified areas of the scheme where additional compliance measures are required to balance increased flexibility in the operation of a RESA.

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13 Refer: www.ess.nsw.gov.au/Accredited_Certificate_Providers/Accreditation_Notice_and_Amendments

14 As long as this is within any other ESC limits the ACP may have.

15 Refer: www.ess.nsw.gov.au/Registry

More specifically, we typically require set-aside deeds for:

- all new ACPs that do not have a compliance record with the scheme
- all new accreditations using the Deemed Energy Savings Method, and
- all ACPs that receive a material error finding at audit (regardless of the ESS Rule method).

The terms and conditions of set-aside deeds vary to reflect the ACP's individual circumstances, but generally they require it to:

- set aside a certain proportion of the ESCs it applies to register in the lead-up to its next audit, and
- forfeit any invalidly created ESCs identified by that audit from the set-aside amount.

Where set-aside deeds are in place, ESCs are automatically put on 'administrative hold' in the ESS Registry until the Scheme Administrator determines that the audit is complete.

After the audit, if the number of ESCs the ACP is asked to forfeit is **less** than the number set aside, all remaining ESCs are released to the ACP for trading. If the number of ESCs the ACP is asked to forfeit is **greater** than the number set aside, it may be asked to voluntarily forfeit additional ESCs.

Where an ACP or applicant does not agree to our request to enter into a set-aside agreement, we may consider reassessing the risk of the ACP. This may result in:

- a reduction in the ACP's ESC creation limit (so it can apply to register fewer ESCs per year or between audits), or
- a requirement for pre-registration audits (so the ACP can only apply to register ESCs after their validity has been confirmed by an audit).

The number of ESCs that an ACP must set aside may be reduced or increased over time, depending on its compliance performance. Our approach for adjusting the set-aside amount for new accreditations and for existing accreditations is described below. Figure 2.1 illustrates how the set-aside amount changes in response to audit findings for new accreditations.

2.3.1 Set-aside amounts for new accreditations

Where an applicant has agreed to enter into a set-aside deed as an accreditation condition, we typically require that 10% of its ESC creation be set-aside. The set-aside amount would remain at 10% for the first two audits, and then:

- **if no material error is found in the first two audits,** it will typically decrease to 5% of ESC creation, and then to 0% thereafter if no material error is found in the third audit (see Figure 2.1.A), or

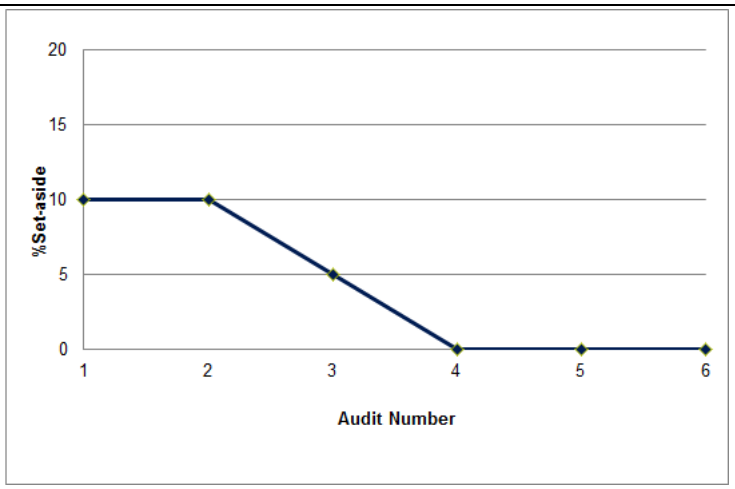
- **if one or more material errors are found in either of the first two audits**, it will typically increase to 20% of ESC creation, and then decrease to 10%, 5% and 0% thereafter if each subsequent audit has no material error (see Figure 2.1.B and Figure 2.1.C), or
- **if no material error is found in the first two audits but the third or subsequent audit is failed,** it will typically increase to 10% again (see Figure 2.1.D).

2.3.2 Set-aside amounts for existing accreditations

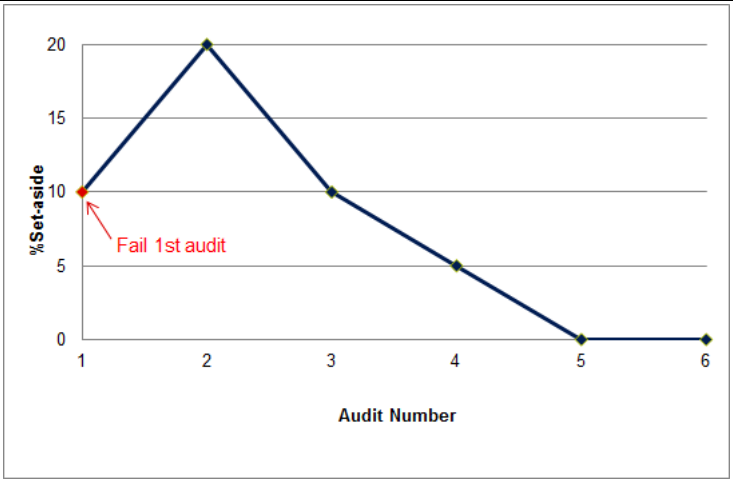
Where an ACP has not entered into a set-aside deed, we will typically ask it to do so when material errors are found in an audit. Initially, the set-aside amount will typically be 10% of ESC creation. This would decrease to 5% and then 0% thereafter if each subsequent audit has no material error.

Figure 2.1 How the set-aside amount changes in response to compliance performance – new accreditations

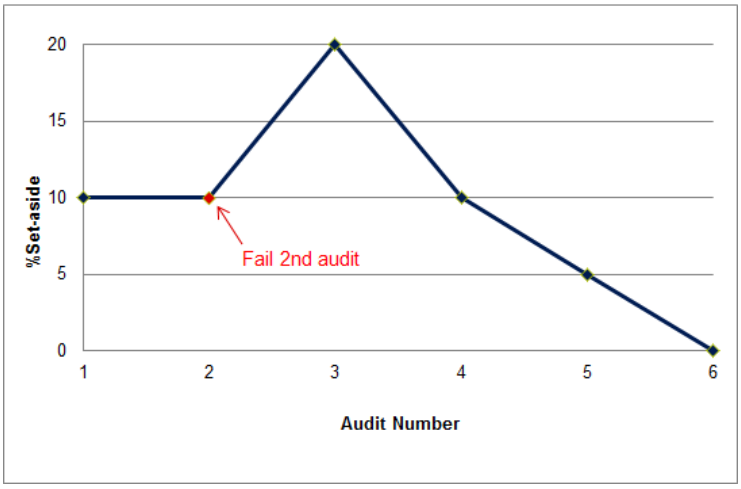
A. Passes first two audits and subsequent audits



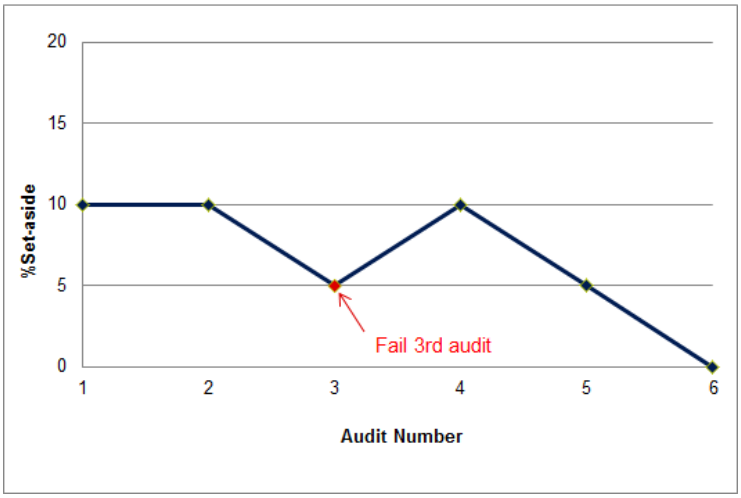
B. Fails first audit then passes subsequent audits



C. Passes first audit, fails 2nd audit then passes subsequent audits



D. Passes first two audits, fails 3rd audit then passes subsequent audits



3 Approach for setting and adjusting ACP audit regimes

An ACP's audit regime for each accreditation includes:

- the type of audit the ACP has been assigned for that RESA (the possible audit types are outlined in Table 3.1), and
- the ESC creation limit (described in section 2.2 of this document).

We specify the initial audit regime as a condition in the ACP's accreditation notice. After the initial audit, we may adjust the audit regime over time, based on the ACP's compliance performance.

Table 3.1 Audit types for ACPs

Audit type	Description
Spot	This is an audit that the Scheme Administrator can require at any time, without notice. We may do so whenever we consider an audit is required, such as when we identify changes in the risk profile of the ACP or RESA, or require increased certainty of ongoing ESC creation. This is the minimum audit that we require. It is specified in all accreditation conditions. As Scheme Administrator we have the right to request a spot audit at any time.
Single (one-off)	A single audit is a one-off audit. We may specify this audit in the accreditation conditions if we consider audit confirmation of ESC creation is necessary after a certain period, but are uncertain of the ongoing audit requirements. After a single audit, the ACP may be moved onto a spot, periodic or volumetric audit regime, depending on the results of that audit.
Periodic	A periodic audit must be completed or commenced at a specified interval/time. The Scheme Administrator limits the number of ESCs that can be created by determining how many can be registered per time period (eg, per year) or for the life of the RESA ('the nominated number of ESCs'). Generally, the initial periodic audit regime is annual (so the initial audit is required one year after accreditation). However, a biennial audit regime may also be set (so the initial audit is required two years after accreditation). Following the initial audit, the frequency of audits is set taking into account the proposed number of ESCs to be created per year.
Volumetric	The Scheme Administrator limits the number of ESCs that can be created before an audit is required (the 'volumetric 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 ongoing compliance and reduces with non-compliance.
Pre-Registration (Voluntary)	The audit is conducted before any ESCs are registered and may be commissioned by an ACP if, for example, it has large numbers of verifiable records to support ESC creation.[16]
Pre-Registration (Mandatory)	The audit is required to be conducted before any ESCs can be registered. This is the strictest level of audit under the scheme, and means an ACP can only register ESCs after their validity has been confirmed through audit.
Pre-Accreditation	An audit to confirm an applicant's eligibility for accreditation. It is used when the proposed ESC creation methodology is very complex, or when the Scheme Administrator requires additional assurance over an application.

[16] As long as this is within any other ESC limits the ACP may have.

3.1 Assigning the initial audit type

The appropriate audit type for an initial audit regime depends on the method the ACP will use to calculate the energy savings and whether the ACP has a compliance history, or is new to the ESS. New ACPs are generally assigned a pre-registration audit regime. Existing ACPs are generally assigned an audit regime that is closely linked to the nature of the RESA being undertaken, which in turn is linked to the frequency, volume and pattern of ESC creation and thus to the inherent risk of invalid ESC creation.

In general, we divide the energy saving calculation methods into three groups:

- **Group 1 – Deemed energy savings methods.** ACPs that use these methods typically have a high volume and/or high frequency of ESC creation upfront for energy savings that will occur over a period of up to 10 years into the future. This means they can create large numbers of ESCs at the start of the period over which the energy savings are expected to be realised, when there is relatively little evidence that the savings will in fact being realised. For this reason, either a pre-registration or volumetric audit is usually appropriate for the initial audit regime.
- **Group 2 – Most metered baseline methods.** Typically, ACPs that use these methods have a lower frequency of ESC creation, and the ESCs are often created after the energy savings have been measured. For these reasons, a periodic or spot audit is usually appropriate for the initial audit regime.
- **Group 3 – Aggregated metered baseline method and project impact assessment with measurement and verification (PIAM&V) method.** At the time of writing this document, no ACP was accredited to use the aggregated metered baseline method, and very few ACPs using the PIAM&V method had commenced implementations or undertaken audits. Therefore, we have limited information on the frequency, volume and pattern of ESC creation for ACPs using these calculation methods. For this reason, we cannot provide guidance on the likely initial audit type for ACPs and RESAs using these methods at this stage.

Table 3.2 shows the specific sub-methods included in each of these groups.

Table 3.2 ESC calculation methods by group

Group 1 – Deemed energy savings methods[a]	Group 2 – Most metered baseline methods (MBM)[b]	Group 3 – Aggregated metered baseline and PIAM&V methods[c]
Commercial lighting energy savings formula	MBM - Baseline per unit of output	MBM - Aggregated metered baseline
Installation of high efficiency appliances for businesses	MBM - Baseline unaffected by output	Project impact assessment with measurement & verification
Removal of old appliances	MBM - Normalised baseline	
Sale of new appliances	MBM - NABERS baseline	

Group 1 – Deemed energy savings methods[a]	Group 2 – Most metered baseline methods (MBM)[b]	Group 3 – Aggregated metered baseline and PIAM&V methods[c]
Public lighting energy savings formula		
Power factor correction energy savings formula		
High efficiency motor energy savings formula		
Home energy efficiency retrofits		

a ESS Rule, clause 9
b ESS Rule, clauses 8.5 to 8.8
c ESS Rule, clauses 8.9 and 7A

We consider each application for accreditation, or amendment of accreditation conditions, on a case-by-case basis, and therefore may assign the audit type that we consider appropriate. However, as a guide, Table 3.3 summarises the audit types are most typically assigned to an ACP as part of the initial audit regime.

Table 3.3 Audit type mostly likely to be assigned as part of initial audit regime by calculation method

Calculation method	Audit type		
	Periodic or spot	Volumetric or pre-registration	Any of the four types
Group 1: Deemed energy savings methods[a]		✓	
Group 2: Most metered baseline methods[b]	✓		
Group 3: Aggregated metered baseline and PIAM&V methods[c]			✓

a ESS Rule, clause 9
b ESS Rule, clauses 8.5 to 8.8
c ESS Rule, clauses 8.9 and 7A

Most ACPs will be assigned either volumetric or periodic audits. However in specific circumstances, spot or single audits are also used.

Volumetric audits are typically required:

- where the RESA delivery model means it takes place at multiple sites, or involves multiple energy savers, which increases the complexity of delivery
- where the ACP expects frequent ESC creation (eg, a number of times through the year) from the RESA, or
- where periodic auditing is considered too infrequent to capture potential invalid ESC creation in a timely manner.

Periodic audits are typically required:

- where the RESA takes place at a single site, or where a simple delivery model is used for a multi-site RESA
- where the ACP expects low-frequency ESC creation from the RESA (eg, creates ESCs annually), or
- where measurement and verification techniques are used to calculate ESCs.

Spot audits are typically required:

- where the ACP is the original energy saver
- where the ACP expects a low volume of ESC creation from the RESA, or
- where all energy savings from the RESA occur at a single site, or a defined list of sites.

Single audits are typically required:

- where the ACP is the original energy saver, or
- where the ACP expects a one-off large number of ESC creation from the RESA.

In assigning the initial audit type, we may also consider whether the ACP agrees to enter into a set-aside agreement (described in section 2.3 of this document).

3.2 Setting the initial ESC registration limit

As outlined in section 2.2, we also set an initial ESC creation limit as part of the initial audit regime. In general, this involves using the information the applicant provides during the accreditation application process to assess the level of confidence we have in ongoing compliance, particularly the likelihood of invalid ESC creation. However, our approach varies depending on whether or not the applicant has a previous compliance history with the ESS. A previous compliance history exists when an applicant has one or more existing accreditations for which audits have been conducted. If an applicant has other accreditations but no audits have been conducted (ie, their compliance has not been reviewed) they will be regarded as having no compliance history with the ESS.

3.2.1 For applicants with a previous compliance history within ESS

Many of the applications for accreditation we receive are from applicants that are already accredited for one or more existing RESAs. These ACPs will typically already have a compliance history under the ESS. Where this is the case, we consider this history as the most relevant basis on which to assess the ACP's future compliance behaviour for the new accreditation. Therefore, we set the initial audit limits for the new accreditation by:

- assessing this compliance history and three other factors, and applying a confidence rating to each of these four factors (either high, medium or low)
- assigning points and weightings to these ratings to give an overall score
- determining what the initial audit limit typically would be, based on the overall score, and
- considering other factors specific to the application for accreditation.

Assessing factors and applying confidence ratings

We consider and rate four factors that relate to the risk of non-compliance associated with the accreditation:

- the applicant's compliance history
- the number of sites at which the RESA will be undertaken
- whether the applicant is the original energy saver or the nominated energy saver, and
- the energy savings calculation method to be used.

Table 3.4 provides more information on each of these factors, and Table 3.5 sets out the criteria we use to rate each factor.

Table 3.4 Factors we consider for applicants with previous compliance history

Factor	Description
Compliance history	This includes the applicant's track record in the scheme, including but not limited to its performance in audits and reporting, and other factors such as its responsiveness to requests.
Number of sites	In general, when a RESA is undertaken at a single site, audit findings will be more accurate because sampling at a site level is not required (though sampling of documents for a site may still occur). The risk of non-compliance increases if the RESA is implemented across multiple sites and sampling is required.
Original or nominated energy saver	When the applicant is the original energy saver there is more incentive for it to implement the RESA in a way that achieves genuine energy savings. This is because it is the original energy saver that benefits from the savings (through reduced energy bills), rather the nominated energy saver that is focused on ESC revenue.
Calculation method	We consider which of the three groups the ESC calculation method falls into (see Table 3.2) and the implications of this for the inherent risk of non-compliance.

Table 3.5 Criteria for allocating a high, medium or low confidence rating for each factor for applicants with previous compliance history

Confidence rating			
Factor	**High**	**Medium**	**Low**
Compliance history (for the most recent audit/s)	A minimum of two passed ESS audits[a]	A passed ESS audit[a]	A failed ESS audit[a]
Number of sites	Single site	Defined number of identified sites	Multiple sites undefined and not identified
Original or nominated energy saver	Original energy saver	N/A	Nominated energy saver
Calculation method[b]	Group 2 Group 3 – in some cases	Group 3 – in some cases	Group 1 Group 3 – in some cases

[a] Where the applicant has multiple accreditations under the scheme, the passed audit findings (ie, no material error) must be for the most recent audit(s) conducted for each accreditation.

[b] Table 3.2 lists the calculation methods in each group.

Assigning points and weightings to determine overall score

Once we have allocated a confidence rating for each factor, we score and weight these ratings as shown in Table 3.6 below, to give an overall score for the proposed accreditation. The confidence rating for the applicant's previous compliance under the ESS has the highest weighting – making up half the overall score – because our experience is that this history is the clearest indicator of its future compliance behaviour.

Table 3.6 Points and weightings for determining overall score

Factor	Compliance history	Number of sites	Nature of energy saver	Calculation method
High rating	3	3	3	3
Medium rating	2	2	N/A	2
Low rating	1	1	1	1
Weighting	**3**	**1**	**1**	**1**
Maximum Points	9	3	3	3
Total maximum points				**18**

Determining relationship between overall score and initial audit limits

Once we have determined the overall score (as points out of a maximum of 18), we categorise this score as either 'satisfactory' (high score), 'moderate' (medium score) or 'low' (low score) as shown in Table 3.7.

Table 3.7 Categorisation of overall scores

Category	Overall score (/18)
Low	≤ 6
Moderate	7 ≤ to ≤ 11
Satisfactory	≥ 12

We then set the initial ESC creation limits by considering the typical limits for the overall score category (shown in Table 3.8) and taking account of any other considerations specific to the application such as the proposed number of ESC creations.

Table 3.8 Typical initial ESC creation limits for each overall score category

Overall score category	Volumetric audit	Periodic audit
Low	First audit before any ESCs are registered[a]	First audit before any ESCs are registered[a]
Moderate	First audit after a maximum of 5,000 ESCs are registered	First audit one year after accreditation
Satisfactory	First audit after a maximum of 10,000 ESCs are registered	First audit: one year after accreditation if ≥ 20,000 ESCs/year proposed, or two years after accreditation if < 20,000 ESCs/year proposed

[a] Effectively, this audit limit means that a pre-registration audit is required.

3.2.2 For applicants without a compliance history in the ESS

For applicants without a compliance history under the ESS, our default position is to set the ESC creation limits in line with the 'low' overall score category, shown in Table 3.8 above. In effect, this means that the most likely initial audit regime for applicants without a compliance history is a pre-registration audit regime. Applicants without a compliance history in the scheme will not be able to achieve a 'satisfactory' overall score.

However, applicants can make a case for a different initial ESC creation limit by providing additional evidence in their application.

Table 3.9 below presents a list of the evidence an applicant without a compliance history under the scheme can provide to make its case for a different initial ESC creation limit, and how we score this evidence.

Table 3.9 Evidence that applicants without a compliance history can provide and how we score this evidence

Evidence	Maximum points	Breakdown of points (where applicable)
'Satisfactory' compliance history under another similar scheme eg, VEET, RET	3 points	▾ Two or more passed audits for the last two projects under another scheme less than two years old = 3 points ▾ One passed audit for the most recent project under another scheme less than two years old = 1 point
'Satisfactory' external audit on business systems, quality assurance, record keeping or other business processes by a professional auditor where the audit is less than two years old	3 points	▾ If the passed audit is less than one year old and assessed to be satisfactory = 3 points ▾ If the passed audit is less than two years old and assessed to be satisfactory = 1 point
All business systems aligned with a Quality Management System with a 'satisfactory' audit by a professional auditor where the audit is less than two years old	5 points	▾ If the passed audit is less than one year old and assessed to be satisfactory = 5 points ▾ If the passed audit is less than two years old and assessed to be satisfactory = 3 points
Accreditation (less than one year old) and/or 'satisfactory' audit (less than two years old) of an accredited Quality Management System eg, ISO 9001	5 points	No breakdown

We assess and score this evidence. If the applicant only achieves a score of five points as described in Table 3.9, we may set its initial ESC creation limit in line with the 'low' overall score category shown in Table 3.8 above.

3.2.3 For applicants applying for accreditation under the HEER method

Applications for accreditation under the Home Energy Efficiency Retrofits (**HEER**) method[17] will include an additional assessment that we will conduct prior to assessing the application under sections 3.2.1 or 3.2.2.

Our initial assessment will consider whether the applicant has demonstrated experience installing, or managing the installation of, the relevant equipment in households or small businesses.

If the applicant can demonstrate experience, we will proceed with assessing the initial audit regime and ESC creation limit as outlined in sections 3.2.1 and 3.2.2. If the applicant cannot demonstrate experience, an initial pre-registration audit limit will be typically assigned, if the application is successful.

17 ESS Rule, clause 9.8

3.3 Setting and adjusting ongoing audit regimes

After an ACP's first audit of an accreditation, we may consider amending the audit regime, based on the results of this audit. We may also adjust the audit over time as the ACP establishes 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 they are more lenient, or
- if an ACP demonstrates poor compliance – ie, if material errors are found – we may vary the audit requirements so they are more stringent.

Our approach for setting the ongoing audit regime differs depending on whether the ACP has been assigned periodic or volumetric audits for their accreditation, and on whether the ACP is accredited for a number of RESAs in a 'portfolio'.

3.3.1 For ACPs with a compliance history including a volumetric audit regime

In general, if an ACP with a volumetric audit regime for an accreditation demonstrates compliance at its initial audit, we may increase its audit limit so it can register a larger number of ESCs between audits. But if the ACP demonstrates poor compliance, we may decrease the audit limit so it can register a smaller number of ESCs between audits.

Table 3.10 provides more detailed guidance on our typical approach for adjusting volumetric audit limits to reward ongoing compliance. If the first audit of the ACP's accreditation finds no material errors, we may increase the number of ESCs that can be registered between audits (by one audit step). However, we will determine the actual number of ESCs that can be registered between audits on a case-by-case basis.

Figure 3.1 illustrates how this general process works in graphic form. For example, Figure 3.1.A shows an accreditation initially assessed as having a 'satisfactory' level of confidence and given an audit limit of 10,000 ESCs. If the first audit of the ACP's accreditation is successful, we may increase the audit limit (by one audit step) to 25,000 ESCs. If the second and third audits of the ACP's accreditation are also successful, we may increase the audit limit (by another audit step) to 50,000 ESCs.[18]

If subsequent audits also find no material errors, and the ACP builds up a record of ongoing compliance in respect of that accreditation, the number of ESCs that can be registered between audits continues to increase (audit step two onwards).

[18] An application to amend the audit limit may be made to the Scheme Administrator via the ESS Portal: www.ess.nsw.gov.au/ESS_Portal

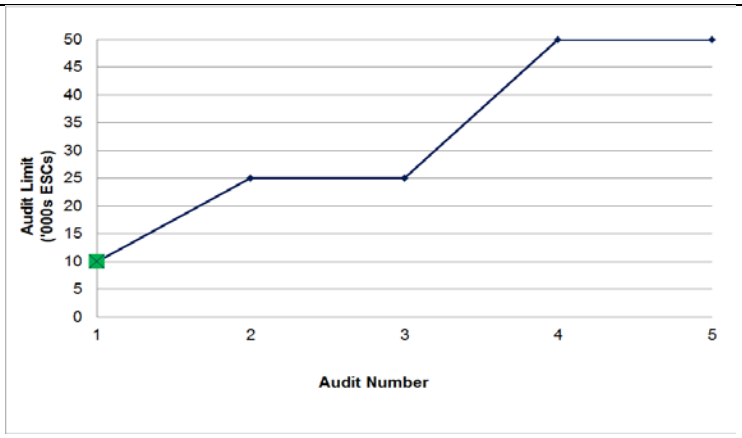
Table 3.10 Our general process for adjusting volumetric audit limits to reward ongoing compliance

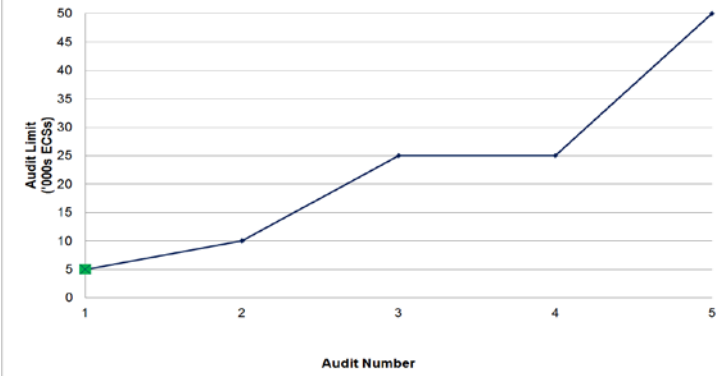
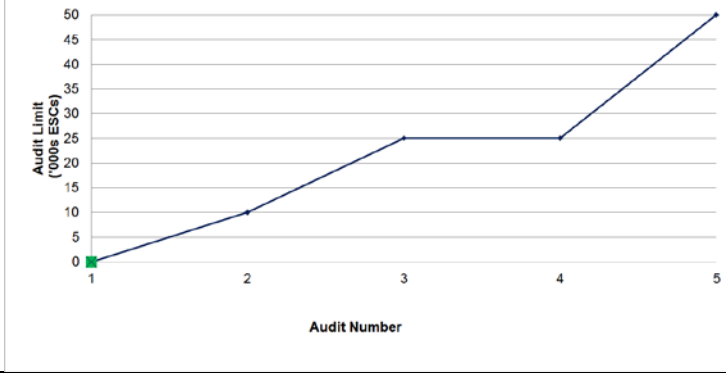
	Volumetric audit steps	Requirements to progress to the next audit step	
Audit step	Number of ESCs that can be registered between audits (per audit)	Minimum number of ESCs to be audited (at current audit step)	Number of consecutive successful audits (at current audit step)
0	Pre-registration or 5,000	2,500	1
1	10,000	5,000	1
2	25,000	25,000	2
3	50,000	50,000	2
4	75,000	75,000	2
5	100,000	100,000	3
6	150,000	150,000	3
7	200,000	n/a	n/a

a For example, when the limit is 75,000 ESCs (audit step 4), at least 75,000 ESCs must have been audited at that step and a minimum of two consecutive audits must be successfully completed at that 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.

Figure 3.1 Increasing volumetric audit limits using Table 3.10, for new accreditations with different initial audit limits based on overall score categories (Table 3.8)

A. Satisfactory level of confidence: Initial audit limit 10,000 ESCs



B. Moderate level of confidence: Initial audit limit 5,000 ESCs	
C. Low level of confidence: Initial requirement for pre-registration audit	

3.3.2 For ACPs with demonstrated compliance under periodic audit regimes

Where periodic audits are assigned, our approach for setting the ongoing audit regime is simpler because, as outlined in section 3.1, this audit type is typically assigned to accreditations with a regular pattern or low frequency of ESC creation. In general, if an ACP receives three annual audit findings of no material error in relation to an accreditation, we may reduce the audit frequency from once a year to once every two years, if requested by the ACP. However, this will be at the discretion of the Scheme Administrator.

4 Approach for managing non-compliance

Whenever an ACP fails to meet the requirements of the Act, Regulation, ESS Rule or its accreditation conditions, it is considered a non-compliance. All non-compliances are considered to be serious.

Non-compliances can occur at any time, and can include failure to comply with various requirements, for example:

- 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 section 1.1).

In considering an ACP's compliance performance, we will examine its regular compliance reports, its history of audit findings, and its response to any significant recommendations made by the auditor to help mitigate problems with future ESC creation.[19]

We may also consider any relevant, investigated complaints we receive as Scheme Administrator and an ACP's performance in other schemes.

If we consider the compliance performance of the ACP is poor, we will consider the most appropriate mechanism(s) to manage this. If we decide to use a mechanism, 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.

All non-compliances are reported in our Annual Report to the Minister. This report is publicly available on our website.[20]

4.1 Mechanisms for managing non-compliance

We can use a range of mechanisms to manage poor ACP compliance. These include:

- adjusting audit requirements such as volumetric audit limits (discussed further below)
- adjusting audit frequency
- establishing and adjusting set-aside agreements (refer section 2.3 of this document)
- requesting voluntary forfeiture of invalidly created ESCs
- issuing notices of apparent contravention
- amending accreditation conditions – to require that audit recommendations or other specific issues be addressed before further ESCs can be created
- suspending or cancelling accreditations
- issuing penalty notices,[21] and
- initiating a prosecution (eg, in relation to the improper creation of ESCs under section 133 of the Act).

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19 Audit reports often contain recommendations made by the Auditor to help mitigate problems with future ESC creation. If we consider these audit recommendations to be significant, ACPs will be notified as part of the process of finalising audits. Failure to implement significant audit recommendations in a timely manner may result in a change to audit requirements.

20 Refer: www.ess.nsw.gov.au/How_the_scheme_works/Scheme_Performance

21 *Act*, section 187

Where ACPs are accredited for a number of RESAs in a 'portfolio', the audit performance of each individual accreditation may influence the ongoing audit requirements across the portfolio. In general, if such an ACP receives two or more findings of failed audit across the portfolio, we may require pre-registration audits for the next audit of that accreditation and for the next audits across all the accreditations in the portfolio if a systemic error (or other major concern) was identified.

For Scheme Participants, we have explicit powers to:

- require the provision of documents
- require audits
- assess and determine an energy savings shortfall penalty payable by Scheme Participants, and
- prosecute a Scheme Participant under certain circumstances.

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.[22] The companies and activities associated with these non-compliance events are named in the report.

4.2 Approach for adjusting volumetric audit limits in response to non-compliance

For ACPs with volumetric audit regimes, we may adjust their audit limits in response to non-compliance so they can register a smaller number of ESCs between audits.

Table 4.1 outlines our general process for adjusting these limits as a consequence of compliance issues. In limited circumstances, we may choose to deal with compliance issues on a case-by-case basis instead of the process outlined here.

Table 4.1 General approach for adjusting volumetric audit limits in response to non-compliance

Audits findings	Response
Failed Audit: for the First or Second Audit	▼ Remain at current audit step ▼ The count of audits on the audit step is reset to zero ▼ The number of ESCs subject to the set-aside agreement is raised to 20%

[22] Refer: www.ess.nsw.gov.au/How_the_scheme_works/Scheme_Performance

Audits findings	Response
Failed Audit: for third or subsequent audits	▾ Remain at current audit step[a] ▾ 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%
Two failed audits in a row	▾ Pre-registration audit required and other compliance actions considered by the Scheme Administrator ▾ Following the pre-registration audit: – 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 (but quantitative elements passed)	▾ The count of audits on the audit step is reset to zero ▾ Audit limits are not adjusted
Significant recommendations of a previous audit not addressed	▾ The count of audits on the audit step is reset to zero ▾ Audit limits are not adjusted

[a] Refer Table 3.10 for audit steps

4.3 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.

5 Glossary

Category	Definition
Absolute Error Rate	The absolute error rate determines the materiality of quantitative errors. It is calculated by dividing the gross number of all relevant misstatements (including under and over creation of ESCs) by the number of ESCs in the sample. An absolute error rate of ≥ 5% is a material error and affects the audit opinion, progression of volumetric audits and may affect set-aside deeds.
Accreditation Conditions	Conditions imposed by the Scheme Administrator on the accreditation of an ACP under section 138(1)(b) of the Act and specified in their Accreditation Notice.
Accreditation Notice	A written notice issued by the Scheme Administrator under clause 48(1) of the Regulation specifying any Accreditation Conditions.
Accredited Certificate Provider (**ACP**)	ACPs are voluntary participants in the scheme. They are parties that are accredited to create Energy Savings Certificates (**ESCs**) from carrying out Recognised Energy Saving Activities (**RESAs**) that increase the efficiency of electricity and/or gas consumption.
Annual Energy Savings Statement	The Annual Energy Savings Statement (**AESS**) is used by Scheme Participants to self-assess their individual energy savings target.
Audit	An independent assessment of whether the auditee has complied, in all material respects, with the requirements of the ESS legislation and accreditation conditions. In relation to ESC creation this can occur either before ESC registration (pre-registration) or after ESC registration (post-
Audit History	Audit history is a subset of the ACP or Scheme Participant's compliance history. Audit history assesses how ACPs or Scheme Participants perform in audits, including the number of passed and failed audits, the absolute and net error rates, the number of repeat recommendations and the timeliness of commissioning audits.
Completed Audit	An audit that has been closed out by the Scheme Administrator and the Scheme Administrator has written to the ACP to confirm that the audit has been completed.
Compliance	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 (**Registry**).
Compliance History	An ACP's or Scheme Participant's track record of compliance with the scheme requirements. It includes but is not limited to performance in audits (audit history), reporting, compliance with accreditation conditions and other factors such as its responsiveness to requests and voluntary actions.
Energy Saver	Means the person who has the right to create ESCs for particular energy savings arising from an implementation of a RESA at a site, as defined in the relevant calculation method of the ESS Rule.
Energy Savings Certificates (**ESCs**)	A transferable certificate under Part 9 of the Act that is created in accordance with the ESS Rule, and that represents the energy savings associated with the installation, modification, replacement or removal of energy using equipment.
Failed Audit	An audit with one or more material errors (either quantitative or qualitative) as determined by the auditor. This includes repeat recommendations that are not resolved.

Category	Definition
Invalid ESCs	ESCs not created in a way that meet the requirements of the Act, Regulation, ESS Rule and any accreditation conditions imposed on the ACP. In general, invalid ESCs must be forfeited by the ACP.
Material Error	A quantitative material error is when the absolute error rate (as determined by the auditor) is ≥5%. A qualitative material error is determined by the auditor; it typically relates to issues identified by the auditor that reduce their confidence that the auditee has adequate systems in place to support ESC creation.
Net Error Rate	The net error rate determines the number of improperly created ESCs and if errors are systemic. It is calculated by dividing the difference of all identified misstatements (over creation minus eligible under creation of ESCs) by the number of ESCs in the sample. A net error rate of ≥ 5% is a systemic error.
Passed Audit	An audit that is not a failed audit.
Recognised Energy Savings Activity (**RESA**)	Activities that are eligible under the ESS Rule. ACPs are accredited to carry out these activities at a single site, or at multiple sites as a program of energy savings activities.
Scheme Participant	Mandatory participants in the scheme, primarily electricity retailers, who are required to meet individual energy savings targets through the surrender of ESCs or payment of a penalty.

Appendices

A. Treatment of errors and sampling during audit

This appendix describes our general approach for addressing the errors identified in audits. Further guidance on how auditors determine sample sizes and assess and report on errors in audits is provided in the *Audit Guideline*.[23]

A.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 scheme if the omission or misstatement of information could adversely impact:

- the correctness of an AESS
- decisions relating to the accreditation of an ACP, 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.

A.2 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**' is greater than or equal to 5%. If an auditor finds an absolute error rate above this materiality threshold, the audit is considered to be a fail. This will impact on progression of volumetric audit limits and may affect set-aside deeds.

The absolute error 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.

[23] Refer: www.ess.nsw.gov.au/Audits_and_Compliance/Audit_and_compliance_guides.

For ACPs, we have specified that quantitative errors are systemic if the calculated '**net error rate**' is greater than or equal to 5%. If an auditor finds a net error rate above this systemic threshold, the net error rate is applied across the population of ESCs being audited to determine the total number of improperly created ESCs that should be forfeited.

The net error rate is the difference of all identified misstatements (over creation minus under creation of ESCs that are still eligible for creation), divided by the number of ESCs in the sample.

If the net error rate is less than 5%, the actual number of invalid ESCs identified in the audit is the number of improperly created ESCs. Over created ESCs will be asked to be forfeited. Under created ESCs may be registered, provided that vintage can still be registered. If the vintage can no longer be registered, the ESCs can't be registered.

The auditor will identify a number of ESCs over which it 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.

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).

A.3 Qualitative errors

Qualitative errors 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 ESC 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 may not result in a material qualitative error being identified.

A.4 Treatment of material errors and their effect on audit results

Where a material error (absolute error rate of ≥5% or material qualitative error) is identified, we may:

- Ask 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.
- 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.[24]
- 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 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.

Auditors are asked to provide an opinion on whether the material error is systemic or 'one-off'. This opinion will inform our decision about the treatment of the error. Where the errors are systemic, 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 conditions to reflect important audit recommendations following audits where material errors are identified, or audit recommendations are not addressed in subsequent audits.

A.5 Non-material errors

Where an audit identifies either no errors or only non-material errors (ie, an error rate of <5%), we will request that the ACP voluntarily forfeit all invalid ESCs identified.

For example, if an over-creation of eight ESCs is found in an audit sample of 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 eight ESCs identified by the auditor as invalid. The ACP would have 'passed' the audit.

[24] 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

A.6 Pre-registration audits

For pre-registration audits, the auditor will examine the total number of ESCs the ACP proposes to create and identify the number of ESCs it considers can be validly created. If it considers that some of the proposed ESC creation is invalid, this must be shown in the audit report and a net error rate determined. Results of pre-registration audits count towards an ACP's compliance history but do not affect deed requirements.

Following the successful completion of the audit, the ACP will be able to apply to register the number of ESCs the auditor found can be validly created.

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.

A.7 Audit sampling

Audit sampling is conducted at the auditor's discretion, subject to detailed scope of works for an audit. The auditor must sample a sufficient amount of supporting evidence to give them confidence that no material misstatements exist and that ESC 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 of ±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), and
- differing installers or RESA delivery models (contractor/employees).

Auditors should also have regard to any specific advice we publish for audits of different types of RESAs. This can be found in the *ESS Audit Scope – audits of ESC creation for ACPs*[25]

A.8 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 three tiers. Table A.1 lists the characteristics of each audit tier.

The sample size is reduced from Tier 1 (desktop review) to Tier 3 (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 that was subject to the desktop review. In this way the records for each site visit will have had both detailed and desktop reviews.

Table A.1 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: – Evidence Pack(if applicable) and required supporting information – energy saver nomination forms – 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 verify the evidence provided.

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

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 for this level of review.

Site visits provide a higher level of assurance resulting from the physical inspection of energy saving 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 verify (or 'ground truth') a representative sample of the sites for which more high-level reviews have taken place.

[25] Refer: http://www.ess.nsw.gov.au/Audits_and_Compliance/Audit_scopes