



**Single Electricity Market
(SEM)**

Capacity Market Code

Terms of Reference for the Year 2 Market Audit

Decision Paper

SEM-21-003

14 January 2020

Contents

1. Executive Summary 3

2. Background 4

3. Proposed Year 2 Audit Report Scope 5

4. Responses to SEM-20-073 5

5. SEM Committee Response 9

6. SEM Committee Decision 11

7. Next Steps 13

Appendix A (i) – BGE response SEM-20-073

Appendix A (ii) – SSE Response SEM-20-073

Appendix A (iii) – Energia response SEM-20-073

1. EXECUTIVE SUMMARY

The Capacity Market Code (“CMC”) sets out the arrangements whereby market participants can qualify for, and participate in, auctions for the award of capacity. The settlement arrangements for the Capacity Remuneration Mechanism (CRM) form part of the revised Trading and Settlement Code. Decisions made during the development of the I-SEM CRM Detailed Design were translated into auction market rules to form the Capacity Market Code (CMC) (SEM-17-033) which was published in June 2017 and the most recent version is dated 31 July 2020.

Section B.11 of the CMC states the Regulatory Authorities (RAs) shall appoint a person or firm as Capacity Market Auditor who in turn is required to conduct an audit of the operation and implementation of the arrangements, procedures and processes under this Code at least once a Year, in accordance with the terms of reference determined by the Regulatory Authorities.

As stated under B.11.2.4 of the CMC the RAs shall specify the precise terms of reference for an audit following the consultation process under paragraph B.11.2.3 and in sufficient time to enable the Capacity Market Auditor to complete the work in a timely manner.

This paper sets out the Terms of Reference (TOR) that the SEM Committee has set for the Capacity Market Year 2 Audit Report, following the publication of the consultation paper [*SEM-20-073 Capacity Market Code Terms of Reference for the Year 2 Market Audit*](#).

Following the closure of the period for consultation, the RAs received three responses, none of which were marked as confidential. Based on these responses the SEM Committee has decided to implement the following:

1. Timescale

The SEM Committee has decided that the Year 2 Capacity Market Audit Report will cover the 12 month period from 1 May 2019 to 30 April 2020.

2. Reporting

The SEM Committee has decided the Market Auditor will continue to conduct audit process under the International Standard on Assurance Engagements (ISAE 3000).

3. Terms of Reference

The SEM Committee has decided to implement the following TOR for the Year 2 Market Audit Report:

- Accession and Registration;
- Default, Suspension and Termination;
- Qualification;
- Operation of the auction and award of capacity;
- Secondary trading;
- Implementation agreements;
- SO and other Charges;
- Invoicing and Payment;
- Credit Cover management;

- Disputes;
- Modifications; and
- Design Authority / Code development and Systems Upgrade

Following the publication of this decision paper the Market Auditor will begin work on the Year 2 Audit Report. The Auditor will provide the RAs with an interim audit report in Q3 2021 and the Final Audit report will be made available in Q1 2022.

2. BACKGROUND

As set out under section B.11.2.1 of the CMC the Capacity Market Auditor is required to conduct an audit of the CMC, its operation and implementation of the arrangements, procedures and processes under the CMC at least once a Year.

Ahead of the Auditor undertaking the steps required to compile the report, paragraph B.11.2.3 of the CMC firstly requires the RAs to consult with Parties on the terms of reference for the audit. Paragraph B.11.2.4 requires the RAs to specify annually the precise terms of reference for the audit following this consultation process.

The purpose of this paper is to set out the SEM Committee decision relating to the TOR applicable to the Capacity Market Year 2 Auditor Report.

The first Capacity Market Audit was conducted in 2019/20 and covered the time period between 15 December 2017 and 30 April 2019. This 17 month period encompassed the following Capacity Auctions:

- T-1 CY2018/2019 – which took place on 15 December 2017;
- T-1 CY2019/2020 – which took place on 13 December 2018; and
- T-4 CY2022/2023 – which took place on 28 March 2019.

The basis of the Auditor's Opinion was also conducted under the International Standard on Assurance Engagements (ISAE 3000).

3. PROPOSED YEAR 2 AUDIT REPORT SCOPE

On 16 November 2020 the RAs published the Consultation Paper on the proposed TOR for the Year 2 Capacity Market Code Market Audit ([SEM-20-073](#)). The key proposals for scope are outlined below.

- The Year 2 audit will cover the 12-month period of 1 May 2019 – 30 April 2020. This audit report will incorporate the following Capacity Auctions:
 - ❖ T-1 CY2020/2021 – which took place on 26 November 2019;
 - ❖ T-2 CY2021/2022 – which took place on 5 December 2019; and
 - ❖ T-4 CY2023/2024 – which took place on 27 April 2020.

- The Capacity Market Auditor’s Opinion will continue to be conducted under the International Standard on Assurance Engagements (ISAE 3000);

- Taking the following into account that there have not been any changes to processes within the CRM as yet (for example, the Secondary Trading Process not implemented within the window of the Year 2 report) and the view that the issues highlighted in the Year 1 report should not persist. The SEM Committee proposed that the Year 2 audit report will mirror those covered in Year 1. This includes:
 - ❖ Accession and Registration;
 - ❖ Default,
 - ❖ Suspension and Termination;
 - ❖ Qualification;
 - ❖ Operation of the auction and award of capacity;
 - ❖ Secondary trading;
 - ❖ Implementation agreements;
 - ❖ SO and other Charges;
 - ❖ Invoicing and Payment;
 - ❖ Credit Cover management;
 - ❖ Disputes;
 - ❖ Modifications; and
 - ❖ Design Authority / Code development and Systems Upgrade.

4. RESPONSES TO SEM-20-073

This paper includes a summary of the responses made to the Capacity Market Code Terms of Reference for the Year 2 Market Audit consultation paper ([SEM-20-073](#)) which was published on 16 November 2020 and closed on 14 December 2020.

A total of three responses were received by close of the consultation period and none were marked confidential. The respondents are outlined below and copies of each response can be obtained from the SEM Committee website.

- Bord Gáis Energy (BGE)
- SSE
- Energia

Each of the respondents welcomed the opportunity to provide commentary on the proposed TOR for the Year 2 Market Auditor Report.

BGE Comments

In principle, BGE welcomed that the Terms of Reference for the audit of Year 2 operations of the Capacity Market Code will mirror those that covered the audit in Year 1 stating that consistency of approach and reporting is important to ensure the operation of the CMC within its scope and in line with requirements.

The also stated that the RAs proposal to retain the requirements set out in SEM Committee Decision Paper SEM-17-023 supports continuity in the approach, roles and completion of the audit process including the application of recognised international standards.

BGE advised it is important that the upcoming audit on Year 2 operations examines the effectiveness of the auctions in meeting the CMC requirements under the auction format(s) used.

They believe this as an important review of the success, and potential shortcomings, of the auction formats used to date given the pending introduction of Auction Format D for the next capacity auction (Capacity Year 2024/25 T-4) that is due to be run in January 2021. BGE stated that they would welcome any views the audit may have relating to the previous auction formats to demonstrate any improvements that Auction Format D is seeking to address.

BGE took the opportunity to state that they continue to support the independent oversight of the CMC operations played by both the Auction Monitor and Auction Auditor. They elaborated that their position remains that these two roles should remain separate and be performed by different entities to avoid any potential undermining of the integrity of each role due to perceived/ actual conflicts of interest that may arise.

BGE stated they would welcome the auditor's views on the embedding by the System Operator of the solutions to issues identified in the last audit report, particularly with regards to the publication of participant relevant information.

They referred to matters identified in the Year 1 Capacity Market Audit report which highlighted that there were instances where *"Information not published as required"*.

BGE highlighted that whilst this was not reported as significant in nature, they are of the view that it raises concerns in what is an important area to participants who look to the System Operator to publicly provide information on all market participants for transparency.

BGE elaborated that high levels of transparency of information are increasingly important for market participants, especially with the implementation of the Supplementary Secondary Trading Arrangements for capacity contracts and the reliance on up-to-date Capacity Contract registers.

BGE reiterated that the SEMO website is an important communications and information tool to participants, and they feel it is important that the website is as clear and informative as possible for all market participants.

These comments relating to transparency and delays to deliverables were also echoed in the SSE response to the consultation.

SSE Comments

In their response, SSE stated that having had experience of the T-1 and T-4 auctions for several years, they welcome the intention for a second audit of compliance under the Capacity Market Code and elaborated that they understand the scope covers all areas required under the CMC and are supportive of the specific auditing standards being employed.

Whilst supportive of standards set out in the consultation paper, SSE took the opportunity to raise a number of concerns with regards to the responsiveness of the System Operators, specifically around publication deadlines and transparency.

Their first concern they wish to be considered in the audit relates to the delays relating to deliverables and milestones on an ongoing basis. They have directly referred to delays experienced with the publication of Initial and Final Information Packs, stating that this has an impact on those participating in the auctions. They further have stated that this has occurred on several occasions alongside other delays to milestones and deliverables within the auctions and requested that persistent delays must be examined in the context of compliance with the overall process and delivery of the auctions.

The second concern raised by SSE is in regards to their belief that transparency is not as optimal as it could be. They have referred to similar auctions in GB, whereby qualification registers are published before the auctions and provide a level of transparency for participants to prepare. SSE encouraged that this must be considered in the context of delivery of the qualification requirements, otherwise, it should be seriously considered as a modification to the CMC.

SSE did however note that recently, SEMO has published all the details after the auction, which is a welcome first step, but believe this is of little value to participants following the auction.

SSE's final concern was in regards to a lack of version control relating to the qualification documentation, stating the example whereby if there is an error and is required to be withdrawn and updated, it is not always clear what changes have been made as the previous documentation is overwritten. They elaborated that for participants to be able to adequately prepare and track changes, version control should be considered as an obvious project management strategy to ensure an appropriate data trail for future assessment of compliance.

Energia Comments

Energia welcomed the opportunity to respond to the Consultation stating that Capacity Market Audit function serves an important purpose in providing independent assurance to both market participants and to the Regulatory Authorities on the operation and conduct of the Capacity Market.

In relation to the Audit Report Format, Energia advised that the Consultation Paper indicates a position to conduct the Year 2 Market Audit under the same ISAE 3000 format that was used for the Year 1 Market Audit. However, Energia elaborated that, upon review of the Decision Paper in relation to the original Terms of Reference for the Capacity Market Audit, the audit opinion was to be provided using the Agreed upon Procedures approach set out in ISRS 4400. Energia requested clarity be provided on the differences between the two reporting formats and why the Market Audit reports are to use a different format than that stated in the SEM-17-023 Decision Paper.

In regards to the Audit Scope, Energia referred to two areas which are included within the proposed scope of the auditor's review, namely Qualification and Operation of the auction and award of capacity appear to have been omitted from the Year 1 Report.

They have highlighted that the report states that *"the RAs have confirmed that those areas already assessed and reported on by the Capacity Auction Monitor are not required to also be assessed by the Capacity Market Auditor – in broad terms....this excludes from the Auditor scope the activities relating to Qualification and Operation of the Auction for the three Auctions included in the Auction Period"*.

Of the three Auctions referred to in the Auction Period for the Year 1 Market Audit report, Energia advise they have only been able to source publication of the Capacity Auction Monitor Report for the T-4 CY2022/2023 auction and are unclear as to whether the Auction Monitor Reports for the remaining auctions have been published. They advised they would welcome clarity on this in advance of the upcoming Year 2 Market Audit given that for two of the specified auctions within the Year 2 Audit Period i.e. the T-1 CY2020/2021 auction and the T-2 CY2021/2022 auction, the Capacity Auction Monitor Reports do not appear to have been published.

Energia took this opportunity to provide comment on the timing of publication of the Capacity Market Audit Report. Advising that the Year 1 report was finalised on 14 July 2020 however it was not published until November 2020. Energia recommend more timely publication of the Capacity Audit Market Report to help provide clarity for all parties concerned. Paragraph B.11.2.6 of the Capacity Market Code (CMC) states that the System Operators shall arrange publication of the Audit Report in its final form upon delivery but does not specify a time period for which this must be completed.

They have recommended that a reasonable timeframe for publication of the Audit Report by the System Operator be codified in the CMC to assist with providing transparency in a timelier manner.

5. SEM COMMITTEE RESPONSE

Reporting based on Auctions Format

In their response to the consultation, BGE requested that the Year 2 Audit Report examines the effectiveness of the auctions in meeting the CMC requirements under the auction format(s) used. However, whilst the SEM Committee recognise the point being made, they are of the view that this is not necessary as part of the Year 2 TOR.

The period covered under the Year 2 timeframe will include the T-1 CY2020/21, T-2 CY2021/22 and the T-4 CY2023/2024 – all of which utilised the Interim Auction Solution Methodology. Given that the IASM format had been utilised for the auctions to be covered in the Year 2 report, the SEM Committee do not deem it appropriate for the Auditor to review what BGE referred to as any “potential shortcomings” between previously utilised auctions formats and Auction Format D. Furthermore, the SEM Committee would also reiterate that the T-4 CY2024/25 Capacity Auction, which is expected to be run using Auction format D is not subject to the Year 2 report, instead would be covered by a subsequent future report.

Capacity Market Auditor and Capacity Auction Monitor Roles

In their response, BGE also stated it is their preference that the roles performed by the Capacity Market Auditor and Capacity Auction Monitor should remain separate and be performed by different entities.

Both the Market Auditor and Auction Monitor roles are currently performed by two different entities and are currently contracted to perform their respective individual tasks. Whilst the SEM Committee note the concern raised, they are of the view that this concern is mitigated by the current status quo. It should also be noted that under the TOR for the Year 2 Market Audit, the SEM Committee are not suggesting this status quo will be changed.

Delays to the Publication of System Operator Papers

Both BGE and SSE raised concerns with the number of delays that have been experienced with regards to information not being published when required. BGE advised that this raises concerns as Market participants who to the System Operator to publicly provide information on all market participants for transparency. SSE had similar concern whereby the referred to delays experienced with the publication of Initial and Final Information Packs.

The SEM Committee have raised the issue of delays, not only in regards to publications, but delays in terms of processes also, with the System Operator. As part of the Year 1 report, the System Operator has set out how they intend to mitigate issues experienced within the Year 1 audit process. The SEM Committee reiterate that they adopted the minded-to position cover the same TOR in the Year 2 report as in the Year 1 report to ensure that issues experienced do not become perennial.

Concerns relating to Transparency

In their response, SSE stated it is their view that transparency is not as optimal as it realistically could be. They have referred to the situation whereby, in GB, and ahead of Capacity Auctions there qualification registers are published which provide a level of transparency for participants. They have also raised concerns relating to transparency specifically when it comes to version control relating to the documentation published by the System Operators.

Whilst the SEM Committee recognise these concerns they reiterate that the role of the Market Auditor is to monitor the processes currently in place within the Capacity Market.

The SEM Committee would encourage SSE to propose a modification for discussion if they believe this would aid in increasing the levels of transparency around publications and version control.

Audit Report Format

Energia referred to Year 1 report being completed under International Standard on Assurance Engagements (ISAE 3000) and queried why this varied from the original TOR decision, set out in SEM-17-023, whereby the opinion was that the Market Auditor should report using International Standards on Related Services 4400 (ISRS 4400). They had also requested clarity on the differences between the two reporting formats.

In terms of the differences between the two reporting techniques, it should be noted that there is a hierarchy that exists between the two formats, with ISAE 3000 being the preferred option.

- ISAE 3000 requires the auditor to provide an assurance opinion (e.g. limited assurance or reasonable assurance), which the SEM Committee deem to be the preferred outcome; and
- ISRS 4400 is an Agreed Upon Procedures audit – In this instance the auditor does not give an opinion, instead they set out the facts as they have observed them in terms of the process followed.

Within the original TOR Consultation paper (SEM-17-007) the question was asked as to whether ISAE 3000 or ISRS 4400 should be utilised. In the subsequent decision paper (SEM-17-023) the reporting technique to be utilised was listed as ISRS4400, however, this was an error and the result of a mix up in the references between the TS&C and Capacity Market reports and should have been set as ISAE 3000.

The SEM Committee note that given the ISAE 3000 is a stronger audit report and the Regulatory Authorities always try to seek an assurance report where possible, this is and has been the preferred option.

Taking this into account, the Year 1 Market Audit Report has been conducted as had originally been intended.

Audit Scope

Energia stated that within the Capacity Market Auditors scope Qualification and Operation of the auction and award of capacity appear to have been omitted from the Year 1 Report. They further stated that of the three Auctions referred to in the Auction Period for the Year 1 Report, they have only been able to source publication of the Capacity Auction Monitor Report for the T-4 CY2022/2023 auction.

Taking account of the fact that the Capacity Auction Monitor have already reported on these areas, the SEM Committee deemed that it was not appropriate, nor required that the Market Auditor revisit these areas.

Delay to the Publication of the Year 1 Report

Energia requested clarity with regards to the delay to the publication of the Year 1 Market Auditor Report and assurances that the Year 2 report would be made available within a reasonable timeframe.

The SEM Committee would like to note that the publication of the report was delayed due to a number of various issues, including the impacts resulting from the COVID-19 pandemic. This had a substantial impact with regards to the finalisation of the Year 1 report.

The SEM Committee intend for the Year 2 Audit Report to be available in Q1 of 2022, however would stress that, whilst they will use reasonable endeavours to publish the Report as soon as practically possible, this is not a fixed deadline.

6. SEM COMMITTEE DECISION

Following the receipt and analysis of the responses to the consultation paper the SEM Committee has decided to implement the following approach and TOR for the Year 2 Capacity Market Auditor Report:

1. Timescale

As set out under B.11.2.2 of the CMC the annual period covered by the audit shall be 1 January to 31 December *unless the terms of reference specify a different period*. In this instance the SEM Committee hereby state that the Year 2 Audit report will cover the 12 month period between 1 May 2019 and 30 April 2020.

2. Reporting

The basis of the Auditor's Opinion for the Year 1 Audit Report was conducted under the International Standard on Assurance Engagements (ISAE 3000). As advised, the Terms of Reference for the Capacity Market Auditor and Capacity Auction Monitor Decision Paper (SEM-17-023) published in April 2017, listed the Audit Reporting type incorrectly as ISRS4400.

Taking account of the fact that ISAE 3000 requires the auditor to provide an assurance opinion, which is the preferred option, the SEM Committee have decided that in conducting the Year 2 Audit report, the Auditor will continue to do so under ISAE 3000.

The SEM Committee considers an assurance opinion is likely to produce the most useful information for the RAs and Market Participants.

3. Terms of Reference

As set out in the consultation paper, the SEM Committee proposed that the TOR for the Year 2 Audit remain as they were for the Year 1 Audit.

The SEM Committee were of the view that given there has not been the implementation of any major processes within the CRM during the period to be covered by the Year 2 audit report, it was unnecessary to amend the TOR at this stage.

Within the consultation paper the SEM Committee had also stated that as a result of the multiple issues identified as part of the Year 1 Audit report¹ (published on the SEMO website on 23 November 2020), there was a justification for the TOR to remain as is, to ensure that the issues raised in the Year 1 report do not persist.

It is the SEM Committee's view on this has not changed and therefore the TOR for the Year 2 Audit Report will include:

- Accession and Registration;
- Default, Suspension and Termination;
- Qualification;
- Operation of the auction and award of capacity;
- Secondary trading;
- Implementation agreements;
- SO and other Charges;
- Invoicing and Payment;
- Credit Cover management;
- Disputes;
- Modifications; and
- Design Authority / Code development and Systems Upgrade

¹ Capacity Market Audit Year 1 Report: <https://www.sem-o.com/documents/general-publications/Final-Capacity-Audit-Report-14-July-2020-REDACTED.PDF>

7. NEXT STEPS

Following publication of this paper the Capacity Market Auditor will begin work on the audit. The Auditor will provide the RAs with an interim audit report in Q3 2021.

The interim audit results will not be published, but if major issues arise the RAs will articulate these to market participants. The final audit report will be published in Q1 2022.