



Making a positive difference
for energy consumers

Chartered Institute of Internal
Auditors
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Date: 08 May 2024

Dear Sir/Madam,

Ofgem's response to the Chartered Institute of Internal Auditors Revised Internal Audit Code of Practice Consultation.

Thank you for the opportunity to respond to the consultation setting out revised code practices for financial services, private and third-party organisations.

Ofgem is the GB energy regulator, and our principal aim is to protect the interests of current and future GB energy consumers.

In Ofgem's Multiyear Strategy¹ we outlined our focus on improving financial resilience measures and monitoring across all parts of the energy market we regulate, in particular retail supply, networks, and to protect security of supply (generators and gas shippers).

As we saw from the recent energy crisis, a lack of financial resilience and poor practices can lead to excessive risk taking and disorderly exits from the retail energy market which in turn lead to significant financial costs for consumers².

Since 2021 we have introduced a range of measures designed to improve the financial resilience of energy supply licensees. For example, we introduced a common minimum capital requirement for domestic suppliers and modified the licence so that we can direct suppliers

¹ Our Multiyear Strategy can be found [here](#)

² The cost from Supplier of Last Resort (SoLR) is currently estimated at £2.6bn²

to ringfence customer credit balances when certain triggers are met unless it would not be in the consumer interest to do so. We also enshrined in the licence a requirement for suppliers to ringfence their Renewable Obligations attributable to domestic supply and to enhance the existing Financial Responsibility Principle set out in the supply licence.

We also recognise the importance of energy firms having robust financial governance in place, including appropriate internal auditing arrangements. As part of our new financial resilience measures, we have enhanced our Financial Responsibility Principle for energy supply licensees, introducing a framework for managing financial risks to be used when considering the capital and liquidity requirements of the business. To help support their capital and liquidity planning, we have set out how we expect energy supply licensees to either have an independent internal audit function or explain why they do not as part of their Annual Adequacy Self Assessments³.

We have also begun a consultation process with the Gas Distribution and Transmission networks with a view to improving the measures and monitoring of financial resilience in the sector⁴.

We believe that strong financial governance should enable risks to be quickly surfaced, communicated, and managed, and support effective financial decision making while prioritising consumers' interests. We would also expect energy firms' governance approaches to continually evolve, taking account of changing circumstances, shifts in consumer interest and learning from best practices and previous mistakes. We believe that internal audit can play an important role in enabling firms to achieve these outcomes, including by monitoring, measuring, and managing risk and communicating this clearly within the organisation.

We recognise how the revised Code of Practice may be useful for energy firms and acknowledge the Chartered Institute of Internal Auditors' efforts to strengthen the existing code. We comment on some specific points arising from the consultation in the remainder of our response.

Outcome Statements

The revised code places significance on the overall impact and effectiveness of internal audit within organisations and we recognise the benefits this approach may have. In particular, we can see the value in introducing 'Outcome Statements' at the beginning of each section of

³ The Annual Adequacy Self-Assessment ('the AASA') is a requirement for licensees to provide Ofgem with an assessment of their business model, risks and mitigations over the previous 12 months and the coming year, evidencing how they are compliant with our Financial Responsibility Principle. Further information can be found in our [guidance](#) under section 3.75.

⁴ The consultation to changes RII03 changes can be found [here](#)

the code, and their intended effect, namely providing substantial understanding and clarity about the impact of each principle alongside improving efficiency in delivering these principles.

Scope and Priorities section

We also recognise the beneficial additions to the scope and priorities section of the code. We anticipate independent internal audit likely being used to support judgements about business and capital and liquidity planning. We therefore acknowledge the benefits from the proposal to include the modelling and management of organisations' capital and liquidity risks as being in scope of internal audit functions for all types of organisations is likely to have.

Principle One

We note that Principle One is focused on ensuring the protection of a company's assets, reputation, and sustainability. As stated above, Ofgem's principal aim is to protect energy consumers and we expect consumers to be placed at the forefront of licensee's priorities. We believe that energy firms can develop their business models and governance practices in a way that suitably balances and prioritises each of these aims and would expect them to do so.

Proportionality

We are conscious that the diversity across the energy market means that it is unlikely one approach will suit every licensee. While we see an independent internal audit function as an important way to ensure risk management and wider governance arrangements operate effectively, we recognise the importance of ensuring an appropriate balance is struck when integrating internal auditing across, for example, all energy supply licensees to ensure proportionality.

We recognise the reference in the revised Code of Practice under 'risk management, compliance, finance, and control functions' in Section D and in the original Internal Audit Code of Practice to the function of internal audit including assessing and interacting with the risk management, compliance, finance, and other control functions. We recognise the importance of complying with legal and regulatory requirements and would expect to see this reflected in the revised guidance.

We are grateful for the opportunity to respond to this consultation and look forward to observing and contributing to further related work.

Yours sincerely,

David Hall

Deputy Director of Financial Resilience and Controls