



Report on the Audit of Net Settlement Surplus/Deficit

**Third Quarter Audit of CY 2021
26 June to 25 September 2021**

DECEMBER 2023

This Report is prepared by the
Philippine Electricity Market Corporation –
Market Assessment Group for the
PEM Audit Committee

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Contents

FOREWORD.....	2
1.0 ABOUT THIS REPORT.....	4
2.0 EXECUTIVE SUMMARY	4
2.1 BACKGROUND	4
2.2 AUDIT SCOPE AND OBJECTIVES	5
2.3 AUDIT METHODOLOGY	5
2.4 AUDIT FINDINGS AND CONCLUSION.....	6
2.4.1 IT GENERAL CONTROLS (ITGC) REVIEW OF THE NSS/NSD TOOL	6
2.4.2 RECALCULATION OF NSS/NSD AND ITS ALLOCATION, CORRESPONDING VALUE- ADDED TAX AND INTEREST AMOUNTS, AND BILLING AND COLLECTION.....	7

FOREWORD

In its Resolution No. 07 Series of 2019, the Energy Regulatory Commission (ERC) directed the Philippine Electricity Market Corporation (PEMC) to perform an audit. This audit encompasses the actual calculation of Net Settlement Surplus (NSS) or Net Settlement Deficit (NSD), its allocation, Value Added Tax (VAT) along with interest amounts, as well as the actual billing and collection. Additionally, the ERC specified that this audit should occur quarterly and be carried out by a qualified third-party auditor.

In compliance with the said provision, the Philippine Electricity Market Audit Committee (PAC) conducted the NSS/ND Audit covering the period 26 June to 25 September 2021, utilizing the services of the Independent Auditor, Roxas Cruz Tagle & Co.

The audit aimed to assess compliance of the of the Independent Electricity Market Operator of the Philippines (IEMOP) with the Market Rules and Manuals, and directives of the ERC through its communications, orders, and issuances. The audit also determined the relevant controls (or lack thereof) and verified the effectiveness of identified controls to prevent, detect and/or correct errors on NSS/NSD.

The audit commenced in September 2022 and was concluded with a closing meeting held on 04 October 2023.

It may be noted that the audit period covered marked the commencement of the implementation of the enhanced WESM design and operations or the 5-minute market.

Following the completion of the audit, Roxas Cruz Tagle & Co. submitted a report outlining the findings as follows:

- Calculation of NSS/NSD and its allocation, corresponding VAT: No exception was noted between the results of Roxas Cruz Tagle & Co. and IEMOP calculations
- Billing and collection: No exception was noted in the final trading amounts billed to market participants
- IT General Controls (ITGC) Review: The control gaps identified were already addressed by IEMOP

The PAC wishes to convey its appreciation and gratitude to the PEMC management and the IEMOP management for their continuous cooperation and support. This support was invaluable in ensuring the successful completion of the audit.

For the PEM Audit Committee,


FRANCISCO LEODEGARIO R. CASTRO, JR.
Chairperson


CONCEPCION I. TANGLAO
Member


ROSSANO C. LUGA
Member

1.0 ABOUT THIS REPORT

This report is prepared in accordance with Section 3.3.1 of the PEM Audit Market Manual Issue 3.0. It contains the objectives, scope, and audit methodology for conducting the assessment of Net Settlement Surplus/ Net Settlement Deficit (NSS/NSD). Additionally, it presents the findings and recommendations identified during the audit process.

2.0 EXECUTIVE SUMMARY

2.1 BACKGROUND

The Net Settlement Surplus/ Net Settlement Deficit (NSS/NSD) is the surplus or deficit resulting from the locational marginal pricing design and differences between total trading amounts received and paid out in the Wholesale Electricity Spot Market (WESM). Net surpluses must be redistributed to applicable trading participants in accordance with the WESM Rules.

On 23 October 2019, the Energy Regulatory Commission (ERC) promulgated Resolution No. 07, Series of 2019 “A Resolution Adopting Amendments to the Rules for the Distribution of Net Settlement Surplus” or the 2019 NSS Rules. The 2019 NSS Rules came into effect on 25 November 2019.

In Article VII of the 2019 NSS Rules, the ERC directed the Philippine Electricity Market Corporation (PEMC) to comply with the provisions of the WESM Rules on the conduct of Spot Market Audit and include in the said audit, the actual calculation of NSS or NSD, its allocation, VAT along with interest amounts, as well as the actual billing and collection. Additionally, the ERC specified that this audit should occur quarterly and be carried out by a qualified third-party auditor.

During the PAC meeting on 14 October 2020, PEMC presented its proposals for implementing the directives. Given the regulatory nature of these directives, the PAC concurred with PEMC’s suggestion to conduct an independent audit of NSS/NSD within the context of WESM Rules and PEM Audit Manual. Additionally, the PAC agreed with the proposal to retain an Independent Auditor to meet the quarterly audit requirement.

On 17 December 2020, PEMC presented these recommendations to the IEMOP, to which the latter agreed.

Furthermore, during a meeting held on 06 January 2021, the ERC-Market Operations Services (ERC-MOS) also expressed, in principle, their agreement with the recommendations put forth by PEMC. In response to instructions from ERC-MOS during that meeting, PEMC officially conveyed the recommendations to the Commission on 13 January 2021.

On 24 February 2021, the PEM Board granted approval for the engagement of an Independent Auditor for the NSS/NSD audit. Thereafter, PEMC entered into an engagement with Roxas Cruz Tagle & Co. to conduct the NSS/NSD audit, for the following audit periods:

Audit Period	Covered Billing Months
First Quarter	26 November 2019 to 25 March 2021
Second Quarter	26 March 2021 to 25 June 2021
Third Quarter	26 June 2021 to 25 September 2021
Fourth Quarter	26 September 2021 to 25 December 2021

The audit project commenced with a kickoff meeting on 13 April 2021. Subsequently, the closing meeting for the first quarter audit was held on 26 August 2022.

Following this, Roxas Cruz Tagle & Co. proceeded to conduct the audits for the second quarter in conjunction with the third and fourth quarters. All three (3) audits were concluded with a closing meeting on 04 October 2023.

2.2 AUDIT SCOPE AND OBJECTIVES

The third quarter audit covers the period 26 June to 25 September 2021.

The audit was conducted to assess compliance with the Market Rules and Manuals, and directives of the ERC through its communications, orders, and issuances. The audit also determined the relevant controls (or lack thereof) and verified the effectiveness of identified controls to prevent, detect and/or correct errors on NSS/NSD.

2.3 AUDIT METHODOLOGY

The auditor's work covers the following general procedures (GP) to satisfy the objectives and requirements specified in the Terms of Reference. These procedures are aligned with the Methodology and Philippine Standards on Related Services 4400, *Engagement to Perform Agreed-Upon Procedures Regarding Financial Information*.

GP1. Obtain understanding of the relevant laws, pronouncements, Market Rules and Manuals and directives of ERC.

GP2. Obtain an understanding of the NSS/NSD Tool and identify relevant controls (or lack thereof) and verify effectiveness of identified controls on NSS/NSD Tool.

GP3. Perform an understanding and walkthrough of the processes surrounding the NSS/NSD with the assistance of IEMOP.

GP4. Perform recalculation of NSS/NSD and its allocation, corresponding Value-added Tax and interest amounts, as well as the actual billing and collection performed by IEMOP and determine any inconsistencies and non-compliances.

GP5. Assess any inconsistencies and non-compliances of the foregoing.

GP6. Report the assessments and findings.

In performing GP4, recalculation of NSS/NSD, the auditor selected at least 10 days with the highest amount or at least 50% of total NSS/NSD, whichever is higher, for the billing months spanning July to September 2021.

2.4 AUDIT FINDINGS AND CONCLUSION

2.4.1 IT GENERAL CONTROLS (ITGC) REVIEW OF THE NSS/NSD TOOL

The Independent Auditor noted that IT personnel were able to access the production environment. According to the provided users list as of 08 December 2022, six (6) out of 29 active and inactive users of Central Registration and Settlement System (CRSS) belong to the Information Systems and Technology Department (ISTD).

The Independent Auditor recommended the monitoring of IT personnel activities within the production environment. This can be achieved by generating transaction logs or audit trail documenting IT personnel's actions, which should subsequently undergo management review.

It was also recommended to carry out an annual periodic review of user access to confirm the proper assignment of access rights to all users. This review should include the validation of the continued validity of IT personnel's access to the production environment.

In response, the auditee clarified that the ISTD personnel also provides support for the CRSS and other market systems. Furthermore, due to limited manpower, one of ISTD's responsibilities is to provide support during market operations emergencies and the switch-over from primary system to back-up site. Hence, their access cannot be removed.

Regarding the employees who have resigned, their access to the market systems has been revoked by removing them from the active directory.

The auditee committed to include the review of activity logs as part of its Integrated Management System internal audits. In addition, as of 07 March 2023, the Independent Auditor was able to obtain the following:

- Screenshots of activity logs in CRSS for the three (3) remaining active users; and
- Screenshot of disabled access of the three (3) resigned users.

2.4.2 RECALCULATION OF NSS/NSD AND ITS ALLOCATION, CORRESPONDING VALUE-ADDED TAX AND INTEREST AMOUNTS, AND BILLING AND COLLECTION

Recalculation of NSS/NSD and its Allocation

No exception was noted between the results of the recalculation performed by the Independent Auditor when compared to the auditee's calculation. The Independent Auditor noted either no differences or only minimal differences in their recalculation, attributing the minimal differences to rounding off. It is important to clarify that the amounts presented represent the total amounts of the sampled data for the month, and not the actual total amount for the month.

Recalculation of Value-Added Tax (VAT)

The Independent Auditor reviewed the VAT imposed on the VATable sales per Market Participant and assessed its compliance with BIR regulations. The Independent Auditor noted no exception on the VAT recalculation and attributed minimal differences to rounding off.

Validation of Billing and Collection

The Independent Auditor noted no exception in the validation of Billing and Collection.

In particular, no difference was noted between the monthly final trading amounts calculated by the auditee and the final trading amounts stated in the billing statement of sampled Market Participants.

Moreover, the Independent Auditor compared the billed amount with the collected amount and noted that there are uncollected amounts which represent withholding taxes and unsettled amounts. Likewise, the Independent Auditor noted unsettled VAT for one (1) Market Participant and reiterated that under the Tax code for sale/purchase of service, VATable transactions should be subjected to VAT and should be remitted once collected. Failure to remit VAT will expose an entity to penalties and interests.

For Market Participants with outstanding balances, the auditee issues default notices after the scheduled due date.

As per the Independent Auditor's assessment, the Billing and Collection process has been implemented properly by the auditee. In addition, the Independent Auditor noted that the final billing statements have no wet signature from reviewers and approvers. The auditee clarified that the wet signature was not required since the final billing statements are system generated.