



Improved Monitoring of Balancing Accounts Would Better Ensure That Utility Rates Are Fair and Reasonable

Report 2013-109



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March 4, 2014

2013-109

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the California Public Utilities Commission's (commission) oversight of utility balancing accounts of entities it regulates.

This report concludes that the commission lacks adequate processes to provide sufficient oversight of utility balancing accounts to protect ratepayers from unfair rate increases. State law directs the commission, whenever it authorizes any rate change that includes costs passed on to customers, to require utilities to establish a balancing account. A balancing account is a tracking mechanism used to ensure that a utility recoups from ratepayers costs the commission has authorized and that ratepayers do not pay more than they should. If a balancing account has a balance—indicating an over- or under-collection from ratepayers—the utility will generally seek periodically to adjust future rates to either refund or recoup the balance. State law requires the commission to review semiannually certain balancing accounts; however, it does not otherwise require the commission to review all balancing accounts. Currently, the commission only reviews some balancing accounts when a utility requests to incorporate the balance in that account into future rates as a surcharge or a credit. This practice does not ensure that the commission adequately reviews balancing accounts to protect ratepayers from unreasonable rates. Although the commission relies on the Office of Ratepayer Advocates (Ratepayer Advocates)—an independent office within the commission—to review energy utility balancing accounts, this reliance is misplaced because Ratepayer Advocates is not required to review all energy utility balancing accounts. Ratepayer Advocates primarily focuses on balancing accounts that energy utilities include in formal proceedings, which resulted in it reviewing only 58 percent of the value of large energy utilities' balancing accounts active during 2009 through 2011. It did not review other balancing accounts with a value of \$37.6 billion during this period.

Given that balancing accounts directly affect rates that a utility charges ratepayers and given the broad authority the commission has to inspect and audit utilities' books, accounts, and records, we believe that the commission should use a systematic process that ensures a review of all those balancing accounts that can have the most impact on ratepayers. However, the commission lacks the necessary information, such as the size of a balancing account and the last time it was reviewed, to determine which balancing accounts it should review. In addition to not providing adequate oversight over balancing accounts, the commission has not always complied with a requirement to audit utilities' books and records according to the schedule prescribed by state law. Also, for over three decades, it has not provided the results of these audits to the California State Board of Equalization (Equalization) for tax assessment purposes, as required by state law. Although Equalization believes that this requirement is no longer appropriate, neither Equalization nor the commission has sought to change the law.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The California Public Utilities Commission (commission) is responsible for ensuring that California utility customers have safe, reliable utility service at reasonable rates, for protecting utility customers from fraud, and for promoting the health of California's economy. The commission has broad authority, including the authority to inspect and audit the records of regulated utilities. As such, it regulates the six electric, seven natural gas, and 116 water investor-owned utilities (utilities) in California, and it is responsible for authorizing the rates these utilities may charge ratepayers. Utilities must justify their proposed rates by presenting cost information to the commission during general rate case proceedings (general rate case), typically every three years. The commission's staff, the Office of Ratepayer Advocates (Ratepayer Advocates), and advocacy groups review the information that utilities present during the general rate case to determine whether proposed costs are necessary and reasonable. Ratepayer Advocates is an independent office within the commission with a mission to obtain the lowest possible rate for service consistent with reliable and safe service levels. Based on the reviews and recommendations and upon hearing all evidence and testimonies during a formal hearing, the commission authorizes the rates that utilities may charge their customers.

Because the rates are derived from projected costs and projected consumption of service, state law directs the commission to require utilities to establish *balancing accounts* to track the actual costs and the related revenues the utilities collect from ratepayers for certain activities. The purpose of a balancing account is to allow the utilities to recoup the costs the commission has authorized, while ensuring that ratepayers do not pay more than they should. If a balancing account has a balance—indicating that the utilities have over- or under-collected from ratepayers compared to their costs—the utilities generally seek periodically to adjust their future rates to either refund or recoup the balance. The utilities use both formal and informal proceedings to do so. Although the Energy Division (energy division) performs a high-level review of energy utilities' informal filings, the commission's Division of Water and Audits (water division) and Ratepayer Advocates perform a more detailed review of some balancing accounts when the utilities file for a formal or informal proceeding to refund or recoup their balances.

We noted, however, that the commission lacks adequate processes to provide sufficient oversight of balancing accounts to protect ratepayers from unfair rate increases. The commission relies on Ratepayer Advocates to review balancing accounts of energy

Audit Highlights . . .

Our audit on the California Public Utilities Commission's (commission) monitoring of balancing accounts highlighted the following:

- » *The commission lacks adequate processes for sufficient oversight of utility balancing accounts to protect ratepayers from unfair rate increases.*
- » *The Office of Ratepayer Advocates (Ratepayer Advocates) reviewed only 58 percent of the value of large energy utilities' balancing accounts active during 2009 through 2011, leaving a value of \$37.6 billion in other balancing accounts unreviewed.*
- » *The commission does not have a systematic process for selecting balancing accounts to review.*
- » *Ratepayer Advocates does not ensure that its analysts adequately document and receive formal supervisory approval for reviews of balancing accounts.*
- » *The commission does not periodically audit the accounting records of the utilities it regulates according to a schedule prescribed in law.*
- » *A state law requiring the commission to provide the audit reports to the California State Board of Equalization is outdated.*

utilities (electric, natural gas, or both). However, Ratepayer Advocates only reviews those energy utilities' balancing accounts that are included in certain formal proceedings before the commission. Specifically, Ratepayer Advocates reviewed only 23 percent of large energy utilities' balancing accounts active during 2009 through 2011, representing 58 percent of the dollar value of these balancing accounts. It did not review other balancing accounts that had a total value of \$37.6 billion during this period.

Given that balancing accounts directly affect rates that a utility charges ratepayers and given the broad authority the commission has to inspect and audit utilities' books, accounts, and records, we believe that the commission should use a systematic process that ensures a review of all those balancing accounts that can have the most impact on ratepayers. However, the commission does not have the necessary information, such as the size of the balancing account and the last time the commission reviewed it, to help determine which balancing accounts it should review. Although the commission obtained this information from the utilities upon our request, we found omissions and errors in that information, which will limit its usefulness as a monitoring tool.

In addition to the commission lacking an adequate review process, Ratepayer Advocates' process for performing these reviews had weaknesses. Of the 18 reviews of balancing accounts we examined, only two had sufficient documentation to demonstrate the procedures that Ratepayer Advocates performed. The other 16 reviews were either poorly documented or not documented at all. The lack of documentation for many of the 18 reviews may be caused in part because Ratepayer Advocates does not require supervisors to formally approve analysts' reviews of balancing accounts. Instead, supervisory approval happens during informal discussions about the conclusions analysts have reached in a review without examining the actual work the analysts performed. We believe that a documented supervisory review is necessary to assure Ratepayer Advocates management and other stakeholders that the analyst has performed all planned procedures appropriately and that any reductions in recovery amounts that the analyst may be proposing are accurate. In contrast, most of the water division's reviews of balancing accounts that we tested had appropriate documentation and had received formal approval from a supervisor.

We also found the commission does not audit the accounting records of the utilities it regulates according to the schedule prescribed by state law: every three years for those utilities that serve more than 1,000 customers and every five years for those utilities that serve 1,000 or fewer customers. The intent of the law is to ensure that the commission regularly audits all utilities to increase public confidence in the regulatory process.

The commission generally complies with the audit requirement through procedures it performs during the review of a utility's general rate case. However, the commission does not ensure that all utilities file a general rate case every three or five years to coincide with the audit requirement. Specifically, the commission has allowed five energy utilities with more than 1,000 customers to file their general rate cases beyond a three-year cycle, and it has allowed another small energy utility to adjust rates through informal filings without a general rate case. Further, because it only requires the 10 largest water utilities to file their general rate case every three years, more than half of the remaining 106 water utilities had not filed their general rate cases in time to coincide with the audit requirement in state law. As a result, the commission is not ensuring that it audits these utilities within the time frames the law requires.

Finally, the California State Board of Equalization (Equalization) believes that the law requiring the commission to provide audit reports to Equalization is out of date. Specifically, state law requires the commission to provide its audit reports on utilities' accounting records to Equalization for use in assessing taxes on those utilities. However, the commission has not done so in over three decades. Equalization stated that the commission's general rate cases do not focus on the same components of a utility's operations and finances as assessment of taxes requires. Further, Equalization told us that it assesses taxes on many more companies than those that the commission regulates. Equalization has established its own process to audit all companies, including utilities, in the State and believes that it is in a better position to carry out this function than the commission. Equalization believes that requiring the commission to do the work necessary to allow Equalization to assess taxes on utilities may not be cost-effective for the State. The director of the energy division noted that the commission has not taken a position on whether to change the existing law. Although Equalization believes that the law should be revised to remove the requirement that the commission provide its audit reports to Equalization for tax assessment purposes, neither of them has sought to change the law.

Recommendations

To ensure proper oversight of balancing accounts, the Legislature should amend California Public Utilities Code, Section 792.5, to require the commission to develop a risk-based approach for reviewing all balancing accounts periodically to ensure that the transactions recorded in the balancing accounts are for allowable purposes and supported by appropriate documentation, such as invoices.

To ensure that it has the necessary information to provide appropriate oversight of the balancing accounts of regulated utilities and thus protect ratepayers from unfair rate increases, the commission should regularly update the list of balancing accounts that it authorized and verify its accuracy. Both the commission and Ratepayer Advocates should use this list to guide their oversight efforts.

To ensure that it efficiently and effectively monitors energy utilities' balancing accounts to protect ratepayers from unfair rate increases, the commission should direct its energy division to perform in-depth reviews of balancing accounts that Ratepayer Advocates has not reviewed.

Both Ratepayer Advocates and the water division should, within six months, develop policies to ensure that reviews of balancing accounts are appropriately documented, subjected to supervisory approval, and retained.

The commission should follow the state law requirement to inspect and audit the accounting records of utilities it regulates within required time frames.

The Legislature should amend state law to remove the requirement that the commission provide audit reports to Equalization.

Agency Comments

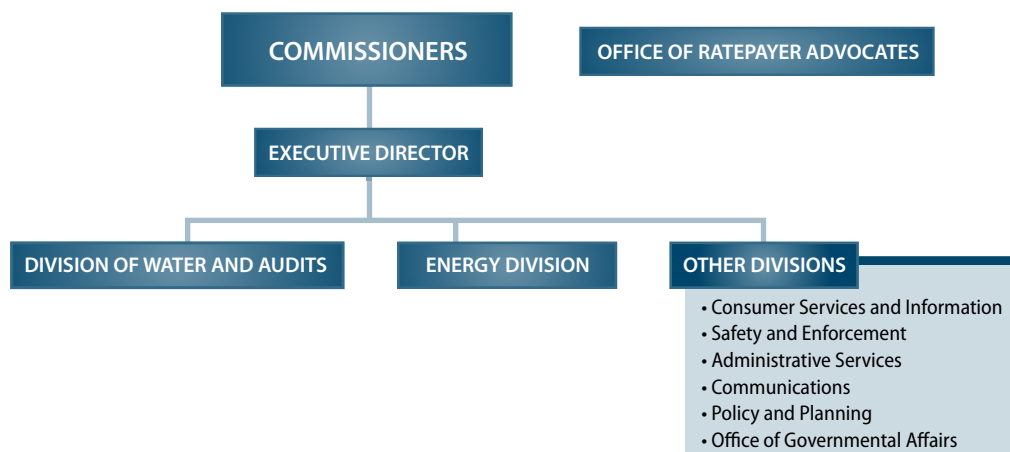
Although Ratepayer Advocates disagreed with some of our conclusions, both it and the commission agreed with our recommendations and plan to implement them.

Introduction

Background

The California Public Utilities Commission (commission) is responsible for ensuring that California utility customers have safe, reliable utility service at reasonable rates, for protecting utility customers, and for promoting the health of California's economy. The commission consists of five members appointed by the governor and approved by the Senate. Along with supporting staff, it regulates all investor-owned utilities (utilities) in the State and is responsible for authorizing the rates these utilities may charge ratepayers. It has broad authority, including the authority to inspect and audit the records of regulated utilities at any time. As of 2013 there were six electric, seven natural gas, and 116 water utilities regulated by the commission in California that served 11.5 million, 10.7 million, and 6.8 million customers, respectively. As Figure 1 shows, the commission has several divisions. The Energy Division (energy division) and the Division of Water and Audits (water division) are responsible for ensuring that utilities comply with commission directives, among other duties. The commission also includes the Office of Ratepayer Advocates (Ratepayer Advocates), an independent office whose director is appointed by the governor; it was established to represent the interests of public utility customers, with the goal of obtaining the lowest possible rate for service consistent with reliable and safe service levels. State law provides Ratepayer Advocates independent authority to review the records of regulated utilities during rate-setting proceedings.

Figure 1
Organization of the California Public Utilities Commission



Source: The California Public Utilities Commission.

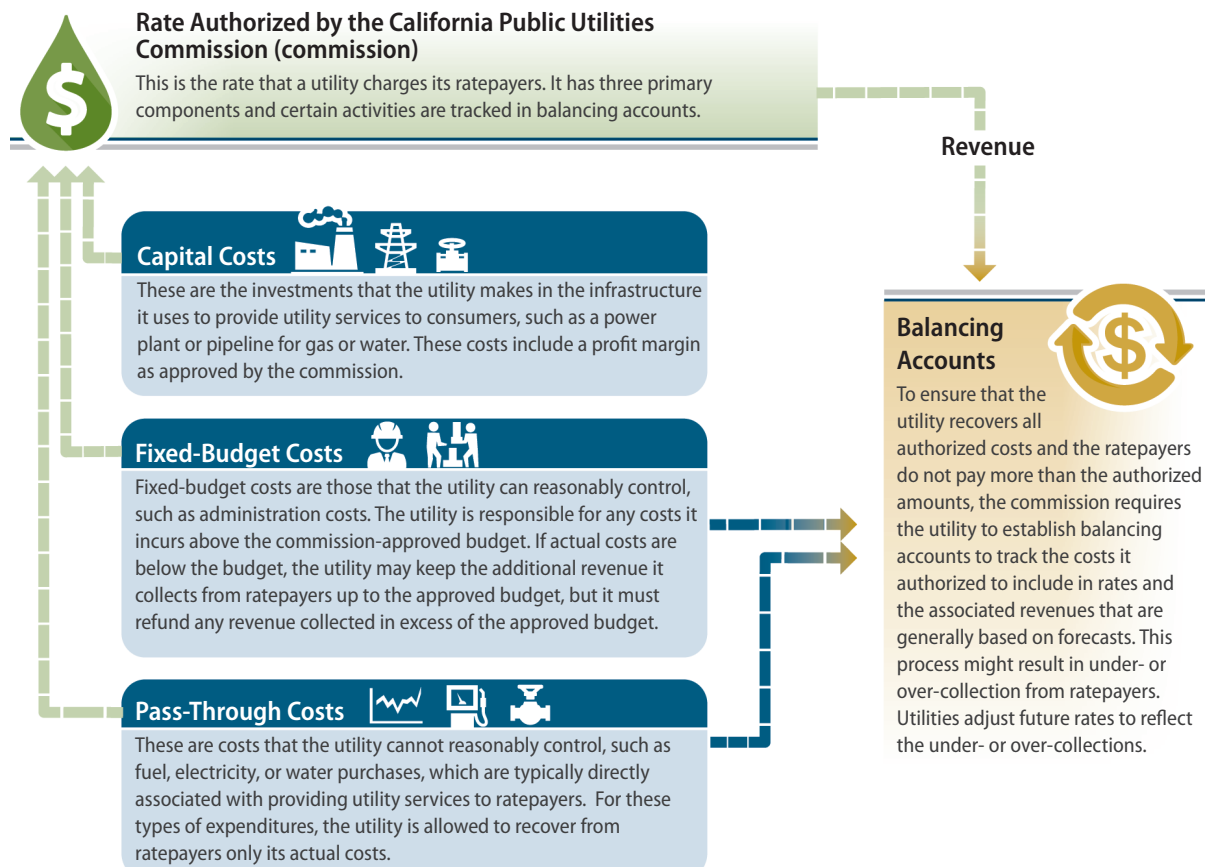
Utilities Establish the Rates Charged to Consumers Through a General Rate Case Proceeding

The commission authorizes the rates that utilities may charge their customers through a process known as the *general rate case*, which typically occurs every three years. Rate setting is a complex process: utilities present their financial records to the commission as well as their proposed rates, which are based on the differing costs of serving various customer classes, on certain statutory requirements, and on public policy reasons for charging different rates per unit.

As Figure 2 shows, when developing its proposed rates, a utility presents costs in three main categories: capital costs, fixed-budget costs, and pass-through costs. The commission allows utilities to make a certain level of profit on capital costs, which represent the utilities' investment in the infrastructure and equipment used to provide electricity, natural gas, or water to consumers, such as a power plant or a pipeline for natural gas or water. For fixed-budget costs, the commission generally authorizes a budget for the utility to recoup the costs that it can reasonably control, such as administration costs. The utility must absorb any fixed-budget costs it incurs that are in excess of the authorized budget, but if costs are under budget, it keeps the amount saved as profit. Finally, for pass-through costs, which are costs that are difficult to reasonably predict, such as costs of purchasing electricity, natural gas, or water, the commission allows the utility to recoup, through rates and without any mark-up, all costs the utility incurs. These three types of costs, including allowed profit margins on capital costs, are incorporated into the rate that the utility proposes to collect from different classes of ratepayers.

After the commission has determined the total amount it will authorize the utility to recover from its customers based on the cost to provide services, the next step is to develop a per unit rate (for example, cents per kilowatt-hour for electricity). However, the cost of serving customers in different classes can vary. For example, some large industrial customers may receive electrical service directly from a transmission line without using additional utility infrastructure, resulting in a lower rate than residential customers who need intermediary utility infrastructure, such as substations and distribution lines, to receive electricity. To reflect these differences in costs, the commission approves different rates for customer classes. The utilities develop these rates based on their forecasts of sales and costs, then they propose the rates to the commission.

Figure 2
The Relationship Between Approved Rates and Balancing Accounts



Source: California State Auditor's review of documentation from the commission.

When a utility files a general rate case, the commission, its staff, Ratepayer Advocates, and other advocacy groups review the costs the utility presents to ensure that the costs are necessary, reasonable, and fair. During the general rate case process, Ratepayer Advocates reviews the utility's accounts, past and projected expenses, revenue forecasts, capital costs, and plant additions; and it may protest the utility's proposed rates on behalf of the ratepayers. Moreover, individuals and groups that represent the interest of ratepayers, businesses, and special interests known as *interveners*, may also provide testimony to the commission regarding proposed rates. These parties may reach an agreement with the utility to adjust its proposed rates. The commission ultimately authorizes the rates the utility may charge its customers after hearing testimony from all involved parties. Because a utility presents numerous documents to justify its proposed rates and because of the time required for the parties to review those documents and to reach an agreement on any adjustments to the

proposed rates, the general rate case may last as long as 18 months. As a result, a utility typically files for the general rate case well in advance of the date the proposed rate would become effective in order to help ensure that it receives commission approval on time. If the commission does not approve the proposed rate before it is due to become effective, the utility may charge ratepayers an interim rate based on the most recent commission-approved rate adjusted for inflation and then recoup or refund the difference between the interim and final rate from ratepayers after the commission has authorized the final rate.

The Commission Requires That Utilities Track Certain Costs and Related Revenues Using Balancing Accounts

State law requires the commission to direct utilities to track specific types of costs and related revenues from customers using a tracking mechanism. This tracking mechanism—known as a *balancing account*—protects ratepayers and utilities by identifying any under- or over-collection of revenue from ratepayers compared to the utilities' actual allowed costs. Because the rates that the commission approves are predicated on projected costs of the utility and projected consumption by ratepayers, both the utilities and the commission have a vested interest in determining the actual costs and revenues related to certain components to determine whether the utility under- or over-collected from ratepayers. For example, the price of natural gas that a gas utility purchases for its ratepayers can fluctuate widely in a short time. Thus, the actual cost that a utility incurs to purchase natural gas can vary from the cost that the utility projected and incorporated into the authorized rate. Because a natural gas utility can only collect from ratepayers up to the price it paid for the purchase of natural gas, the cost of purchasing natural gas and related revenue from ratepayers must be tracked to ensure that the utility recovers its costs and ratepayers do not pay more than the utility's costs.

Before setting up a balancing account, a utility must file a statement that details the purpose of the balancing account and the types of costs or revenue to be tracked in the account with the commission for approval. This statement also details the specific accounting procedures the utility must perform to record a transaction in this balancing account.

The Commission Generally Reviews Balancing Accounts When a Utility Wishes to Incorporate the Balance of an Account Into Future Rates

To the extent that a balancing account has a balance, reflecting either over- or under-collection of revenue from ratepayer charges compared to authorized costs, the utility will periodically incorporate the balance into future rates by providing a reduction or an increase to future rates. Although a utility typically incorporates the balances in these accounts into future rates when it files for a general rate case, at other times it

may request a rate adjustment to reflect the balance by filing an advice letter, which is an informal filing, or by filing a formal application for certain proceedings. The commission noted that allowing a utility to incorporate the balance in a balancing account into future rates before the next general rate case, can mitigate sudden large swings in rates for ratepayers by making smaller changes to the rates more frequently.

The commission provides specific guidance on when the utilities can incorporate a balance into future rates. A large water utility, one with more than 10,000 service connections, may choose to incorporate the balance in an account into future rates using an informal process by filing an advice letter with the commission's water division when the balance exceeds 2 percent of the utility's total annual gross operating revenue. A smaller water utility, one with 10,000 or fewer service connections, is required to file an advice letter at any time before its next general rate case if the balance in one of its balancing accounts exceeds 2 percent of the utility's total annual gross operating revenue. Those advice letters, filed with the water division, contain such information as the total balance in the account, the amount of the credit or surcharge the utility wishes to add to future rates, and other supporting documents. After the water division approves the advice letter, the utility adds the credit or surcharge to its rates.

An energy utility—electric, natural gas, or both—can also use the informal process by filing an advice letter with the energy division. However, unlike a water utility, an energy utility is generally not subject to a similar threshold and it may choose to file an advice letter to incorporate the balance into future rates at any time it deems necessary before its next general rate case.

An electric utility also presents certain costs, such as those for fuel and purchased power, twice each year to the commission through formal proceedings known as Energy Resource Recovery Account (ERRA) proceedings. In the first ERRA proceeding, the utility presents its fuel and purchased power forecasts to the commission for review. In the second ERRA proceeding, the utility submits balancing accounts, such as the utility's designated ERRA balancing account, to incorporate their balances into future rates. Similarly, a natural gas utility must incorporate into future rates the balances in certain balancing accounts through two separate formal proceedings before the commission. Specifically, it must annually file an application for the Gas Procurement Incentive Mechanism proceeding, which allows the commission to review the utility's natural gas purchasing activities to ensure that it is obtaining the best prices. In addition, a natural gas utility must file an application for either the Biennial Cost Allocation Proceeding or the Triennial Cost Allocation Proceeding. These proceedings address the way the utility allocates its costs for providing services to customers. An energy utility can choose to include balancing accounts during these proceedings as a means to incorporate any balances into its rates.

State law grants the commission authority to inspect the accounts, books, papers, and documents, including balancing accounts, of any public utility at any time. In addition to giving the commission this authority, state law also gives Ratepayer Advocates access to any information from public utilities that it deems necessary to perform its duties. State law requires the commission to audit the books and records of all utilities it regulates every three or five years depending on the number of customers a utility serves and to provide these audits to the California State Board of Equalization for tax assessment purposes. Although state law requires the commission to review power procurement balancing accounts semiannually, commonly referred to as ERRA, there is no requirement for the commission or Ratepayer Advocates to specifically review other balancing accounts. The energy division and the water division, as well as Ratepayer Advocates, review balancing accounts that a utility includes in informal advice letters or applications for formal proceedings, and they may request that the utility provide additional support to verify the costs and revenues charged to each balancing account included in these filings. As Table 1 shows, the details included in these reviews vary based on the entity performing the review and the purpose of the review.

The energy division is responsible for reviewing all filings by energy utilities to ensure that the utilities are complying with commission decisions, including making changes to the utility rates based on under- or over-collection in a balancing account before the next general rate case. This review includes verifying that the utility has appropriate authorization to file for rate adjustment, and the energy division may request additional information from the utility if the balance is very large. However, when reviewing those informal filings requesting a change to rates, the energy division does not verify the accuracy or appropriateness of the costs that the energy utility has charged to the balancing account by reviewing detailed documentation, such as invoices. On the other hand, the commission's water division, which is responsible for reviewing informal filings by water utilities, does verify the accuracy and appropriateness of the costs the utility has charged to the balancing account.

Ratepayer Advocates reviews balancing accounts for both water and energy utilities during informal and formal filings. In reviewing informal filings by a water utility, Ratepayer Advocates may initially complete a high-level review of the balancing accounts included in the filing, and it may complete a more comprehensive review if the initial review raises any concerns. While Ratepayer Advocates reviews the informal filings by energy utilities only to ensure that the balances and proposed changes to the balances they included in the filing are reasonable, its oversight efforts are focused on the formal proceedings, during which it completes a more comprehensive review of all of the balancing accounts the energy utility includes during that proceeding.

Table 1
The Nature of Oversight the Various California Public Utilities Commission Units Provide for Balancing Accounts

ENTITY PROVIDING OVERSIGHT	WATER UTILITY BALANCING ACCOUNTS	ENERGY UTILITY BALANCING ACCOUNTS
Energy Division		<p>Performs a high-level review of energy utilities' balancing accounts included in informal advice letter filings by all energy utilities. Specifically, it takes the following steps:</p> <ul style="list-style-type: none"> • Verifies that the utility has appropriate authorization to file for rate recovery by reviewing relevant California Public Utilities Commission (commission) documents such as decisions and preliminary statements. • May request additional information from the utility if the under- or over-collection is very large. • Examines balances included in a balancing account to assess reasonability of the size of the balance submitted.
Division of Water and Audits (water division)	<p>Performs an in-depth review of balancing accounts included in informal advice letter filings by all water utilities and formal rate-making applications for the 106 smaller water utilities. Specifically, it takes the following steps:</p> <ul style="list-style-type: none"> • Verifies the accuracy and appropriateness of the costs the utilities charged to the balancing accounts by reviewing invoice-level documents to determine whether costs are supported and for allowable purposes. • If it identifies any costs that it believes should not be allowed, it requests that the utility make adjustments to the balance. • May perform audits of a limited number of balancing accounts at the direction of the commission. 	
Office of Ratepayer Advocates	<p>Performs a review of balancing accounts included in formal proceedings and informal advice letter filings by the 10 largest water utilities. Specifically, it takes the following steps:</p> <ul style="list-style-type: none"> • Performs a high-level review of all balancing accounts included in advice letters to verify mathematical accuracy of the balance and to ensure that costs and revenues presented are adequately supported with documentation and are consistent with the commission's authorization for the balancing account. • If it identifies any concerns through the high-level review, it may perform a more in-depth review to verify that the costs and revenues charged to the account are supported by adequate accounting records that agree with invoice-level details or other documents. • If it identifies concerns through the in-depth review or high-level review, it recommends in a formal protest letter that the water division either require the utility to make appropriate corrections or modifications, or to reject the advice letter. 	<p>Reviews all balancing accounts included in informal advice letter filings submitted by energy utilities and examines balances for those accounts to assess reasonability of the size of and changes to the balances submitted, but it does not perform any detailed verification at that time to ensure that balances are accurate.</p> <p>Performs an in-depth review of balancing accounts included in formal applications for three formal proceedings (two for natural gas, one for electric) by doing the following:</p> <ul style="list-style-type: none"> • Verifies balance submitted for balancing accounts is supported by documents such as invoices and accounting records. • Reviews relevant commission documents, such as decisions and preliminary statements, to verify that costs included in the account are allowable. • Following completion of the comprehensive review, prepares written testimony that describes the results of the review and identifies any issues and adjustments to the amount the utility requested for recovery.

Source: California State Auditor's review of the commission's procedures for reviewing balancing accounts.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor to audit the commission's policies and procedures for overseeing the balancing accounts of the utilities it regulates. The analysis the audit committee approved contained seven separate objectives. We list the objectives and the methods we used to address them in Table 2.

Table 2
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Obtained, reviewed, and evaluated laws, rules, and regulations pertaining to the California Public Utilities Commission's (commission) oversight of balancing accounts.
2 Determine how the commission oversees the entities it regulates by performing, at a minimum, the following: a. Review and evaluate the commission's policies and procedures for inspecting and auditing* the revenues and expenditures of the balancing accounts of those entities. b. Determine whether such policies and procedures comply with applicable laws, regulations, and auditing standards.	<ul style="list-style-type: none"> • Obtained and reviewed commission policies and procedures for establishing utility rates and for requiring utilities to track certain expenses and revenues using balancing accounts. • Interviewed appropriate commission staff and reviewed documents to understand the commission's practices for overseeing balancing accounts. • Assessed whether the commission's policies, procedures, and practices comply with applicable laws and regulations.
3 Determine the number of balancing accounts authorized and established over the last nine years, and the number and frequency with which the commission audited them. If all required audits were not completed, determine why.	<p>To determine the number of balancing accounts authorized and established over the last nine years, we requested and obtained data from the commission about all balancing accounts authorized and established over the last nine years.</p> <p>To determine the number and frequency with which the commission reviewed balancing accounts, we did the following:</p> <ul style="list-style-type: none"> • Obtained from the Office of Ratepayer Advocates (Ratepayer Advocates) a list of balancing account reviews it conducted over the last nine years. • Selected three reviews per year to ensure balancing accounts reported as reviewed were, in fact, reviewed. We found no errors. • We requested the commission's Division of Water and Audits (water division) to provide similar information, but it could not. However, it identified certain balancing accounts included in two audits performed at the direction of the commission. • Determined the number and value of the balancing accounts that the commission did not review for the six largest energy utilities. <p>Determined whether the commission completed reviews of balancing accounts in accordance with any legal requirements. However, we found that there is no legal requirement for the commission or Ratepayer Advocates specifically to review balancing accounts.</p>

AUDIT OBJECTIVE	METHOD
<p>4 Review the commission's practices over the last three years and determine whether the commission has complied with applicable laws, regulations, and policies in auditing the balancing accounts of the entities it regulates. If not, assess the reasons for noncompliance.</p>	<ul style="list-style-type: none"> • Interviewed Ratepayer Advocates and water division staff to identify how these entities determine which balancing accounts to review. • Inquired with Ratepayer Advocates and the water division whether they have requested additional resources to carry out reviews of balancing accounts. Ratepayer Advocates indicated its staffing was sufficient and the water division had not submitted any budget change proposals over the past three years.
<p>5 From a selection of commission audits conducted on balancing accounts in the last three years, determine the following:</p> <ol style="list-style-type: none"> Whether the audits were conducted in accordance with applicable laws, policies, and procedures, including any reporting requirements. The findings and conclusions reached in each audit and the actions the commission took in response to those findings. The revenues and expenditures for the selected accounts in each of the three years. 	<p>From the list of reviews Ratepayer Advocates conducted, selected two reviews for each of the three types of utilities (natural gas, electric, and water) during fiscal years 2010–11 through 2012–13, for a total of 18 reviews. For these reviews, we performed the following:</p> <ul style="list-style-type: none"> • Determined if Ratepayer Advocates followed its policies and procedures (including review plans and methodologies) when conducting these reviews and that supervisory approvals were performed. • Examined available review documents to determine whether findings and conclusions were supported and reported. • Determined whether the commission agreed with any recommendations Ratepayer Advocates made to reduce amounts in balancing accounts that utilities proposed to recover in rate increases. <p>Selected a sample of six reviews of balancing accounts the water division performed from 2010 through mid-2013 and evaluated the methodologies to determine if they were reasonable for the purpose of the reviews.</p>
<p>6 From a selection of balancing accounts that were not audited, or using the selection identified in objective number 5 above, to the extent possible determine:</p> <ol style="list-style-type: none"> The purpose for which each account was authorized and whether each account was appropriately funded. The sources of revenue and the major types of expenditures. For a selection of expenditures, determine whether they were allowable and reasonable. 	<p>Selected nine balancing accounts that the commission did not review during fiscal years 2010–11 through 2012–13, and performed the following procedures:</p> <ul style="list-style-type: none"> • Reviewed relevant documents the commission approved to determine the purpose for which the balancing accounts were established. • Reviewed relevant documents to identify the total revenues and expenditures charged to the selected accounts during the year reviewed. • Selected five expenditures from each selected balancing account and traced them to supporting documentation such as invoices and the utilities' accounting records. Determined whether these expenditures were allowable and reasonable.
<p>7 Review and assess any other issues that are significant to the reviews of balancing accounts by the commission.</p>	<p>To determine whether the commission complies with a state law requiring it to conduct periodic audits of the books and records of utilities it regulates for regulatory and tax purposes and to provide its reports to the California State Board of Equalization (Equalization) for tax assessment purposes, we performed the following:</p> <ul style="list-style-type: none"> • Interviewed commission staff to determine how the commission complies with this legal requirement. • Assessed whether the commission's processes are adequate to ensure compliance. • Discussed with Equalization any concerns it had with the commission's audits.

Sources: California State Auditor's analysis of the Joint Legislative Audit Committee's audit request number 2013-109, planning documents, and analysis of information and documentation identified in the column titled *Method*.

* For the purposes of our audit report, we use the term "review" to describe the commission's oversight efforts related to balancing accounts because the commission's procedures do not constitute a complete audit under audit standards.

Assessment of Data Reliability

In performing this audit, we obtained electronic data files the commission received from the utilities it regulates identifying the balancing accounts active during 2004 through 2012. The U.S. Government Accountability Office, whose standards we follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations. We did not perform accuracy and completeness testing of these data because the source documents required for this testing are maintained by utilities located throughout the State that provided the information to the commission, making such testing cost-prohibitive. Consequently, we determined that the data were of undetermined reliability for the purpose of identifying all balancing accounts the commission authorized during 2004 through 2012. However, as we discuss in the Audit Results, we identified certain concerns with the data based on limited comparison of these data against the records of the commission and of Ratepayer Advocates.

Audit Results

The California Public Utilities Commission Does Not Have Adequate Processes for Monitoring Utility Balancing Accounts

The California Public Utilities Commission (commission) lacks adequate processes for sufficient oversight of balancing accounts to protect ratepayers from unfair rate increases. Given that balancing accounts directly affect rates that a utility charges ratepayers and given the broad authority the commission has to inspect and audit utilities' records, we believe that the commission should use a systematic process that ensures a review of those balancing accounts that can have the most impact on ratepayers. Currently, the commission only reviews balancing accounts when a utility requests to revise the future rates to recoup or refund the balance in the balancing account. Moreover, the commission relies on the Office of Ratepayer Advocates (Ratepayer Advocates) to review balancing accounts of energy utilities (electric, natural gas, or both), but Ratepayer Advocates only reviews the balancing accounts of energy utilities that are included in certain formal proceedings before the commission. During 2009 through 2011, Ratepayer Advocates reviewed only 58 percent of the authorized amounts for the balancing accounts of the six largest energy utilities, leaving balancing accounts with a total value of \$37.6 billion unreviewed. Further, the commission lacks the necessary information, such as the size of the account and the last time the commission reviewed it, to help identify those balancing accounts that are good candidates for review. Although the commission obtained this information from the utilities upon our request, the omissions and errors we found in the information will limit its usefulness as a monitoring tool.

The Commission Has Not Reviewed Many Large Balancing Accounts for Energy Utilities

State law directs the commission, whenever it authorizes any rate change that includes costs passed on to customers, to require utilities to establish balancing accounts so that any under- or over-collection of payments from ratepayers is appropriately incorporated into future rates as a surcharge or a credit. A state law requires the commission to review semiannually certain balancing accounts called *power procurement balancing accounts*, which are commonly referred to as Energy Resource Recovery Accounts (ERRA) and which track the difference between a utility's forecasted and actual costs to procure electricity for its customers. However, state law does not otherwise expressly require the commission to review other balancing accounts although it does authorize the commission to review utilities' records in the context of rate-setting

The commission's current practice for reviewing balancing accounts when a utility requests to incorporate the balance in that account into future rates as a surcharge or a credit does not protect ratepayers from unreasonable rate increases.

procedures. Moreover, state law authorizes the commission, at any time, to inspect and audit utilities' books, accounts, and records, which would include balancing accounts. Thus, given the commission's important responsibility to monitor balancing accounts to ensure that ratepayers are fairly charged and that utilities are fairly compensated, and in light of the broad authority granted to the commission to review utilities' records, we believe the commission should adopt a process to provide more thorough oversight of balancing accounts through a risk-based approach.

Currently, the commission only reviews balancing accounts when a utility requests to incorporate the balance in that account into future rates as a surcharge or a credit. This practice does not ensure that the commission adequately reviews balancing accounts to protect ratepayers from unreasonable rate increases. For example, utilities have an incentive to file more quickly with the commission to recover the under-collections reflected in their respective balancing accounts as this will result in an increase in their rates. On the other hand, for balances that utilities would need to refund to their ratepayers through a reduction in rates, less incentive may exist for the utilities to file quickly.

Although it has a clear authority to review balancing accounts, as a result of its current practice, the commission has not reviewed many of the balancing accounts it has authorized over the past three years. The Energy Division (energy division), which has oversight responsibility for energy utilities, does not review balancing accounts in detail. Instead, as we show in Table 1 on page 11, the energy division performs several high-level procedures that do not provide the assurance that a detailed review would provide. According to the commission, the energy division's higher-level review is acceptable because Ratepayer Advocates examines balancing accounts dealing with procurement costs in depth each year. Therefore, the commission relies on Ratepayer Advocates to review energy utility balancing accounts rather than having the energy division perform these reviews.

However, the commission's reliance is misplaced as Ratepayer Advocates' reviews do not focus on all energy utility balancing accounts. As we discuss in the Introduction, Ratepayer Advocates focuses only on certain formal proceedings, such as the ERRA proceeding for electric utilities and the Gas Procurement Incentive Mechanism and Biennial or Triennial Cost Allocation proceedings for natural gas utilities, which it considers to have the most impact on consumer utility rates. The commission requires energy utilities to request to incorporate the balances in certain balancing accounts into future rates through these formal proceedings. An energy utility may, at its discretion, include other balancing accounts in an ERRA proceeding. Ratepayer Advocates asserted that by focusing on the balancing accounts included in these proceedings, it covers the balancing accounts that are most significant to its mission to reduce utility rates for customers consistent with

reliable and safe service levels. However, Ratepayer Advocates does not have a formal policy for identifying the balancing accounts that it believes are most significant; instead, it considers whether a review would be beneficial for making a case for a lower utility rate.

Ratepayer Advocates also asserted that it is reviewing the majority of authorized amounts in balancing accounts. However, our review found that the number and dollar value of the balancing accounts that Ratepayer Advocates reviewed varied considerably among the six largest energy utilities. As Table 3 shows, only 23 percent of these utilities' balancing accounts active during 2009 through 2011—representing 58 percent of the costs and related revenues being tracked in all authorized balancing accounts—were subject to review. Further, among the six utilities, the number and value of the reviewed balancing accounts differed significantly. For example, as shown in Table 3, Ratepayer Advocates reviewed more than half of Southern California Edison's (Edison) balancing accounts, representing 94 percent of the dollar value of these accounts. In contrast, Ratepayer Advocates reviewed 5 percent of the balancing accounts for Pacific Gas and Electric Company (PG&E), which represent only one-third of the costs and related revenues being tracked through its electric utility balancing accounts. For the other energy utilities and PG&E's natural gas utility, the dollar value of the balancing accounts that Ratepayer Advocates reviewed ranged from 27 percent to 79 percent.

Table 3
Balancing Accounts for the Large Energy Utilities Reviewed in Formal Filings by the Office of Ratepayer Advocates During 2009 Through 2011

UTILITY TYPE	UTILITY NAME	TOTAL NUMBER OF BALANCING ACCOUNTS [†]	SUM OF AUTHORIZED AMOUNTS TRACKED IN BALANCING ACCOUNTS [†] (IN MILLIONS)	BALANCING ACCOUNTS THAT THE OFFICE OF RATEPAYER ADVOCATES REVIEWED*			
				NUMBER [†]	PERCENT OF TOTAL NUMBER	AUTHORIZED AMOUNTS [†] (IN MILLIONS)	PERCENT OF TOTAL AUTHORIZED AMOUNTS
Electric	Pacific Gas and Electric Company	38	\$33,268	2	5%	\$11,022	33%
	San Diego Gas and Electric Company	22	6,817	2	9	1,819	27
	Southern California Edison	24	30,137	13	54	28,478	94
Natural Gas	Pacific Gas and Electric Company	36	11,808	3	8	4,734	40
	San Diego Gas and Electric Company	18	883	8	44	689	78
	Southern California Gas Company	28	7,116	11	39	5,652	79
Totals		166	\$90,029	39	23%	\$52,394	58%

Sources: California State Auditor's analysis of balancing account data provided by the California Public Utilities Commission and the Office of Ratepayer Advocates (Ratepayer Advocates).

* Ratepayer Advocates indicates that several regularly scheduled balancing account reviews are underway but not yet completed, and they will be reviewed retroactively in future proceedings.

† Numbers and amounts for balancing accounts are for the three-year period. Balancing accounts are included only once in the number outstanding, but the value represents the total value of the balancing accounts over the three-year period. Amounts represent the total authorized balances, regardless of whether the balancing account tracks expenditures or revenues.

Although some of the individual balancing accounts that Ratepayer Advocates did not review were relatively small in value, together those balancing accounts not reviewed tracked authorized costs and related revenues totaling \$37.6 billion, or 42 percent of the value of the energy utilities' balancing accounts existing during 2009 through 2011. For example, in 2011 PG&E had more than \$601 million in outstanding balances in its electric balancing accounts that Ratepayer Advocates did not review, an amount that may be passed on to customers in future rates. Table 4 shows that Ratepayer Advocates did not review some accounts that tracked as much as \$9.1 billion in authorized amounts during 2009 through 2011. Because of the large authorized amounts, as well as the balances that utilities will pass on to ratepayers, these balancing accounts have significant potential to affect rates.

Table 4
Three Largest Balancing Accounts for Large Energy Utilities That Did Not Undergo Detailed Review 2009 Through 2011

UTILITY NAME			BALANCING ACCOUNT NAME	AUTHORIZED AMOUNT (IN MILLIONS)*
Electric Utilities	Pacific Gas and Electric Company	Distribution Revenue Adjustment Mechanism	\$9,113	
		Utility Retained Generation Base	3,875	
		Department of Water Resources Power Charge Collection	2,310	
	San Diego Gas and Electric Company	Electric Distribution Fixed Cost	2,558	
		Non-Fuel Generation	769	
		Advanced Metering Infrastructure	176	
	Southern California Edison	Procurement Energy Efficiency	761	
		Energy Efficiency Program	301	
		California Solar Initiative	220	
Natural Gas Utilities	Pacific Gas and Electric Company	General Rate Case Distribution Base Revenues	3,288	
		Local Transmission	495	
		Backbone Transmission	483	
	San Diego Gas and Electric Company	Gas Energy Efficiency	48	
		Advanced Metering Infrastructure	42	
		California Alternate Rates for Energy	41	
	Southern California Gas Company	California Alternate Rates for Energy	392	
		Integrated Transmission	349	
		Demand Side Management	275	
Total			\$25,496	

Sources: California State Auditor's analysis of data provided by the California Public Utilities Commission and the Office of Ratepayer Advocates.

* Amounts represent the total authorized balances over the three-year period, regardless of whether the balancing account tracks expenditures or revenues.

Ratepayer Advocates' inconsistent level of review results from its focus on certain formal proceedings, primarily those related to ERRRA filings, which vary considerably among the electric utilities in the value of the balancing accounts. For example, Edison included more balancing accounts than PG&E in formal filings Ratepayer Advocates reviewed. When presented with the results shown in Table 3 on page 17, Ratepayer Advocates could not explain how reviewing far more balancing accounts for Edison than for other electric utilities furthered its mission. However, Ratepayer Advocates believes that the commission is responsible for providing the oversight on all balancing accounts and that the commission cannot rely upon Ratepayer Advocates to conduct reviews of the energy utilities. As we stated in the Introduction, neither the commission nor Ratepayer Advocates is required to specifically review balancing accounts.

In contrast, the Division of Water and Audits (water division) told us that its practice is to perform a detailed review of all balancing accounts that a water utility includes in its informal filings. The commission requires a water utility with 10,000 or fewer service connections to file an informal advice letter to incorporate the balance in a balancing account into future rates when the balance exceeds 2 percent of the utility's total annual gross operating revenue. Although this requirement was intended to prevent utilities from filing to recover balancing account balances too frequently, it could also mitigate the risk that a water utility may not file a timely request to refund over-collections from ratepayers. For these smaller water utilities, the water division indicates it will review balancing accounts the utility includes in the general rate case. For large water utilities—those with more than 10,000 service connections—Ratepayer Advocates will review the general rate case.

The Commission Does Not Have a Systematic Process for Selecting Balancing Accounts to Review

We believe that the commission's process for reviewing balancing accounts should be based on the risk and the magnitude of the potential for unfair rate changes, which would require that the commission maintain an accurate and up-to-date list of all balancing accounts, including information regarding the balances in those accounts. However, the commission neither maintains such a list of all balancing accounts nor has it been tracking the authorized amounts for those accounts in order to assess which accounts may be candidates for a closer review. When we asked the commission for a list of all utility balancing accounts it had authorized over the past nine years, the commission indicated it did not have that information available but was in the process of compiling a list in response to a recent Legislative Analyst's Office report.

The commission's process for reviewing balancing accounts should be based on the risk and the magnitude of the potential for unfair rate changes.

According to the commission, it did not have a master list because balancing account reviews are conducted by staff that have worked with the utilities and that are most knowledgeable about specific balancing accounts.

However, in response to our request, the commission asked the utilities for this information and was able to compile a list of energy balancing accounts for us during the audit. Going forward, the commission plans to obtain balancing account information periodically from utilities and maintain such a database to identify the balancing accounts of energy utilities it should review. The water division had already developed a database where it tracked advice letter filings, including advice letters filed to recover balances in balancing accounts; but as we discuss below, that database does not always identify the balancing accounts included in a water utility's filing. As a result, the water division also had to request information from utilities to compile its list of balancing accounts for us.

Because the commission obtained these lists from the utilities, we did not perform accuracy and completeness testing on these data. However, through our limited comparison of these data with the records of the commission and of Ratepayer Advocates, we identified concerns about the completeness and accuracy of the information that the utilities provided and that the commission compiled, which would limit these lists' usefulness for guiding the commission's future oversight efforts. For example, utilities did not always identify the authorized amount for a balancing account, and it was not always clear if this meant that the account had been closed or if there was a different reason. In certain instances, the commission noted that there were reasons why a balancing account would not have an authorized amount. We also discovered several instances in which Ratepayer Advocates reported reviewing a specific utility balancing account, but the utility did not include that balancing account in the information it provided to the commission for the lists. While the commission compiled these lists from information that the utilities submitted, it could not provide assurance that the information was complete and accurate. Although the lists are a helpful start, if the commission does not verify the accuracy and completeness of the lists, they will be of questionable value for future oversight purposes. We present the information from these lists in Appendix A.

The commission does not have a complete list of all balancing accounts it has reviewed during each year, which may hinder its ability to identify the balancing accounts it has not recently reviewed.

The commission also does not have a complete list of all balancing accounts it has reviewed during each year, which may hinder its ability to identify the balancing accounts that it has not reviewed recently. Although Ratepayer Advocates could tell us the reviews it had performed, the water division was unable to provide similar information because its database does not always identify any

balancing accounts the water utility included in the informal filing. Without knowing when the water division last reviewed a balancing account, the commission cannot adequately assess the timing of when to review the balancing accounts of water utilities. The water division acknowledged this problem and plans to take steps to record all future reviews.

Analysts Do Not Always Document and Supervisors Do Not Always Approve Ratepayer Advocates' Reviews of Balancing Accounts

Ratepayer Advocates does not ensure that its analysts adequately document and that its supervisors properly approve reviews of balancing accounts. When utilities file to change future rates based on balances in a balancing account, Ratepayer Advocates analysts request and review various documents to determine whether the commission should grant the requested rate change. Ratepayer Advocates stated that when the analyst completes a balancing account review, he or she sends a written testimony, if applicable, summarizing the findings to a supervisor for approval. The analyst's supervisor and program manager review and edit the written testimony, which includes any findings, the amount of any proposed reductions in recoveries, or other documents that Ratepayer Advocates recommends the commission consider during a formal hearing process. In our examination of 18 reviews that Ratepayer Advocates analysts conducted, we found that only two reviews contained adequate documentation of the procedures that analysts completed and the conclusions they reached. Compounding the lack of adequate documentation, Ratepayer Advocates does not require formal supervisory approval of an analyst's review of a balancing account; instead it relies on informal interactions between analysts and their supervisors to ensure that reviews are properly done. Formal supervisory review would be beneficial to ensure that Ratepayer Advocates can appropriately support its conclusions and recommendations to the commission regarding whether utilities should be allowed to incorporate the amounts in balancing accounts into their utility rates.

In our examination of 18 reviews of balancing accounts that Ratepayer Advocates conducted, only two reviews contained adequate documentation of the procedures analysts completed and conclusions they reached.

Ratepayer Advocates Does Not Always Properly Document or Retain Its Reviews

Ratepayer Advocates does not always properly document its reviews of balancing accounts, and because it lacks a document retention policy, some documentation of its reviews was not retained. Because Ratepayer Advocates' reviews of balancing accounts can result in recommending that the commission disallow certain costs that utilities seek to incorporate into future rates, we expected these reviews to include adequate documentation

For 16 reviews of balancing accounts, we found that Ratepayer Advocates' documentation was inadequate to demonstrate the work performed, was not created by the analyst, or was unavailable because it had been discarded.

evidencing the steps the analysts took to support their conclusions. However, we found that the extent of supporting documentation that Ratepayer Advocates' staff prepared when reviewing balancing accounts varied considerably among those conducting the reviews. As shown in Table 5, we examined 18 reviews of balancing accounts that Ratepayer Advocates conducted in the last three fiscal years for which Ratepayer Advocates analysts indicated, among other procedures, that they had verified the accuracy and allowability of expenditures charged to those accounts, as applicable. We found that only two reviews had adequate documentation and analyses to demonstrate the procedures that the analysts performed and the conclusions that they reached. For example, for one of these two well-documented reviews, Ratepayer Advocates reviewed PG&E's 2013 ERRRA balancing account. Ratepayer Advocates highlighted each sample it had chosen, and each line item had a reference letter and number that corresponded to the supporting documentation, such as invoices.

For the 16 remaining reviews, Ratepayer Advocates' documentation was inadequate to demonstrate the work performed, was not created by the analyst, or was unavailable for our review because it had been discarded. Although Ratepayer Advocates was able to provide supporting documentation for seven of these 16 reviews, the analyses included with that documentation were not clear enough or detailed enough to demonstrate the work the analyst performed. For example, as part of its review of Edison's Base Revenue Requirement balancing account, which requested incorporating a nearly \$171 million balance into future rates, the Ratepayer Advocates' analyst reviewed utility-created spreadsheets, accounting ledger entries, and invoices supporting the amount in the balancing account. Although we observed that the analyst made notations on these documents, indicating some level of review, these notations were not adequate to allow us to verify that the analyst performed the review steps he identified in his final written testimony.

For another six of these 16 reviews, Ratepayer Advocates indicated that the analysts performing the reviews did not create any documentation during the review to demonstrate the procedures they followed. For example, in one instance Ratepayer Advocates was unable to provide documentation of the procedures the analyst had performed; it reported that because the analyst did not identify any needed adjustments to the balancing account, the analyst had created no documentation for the review.

Table 5
Adequacy of Selected Reviews That the Office of Ratepayer Advocates Performed
During Fiscal Years 2010–11 Through 2012–13

UTILITY NAME	BALANCING ACCOUNT REVIEWED	REVIEW WAS ADEQUATELY DOCUMENTED AND RETAINED	REVIEW WAS DOCUMENTED, BUT DOES NOT DEMONSTRATE THE PROCEDURES PERFORMED	REVIEW WAS DOCUMENTED BUT NOT RETAINED	REVIEW WAS NOT DOCUMENTED	AMOUNT OF UNDER-COLLECTION RECOMMENDED FOR REDUCTION (IN MILLIONS)	TOTAL (OVER-) OR UNDER-COLLECTION THAT THE UTILITY REQUESTED FOR INCORPORATION INTO FUTURE RATES (IN MILLIONS)
California Water Service Company	Lucerne				X	–	\$6.5
Golden State Water Company	Conservation Expenses One-Way				X	NA*	–
Golden State Water Company	City of Torrance				X	NA*	–
Apple Valley Ranchos Water Company†	Modified Production Cost				X	–	2.3
California-American Water Company	Interim Rate True-Up Account		X			\$4.8	8.7
California-American Water Company	San Clemente Dam Memorandum Account		X			21.7	21.8
Bear Valley Electric Service	General Rate Case				X	–	–
California Pacific Electric Company	Energy Cost Adjustment Clause Account			X		8.8	48.7
San Diego Gas & Electric Company (Electric)	Transition Cost			X		–	(26.9)
Pacific Gas & Electric Company (Electric)	Energy Resource Recovery Account	X				–	(74.8)
Southern California Edison	Base Revenue Requirement		X			–	(170.9)
Pacific Gas & Electric Company (Electric)	Diablo Canyon Seismic Studies		X			3.8	39.9
Southern California Gas Company	Purchased Gas Account		X			–	5.4
Southern California Gas Company	Core Fixed Cost Account	X				–	(95.4)
San Diego Gas & Electric Company (Natural Gas)	Integrated Transmission			X		–	(4.9)
Southwest Gas Corporation	Fixed Cost Adjustment Mechanism‡		X			–	–
Pacific Gas & Electric Company (Natural Gas)	Core Pipeline Demand Charge Account		X			–	4.3
Pacific Gas & Electric Company (Natural Gas)	Core Firm Storage Account §				X	–	–
Totals		2	7	3	6	\$39.1	\$510.5

Source: California State Auditor's analysis of balancing account reviews the Office of Ratepayer Advocates (Ratepayer Advocates) completed.

NA = Not applicable.

* The utility did not ask to incorporate the balance in this account into future rates. Ratepayer Advocates' focus during this review was to determine the balance and the appropriateness of continuing this account. It indicated finding no exceptions.

† The total under-collection of \$2.3 million includes both the Modified Production Cost Balancing Account and a related balancing account included in the utility's filing.

‡ The utility did not request recovery from this account when filing its general rate case.

§ Ratepayer Advocates indicates reviewing this balancing account in the same proceeding as the Core Pipeline Demand Charge Account (CPDCA) for the Pacific Gas and Electric Company, but it did not create supporting documentation. Further, this balancing account's effect on customer rates is included in the \$4.3 million for the CPDCA.

|| Total is absolute value to show magnitude of outstanding values in balancing accounts.

For the remaining three of these 16 reviews, Ratepayer Advocates indicated that although the analysts had prepared supporting documentation for the reviews, the documentation was not retained because it was not needed. Ratepayer Advocates does not have a document retention policy; after proceedings are completed and the amount from the balancing account that the utilities will be allowed to incorporate into rates is finalized, it allows analysts to retain documents at their discretion if there are no major adjustments or issues. However, state law requires every state agency, including Ratepayer Advocates, to have a document retention policy. It is especially important for Ratepayer Advocates to have such a policy considering the impact that its reviews can have on utility rates.

Because of the lack of adequate documentation, we could not analyze Ratepayer Advocates' recommendations to the commission that utilities not be allowed to recover all costs in balancing accounts. For the 18 reviews we examined, Ratepayer Advocates recommended that the commission reduce by \$39 million the \$119 million that utilities requested they be allowed to recover from four balancing accounts. Ratepayer Advocates did not have adequate documentation for any of these balancing accounts. For the reviews relating to two of these four balancing accounts, the commission rejected Ratepayer Advocates' protests. Although the commission did not reject Ratepayer Advocates' findings and recommendations for these two reviews on the basis of inadequate documentation, without proper documentation Ratepayer Advocates lacks assurance that its reviews are adequate and complete, nor can supervisors verify the conclusions that staff reach. Moreover, without adequate documentation, supervisors are unable to determine whether staff have missed other amounts that utilities should not be allowed to recover.

Ratepayer Advocates Does Not Ensure That Supervisors Approve Analysts' Reviews of Balancing Accounts

Ratepayer Advocates does not have a formal policy requiring supervisors to document their examination of the analyst's work that supports the prepared testimony, even if the analyst recommends reducing the proposed recovery. Instead, it indicated that supervisory approval occurs during discussions, meetings, draft testimony review, and e-mail discussions with staff about the conclusions reached in a review, but supervisors do not examine the actual work analysts perform to ensure that all planned procedures were performed appropriately and to ensure that any proposed reductions in recovery amounts are accurate. In fact, Ratepayer Advocates was unable to provide evidence of formal supervisory approval for any of the 18 balancing account reviews we examined and that are listed in Table 5 on page 23.

Ratepayer Advocates' supervisors do not examine the actual work analysts perform to ensure that all planned procedures were performed appropriately and any proposed reductions in recovery amounts are accurate.

Considering that 16 of the 18 reviews we selected lacked adequate documentation, Ratepayer Advocates cannot be certain that the reviews that analysts performed were adequate and complete without documented supervisory approval. A more appropriate practice, and one that most organizations use when conducting reviews, is to have supervisors examine and approve the documentation supporting an analyst's review to ensure that the costs that are questioned and other conclusions reached are accurate, supported, and appropriately documented. In addition to providing assurance that the analyst's conclusion to question some costs is appropriate, such a practice would ensure that the analyst did not overlook any other unallowable costs. Moreover, Ratepayer Advocates performs these reviews to fulfill its mission to obtain the lowest possible rate for reliable and safe service, which could be undermined by the lack of a supervisory approval process. Therefore, to best protect ratepayers, Ratepayer Advocates should be taking steps to ensure that it appropriately performs and approves reviews of balancing accounts.

Most Water Division's Reviews of Balancing Accounts Had Supporting Documentation and Approvals From Supervisors

Most reviews of balancing accounts that the water division performed had appropriate documentation to show the procedures that analysts performed and that it had received supervisory approval. The water division reviews supporting documentation when water utilities file informally to incorporate the balance from a balancing account into rates; they also review documentation for smaller utilities during formal proceedings. As Table 6 on the following page shows we examined six reviews of balancing accounts that the water division performed from 2010 through mid-2013. Five of these six reviews had adequate documentation to show that analysts had verified the accuracy and allowability of the charges the utilities included in the balancing accounts. For these reviews, we found that the analyst generally verified the balances by analyzing supporting documentation, such as invoices, as appropriate.

For the remaining balancing account review, which was of Park Water Company's filing to recover nearly \$2.5 million in its Water Revenue Adjustment Mechanism balancing account, the analyst's documentation was not sufficient for us to determine the procedures he performed. The water division uses a coversheet to summarize the analyst's work and conclusions as well as to evidence a supervisor's approval of the work. On the coversheet for this review, the analyst indicated he checked the support for the filing and recommended its approval. However, although the review file contained accounting records and numerous invoices, there were no notations or marks on these documents to demonstrate

the steps the analyst took to verify the accuracy and allowability of the costs. The analyst's supervisor acknowledged that the review was not properly documented. He stated that the water division does not have a specific policy requiring analysts to document their reviews.

Table 6
Adequacy of Selected Balancing Account Reviews That the Division of Water and Audits Performed From January 2010 Through June 2013

WATER UTILITY	BALANCING ACCOUNT REVIEWED	WAS THE REVIEW ADEQUATELY DOCUMENTED?	WAS SUPERVISORY REVIEW PERFORMED?	WAS THE ADVICE LETTER APPROVED?	RECOVERY REDUCTION THAT THE REVIEW IDENTIFIED	TOTAL (OVER-) OR UNDER-COLLECTION THAT THE UTILITY REQUESTED FOR INCORPORATION INTO FUTURE RATES
California Water Service Company	Incremental Cost	Yes	Yes	Yes	–	\$1,325,498
Park Water Company	<ul style="list-style-type: none"> Water Revenue Adjustment Mechanism Modified Production Cost Incremental Cost 	No	Yes	Yes	–	2,473,561
Del Oro Water Company (Paradise Pines)	Full Cost Water Supply	Yes	Yes	Yes	–	64,406
Bass Lake Water Company	California Department of Public Health User Fee	Yes	No	Yes	–	10,508
Mountain Mesa Water Company	Contract Work	Yes	Yes	Yes	\$435	9,819
West San Martin Water Works, Inc.	Water Quality	Yes	Yes	Yes	–	4,394

Source: California State Auditor's analysis of reviews completed by the California Public Utilities Commission's Division of Water and Audits for six advice letter filings.

Finally, for one of the reviews with adequate documentation, a supervisor did not sign off on the analyst's review. The director of the water division indicated that the water division requires supervisory approval of all reviews and that the lack of supervisory sign-off on this review was an oversight.

The Commission Does Not Comply With Certain Auditing and Reporting Requirements of State Law

The commission also does not inspect and audit the records of utilities it regulates according to the schedule prescribed by law, nor does it provide the reports of these audits to the California State Board of Equalization (Equalization). Specifically, state law requires that the commission audit the accounting records of a utility every three or five years, depending on the number of customers the utility serves. The commission generally fulfills this audit requirement using the procedures it conducts in connection with a

general rate case, as the law allows. However, the commission does not ensure that utilities file general rate cases every three or five years to coincide with the audit requirement. As a result, it has not always complied with the legal requirement to periodically audit the utilities according to the prescribed schedule. This law also requires the commission to provide the reports of these audits to Equalization for use in assessing taxes on public utilities. However, the commission discontinued providing the required reports to Equalization shortly after the law became effective in 1975 because Equalization notified the commission that the audit reports were not useful for tax assessment purposes. Equalization believes that requiring the commission to perform the audit work for tax assessment purposes would not be cost-beneficial for the State because Equalization already possesses this expertise.

The Commission Does Not Always Audit Periodically the Books and Records of the Utilities It Regulates According to the Schedule Prescribed by Law

The commission does not always conduct periodic audits of the books and records of the utilities it regulates according to the schedule prescribed by state law. Specifically, state law requires that every three years the commission audit the accounting records of utilities that serve more than 1,000 customers. The law also requires the commission to audit every five years those utilities that it regulates that have 1,000 or fewer customers. As state law allows, the commission fulfills this audit requirement using the procedures conducted in connection with a general rate case. During that proceeding, the commission's staff, Ratepayer Advocates, and advocacy groups review the various costs and other financial information that the utility presents to support its proposed rates. The commission facilitates and, if needed, compels the utility to provide additional information that the parties request to evaluate the reasonableness of its request for cost recovery.

However, the commission does not ensure that all regulated energy and water utilities file their general rate cases on a three- or five-year cycle to allow it to meet the law's audit requirement. Although the commission requires most energy utilities to file a general rate case every three years, it has allowed two energy utilities to file rate cases on a four-year cycle and it does not require three other smaller energy utilities to be on a three-year cycle. Because each of these five energy utilities serve more than 1,000 customers, having them file beyond the three-year cycle does not allow the commission to fulfill the state law's requirement that they be audited every three years. The commission also allows one energy utility with fewer than 1,000 customers to adjust its rates solely using informal proceedings without periodically filing a general rate case. The director for the energy division acknowledged

The commission does not ensure that all regulated energy and water utilities file their general rate cases on a three- or five-year cycle to allow it to meet the law's audit requirement.

that the commission was not in compliance with the law but indicated that these utilities might file a general rate case every three years in the future.

In addition to the six energy utilities that it has not required to file general rates cases every three or five years, the commission also does not require all water utilities to file their general rate cases on a regular schedule. Of the 116 water utilities that the commission regulates, 26 have more than 1,000 customers, requiring that they be audited every three years. The remaining 90 have 1,000 or fewer customers, requiring the commission to audit them every five years. However, the commission only requires the 10 largest water utilities to file a general rate case every three years. The director of the water division reported that the commission does not require smaller water utilities to file their general rate cases under any specific schedule. When we reviewed the dates that water utilities had filed their last two general rate cases, we found six of the 26 largest utilities subject to the three-year audit requirement and 53 of the 90 smaller water utilities subject to the five-year audit requirement did not always meet their respective timelines. One of these smaller utilities had not filed a general rate case since 1993, and another filed its most recent general rate case more than 20 years after its previous one.

Because the commission relies upon the general rate case to comply with the audit requirement, to the extent that water utilities do not file their general rate cases every three or five years, the commission is not in compliance with state law. The director of the water division indicated that because of the complexity involved in establishing utility rates, many smaller water utilities require the water division's assistance to file their general rate cases and resource constraints limit the water division's ability to assist them. Further, he asserted that the water division lacks the resources to audit all water utilities that do not file their general rate cases within the statutory timeline. Moreover, the commission noted that when the smaller water utilities establish their rates, it performs a thorough review of the utility's expenses and plant to determine that the approved rates are reasonable. The commission noted that utilities file for a general rate case to request authority to increase their revenues from ratepayers. Therefore, it was the commission's belief that to the degree that these smaller water utilities are not filing for general rate cases, their customers benefit from stable rates.

Without regularly reviewing utilities' accounting records, the commission cannot be certain that it is adequately protecting the ratepayers from high utility rates.

However, without regularly reviewing these utilities' accounting records, the commission cannot be certain that it is adequately protecting the ratepayers from high utility rates. The legislative history of the state law requiring the commission to regularly audit these utilities indicates that the Legislature intended that these audits would be safeguards for the public and would protect against excessive rates. To the extent that the commission does not

ensure that it audits all regulated utilities as required, it does not meet the intent of the law to maintain public confidence in the regulatory process.

Equalization Believes a State Law Requiring Coordination of Audits With the Commission Is Out of Date

Equalization believes that a provision of state law requiring the commission to provide audit reports to Equalization is no longer appropriate. The law that requires the commission to audit periodically the records of utilities also requires that the commission provide the audit reports to Equalization for use in assessing taxes on public utilities. As noted in the previous section, the commission has chosen to meet the audit requirement through general rate cases, which results in written testimonies that summarize the results of the reviews of a utility's costs; staff present these testimonies to the commission during a hearing.

Because general rate cases are regulatory proceedings that examine a utility's operations and costs and are concerned with the rates that the utility may charge its customers, these proceedings do not focus on the utility's accounting records for taxation purposes and they are thus of no use to Equalization. For example, although Equalization assesses taxes on the cost of construction work that is not yet completed, the commission does not allow a utility to consider this type of cost when developing rates until the construction is completed and the property is put into service. Additionally, Equalization has taxing authority only over those taxable properties that are within California, while some utilities have assets outside of California that nevertheless can influence the commission's rate setting. For example, an electric utility might own a power plant in another state to generate electricity to provide to California ratepayers. The commission allows the utility to recoup through its rates some or all of the cost of building the out-of-state power plant. However, because the plant is in another state, Equalization does not have the authority to assess taxes on it.

According to Equalization, in addition to the lack of tax-related information within the commission's reports, the timing of the general rate case for a utility is often not when Equalization needs the information for tax purposes. For example, the commission usually requires an electric utility to file a general rate case every three years. However, Equalization must complete audits on utilities within a four-year period, which may not align with the general rate cases. Equalization indicated the property tax audits that its staff perform focus on the taxable or nontaxable nature of property costs at a level of detail that is not available from the commission's reports. It further noted that it has maintained an audit program

Because the commission's general rate cases are regulatory proceedings, these proceedings do not focus on the utility's accounting records for taxation purposes and are thus of no use to Equalization.

since 1977 and therefore has not required the commission's reports. As a result, despite the legal requirement to do so, the commission has not provided these required reports to Equalization in more than three decades.

Equalization indicated that because it needs to assess taxes on a variety of companies that may not be regulated by the commission, it has a process in place to audit these companies as necessary. According to Equalization, it does not have auditors specifically dedicated to auditing utilities that the commission regulates so it cannot quantify the cost of auditing those utilities; however, Equalization asserted that the additional cost it incurs for auditing the utilities the commission regulates is insignificant. Moreover, Equalization noted that it has been performing the tax assessment audits of utilities for many years and its staff possess the specific qualifications required of tax auditors. Equalization believes that the cost for the commission to begin performing this work would outweigh any benefits or cost-savings Equalization might realize. Although Equalization's conclusion appears reasonable, unless the statute is amended to remove this duty to provide the audits, the commission will continue to be out of compliance with the law. The director of the energy division indicated that in order for the commission to take a position on changes to existing law, it is required to vote on the matter. Therefore, commission staff cannot provide an official position on any changes to this law.

Recommendations

To ensure proper oversight of balancing accounts to protect ratepayers from unfair rate increases, the Legislature should amend the California Public Utilities Code, Section 792.5, to require the commission to develop a risk-based approach for reviewing all balancing accounts periodically to ensure that the transactions recorded in the balancing accounts are for allowable purposes and are supported by appropriate documentation, such as invoices.

To ensure that it has the necessary information to provide appropriate oversight of the balancing accounts, the commission should maintain accurate and timely information on utility balancing accounts. Specifically, it should do the following:

- Review the accuracy and completeness of the data it has obtained from utilities to ensure that it has a complete list of balancing accounts.

- Regularly update this list of balancing accounts when the commission issues decisions authorizing opening new balancing accounts or closing existing balancing accounts, when utilities file balancing account updates, and when the commission performs reviews of balancing accounts.
- Use this list to guide its efforts to oversee balancing accounts more effectively, by using a risk-based approach to select a sufficient number of balancing accounts, as well as those with the most potential impact on ratepayers, for review each year to provide appropriate coverage over all regulated utilities.

To ensure that it efficiently and effectively monitors energy utilities' balancing accounts to protect ratepayers from unfair rate increases, the commission should do the following:

- Direct the energy division to perform in-depth reviews of balancing accounts to verify that account balances contain only allowable transactions and are supported. These reviews should include ensuring that transactions recorded in a balancing account are supported by appropriate documentation, such as invoices.
- Direct the energy division to coordinate with Ratepayer Advocates to identify which balancing accounts Ratepayer Advocates plans to review during the year to avoid duplicating efforts.

To further its mission to obtain the lowest possible rates for reliable and safe utility service for ratepayers through its reviews of balancing accounts, Ratepayer Advocates should do the following:

- Use the commission's list of balancing accounts to guide its selection of the number, size, and type of balancing accounts to review so that its review coverage is more proportional across all utilities.
- Document the method used for its selection of balancing accounts to review.
- Coordinate with the energy division to avoid duplicating review efforts.

To ensure that findings and conclusions resulting from the reviews of balancing accounts are appropriate, complete, and supported, Ratepayer Advocates should perform the following, within six months:

- Develop policies that clearly describe how analysts are to document their reviews of balancing accounts, including all work reviewed and conclusions reached for each sampled item that supports their conclusions.

- Develop a document retention policy for all documents related to, among other things, balancing account reviews for a minimum of three years after the completion of these reviews.
- Implement a formalized and documented method to ensure that supervisors approve analysts' reviews of balancing accounts by checking the accuracy and completeness of the work that analysts prepare to support the conclusions of their reviews, including any proposed reductions in recoveries.

To ensure that findings and conclusions resulting from the reviews of balancing accounts are appropriate, complete, and supported, the water division should remind analysts to document their reviews properly and remind supervisors to formally indicate that they checked the accuracy and completeness of reviews.

The commission should follow the requirement in state law to inspect and audit the accounting records of utilities it regulates within required time frames. If the commission chooses to continue to meet this requirement through the general rate case process, it should ensure that all utilities file a general rate case on a regular schedule so as to comply with the state law's audit requirement. However, the commission should follow alternate methods to comply with the audit requirement when a utility will not be filing for its general rate case in time to be audited within three or five years, depending on the timing of the required audit for that utility.

The Legislature should amend California Public Utilities Code, Section 314.5, to remove the requirement that the commission provide audit reports to Equalization.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: March 4, 2014

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Appendix A

PUBLIC UTILITY BALANCING ACCOUNTS ACTIVE DURING THE LAST NINE YEARS AND THE FREQUENCY OF THEIR DETAILED REVIEW

State law requires the California Public Utilities Commission (commission) to direct utilities to track specific types of costs and related revenues from customers using a tracking mechanism. This tracking mechanism—known as a *balancing account*—protects ratepayers and utilities by identifying any under- or over-collection of revenue from ratepayers compared to the utilities' actual allowed costs. Utilities establish and maintain the balancing accounts after the commission authorizes those accounts. However, the commission does not maintain a central database of all balancing accounts and related revenue requirements it has authorized for a utility. Upon our request, the commission obtained the information from the utilities it regulates related to balancing accounts established over the past nine years—2004 through 2012—and provided that information to us. However, as we stated in the Audit Results, we did not audit this information to verify its accuracy and completeness. As such, the information the commission provided us is of undetermined reliability. However, through our limited comparison of these data with the commission's and the Office of Ratepayer Advocates' (Ratepayer Advocates) records, we noted some concerns with the data that the utilities reported to the commission. For instance, we found several instances in which a utility did not include at least one balancing account. However, it is the only source of information available and we present it in Table A on the following pages.

We also obtained information from Ratepayer Advocates and the Division of Water and Audits (water division) to determine which balancing accounts they reviewed during the nine-year period from 2004 through 2012. We performed limited tests to verify the accuracy of the information Ratepayer Advocates provided by reviewing the appropriate documents or reports to ensure that the selected balancing accounts were reviewed as noted. On the other hand, as indicated in the Audit Results, the water division cannot identify a comprehensive list of balancing accounts it has reviewed without devoting significant resources. Therefore, we could not include the reviews that the water division performed of water utility balancing accounts. However, the water division was able to identify certain balancing accounts it reviewed as part of two audits it performed at the direction of the commission. Table A shows the number of accounts active during the nine-year period from 2004 through 2012 and whether the commission reviewed them.

Table A

[illegible]

UTILITY NAME		BALANCING ACCOUNT NAME	ACTIVITY YEAR REVIEWED										2012 AUTHORIZED AMOUNT*
			2004	2005	2006	2007	2008	2009	2010	2011	2012		
Electric Utilities		Advanced Metering and Demand Response											
		Affiliate Transfer Fees											
		Air Conditioning Cycling/Air Conditioning Expenditures/Demand Response Revenue											
		British Columbia Renewable Study—Electric											
		Climate Smart											
		Colusa Power Plant											
		Demand Response Expenditures/Demand Response Revenue											
		Electric Reimbursable Fees											
		Electric Restructuring Costs											
		Electric Vehicle											
		Family Electric Rate Assistance											
		Hazardous Substance Mechanism											
		Headroom											
		Humboldt Generating Station											
		Meter Reading Cost											
		Non-Tariff											
		Procurement Energy Efficiency Revenue											
		Procurement Transaction Auditing											
		Public Purpose Programs Revenue Adjustment Mechanism											
		Research, Development and Demonstration											
		Regulatory Asset Revenue Requirement											
		Regulatory Asset Revenue Requirement True-Up Tracking											
		Renewables											
		Retirement Plan (Distribution and Generation)											
		Revised Customer Energy Statement											
		Streamline Residual											
		Trust Transfer Amount											
		Vaca Dixon (2 Megawatt Photovoltaic Pilot Project)											
	PacifiCorp		Energy Cost Adjustment Clause										\$25,800,000
			California Alternate Rates for Energy										2,900,000
			Solar Incentive Program										1,075,000
			Demand Side Management Programs										
			Demand Side Management Programs (Surcharge Schedule S-191)										
			Greenhouse Gas Allowance Costs										
			Greenhouse Gas Allowance Revenue										
			Low-Income Energy Efficiency Program										

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UTILITY NAME	BALANCING ACCOUNT NAME	ACTIVITY YEAR REVIEWED									2012 AUTHORIZED AMOUNT*
		2004	2005	2006	2007	2008	2009	2010	2011	2012	
Electric Utilities	San Diego Gas and Electric Company										\$883,863,000
	Electric Distribution Fixed Cost										
	Energy Resource Recovery—Ongoing	✓	✓	✓	✓	✓	✓	✓			746,597,000
	Non-Fuel Generation										381,918,000
	Electric Procurement Energy Efficiency										74,133,000
	Transition Cost (Competition Transition Charge)				✓	✓	✓	✓			62,615,000
	California Alternate Rates for Energy										43,623,000
	Pension										22,410,000
	Tree Trimming										19,652,000
	Electric Program Investment Charge										12,730,000
	Nuclear Decommissioning Adjustment Mechanism										9,018,000
	Post-Retirement Benefits Other Than Pension										7,231,000
	Research, Development and Demonstration Expense										2,556,000
	On Bill Financing										850,000
	Advanced Metering Infrastructure										
	Baseline										
	Common Area										
	21 st Century Energy Systems										
	California Solar Initiative										
	Electric Vehicle										
	Hazardous Substance Cleanup Cost										
	Post-1997 Electric Energy Efficiency										
	Renewables										
	Research, Development and Demonstration										
	Rate Design Settlement Component (Total Rate Adjustment Component)										
	Rewards and Penalties										
	Streamlining Residual										
	Southern California Edison										
	Base Revenue Requirement	✓			✓	✓	✓	✓	✓		5,541,288,000
	Energy Resource Recovery	✓	✓	✓	✓	✓	✓	✓	✓		4,084,426,000
	Public Purpose Programs Adjustment Mechanism	✓		✓	✓	✓	✓	✓	✓		525,052,000
	Procurement Energy Efficiency										297,251,600
	Pensions Cost				✓	✓	✓	✓	✓		161,175,000
	Medical Program				✓	✓	✓	✓	✓		145,990,000
	California Solar Initiative										110,000,000
	Energy Efficiency Program										100,415,000
	Low-Income Energy Efficiency Programs (Name changed later to Energy Savings Assistance Programs Adjustment Mechanism)			✓							72,462,000
	New System Generation				✓	✓	✓	✓	✓		64,012,000
	Demand Response Program				✓	✓	✓	✓	✓		61,858,000
	Post-Employment Benefits Other Than Pensions Costs				✓	✓	✓	✓	✓		51,086,000

UTILITY NAME		BALANCING ACCOUNT NAME	ACTIVITY YEAR REVIEWED									2012 AUTHORIZED AMOUNT*
			2004	2005	2006	2007	2008	2009	2010	2011	2012	
Electric Utilities		Electric Program Investment Charge—California Energy Commission										\$46,140,000
		Solar Photovoltaic Program										36,194,000
		2012 Electric Program Investment Charge Renewables										29,924,000
		2012 Electric Program Investment Charge Research, Development and Demonstration										28,563,000
		Nuclear Decommissioning Adjustment Mechanism	✓			✓	✓	✓	✓	✓		23,573,000
		California Alternate Rates for Energy	✓		✓	✓	✓	✓	✓	✓		17,842,000
		Electric Program Investment Charge—Southern California Edison										12,058,000
		On Bill Financing										5,333,000
		Mohave				✓	✓	✓	✓	✓		4,584,000
		Research Development and Demonstration										2,781,000
		Purchase Agreement Administrative Costs										1,047,175
		Electric Program Investment Charge—California Public Utilities Commission										289,000
		Clean Technology Generation										
		Community Choice Aggregation Implementation										
		Employee-Related										
		Family Energy Rate Assistance										
		Gas Catalina Adjustment Clause										
		Late Payment Charge Revenue										
		Optional Pricing Adjustment Clause										
		Other Distribution Adjustment Mechanism	✓									
		Palo Verde				✓	✓	✓	✓	✓		
		Smart Connect				✓	✓	✓	✓	✓		
		San Onofre Nuclear Generating Station 2 & 3 Steam Generator Removal and Disposal										
		San Onofre Nuclear Generating Station 2 & 3 Steam Generator Replacement										
Natural Gas Utilities	Pacific Gas and Electric Company	Purchased Gas	✓	✓	✓	✓	✓	✓	✓			1,437,574,000
		General Rate Case Distribution Base Revenues										1,166,429,000
		Local Transmission										208,606,000
		Backbone Transmission										139,103,000
		Public Purpose Programs Surcharge-California Alternate Rates for Energy Shortfall										118,884,000
		SmartMeter™ Project										82,514,000
		Public Purpose Programs Energy Efficiency-Gas			✓							80,280,000
		Public Purpose Programs—Low-Income Energy Efficiency										69,960,000
		Pension										43,764,000
		Storage										35,729,000
		Public Purpose Programs—Research, Development and Demonstration										10,717,000

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	UTILITY NAME	BALANCING ACCOUNT NAME	ACTIVITY YEAR REVIEWED									2012 AUTHORIZED AMOUNT*	
			2004	2005	2006	2007	2008	2009	2010	2011	2012		
Natural Gas Utilities	San Diego Gas and Electric Company	Core Fixed Cost	✓	✓	✓	✓	✓	✓	✓	✓		\$210,398,000	
		Gas Energy Efficiency										18,533,000	
		Other Operating Costs and Revenues										18,059,000	
		California Alternate Rates for Energy										14,495,000	
		Integrated Transmission					✓	✓	✓	✓		10,587,000	
		Gas Low-Income Energy Efficiency										9,540,000	
		Non-Core Fixed Cost	✓	✓	✓	✓	✓	✓	✓	✓		5,430,000	
		Research Development & Demonstration										1,329,000	
		Advanced Metering Infrastructure											
		Baseline Balance											
		Distribution Integrity Management Program											
		Gas Storage (Core and Non-Core)											
		Hazardous Substance Cleanup Cost	✓	✓	✓	✓	✓	✓	✓	✓			
		Interstate Transition Cost Surcharge											
		Natural Gas Vehicle											
		Non-Margin Fixed Cost											
		On Bill Financing											
		Pension					✓	✓	✓	✓			
		Post-Retirement Benefits Other Than Pension					✓	✓	✓	✓			
		Research, Development and Demonstration 1-Way (Pre 2001)											
		Rewards & Penalties	✓	✓	✓	✓	✓	✓	✓	✓			
		Curtailment Penalty Funds [‡]	✓	✓	✓	✓	✓	✓	✓	✓			
		Purchased Gas [‡]	✓ [†]	✓	✓	✓	✓	✓	✓	✓	✓	✓ [†]	
		Southern California Gas Company	Core Fixed Cost	✓	✓	✓	✓	✓	✓	✓	✓		1,481,501,000
			Purchased Gas	✓	✓	✓	✓	✓	✓	✓	✓		186,575,000
			California Alternate Rates for Energy										140,422,000
Backbone Transmission						✓	✓	✓	✓		135,000,000		
Demand Side Management											96,900,000		
Direct Assistance Program											90,374,000		
Noncore Fixed Cost	✓		✓	✓	✓	✓	✓	✓	✓		83,032,000		
Integrated Transmission	✓		✓	✓	✓						72,898,000		
Advanced Metering Infrastructure											35,793,000		
Post-Retirement Benefits Other Than Pension	✓		✓	✓	✓	✓	✓	✓	✓		26,154,000		
Noncore Storage	✓		✓	✓	✓	✓	✓	✓	✓		26,067,000		
Research, Development and Demonstration Gas Surcharge											12,284,000		
Distribution Integrity Management Program											10,173,000		
Research, Development and Demonstration Expense	✓		✓	✓	✓						10,173,000		
Pension						✓	✓	✓	✓		3,825,000		
Enhanced Oil Recovery	✓		✓	✓	✓						2,724,000		
On Bill Financing											1,017,000		

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			ACTIVITY YEAR REVIEWED									2012 AUTHORIZED			
UTILITY NAME			BALANCING ACCOUNT NAME		2004	2005	2006	2007	2008	2009	2010	2011	2012	AMOUNT*	
Natural Gas Utilities		Aliso/Goleta Tracking													
		Affiliate Transfer Fee	✓	✓	✓	✓									
		Brokerage Fee													
		Conservation Expense													
		Company Use Fuel For Load	✓	✓	✓	✓									
		El Paso Turned-Back Capacity													
		Firm Access Rights													
		Hazardous Substance Cost Recovery	✓	✓	✓	✓	✓	✓	✓	✓					
		Interstate Transmission—Firm Access Rights													
		Interstate Transportation Cost Surcharge													
		Montebello True-Up Tracking	✓	✓	✓	✓	✓	✓	✓	✓					
		Noncore Fixed Cost Tracking													
		Natural Gas Vehicles													
		Pacific Interstate Transmission Company/Pacific Offshore Pipeline Company Transition Cost													
		Rewards & Penalties	✓	✓	✓	✓	✓	✓	✓	✓	✓				
		Compressor Station Fuel & Power†	✓	✓	✓	✓	✓	✓	✓	✓	✓				
		Southwest Gas Corporation	Fixed Cost Adjustment Mechanism Margin Balancing Component	✓	✓	✓	✓	✓	✓	✓	✓	✓			\$81,694,000
			California Alternative Rates For Energy												9,074,000
			Low-Income Energy Efficiency												3,173,000
			Fixed Cost Adjustment Mechanism Upstream Pipeline Charges Component	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
	Purchased Gas Cost					✓†	✓	✓	✓	✓					
	Water Utilities	Alisal Water Corporation	Intrastate Transportation Cost Adjustment Mechanism					✓†	✓	✓	✓				
			Public Interest Research and Development												
			Baseline												
		Apple Valley Ranchos Water Company	Water Conservation												85,000
Water Quality Expenses															
Department of Public Health User Fee															
Water Revenue Adjustment Mechanism/ Modified Cost										✓				2,342,000	
Incremental Cost–Domestic System								✓	✓					207,000	
California Alternative Rates for Water Revenue Reallocation														106,000	
Incremental Cost–Irrigation									✓	✓				38,000	
California Water Service Company	Employee and Retiree Healthcare														
	Pension Expense														
	Water Revenue Adjustment Mechanism/ Modified Cost												385,046,000		
	Pension Cost										✓†	✓	22,392,000		
	Conservation Expense One-Way 2009 General Rate Case										✓	✓	9,676,000		

		ACTIVITY YEAR REVIEWED										2012 AUTHORIZED	
UTILITY NAME		BALANCING ACCOUNT NAME	2004	2005	2006	2007	2008	2009	2010	2011	2012	AMOUNT*	
Water Utilities		Water Conservation for 2005 and 2007 General Rate Cases										—	
		Purchased Power and Water											
		Low-Income Ratepayer Assistance											
		Temporary Interest Rate								✓†	✓		
		Rate Support Fund								✓†	✓		
		Lucerne						✓†	✓	✓	✓		
		Incremental Cost (one account per district)‡								✓	✓		
	California-American Water Company		General Expense										\$11,597,000
			Water Revenue Adjustment Mechanism—Monterey (Old Water Revenue Adjustment Mechanism)										10,435,000
			Ventura Interim Rate True Up										6,399,000
			Los Angeles Interim Rate True Up							✓†			5,796,000
			Sacramento Interim Rate True Up					✓					4,021,000
			Monterey Expense										2,836,000
			Monterey Seaside Adjudication Costs										2,756,000
			Monterey Aquifer Storage and Recovery & Los Angeles Patton Well Projects										2,680,000
			Purchased Power and Water—Los Angeles		✓	✓	✓	✓	✓	✓†			1,231,000
			Purchased Power and Water—Village										1,159,000
			Purchased Power and Water—Sacramento			✓	✓	✓	✓	✓†			798,000
			Purchased Power and Water—Monterey										534,000
			Toro Interim Rates										404,000
			Purchased Power and Water—Coronado		✓	✓	✓	✓	✓	✓†			392,000
			Los Angeles Distribution System Investment Charge Surcharge										184,000
			Purchased Power and Water—Larkfield	✓	✓	✓	✓	✓	✓	✓†			70,000
			Low-Income Program										(242,000)
			Monterey Carmel River Dam Abandonment Project										(417,000)
			Pension Surcharge—Monterey										(1,664,000)
			Purchased Power and Water—Felton										
			Monterey Conservation Surcharge										
			Felton Interim Rate True Up										
			Monterey Interim Rate True Up										
			Monterey Seaside Groundwater Basin										
			Pension Surcharge—Felton										
			Monterey Emergency Water Revenue Adjustment Mechanism										
			Monterey Emergency Rationing Costs for Monterey Peninsula Water Management District										
		Larkfield Interim Rate True Up											
		Temporary Interest Rate											

continued on next page...

[illegible]

UTILITY NAME		BALANCING ACCOUNT NAME	ACTIVITY YEAR REVIEWED										2012 AUTHORIZED AMOUNT*		
			2004	2005	2006	2007	2008	2009	2010	2011	2012				
Water Utilities	Park Water Company	Purchased Power and Pump Tax Recovery (Advice Letter 192)												—	
		Purchased Power, Pump Tax and Low-Income Program Recovery (Advice Letter 224)												\$(121,304)	
		Water Revenue Adjustment Mechanism/ Modified Cost												2,467,000	
		Incremental Cost												4,637	
		California Alternative Rates for Water Revenue Reallocation													
		One-way Conservation Expense [‡]								✓	✓				
		One-way Conservation Public Information Expense [‡]								✓	✓				
	San Gabriel Valley Water Company	Purchased Power and Water—Fontana						✓	✓	✓	✓ [†]			—	
		Water Revenue Adjustment Mechanism/ Modified Cost—Fontana								✓	✓ [†]			—	
		Purchased Power and Water—Los Angeles		✓	✓	✓	✓	✓	✓					—	
		Water Revenue Adjustment Mechanism/ Modified Cost—Los Angeles												—	
		Conservation Program—Los Angeles													
		California Alternative Rates for Water—Fontana [‡]						✓	✓	✓	✓ [†]				
		San José Water Company	Purchased Power												
	Purchased Water														
	Pump Tax														
	Fire Hydrant														
	Water Rate Assistance Program														
	State Revolving Fund Loan 1														
	State Revolving Fund Loan 2														
	Overlook Drive Presure System														
	Main Office Surcredit														
	City of San José Franchise Surcharge														
	Pension Expense														
	Balancing Account Surcharge														
	Mandatory Conservation Revenue Adjustment Memorandum Surcharge Balance														
	2004 Balancing Account And Interest Tracking														
	2005 Balancing Account And Interest Tracking														
	2006 Balancing Account And Interest Tracking														
	2007 Balancing Account And Interest Tracking														
	2008 Balancing Account And Interest Tracking														
	2009 Balancing Account And Interest Tracking														
	2010 Balancing Account And Interest Tracking														
	2011 Balancing Account And Interest Tracking														
	Suburban Water Systems		Purchased Power/Purchased Water/Pump Tax												4,057,000
			1-Way Conservation												338,000
Water Revenue Adjustment Mechanism/ Modified Cost															

continued on next page...

			ACTIVITY YEAR REVIEWED										2012 AUTHORIZED AMOUNT*
UTILITY NAME		BALANCING ACCOUNT NAME	2004	2005	2006	2007	2008	2009	2010	2011	2012		
Water Utilities	Valencia Water Company	Purchased Power and Water											
		Water Revenue Adjustment Mechanism/ Modified Cost											
		Conservation 1-Way											

Sources: Data that the California Public Utilities Commission (commission) obtained from utilities and the Office of Ratepayer Advocates (Ratepayer Advocates). Most reviews were performed by Ratepayer Advocates, and a few were performed by the Division of Water and Audits (water division). The commission did not provide balancing account information for three small natural gas utilities because it indicated that their balancing account activity was minimal. The commission also did not provide us balancing account information for 100 small water utilities that have fewer than 2,000 service connections because it believed obtaining this information from the small utilities would have been overly burdensome on those utilities. Further, the commission informed us that two larger water utilities did not have any balancing accounts during the nine-year period.

Notes: As we state in the Scope and Methodology, we did not audit these data to verify their accuracy and completeness. Therefore, these data are of undetermined reliability. However, in our limited comparison of these data with the commission's and Ratepayer Advocates' records, we noted some concerns with the data. However, we present this information because it is the only source of data available.

Based on the commission's direction, we shaded balancing accounts tan where the utility did not report any activity in a given year. However, we cannot confirm in each instance if the account was open but inactive, or if it was closed during that time period. In addition, we found some instances where the commission mistakenly indicated that the balancing account was inactive in a year where the utility had recorded activity, or in a year where Ratepayer Advocates indicated a review had occurred.

✓ = Reviewed by Ratepayer Advocates or the water division.

* The utilities did not always identify authorized amounts for all balancing accounts. Although the commission noted that certain accounts do not have annual revenue requirements, and some omissions may have been for accounts that had been closed or were inactive, the commission could not verify the reasons for all accounts for which authorized amounts were not included.

† This review covered less than six months of activity.

‡ The utilities did not include these balancing accounts in the data they provided to the commission. However, these accounts were listed in reviews the Ratepayer Advocates performed.

Appendix B

OUR REVIEW OF BALANCING ACCOUNTS MAINTAINED BY UTILITIES THAT ARE REGULATED BY THE CALIFORNIA PUBLIC UTILITIES COMMISSION

To determine the expenditures the utilities included in selected balancing accounts, we selected and reviewed nine balancing accounts maintained by six utilities that the California Public Utilities Commission (commission) had not reviewed during fiscal years 2010–11 to 2012–13. We chose three balancing accounts related to water utilities, three related to natural gas utilities, and three related to electric utilities. Our selection included larger utilities such as Pacific Gas and Electric Company with over 5.1 million electric customers and 4.3 million natural gas customers as well as utilities such as Suburban Water Systems, which has 300,000 customers. To ensure that we reviewed a cross-section of activities, we selected balancing accounts of differing purposes and of different sizes based on the balances. Table B on the following page shows the results of our review of the nine balancing accounts that the commission had not reviewed. Based on our testing of balancing accounts at these six utilities, we concluded that the balancing accounts were properly maintained and we found no exceptions.

Table B
Results of the Review of Selected Public Utility Balancing Accounts

TYPE OF UTILITY	UTILITY NAME	BALANCING ACCOUNT NAME	DESCRIPTION OF BALANCING ACCOUNT	TOTAL EXPENDITURES FOR FISCAL YEARS 2010-11 THROUGH 2012-13 SUBJECT TO REVIEW (IN MILLIONS)	BALANCING ACCOUNT PROPERLY MAINTAINED?
Electric Utilities	Pacific Gas and Electric Company	Utility Generation	Records the costs a utility incurs to produce power from its own facilities.	\$6,233	Yes
		New System Generation	Records the benefits and costs of power purchase agreements associated with generation resources that will be allocated to benefitting customers.	99	Yes
	San Diego Gas and Electric Company	Electric Procurement Energy Efficiency	Records the costs of the procurement energy efficiency program and the revenues from a surcharge to fund this program.	163	Yes
Gas Utilities	Pacific Gas and Electric Company	SmartMeter Project	Records costs and revenues associated with the SmartMeter™ project.	440	Yes
	Southern California Gas Company	Demand Side Management	Records the cost of the non-low-income energy efficiency program and revenues from a surcharge to fund this program.	200	Yes
		California Alternate Rates for Energy (CARE)	Records expenses of the CARE program, a rate subsidy program, and revenues to fund this program.	374	Yes
Water Utilities	San Gabriel Valley Water Company	Water Revenue Adjustment Mechanism*	Tracks revenues collected under tiered conservation rates against authorized revenues that would have been collected under a single rate.	49	Yes
	San José Water Company	Pension Expense†	Tracks contributions to the employee retirement plan against the pension expense included in the authorized rates.	7	Yes
	Suburban Water Systems	Purchased Power/Purchased Water/Pump Tax‡	Balance authorized costs for purchased power, purchased water, and pump taxes against actual costs.	18	Yes

Source: California State Auditor's review of nine balancing accounts maintained by six public utilities.

* The Water Revenue Adjustment Mechanism Balancing Account tracks revenues, not expenditures. Therefore, the amount in the expenditures column is for the revenues the utility is entitled to receive, which is compared against actual revenues collected.

† The expenditures subject to review for this balancing account were based on calendar years, not fiscal years.

‡ The expenditures subject to review for this balancing account were for the time period January 2010 through April 2013.

STATE OF CALIFORNIA

Edmund G. Brown Jr., Governor

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



February 11, 2014

Elaine M. Howle, CPA*
State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: Response to "California Public Utilities Commission: Improved Monitoring of Balancing Accounts Would Better Ensure That Utility Rates Are Fair and Reasonable"

Dear Ms. Howle:

The California Public Utilities Commission (CPUC) provides the following information and response to the February 6, 2014 draft report in response to the Joint Legislative Audit Committee's June 5, 2013 request for an audit of the CPUC's policies and procedures for auditing utility balancing accounts. We thank you and your staff for your thorough review of the CPUC's practices for reviewing balancing accounts. In general, we agree with the recommendations in this report and our agency has already begun to change its practices as a result of this audit. It is important to note that although we agree with the report's recommendations, the auditors' review of nine balancing accounts found that all of the accounts were properly maintained (see Appendix B of the draft report).

We intend to follow the recommendations to improve our review of balancing accounts and to address our noncompliance with Public Utilities Code Section 314.5. This effort may require a redirection or additional resources in order to perform the reviews and audits recommended by this report and required by law. In addition, the CPUC, along with the Department of Finance, has begun work this year to prepare a zero-based budget. The issues identified in this report will be considered along with our agency's other requirements and statutory mandates as a means to ascertain if our resources are sufficient to allow us to perform the work necessary to achieve our mission to ensure just and reasonable rates for utility service in the state of California.

Finally we note that the Office of Ratepayer Advocates (ORA) will file a separate response to the report that we will include with our submittal. ORA, as a Division within the CPUC, performs audits and reviews to inform its reports and testimonies. As described in the report, the CPUC has relied on ORA's audits and reviews to fulfill the agency's oversight obligations. The CPUC and ORA plan to coordinate our reviews and audits to ensure that the agency is in compliance with Public Utilities Code

* California State Auditor's comments begin on page 53.

Section 314.5 and will work together to develop policies and procedures to improve the balancing account review process.

The Report's Findings and Recommendations Are Distinct for Balancing Account Reviews and Utility Audits

The State Auditor makes findings and recommendations addressing the review of balancing accounts and also separately addresses the CPUC's statutory requirement to audit the books of the utilities. The distinction between review of balancing accounts and the statutory requirements to audit the books is important given the fact that the purpose of the audit was to review the CPUC's audit practices overall, but in particular, with respect to balancing accounts. The State Auditor found that audits performed as part of the CPUC's General Rate Cases comply with requirements of Section 314.5 if the General Rate Cases are submitted every three years.

The State Auditor also determined through their review of the CPUC's practices that the agency should create a formal process for the review of balancing accounts. The report finds that the CPUC should take specific actions to improve its oversight of balancing accounts but does not recommend that the accounts be subject to additional audits. As discussed below, the CPUC will implement this recommendation.

Balancing Accounts Do Not Impact the Rates Consumers Pay for Utility Services Until and Unless the CPUC Approves a Utility Request to Adjust its Revenue Requirement to Reflect an Accounts Balance

The report raises concerns that the CPUC does not keep accurate lists of the utilities' balancing accounts. (Page 16 and 41). The CPUC does not have a business need for a master list of all of the balancing accounts because the account balances have no impact on rates until and unless the utility requests rate recovery. The parameters determining the balances (forecasts of sales, costs and revenues and actual sales, costs and revenues) are pre-authorized in formal CPUC proceedings. Given that the parameters determining the balances in the future are already specified in CPUC decisions, the balances in the balancing accounts are only reviewed when the utilities file requests to amortize the balances. Balances in the balancing accounts cannot be amortized by the utilities without express approval of the CPUC. The CPUC is retaining a list of balancing accounts for both energy and water utilities and will update and verify the accounts on those lists, as recommended by the State Auditor.

State Auditor Recommendations

Recommendation #1: To ensure proper oversight of balancing accounts, the Legislature should amend Public Utilities Code, Section 792.5 to require the commission to develop a risk-based approach for reviewing balancing accounts periodically to

ensure that the transactions recorded in the balancing accounts are for allowable purposes and supported by appropriate documentation, such as invoices.

The CPUC supports the State Auditor's recommendation to perform periodic reviews of balancing account transactions but defers to the Legislature to determine if statutory changes are necessary. The CPUC has already started to collect data on each of the energy balancing accounts on a quarterly basis and will rely on this information to determine if further review is justified based on a specific account balance. Energy Division will establish an internal review process of active balancing accounts and will identify risk factors to consider when determining which accounts should be subject to a detailed transaction review.

Recommendation #2: To ensure that it has the necessary information to provide appropriate oversight of the balancing accounts of regulated utilities and thus protect ratepayers from unfair rate increases, the commission should regularly update the list of balancing accounts that it created and verify its accuracy. Both the commission and Ratepayer Advocates should use this list to guide their oversight efforts.

The CPUC supports this recommendation. Energy Division and the Division of Water and Audits have already established a process to update the balancing account lists and will create procedures to verify the accuracy of the list. The CPUC will share the lists with ORA.

Recommendation #3: To ensure that it efficiently and effectively monitors energy utilities' balancing accounts to protect ratepayers from unfair rate increase, the commission should direct its energy division to perform in-depth reviews of balancing accounts that Ratepayer Advocates has not reviewed.

The CPUC supports this recommendation. The Energy Division will coordinate with ORA to track which accounts have been subject to an in-depth review and from the remaining accounts, develop an approach to determine which accounts should be subject to review. These reviews will require that the CPUC redirect current resources and/or request additional resources. The CPUC will conduct an assessment of its existing resources and determine which part of the agency will conduct these reviews.

Recommendation #4: Both Ratepayer Advocates and the water division should, within 6 months, develop policies to ensure that reviews of balancing accounts are appropriately documented subjected to supervisory approval, and retained.

The CPUC supports this recommendation.

Recommendation #5: The commission should follow the state law requirement to inspect and audit the accounting records of utilities it regulates within required time frames.

The CPUC agrees with this recommendation. We will assess and identify resources needed to meet this statutory obligation.

Recommendation #6: The Legislature should amend state law to remove the requirement that the commission provide audit reports to Equalization.

The CPUC takes no position on this recommendation.

In summary, the CPUC has already taken steps to review the agency's oversight of utility balancing accounts. Public Utilities Code Section 314.5 requires the CPUC to audit utilities with over 1000 customers at least every 3 years and every 5 years for utilities with 1000 or fewer customers. The CPUC will institute a corrective action plan to ensure that the audit requirement is being met and will work with ORA to coordinate audits and balancing account reviews to ensure that the utilities' balancing accounts, books, and records are being adequately reviewed.

If you have any questions, please contact Cynthia Walker, Deputy Director of Energy Division, at (415) 703-1836.

Sincerely,



Paul Clanon
Executive Director

Cc: Michael R. Peevey, President, CPUC
Michelle Cooke, Deputy Executive Director, CPUC
Brian Turner, Deputy Executive Director, CPUC
Joseph Como, Acting Director, Office of Ratepayer Advocates

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CALIFORNIA PUBLIC UTILITIES COMMISSION

To provide clarity and perspective, we are commenting on the California Public Utilities' Commission's (commission) response to our audit. The numbers below correspond to the numbers we have placed in the margin of the commission's response.

The commission misstates the scope of our audit. Specifically, the purpose of our audit was not "to review the [commission's] audit practices overall." As we state in the Scope and Methodology on page 12, the scope of the Joint Legislative Audit Committee's audit request was limited to the commission's oversight of balancing accounts. Table 2 beginning on page 12 lists the objectives of our audit, all of which relate to balancing accounts.

①

The commission's statement implies that we evaluated the appropriateness of the audits it performs in conjunction with general rate case proceedings. To clarify, as we describe on pages 27 to 29, our scope was limited to determining whether the commission met the requirement in Section 314.5 of the California Public Utilities Code to audit the accounting records of a utility every three or five years, depending on the number of customers the utility serves. We did not evaluate the appropriateness of the audit procedures that the commission performs in conjunction with a general rate case proceeding.

②

We disagree with the commission's statement that it "does not have a business need for a master list of all of the balancing accounts." To implement our recommendation on page 31 to develop a risk-based approach for selecting balancing accounts for review, the commission will also need to implement our recommendation to maintain accurate and timely information on utility balancing accounts. Without such a list, the commission will lack information on the overall population of balancing accounts to make informed decisions about which accounts may be candidates for a closer review. Moreover, despite its assertion of not needing this master list, the commission acknowledges later in the response that it will update and verify the list developed in response to our request during the audit.

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ORA
Office of Ratepayer Advocates
California Public Utilities Commission

JOSEPH P. COMO
Acting Director

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San Francisco, California 94102
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<http://ora.ca.gov>

February 11, 2014

Elaine M. Howle, CPA*
State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: Response to California Public Utilities Commission: Improved Monitoring of Balancing Accounts Would Better Ensure That Utility Rates Are Fair and Reasonable

Dear Ms. Howle:

The Office of Ratepayer Advocates (ORA) provides the following information and response to the February 6, 2014 draft report in response to the Joint Legislative Audit Committee's June 5, 2013 request for an audit of the CPUC's policies and procedures for auditing utility balancing accounts. ORA strongly supports the Legislature's laudable intent to ensure utility services are affordable, safe and reliable.

ORA agrees with the intent of the findings in this draft audit, as they pertain to ORA. Furthermore, ORA is committed to addressing and implementing the specific recommendations. In fact, some of the recommendations of the draft report are already being implemented by ORA. Because the report will be a source of information regarding review of balancing accounts ORA takes this opportunity to clarify some key issues discussed in the draft report (See Attachment).

①

I want to thank the California State Auditor and its team for working with ORA to prepare this draft audit report and for accepting this submission in response to the report. I look forward to the ongoing discussion on these issues. If you have any questions, or would like to discuss this matter further, please call me at (415) 703-2381.

Respectfully,

Joseph P. Como
Acting Director, Office of Ratepayer Advocates

Attachment

Ratepayer Advocates in the Gas, Electric, Telecommunications and Water Industries

* California State Auditor's comments begin on page 67.

Attachment

Ratepayer Advocate's Response to March 2014 Draft Audit

SUMMARY - Results in Brief

Statement in Draft Audit

The commission's staff, the Office of Ratepayer Advocates (Ratepayer Advocates), and advocacy groups review the information that utilities present during the general rate case to determine whether proposed costs are necessary and reasonable.

ORA Comment:

GRCs are not the only proceeding where recovery of proposed costs is determined to be necessary and reasonable. Other proceedings, include, but are not limited to, approval of utility owned or third party owned capital projects or third party contracts for products or services such as power or water. The utilities are also not limited to a GRC proceeding to apply to the Commission for recovery of unanticipated expenses such as costs resulting from storm damage or from maintenance activities that were not anticipated in a GRC filing. There are between 200 and 300 proceedings active at the Commission at any one time where the Commission must determine whether proposed recovery of costs are necessary and reasonable.

②

Statement in Draft Audit

Ratepayer Advocates is an independent office within the commission with a mission to obtain the lowest possible rate for service consistent with reliable and safe service levels.

ORA Comment:

The mission is the legislative mandate contained in Public Utilities Code Section 309.5.

Statement in Draft Audit

Because the rates are derived from projected costs and consumption of service, state law directs the commission to require utilities to establish *balancing accounts* to track the actual costs and the related revenues the utilities collect from ratepayers.

ORA Comment:

This statement is too broad. Not all authorized revenues and costs are directed be recorded in balancing accounts. The sentence may be true for a subset of costs. However, most costs are forecasted for a future test year from which rates are set. There is no requirement to true-up rates to actual costs for the most part, with the exception of instances where there are balancing accounts and where those balancing accounts are designated to true-up to actual costs. Among water utilities this is for a minority of balancing accounts such as the Modified Cost Balancing Accounts for purchased water, purchased power and pump tax.

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Statement in Draft Audit

If a balancing account has a balance—indicating that the utilities have over- or under-collected from ratepayers compared to their costs—the utilities generally seek periodically to refund any over-collection to ratepayers or to add a surcharge to future rates to recoup any under-collection.

ORA Comment:

Surcharges and credits are not added to "rates." Surcharges and credits are one-time collections and do not represent ongoing collections in rates. If a balancing account has a balance—indicating that the utilities have over-or under-

④

collected from ratepayers compared to costs—the utilities periodically seek to return any over-collection to ratepayers or to recoup any under-collection in future rates.

Statement in Draft Audit

However, Ratepayer Advocates only reviews energy utilities' balancing accounts that are included in certain formal proceedings before the commission.

ORA Comment:

5

ORA also reviews water utility balancing accounts.

Statement in Draft Audit

Specifically, Ratepayer Advocates reviewed only 23 percent of large energy utilities' balancing accounts active during 2009 through 2011, representing 58 percent of the dollar value of these balancing accounts. It did not review balancing accounts with a total value of \$37.6 billion during this period.

ORA Comment:

6

The perception from this statement may be that covering 58% of the dollar value of these balancing accounts is not satisfactory. In fact, it represents a very large proportion of accounts that are reviewed for proceedings purposes.

7

ORA determines which accounts to review based on its mission and objectives. Many accounts were not presented for review in any formal utility application. Other accounts are currently being audited by ORA. Furthermore, most of ORA's resources including staff that conduct reviews of various utility accounts are assigned to General Rate Case proceeding audits. This issue is also discussed in further detail in responses below.

Statement in Draft Audit

In addition to lacking an adequate review process, Ratepayer Advocates' process for performing these reviews had weaknesses.

ORA Comment:

8

ORA has a multi-tier review process. ORA's purpose is to advocate for the lowest rates in the context of the administrative law practice at the Commission. The rigorous process to examine, not only financial accounts, but also all technical filings by a utility, requires a thoughtful approach aimed at looking for cost savings and involving coordination among engineers, analysts and attorneys to decide, in the administrative litigation environment, the best approach to achieve the greatest effect in administrative hearings and/or settlement negotiations. There is a thorough review process in this context because evidence has to be presented and supported in areas where, in ORA's judgment, it will provide the greatest effect on reducing utility costs. That judgment comes from institutional knowledge of utility practices, knowledge of past practices with a particular account, and knowledge of the commission's approved costs and revenues allowances. The evidence that ORA produces for this purpose goes through several levels of review, such as through case managers, assigned attorneys, first line managers and executive management. Then the same information is subject to discovery and rebuttal by the utilities. Furthermore, the ORA reviewer responsible for the work are subjected to cross examination in the hearing room by the utility that possesses the balancing account and by the administrative law judge. This process ensures little room for error as demonstrated by this BSA review that found no errors in 9 years of ORA audits.

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A better way to conceptualize this idea is that ORA uses audit tools to delve into areas of accounts where other information or evidence would suggest that it will be fruitful for ORA to look. For example, the utility's application may suggest some judgment on the part of the utility about what costs get recorded in a particular balancing account. ORA may want to delve into that particular balancing account versus an account that simply is used to records revenue that the commission has already approved. In essence, ORA uses a risk based approach to determining what accounts or areas of accounts to focus on so it can present evidence to the commission for disallowance consideration.

SUMMARY - *Recommendations*

Statement in Draft Audit

To ensure proper oversight of balancing accounts, the Legislature should amend Public Utilities Code, Section 792.5 to require the commission to develop a risk-based approach for reviewing balancing accounts periodically to ensure that the transactions recorded in the balancing accounts are for allowable purposes and supported by appropriate documentation, such as invoices.

ORA Comment:

PU Code Section 792.5 states that it applies when, “the commission authorizes any change in rates reflecting and passing through to customers specific changes in costs.” (Emphasis added.) This code section only applies to a subset of balancing accounts that are established to track pass through costs. For example, the water utilities’ Modified Cost Balancing Accounts and certain accounts such as pension cost balancing accounts are pass through accounts. Most balancing accounts do not pass through specific changes in costs to customers and thus would not fall under this code section. Therefore, this recommendation to change Section 792.5 would propose implementing risk-based approach for reviewing only a small subset of balancing accounts.

(11)

Statement in Draft Audit

Both Ratepayer Advocates and the water division should, within 6 months, develop policies to ensure that reviews of balancing accounts are appropriately documented, subjected to supervisory approval, and retained.

ORA Comment:

ORA agrees that its reviews would be more useful for purposes other than litigation if specific evidence of supervisory approval were documented. Furthermore, we agree that there should be a more consistent process in ORA for retaining audit records. ORA has already begun the process of drafting rules consistent with these recommendations and is reviewing and establishing minimum practices in auditing that all ORA audits will be required to follow. This should be completed by the end of March 2014.

INTRODUCTION - *Background*

Statement in Draft Audit

During the general rate case process, Ratepayer Advocates reviews the utility's accounts, past and projected expenses, revenue forecasts, capital costs, and plant additions; and it may protest the utility's proposed rates on behalf of the ratepayers.

ORA Comment:

ORA’s focus is mainly on behalf of residential and small commercial ratepayers. Public Utilities Code Section 309.5(a) states that “[t]here is within the commission an independent Office of Ratepayer Advocates to represent and advocate on behalf of the interests of public utility customers and subscribers within the jurisdiction of the commission. The goal of the office shall be to obtain the lowest possible rate for service consistent with reliable and safe service levels. For revenue allocation and rate design matters, the office shall primarily consider the interests of residential and small commercial customers.

Statement in Draft Audit

Moreover, individuals and groups that represent the interest of ratepayer, known as interveners, may also provide testimony to the commission regarding proposed rates.

⑫

ORA Comment:

Not all interveners represent ratepayers. For example, in rate cases interveners may represent their own business interest such as energy wholesalers, water agencies, or large business associations or special interest groups that advocate for specific services for their group. In a transmission or power plant siting proceeding, for example, a local community group may be concerned about visual or environmental impacts of a proposed project.

INTRODUCTION - Utilities Establish the Rates Charged to Consumers Through a General Rate Case Proceeding

Statement in Draft AuditFigure 2ORA Comment:

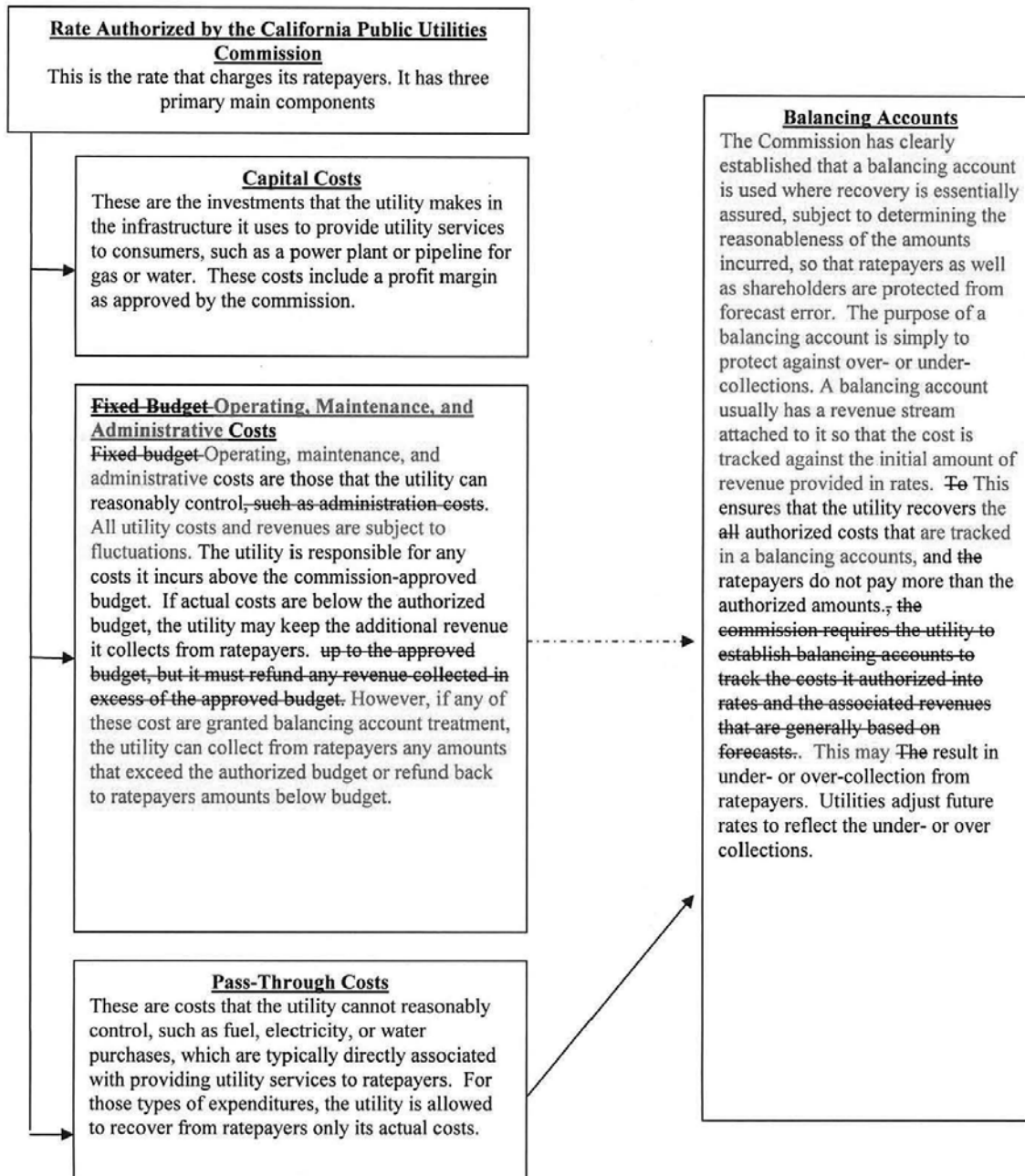
Figure 2 should be revised to minimize any confusion between authorized rates and balancing accounts. The table implies that all authorized utility costs are tracked in balancing accounts and that the Commission requires the utility to establish balancing accounts. Not all costs are tracked in balancing accounts, and utilities are the ones that seek to establish balancing accounts in general rate cases and other proceedings. The Capital Cost box needs to be revised because infrastructure costs are not tracked in balancing accounts. The box with "Fixed Budget Costs" should be revised to remove the use term "Fixed-Budget", and instead these costs should be identified as Operating, Maintenance, and General costs. These are normal costs incurred in by utility in running its business, and are not all subject to balancing account treatment. The Balancing Account box needs to be revised so it's clear what the purpose of balancing account is, and how it operates. Most of the included language comes directly from Commission Decision 12-09-004.

[See revised Figure 2 below.]

⑬

Figure 2
The Relationship Between Authorized Rates and Balancing Accounts

(13)



Source: California State Auditor's review of documentation from the California Public Utilities Commission.

Statement in Draft Audit

If the Commission does not approve the proposed rate before it is due to become effective, the utility may charge ratepayers an interim rate and then prorate the difference between the interim and final rate on consumer bills after the Commission authorized the final rate.

ORA Comment:

"Prorate" is not the correct term since the entire difference between interim and final rates is tracked and recovered in whole.

INTRODUCTION - *The Commission Requires That Utilities Track Certain Costs and Related Revenues Using Balancing Accounts*

Statement in Draft Audit

An energy utility—electric and/or gas utility—can also use the informal process by filing an advice letter with the energy division. However, unlike a water utility, an energy utility is not subject to the same 2 percent of gross revenue threshold, and it may choose to file an advice letter to incorporate the balance into future rates at any time it deems necessary before its next general rate case.

ORA Comment:

Energy utilities typically file for recovery annually through an advice letter to incorporate the balance into future rates.

Statement in Draft Audit

These proceedings address the way a utility allocates its costs for providing services to customers. An energy utility can choose to include balancing accounts during these proceedings as a means to incorporate any balances into its rates.

ORA Comment:

The balancing accounts of the gas utilities are submitted for review in these proceedings.

AUDIT RESULTS - *The California Public Utilities Commission Does Not Have Adequate Processes for Monitoring Utility Balancing Accounts*

Statement in Draft Audit

During 2009 through 2011, Ratepayer Advocates reviewed only 58 percent of the authorized amounts for the balancing accounts of the six largest energy utilities, leaving balancing accounts with a total value of \$37.6 billion unreviewed.

ORA Comment:

This statement misinterprets the purpose of ORA's audits. ORA determines the balancing accounts to review in a proceeding based on a preliminary determination of the likelihood of finding disallowances, which is consistent with ORA's objectives. Furthermore, ORA devotes much of its resources, including auditors, to General Rate Case proceedings and other proceedings that have the greatest impact on rates. In fact, reviewing more than half of total authorized amounts is very high percentage considering the fact that finding disallowances from balancing accounts is a rare event, compared to other account review activities that ORA performs.

AUDIT RESULTS - *The Commission Has Not Reviewed Many Large Balancing Accounts for Energy Utilities*

Statement in Draft Audit

Ratepayer Advocates does not have a formal policy for identifying the balancing accounts that it believes are most significant; instead, it considers whether a review would be beneficial for making a case for a lower utility rate.

ORA Comment:

ORA has a thorough process for identifying balancing accounts and other accounts it believes are most significant. When any application or advice letter is submitted to the commission, ORA reviews the application or advice letter within the organizational branch responsible for the review. ORA is composed of 5 branches – Energy Cost of Service and Natural Gas, Electricity Planning and Policy; Electricity Pricing and Customer Programs, Water, and Communications Policy. Within the appropriate branch, staff are assigned to review the utility submission and make a preliminary recommendation on approach, issues of concern and scope of review to the supervisor. Some applications (like a major Energy General Rate Case to which ORA assigns the majority of its auditors) undergo a very sophisticated review process that starts months before the utility files its application. Weekly meetings are held between the supervisors within the branches and program managers to discuss these new pleadings and staffing needs. ORA’s general counsel (Chief Counsel) also manages the work of the assigned attorneys and advises ORA staff on issues for consideration and litigation approach. First line supervisors are either briefed on a daily basis by staff on issues or are themselves involved in the review process. Additionally, a “week-ahead” document is produced by each ORA program (branch) manager every week that lists the active new utility requests, assigned staff and calendar status. Depending on the size and complexity of the utility request, a request is made by ORA to assign one or more attorneys to the case, and additional staff may be assigned. This may include a combination of attorneys, auditors, engineers and subject area analysts. The project or case team reviews the application or advice letter, develops a plan of discovery and overall plan for litigation. This process refines the areas where ORA auditors will devote their time as part of the review process.

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As the cases proceed, weekly or bi-weekly meeting are held with the branch personnel, deputy director and director to go over the status of case execution and to discuss legal strategy. In major subject areas, such as generation procurement policy, for example, the assigned staff will brief the deputy director and/or director on the approach to the review, litigation strategy and overlap with other areas of commission policy.

The discovery and review process is an iterative process that changes and adapts to the information discovered or needed and is further adapted to issues put forth by other parties to the administrative law process. The scope of the proceedings administered by the commission may change as a utility request is evaluated. ORA’s process is efficient and thorough in that it examines all utility requests and determines what evidence it needs to advocate for the lowest rates, within its own resource constraints.

Statement in Draft Audit

Although some of the balancing accounts that Ratepayer Advocates did not review were relatively small in value, the unreviewed balancing accounts tracked authorized costs and related revenues totaling \$37.6 billion, or 42 percent of the value of the energy utilities’ balancing accounts existing during 2009 through 2011. For example, in 2011 PG&E had more than \$601 million in outstanding balances in its electric balancing accounts that Ratepayer Advocates did not review, an amount that may be passed on to customers in future rates. Table 4 shows that Ratepayer Advocates did not review some accounts that tracked as much as \$9.1 billion in authorized amounts during 2009 through 2011. Because of the large authorized amounts, as well as the balances that utilities will pass onto ratepayers, these balancing accounts have significant potential to affect rates.

ORA Comment:

The question is whether the amounts in the balancing accounts are justified and what assurance does ORA have that it has identified appropriate disallowances that it can recommend to the commission. ORA determines which accounts to review (including balancing accounts) based on the strategy outlined above. Some balancing accounts are relatively simple and straightforward in that they only contain information that is easily verifiable without auditing the account every time. For example, an account may only accumulate revenue and costs for a narrow range of purposes that can be verified from other sources. Costs for a program may have already been reviewed by ORA in the context of a formal proceeding or there may be costs that the commission has already authorized. That dollar amount would then be directly charged to the balancing account. An audit of the cost to this balancing account would not result in a rate reduction or bill credit. Further, the revenue to that balancing account may have already been authorized and easily verifiable from other sources. If the balancing account accumulates revenue based on an authorized \$/kilowatt-

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hour of sales, and the sales are confirmed from other sources, there is no reason to audit the balancing account for the revenue. One only has to confirm that the reported revenue in the balancing account is equal to the \$/kilowatt-hour (authorized rate) x kilowatt-hours sold.

Statement in Draft Audit

When presented with the results show in Table 3, Ratepayer Advocates could not explain how reviewing far more balancing accounts for Edison than for other electric utilities furthered its mission.

ORA Comment:

The question presupposes that auditing every balancing account is the best way to further ORA's mission to advocate for the lowest rates. ORA uses its auditing resources as a litigation tool to support the administrative law process and settlement discussions between ORA and the utility. ORA decides what records to audit and the frequency based on a review of the applications and case planning with analysts, auditors and lawyers. With respect to Edison specifically, Edison generally includes more balancing accounts within its ERRRA applications than other utilities. Since there were more balancing accounts filed within the ERRRA application, in its review ORA audited more of Edison's balancing accounts relative to the other electric utilities for the purposes of developing its litigation strategy in that particular proceeding.

AUDIT RESULTS - Analysts Do Not Always Document and Supervisors Do Not Always Approve Ratepayer Advocates' Reviews of Balancing Accounts

Statement in Draft Audit

Ratepayer Advocates does not ensure that its analysts adequately document and supervisors properly approve reviews of balancing accounts.

ORA Comment:

As noted above, the purpose of an ORA review of balancing accounts is to support its mission to identify areas for disallowances which will result in rate reductions or bill credits. For that purpose, documentation takes the form of written testimony.

However, ORA agrees that an additional method of documentation to conform with general accepted accounting principles will assist the commission in documenting audits for purposes of audit surveillance. ORA is in the process of designing a method.

As for approval of audits by supervisors, all ORA reviews must be approved by the supervisor and may also be subject to review by an attorney, other analysts and the program manager (second level supervisor). What is lacking is a standardized log that shows that audits were specifically approved. ORA is in the process of establishing an audit control and approval process that will provide evidence of approval.

AUDIT RESULTS - Ratepayer Advocates Does Not Always Properly Document or Retain Its Reviews

Statement in Draft Audit

Table 5

ORA Comment:

Table 5 notes that ORA's review was not documented for the Cal Water Lucerne, Golden State Water Company Conservation Expense One-way and City of Torrance accounts. ORA provided these reports to the state auditors during the audit. ORA has documented its review of Cal Water's Lucerne balancing account in ORA's report on memorandum and balancing accounts p. 3-40 through p. 3-43, as well as the general review in Chapter 1 available at <http://ora.ca.gov/WorkArea/DownloadAsset.aspx?id=2245>.

Similarly, Golden State Water Company's Conservation Expenses One-Way and the City of Torrance account reviews are documented in ORA's report on memorandum and balancing accounts p. 4-5, and p. 33-34, respectively. These reports are available at <http://ora.ca.gov/WorkArea/DownloadAsset.aspx?id=1209>.

Statement in Draft Audit

For the remaining three of these 16 reviews, Ratepayer Advocates indicated that although the analysts had prepared supporting documentation for the reviews, the documentation was not retained because it was not needed. Ratepayer Advocates does not have document retention policy because after proceedings are completed and the amount from the balancing account that the utilities will be allowed to incorporate into rates is finalized, it allows analysts to retain documents at their discretion if there are no major adjustments or issues. However, state law requires every state agency, including Ratepayer Advocates, to have a document retention policy. It is especially important for Ratepayer Advocates to have such a policy considering the impact that its reviews can have on utility rates.

ORA Comment:

Note that most of ORA's work product is geared to developing the record in formal proceedings. The results of its investigation and analysis are offered into the record in the form of written testimony accompanied by supporting documents. That testimony is submitted several weeks before hearings, which are devoted primarily to cross-examination on the prepared testimony. ORA further develops the record during hearings through cross-examination of utility witnesses, and by introducing additional evidence. This entire work product becomes part of the record of formal proceedings. Case files are retained by the Commission and are available for public inspection, so it is not necessary for ORA to retain its own copy of every case file. ORA has retained its own records related to audits it performs to the extent those records may be useful in subsequent audits. But ORA recognizes that a more prescriptive and consistent document retention process is needed.

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AUDIT RESULTS - *Recommendations*

Statement in Draft Audit

To further its mission to obtain the lowest possible rates for reliable and safe utility service for ratepayers through its reviews of balancing accounts, Ratepayer Advocates should do the following:

- **Use the commission's list of balancing accounts to guide its selection of the number, size, and type of balancing accounts to review so that its review coverage is more proportional across all utilities.**

ORA Comment:

As described above, ORA's process for reviewing balancing accounts is based on an assessment of the potential for finding disallowances. That assessment is a function of the type of account, a preliminary review of the potential for disallowances and an overall litigation strategy. It would not be efficient for ORA to simply try to cover balancing accounts in a random or proportional basis. Resources are always limited and therefore targeted audit reviews based on a potential for discovering disallowances that the commission will accept is the preferred approach.

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- **Document the method used for its selections of balancing accounts to review.**

ORA is in the process of creating an audit guide to provide guidance on selection of balancing accounts for review.

- **Coordinate with the energy division to avoid duplicating efforts.**

ORA will work with energy division and division of water and audits to coordinate audit activities.

Statement in Draft Audit

To ensure that findings and conclusions resulting from the reviews of balancing accounts are appropriate, complete, and supported, Ratepayer Advocates should perform the following, within 6 months:

- **Develop policies that clearly describe how analysts are to document their reviews of balancing accounts, including all work reviewed and conclusions reached for each sampled item that supports its conclusions.**
- **Develop a document retention policy to retain all documents related to, among other things, balancing account reviews for a minimum of three years after the completion of these reviews.**
- **Implement a formalized and documented method to ensure that supervisors approve analysts' reviews of balancing accounts by checking the accuracy and completeness of the work that analysts prepare to support the conclusions of their reviews, including any proposed reductions in recoveries.**

ORA Comment:

ORA agrees with this recommendation and is already in the process of creating a guide that will accomplish all of the above. That document should be completed by the end of March 2014.

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE OFFICE OF RATEPAYER ADVOCATES OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

To provide clarity and perspective, we are commenting on the response to our audit report from the Office of Ratepayer Advocates (Ratepayer Advocates) of the California Public Utilities Commission (commission). The numbers below correspond with the numbers we have placed in the margin of Ratepayer Advocates' response.

As part of our quality control process, our standard practice is to provide agencies five working days—the agency review period—to review and comment on a draft copy of the report. During this time, we encourage agencies to discuss with us any concerns with the report, including any factual issues or word choices they may identify. In keeping with this practice, we provided copies of the draft report for Ratepayer Advocates staff to read at the exit conference on January 23, 2014. Further, during the agency review period, we contacted Ratepayer Advocates' acting director or senior manager on three occasions and offered to discuss any concerns that the Ratepayer Advocates may have had; yet, Ratepayer Advocates did not accept our offers. In contrast, we had several conversations with the commission during the agency review period and, as appropriate, incorporated the commission's feedback into our final report.

We are aware that utilities may request recovery of certain costs in proceedings other than the general rate case proceeding (general rate case). However, we focused on the general rate case proceedings because the commission indicated that the majority of utility costs are examined and most of the balancing accounts are authorized during general rate case proceedings.

This is an issue that we would have expected Ratepayer Advocates to let us know about during the agency review period. To address Ratepayer Advocates' concern that our statement was too broad, we added the phrase "for certain activities" to the sentence on page 1.

This is an issue that we would have expected Ratepayer Advocates to let us know about during the agency review period. Based on discussions with the commission during the agency review period, we had already revised the text on page 1 to reflect the change that Ratepayer Advocates is suggesting.

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- ⑤ Ratepayer Advocates misunderstands the purpose of our Report Summary, which provides a high-level overview of the key issues in our report, but is not intended to restate every issue. In this instance, we are discussing our concern with the commission's reliance on Ratepayer Advocates for the review of balancing accounts of energy utilities. Later, in the Introduction, we discuss Ratepayer Advocates' oversight of balancing accounts of water utilities in Table 1 on page 11 and in the text on page 10.
- ⑥ Ratepayer Advocates misses the point of our concerns with its practices for reviewing balancing accounts. As we show in Table 3 on page 17, Ratepayer Advocates' level of review varied considerably among the six largest energy utilities. Specifically, although it reviewed 94 percent of the value of Southern California Edison's (Edison) balancing accounts, it reviewed a substantially lower percentage of the value of the balancing accounts for the other five large energy utilities—between 27 percent and 79 percent. Further, as we show in Table 4 on page 18, the value of the three largest balancing accounts that Ratepayer Advocates did not review for the six large energy utilities totaled more than \$25 billion, which could have a significant impact on the future rates that utilities charge ratepayers.
- ⑦ Throughout its response, Ratepayer Advocates refers to the procedures it performs on balancing accounts as "audits." However, as noted in the footnote at the bottom of Table 2 beginning on page 12 of our report, we refer to these procedures as "reviews" because the procedures it performs do not constitute a complete audit under audit standards.
- ⑧ Ratepayer Advocates misinterprets our finding. While Ratepayer Advocates analysts' written testimonies may undergo reviews by supervisors and management, as we state on page 24, its supervisors do not examine the work supporting these testimonies to ensure analysts perform all planned procedures appropriately and that any proposed reductions in recovery amounts are accurate. In fact, we found no evidence of documented supervisory approval of the analysts' work for any of the 18 reviews we tested. Moreover, as discussed on page 22 and as shown in Table 5 on page 23, 16 of these 18 reviews of balancing accounts lacked adequate documentation to demonstrate the work that Ratepayer Advocates' analysts performed, was not created by an analyst, or was not available for our review because it had been discarded.
- ⑨ Ratepayer Advocates' statement is erroneous as our report does not include a finding of "no errors in 9 years of [Ratepayer Advocates] audits." To the contrary, we noted a pervasive lack of documentation and supervisory approval for the 18 reviews that we tested, as shown in Table 5 on page 23 and discussed

on pages 21 through 25. Moreover, as Table 2 beginning on page 12 indicates, we limited our testing of these reviews to fiscal years 2010–11 through 2012–13.

Contrary to Ratepayer Advocates’ assertion of using a “risk based approach,” it was unable to provide us with any evidence of this approach—such as a written policy or methodology, or contemporaneous documentation of its reasons for determining which balancing accounts are most significant to its mission. In fact, a senior manager within Ratepayer Advocates confirmed for us that no written policy existed and that Ratepayer Advocates produces no documentation from the periodic meetings it holds to discuss the selection of balancing accounts to review. Lacking this documentation, we are unable to evaluate or verify Ratepayer Advocates’ claims of employing a risk-based approach to determine the accounts or areas of accounts on which to focus its efforts.

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We are aware that California Public Utilities Code, Section 792.5, as it currently reads, requires balancing accounts to be established to track pass-through costs. However, the commission also authorizes utilities to establish balancing accounts to track other costs and, as we state on pages 10 and 15 of the report, other than a requirement to semiannually review the Energy Resource Recovery Accounts, there is no specific requirement related to reviewing balancing accounts of any other type. Therefore, we stand by our recommendation that the Legislature amend this section to require the commission to develop a risk-based approach to reviewing balancing accounts. Nevertheless, we added the word “all” to our recommendations on pages 3 and 30 to clarify that the risk-based approach should be used to review all balancing accounts.

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This is an issue that we would have expected Ratepayer Advocates to let us know about during the agency review period. To clarify the nature of interveners, we added “businesses” and “special interests” to the description on page 7.

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This is an issue that we would have expected Ratepayer Advocates to let us know about during the agency review period. To clarify that not all costs within each cost component are tracked in a balancing account we added the text “certain activities” in the top section of Figure 2 on page 7. In preparing Figure 2, we worked with the commission during the audit to ensure that it accurately reflected all information. However, after reviewing Ratepayer Advocates’ response, we again reached out to the commission to ensure the figure’s accuracy. Upon further discussion, the commission agreed with Ratepayer Advocates’ assertion that capital costs are not tracked using balancing accounts. We revised the figure to reflect that fact. However, based on discussions with

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the commission, other than these two changes, we believe that the remainder of the information in Figure 2 is accurate, thus we did not make the other changes that Ratepayer Advocates suggests.

- ⑭ This is an issue that we would have expected Ratepayer Advocates to let us know about during the agency review period. Based on our discussions with the commission during the agency review period, we had already revised the text on page 8 to clarify that utilities recoup or refund the difference between the interim and final rate from ratepayers after the commission has authorized the final rate.
- ⑮ Ratepayer Advocates misunderstands our finding. We do not cite generally accepted accounting principles as a reason to properly document and have supervisors approve balancing account reviews. Rather, as we state on page 25, considering that 16 of the 18 reviews we selected lacked adequate documentation, Ratepayer Advocates cannot be certain that the reviews that analysts performed were adequate and complete.
- ⑯ We commend Ratepayer Advocates for beginning the process to establish a standardized log to document supervisory approval of analysts' reviews. However, as part of its supervisors' approval, Ratepayer Advocates will also need to ensure that analysts actually prepare appropriate documentation of their reviews. Moreover, although Ratepayer Advocates asserts that "all [Ratepayer Advocates] reviews must be approved by [a] supervisor," as we note on page 24, none of the 18 reviews we tested had evidence of a supervisory approval.
- ⑰ Ratepayer Advocates confuses its final product—the written testimony—with documentation of the procedures that analysts complete when performing a balancing account review. While Ratepayer Advocates provided us with the testimonies related to the 18 balancing account reviews we tested, including the three balancing accounts it specifically mentions, it was unable to provide us with the analysts' original work used in compiling those testimonies. In fact, on December 17, 2013, a Ratepayer Advocates senior manager confirmed in writing to us that analysts created no documentation for the three reviews. Further, in response to our request for this documentation, because it allows staff to keep their workpapers at their discretion, Ratepayer Advocates generally told us to directly contact analysts who performed the 18 reviews.

cc: Members of the Legislature
Office of the Lieutenant Governor
Little Hoover Commission
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press