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National Association of Regulatory Utility Commissioners
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of the
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Public Utility Commission

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Conducting an Audit

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Purpose of An Audit

An Audit is conducted for the purpose of:

- Examining, on a test basis, evidence supporting the amounts and disclosures of certain information reported by a utility.
- Assessing accounting principles used by a utility and significant estimates made by its management.
- Evaluating the overall statement presentation, if applicable.

Who conducts Audits in PA?

- The Bureau of Audits of the Pennsylvania Public Utility Commission is responsible for conducting audits of Pennsylvania's fixed utilities.
- Occasionally, outside consulting firms are authorized to conduct audits with the oversight of the Audits Bureau staff.

Types of Audits

- Financial Audits
- Annual Adjustment Clause Audits
- Management Audits
- Management Efficiency Audits
- Compliance Audits
- Special Audits or Reviews as Assigned

Financial Audits

Financial Audits:

- Determine the propriety of the property, plant and equipment records together with an evaluation of the usefulness of that equipment.
- Cover a wide variety of financial issues including original cost (OC) audits, original cost studies (OCS), and continuing property records (CPR).

Management Audits/Management Efficiency Reviews

- Management Audits determine extent to which a utility has:
 - Contained costs.
 - Developed reasonable long- and short-range plans for its continued operation and maintenance.
 - Provided proper service to its customers.
 - Provided proper management & organizational structure.

Management Audits/Management Efficiency Reviews (cont'd)

Management Efficiency Reviews:

- Examine effectiveness of management.
- Examine operating efficiency of the utility.
- Assess utilities' progress in implementing recommendations from prior audits.

Management Audits/Management Efficiency Reviews (cont'd)

Management Audits and Reviews in PA:

- Are mandated for approximately 23 electric, gas & water utilities that have plant-in-service of \$10 million or more.
- Conducted every 5 to 8 years.
- Management Audits have been suspended for qualifying Telecommunications utilities consistent with alternative regulatory plans.

Adjustment Clause Audits

Adjustment Clause Audits:

- Verify the costs incurred by a utility to determine if customers were over-billed or under-billed for yearly energy charges.
- Are required by the General Assembly for Gas, Steam-Heat and certain municipal electric utilities (Section 1307 of the Public Utility Code).

Compliance Audits

Compliance Audits:

- Examine a broad range of utility operations and determine adherence to prescribed laws and regulations.
- Performed on a “per request” basis.

Special Projects Audits

- Encompass Commission-ordered operational audits/reviews or other forms of technical assistance to the Commission.
- Examples include:
 - Review of asset sales
 - Power outages
 - Administration of special purpose funds

Preliminaries of an Audit

- Determine the scope of the Audit
 - e.g., original cost, management, cost of service, construction, purchased power, etc.
- Consider Resource Constraints
 - Budget Man-hours/Timelines
 - Big Ticket Items v. Detail

Preliminaries of an Audit (cont'd)

- Issue Entrance-Conference Letter
 - Explain scope of what Audit will cover.
 - List Names of Assigned Auditors.
 - Explain what will be reviewed and what will be requested.

Preliminaries of an Audit (cont'd)

- Be familiar with the Utility's Accounting System (e.g., familiarity with USOA accounts and instructions).
- Obtain historical information about the utility.
- Chart of Accounts
- Gather Specific Information from the System
 - Pull invoices and work orders

Preliminaries of an Audit (cont'd)

- Historical Data Analysis
 - Several years (3-5) of historical data.
 - Can usually be obtained from Annual Reports.
 - Suggested Items to Review (additional detail as needed).
 - Each element of Rate Base
 - Each category of Revenue
 - Each category of Expense
 - Sales Units (minutes, kWh, Mcf)
 - Number of Customers (by class)
 - Number of Employees
 - Other (miles of installed cable)

Preliminaries of an Audit (cont'd)

- Focusing the Audit
 - Historic data spreadsheets
 - Concentrate on larger accounts (e.g., salaries, depreciation, purchased power, etc.)
 - Useful in Rate Case Audits
 - Politically sensitive items
 - Items of concern to Commissioners/public
 - Regulated/Unregulated divisions

Audit - Review of Records

- Review Utility's Audit Committee Minutes
- Request List of all Internal Audit Reports
(request specific reports as necessary)
- Billing Records
- Review Board of Director Minutes
- Chart of Accounts and Account Manual
- Construction Work Orders

Audit - Review of Records (cont'd)

- Construction Budgets
- Continuing Property Records
- Depreciation Studies
- Franchise Fee Records
- General Ledger and Subsidiary Ledgers

Audit - Review of Records (cont'd)

- Income Tax Returns
- Internal Audit Reports & Work papers
- External Audit Reports
- Invoices
- List of Property Units
- Monthly or Quarterly Operating/Financial Reports

Audit - Review of Records (cont'd)

- Organizational Charts
- Payroll Records
- Property Tax Statements
- Sample of Customer Bills (comply with billing standards?)

Rate Case Audits - Test Year

- Definition of Test Year:

Period of Measurement for a recent, consecutive 12-month period consisting of a full year of operations where data is readily available.

- Historic or Future Test Year

- Should be current
- Should be representative of period in which rates will be in effect.

Test Year Adjustments

- Correcting
 - Removal of Prior Period Items from the Test Year.
- Normalizing
 - Adjusting Revenues for Normalized Weather.

Test Year Adjustments (Cont'd)

- Pro Forma
 - General purpose is to transform the relationship that exists between the revenue requirements to make it reflective of what is expected to take place during the time the rates are expected to be in place.
 - E.g., Reflection of Authorized Salary Increases and other known changes

Rate Base Audit

- Definition of Rate Base

The investment base to which a fair rate of return is applied to arrive at the net operating income requirement.

- Original Cost

Cost of the item at the time that asset was first put into utility service. It is the cost that remains with that asset throughout its life.

Rate Base Audit (cont'd)

- Items to consider in Rate Base Audits:
 - Utility Plant In Service.
 - Plant Held For Future Use
 - Construction Work In Progress (CWIP)
 - Acquisition Adjustments
 - Customer Deposits (Customer Contribution in Aid of Construction)
 - Cash Working Capital

Rate Base Audit (cont'd)

- Items to consider in Rate Base Audits:
 - Customer Advances
 - Prepayment
 - Materials & Supplies

Concluding an Audit

- Determine whether any items still need to be provided and when (this should also be ongoing throughout the Audit).
- Analyze all information obtained and verify findings as necessary.
- Develop point sheets.
- Set up Exit Conference
- Share Findings with Utility & give it an opportunity to concur with any changes or corrections.

Concluding An Audit (cont'd)

- Point Sheets Contain 5 Elements of a Finding:
 1. Condition (What is?)
 2. Criteria (What should be?)
 3. Effect (So what?)
 4. Cause (Why did it happen?)
 5. Recommendation (What should be done?)

Point Sheets also contain results of preliminary discussions w/management; Working Paper References; and Disposition, along with preparer and reviewer names.

Concluding An Audit (cont'd).

- Prepare work papers and files (i.e., are they complete, properly indexed and cross-referenced?).
- What might be useful for those looking at the information in several years for the next case? (Include “Notes to Future Auditor” Section in Audit).
- Prepare draft report, including background, findings and conclusions, and recommendations.