



Accounting Systems in Utility Regulation II

Brian Welke, Auditor
Regulated Energy Division, Revenue Requirements Section
Michigan Public Service Commission

June 29, 2010 – 2:30 pm

Preface

- Public Act 286
 - Historical vs. Projected Test Years
 - Applicable Laws
- Conducting an Audit in a Post P.A. 286 Regulatory Environment
 - Historical vs. Projected Data Analysis
 - Timeframes
 - Information Gathering and Verification
- Test Year Adjustments
 - Regulatory Aspects of a Uniform System of Accounts

Public Act 286

Historical vs. Projected Test Years

Act No. 286

October 6, 2008

Sec. 6a.(1) States:

“A utility may use projected costs and revenues for a future consecutive 12-month period in developing its requested rates and charges.”

Conducting an Audit in a Post P.A. 286 Regulatory Environment

- The passage of P.A. 286 has challenged our traditional ways in which we audit.
- However, there is no reference to historical information within our traditional definitions of an audit.

Traditional Definitions of an Audit

- “An examination for accuracy with the intent of verification.”
- “An inspection of the accounting procedures and records.”
- “A methodical examination of a condition or situation.”

Key Principles in Conducting an Audit

1.) Efficiency

2.) Effectiveness

“Inefficient and Ineffective” Example

Case No: U-15645
Witness: Welke, Brian A.
Exhibit No: S-3
Schedule No: C-5
Page 1 of 1

Consumers Energy Company
Case No. U-15645
Staff's Projected 2009 O&M

Line	Description	Amount	Source
a	b	c	d
1	Historical 2007: O&M Expense		587,577 P-521, A-WP (AKR-98)
2	Historical 2007 Non Inflationary Items		
3	Production O&M	120,150	A-WP (AKR-98)
4	Distribution O&M	150,721	Ex. S-3 Sch. C-7
5	Company Adjustments	257,619	WP-BAW-06
6	Total 2007 Non Inflationary Items	<u>528,490</u>	Sum Lines 3 through 5
7	Add: Disallowed Non Inflation Items		
8	DSSP Disallowance	1,517	WP-BAW-01
9	Executive and Director Benefit Administration	502	WP-BAW-01
10	Total Disallowed Non Inflation Items	<u>2,019</u>	Sum Lines 8 and 9
11	Total 2007 Non Inflation O&M	<u>530,509</u>	Line 30 plus Line 48
12	2007 Inflationary O&M	57,068	Line 1 less Line 11
13	2008 Staff Inflation Rate	<u>3.85%</u>	Ex. S-4 Sch. D1.1
14	2008 Inflation Adjustment	<u>2,197</u>	Line 12 x Line 13
15	2008 Inflation Subject Base	59,265	Sum Lines 12 and 14
16	2009 Staff Inflation Rate	<u>-1.23%</u>	Ex. S-4 Sch. D1.1
17	2009 Staff Inflation Adjustment	<u>(729)</u>	Line 15 x Line 16
18	Staff 2009 Inflation Adjustment	<u>1,468</u>	Sum Lines 14 and 17
19	Adjustments to the Historical 2007 Test Year		
20	DSSP Disallowance	(1,517)	WP-BAW-01
21	Executive and Director Benefit Administration	(502)	WP-BAW-01
22	Staff Historical 2007 Test Year Adjustments	<u>(2,019)</u>	Sum Lines 20 and 21
23	Staff 2007 Historical O&M	<u>585,558</u>	Sum Lines 1 and 22
24	Staff Projections		
25	Production O&M	22,884	Ex.. S-3 Sch. C-6
26	Distribution O&M	4,671	Ex.. S-3 Sch. C-7
27	Electric Injuries and Damages Expense	227	WP-BAW-02
28	AMI	581	WP-BAW-03
29	Uncollectibles	(2,761)	WP-BAW-04
30	Base Labor Increase	-	WP-BAW-05
31	EICP	-	WP-BAW-05
32	Adjusted Historical Base Known and Measurable	<u>25,612</u>	Sum Lines 25 through 31
33	Inflation Adjustment	611,170	Sum lines 23 and 32
34	Staff 2009 O&M Projection	<u>1,468</u>	Line 18
35	Staff's Projected 2009 O&M Expense	<u>612,638</u>	Sum Lines 33 and 34
36		<u>25,061</u>	Line 35 less Line 1

35 Questions...

...and I was crossed by the Company.

"Efficient and Effective" Example

Schedule C-5 (BAW)

Michigan Public Service Commission
The Detroit Edison Company
Projected Operations and Maintenance Expense
For 12 Month Period Ending June 30, 2010
(\$000's)

Case No.: U-15768
Witness: BAWelke
Exhibit No.: S-3
Schedule No.: C-5 (BAW)
Date: 7/9/2009
Page No.: 1 of 1

Line	Description (a.)	Source (b.)	Actual 2008 Expenses (c.)	Adjustment (d.)	Projected Test Year Ending 6/30/2010 (e.)
1	MPSC P-521: 2008 O&M	WP-BAW-01	1,368,044,777		
2	MERC	Exh. A-10 Sch. C-5.12	37,275,000		
3	Total	Agrees to MPSC P-521	1,405,319,777		
4	2008 Adjustments:				
5	Staff Adjustments	Exh. S-3 Sch. C-21	52,178,000	(52,178,000)	-
6	Production & Distribution O&M	WP-BAW-01	716,312,124	35,977,770	751,689,894
7	Administrative & General O&M	Exh. S-3 Sch. C-2	250,891,907	380,352	251,272,259
8	Uncollectible Expense	WP-BAW-02	86,997,738	(37,902,000)	49,095,738
9	Injuries and Damages	WP-BAW-03	21,516,310	5,551,431	27,067,741
10	Pension & Other Benefits	Exh. S-3 Sch. C-19	200,290,698	77,722,544	278,013,242
11	LIEEF	WP-BAW-05	39,858,000	-	39,858,000
12	Continuous Improvement Savings	WP-BAW-09	-	(38,800,000)	(38,800,000)
13	Performance Excellence Savings	WP-BAW-10	-	(29,265,000)	(29,265,000)
14	MERC	Exh. A-10 Sch. C-5.12	37,275,000	-	37,275,000
15	Total O&M Expense	Agrees to MPSC P-521	1,405,319,777	(39,112,903)	1,366,206,874

One Question...

...and I was not crossed by the Company.

How do we achieve this efficiency?

It Starts With A Plan

Definition of an Audit Plan:

“An audit plan is a description of the scope and methodology of the audit with sufficient detail to guide the audit.”

Audit Scope:

“An audit’s scope is the boundaries of the audit.”

“An audits scope describes the depth and breadth covered by an audit.”

Why is Scope Important

Act No. 286

October 6, 2008

Sec. 6a.(1) States:

“If the commission has not issued an order within 180 days of the filing of a complete application, the utility may implement up to the amount of the proposed annual rate request through equal percentage increases or decreases applied to all base rates.”

Why is Scope Important

Act No. 286

October 6, 2008

Sec. 6a.(3) States:

“...if the commission fails to reach a final decision with respect to a completed petition or application to increase or decrease utility rates within the 12-month period following the filing of the completed petition or application, the petition or application is considered approved.”

Sample Case Schedule (New)

	Date	Cum. Days
I. Application Filing by Utility	1/27/2010	0
II. Application Accepted by Commission	2/25/2010	29
III. Prehearing; Set Schedule	2/22/2010	26
IV. Filing	7/1/2010	155
V. Motion To Prevent Self-Implementation	7/26/2010	180
VI. Rebuttal Filing (if necessary)	7/16/2010	170
VII. Motions to Strike (if necessary)	7/23/2010	177
VIII. Responses to Motions to Strike (if necessary)	7/27/2010	181
IX. Cross Questions provided to Staff Attorney General	7/30/2010	184
X. Cross Examination	8/9-8/17	202
XI. Initial Briefs	9/9/2010	225
XII. Reply Briefs	9/30/2010	246
XIII. Proposal for Decision	11/16/2010	293
IXX. Exceptions to Proposal for Decision	11/30/2010	307
XX. Reply to Exceptions	12/10/2010	317
XXI. Commission Deliberation	1/24/2011	362
XXII. Commission Order	1/25/2011	363

Why an appropriate Audit Scope is Essential: Components of Payroll

- salaries
- wages
- bonuses & commissions to employees
- overtime pay
- payroll taxes and costs
 - Social Security
 - Medicare
 - federal income tax
 - state income tax
 - state unemployment tax
 - federal unemployment tax
 - worker compensation insurance
- employer paid benefits
 - holidays
 - vacations
 - sick days
 - insurance (health, dental, vision, life, disability)
 - retirement plans
 - profit-sharing plans

Audit Methodology

A step by step guide through the audit process detailing the procedures to be preformed.

Information Gathering and Verification Procedures

1.) Informal Audit Requests

Submitted only to the Company through E-Mail without lawyer intervention

2.) Formal “Discovery”

Submitted to the Company and all parties involved in the case with lawyer intervention

Rules Relating to Audit Requests and Discovery

Timeframes for answers to requests and discovery are set during the pre-hearing

While audit requests are more “informal”, they are just as effective as discovery and answers can be forced through motions to compel

Additional Procedures

- On Site Visits
- Teleconferences
- Requests for Meetings

Test Year Adjustments

“All amounts included in the accounts prescribed herein for electric plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5 Other Deductions.”

Uniform System of Accounts Page 5, Section 2(e.)

The Question

Please provide the dollar amounts for all the items disallowed by the commission in case U-15244 that are included in your projected test year.

- a.) Provide the dollar amounts and other information for each item separately.
- b.) Provide the relevant uniform system of accounts number's in which these amounts appear and how much is in each.
- c.) Provide a brief description of the previously disallowed amounts for each.

Other Adjustments Relating to the Uniform System of Accounts: Another Example

“Records shall be kept so as to show the amount of coverage for each class of insurance carried, the property covered, and the applicable premiums. Any dividends distributed by mutual insurance companies shall be credited to the accounts to which the insurance premiums were charged.”

Uniform System of Accounts Account 924 Section (c).

Other Types of Test Year Adjustments

- Normalizing Adjustments
 - Averages for Injuries and Damages, Uncollectible Accounts and other Highly Volatile Expenses
- Adjustments for Updated Information
 - Updated From Proxy or Financial Statements Provided to the Investment Community
 - Updated to Actual from Budgeted Amounts

Other Types of Test Year Adjustments Continued

- Adjustments for Errors within the Company's Filing
- Adjustments for Differences in Opinion Relating to Projections

Accounting Systems in Utility Regulation II

Brian Welke, Auditor
Michigan Public Service Commission
Regulated Energy Division
Revenue Requirement Section
welkeb1@michigan.gov
(517) 241-1722