



# Ontario Energy Board Commission de l'énergie de l'Ontario



## A Sector Review of Deferral and Variance Accounts for the Electricity Distributors

Audit & Performance Assessment

February 26, 2014

# Disclaimer

- This presentation expresses the views of the Audit and Performance Assessment staff of the Ontario Energy Board (“Audit and Performance Assessment”) which are intended only for discussion purposes and does not represent the Board’s views and is not binding on the Board.

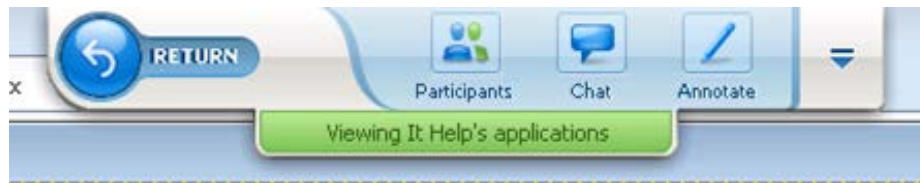
# Agenda

1. Introduction
2. Reasons for Webinar
3. Background Information
4. Scope of this Webinar
5. Approach for the Sector Review of Deferral and Variance Accounts (DVAs)
6. Requirements and Observations from the Sector Review of DVA Balances and Select Audits from Prior Years for the Electricity Distributors
7. Summary of Accounting Procedures Handbook (APH) and Reporting and Record Keeping Requirements (RRR) noted from the Sector Review of DVAs
8. Q & A session
9. Next Steps



# Instructions to Send Questions

- Participants are encouraged to submit their questions during this presentation. Please use the “chat” feature:



- Questions resulting from Board Staff presentation may be sent:
  - Via e-mail, not later than 4:45 p.m. on March 5, 2014 to: [DVASectorReview@ontarioenergyboard.ca](mailto:DVASectorReview@ontarioenergyboard.ca).
- Questions after March 5, 2014 should be sent to Market Participant Enquiries at [market.operations@ontarioenergyboard.ca](mailto:market.operations@ontarioenergyboard.ca).

# Webinar Presentation and Q & A

- Presentation and answers to common questions for today's webinar will be posted on the Board's website, under "Audit & Performance Assessment Webinars".
- This webinar will not address general questions related to accounting procedures or any other requirements within the APH.

# Introduction - Our New Division

- The Industry Operations and Performance Division focuses on the Board's interface with industry. It is responsible for the management of the Board's codes and rules relating to licensed entities, liaison with industry stakeholders, the Board's licensing and reporting functions, **the audit of regulated entities, and the assessment of utility performance.**

# Introduction - Reasons for Webinar

- Audit and Performance Assessment is communicating several observations with respect to the high level Group 1 and Group 2 DVA sector review in order to:
  - Help reduce the risk of incorrect balances being disposed at rate proceedings.
  - Ensure conformity to the RRR, APH and other Board guidance.
  - Ensure greater consistency of regulatory accounting treatment among distributors.

# Background Information

- Audit and Performance Assessment has conducted a high level review of DVA balances reported by distributors to the Board as part of RRR 2.1.7.
- The review included a 2-year period of 2011 and 2012.
  - In 2012, a high level review was completed for 2011 DVA balances. Distributors that were identified with potential issues were followed up and adjustments were made in 2012.
  - Similar review was done in 2013 for the 2012 DVA balances.



# Scope of this Sector Review

- Group 1 DVA review included accounts 1550, 1580, 1584, 1586, 1588, 1589, 1595.
- Group 2 DVA review included accounts 1508, 1518, 1525, 1531, 1532, 1533, 1534, 1535, 1536, 1548, 1570, 1571, 1572, 1574, 1582, and 2425.
  - The review excluded accounts 1521, 1555, 1556, 1568, 1575, 1576, 1592.

# Scope of this Sector Review

- In order to conduct this high level sector review, Audit and Performance Assessment utilized initial enquiry and discussion related to information and materials provided by the distributor's management or available to the Board from filings made under the Board's Electricity RRR filings for electricity distributors and various forms of analyses.
- Audit and Performance Assessment relied on the distributors' representations with respect to inquiries.

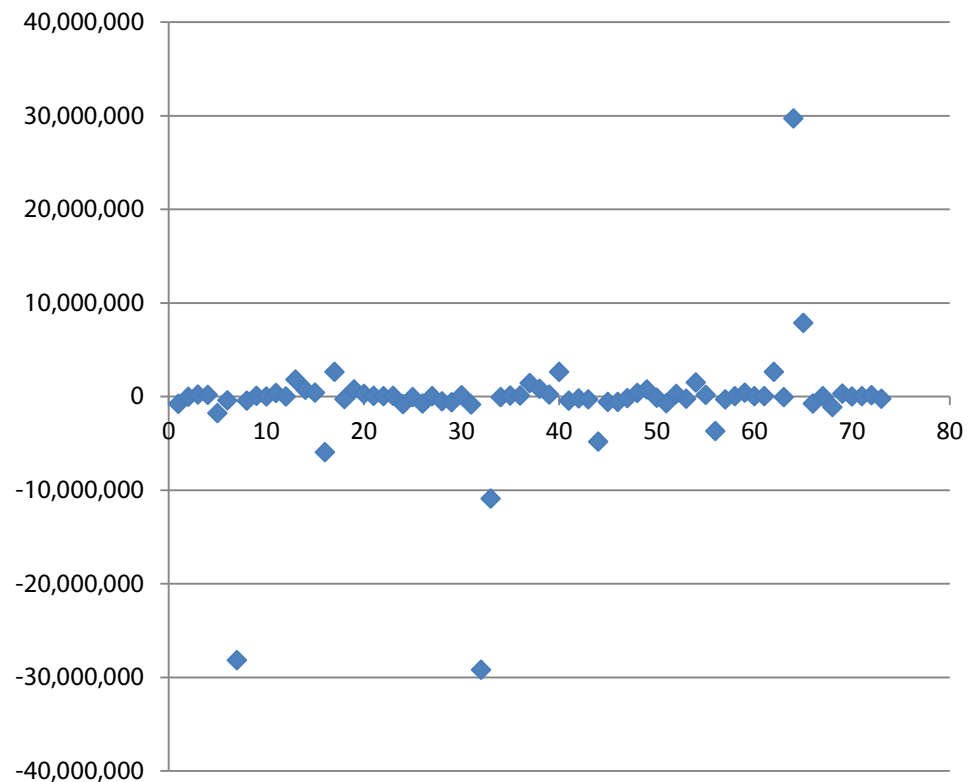
# Scope of this Sector Review

- Due to the nature of the sector review, Audit and Performance Assessment did not perform any of the detailed audit procedures (i.e. examination of the supporting invoices and customer bills related to the transactions recorded in the DVA).
- This review did not include entity-specific audits. However, observations shared in this presentation include a number of relevant audit results from prior audit engagements by Audit and Performance Assessment.

# Approach for the Sector Review of DVA Balances

- A high level review was done on all DVA balances for all electricity distributors.
- Similar charts were completed for 2011 and 2012 balances for each DVA.
- Outliers were identified and considered for further review.

**Account 1588 Balances from RRR  
2.1.7 as at  
December 31, 2012**



# Approach for the Sector Review of DVA Balances – Retail Settlement Variance Accounts (RSVAs)

- Reviewed revenue and expense accounts relating to RSVAs reported in the RRR 2.1.7 to determine if there was a potential profit or loss on energy pass-through costs.
- Reviewed any misalignment of energy revenue and cost of power between audited financial statements (AFS) and the RRR balances.
- Mapping of respective revenue and expense accounts relating to RSVAs reported to the Board as part of RRR 2.1.7.

Revenue USoAs related to RSVA	
4006	Residential Energy Sales
4010	Commercial Energy Sales
4015	Industrial Energy Sales
4020	Energy Sales to Large Users
4025	Street Lighting Energy Sales
4030	Sentinel Lighting Energy Sales
4035	General Energy Sales
4040	Other Energy Sales to Public Authorities
4050	Revenue Adjustment
4055	Energy Sales for Retailers/Others
4060	Interdepartmental Energy Sales
4062	Billed WMS
4066	Billed NW
4068	Billed CN
4075	Billed - LV
<b>Sum of Energy Sales</b>	
Expense USoAs related to RSVA	
4705	Power Purchased
4707	Charges - Global Adjustment
4708	Charges-WMS
4710	Cost of Power Adjustments
4714	Charges-NW
4716	Charges-CN
4750	Charges - LV
<b>Sum of Cost of Power</b>	
<b>Difference (Potential Profit/Loss on Commodity)</b>	

# **Requirements and Observations from the Sector Review of DVA Balances and Select Audits from Prior Years for the Electricity Distributors**



- Accounting treatment of DVAs in accordance with the Accounting Procedures Handbook (APH) and the related guidance.
- Account balances for DVAs are correct before being disposed at a rate proceeding.

# **Regulatory Accounting Procedures Impacting DVA Balances**





# Requirements Regarding Regulatory Accounting Procedures Impacting DVA Balances

- No profit/loss on pass-through costs in AFS or RRR.
- Pro-rate Global Adjustment into RPP and non-RPP portions in Account 1588 and Account 1589.
- Certain IESO Charge Types should be recorded in Account 4708 Charges WMS and reflected in Account 1580 RSVA WMS.
- Account 1570 Qualifying Transition Costs and Account 1571 Pre-market Opening Energy Variance were discontinued and should not be reported in RRR.

# Requirement: No Profit/loss on Pass-through Costs in AFS or RRR

## Board Decisions:

“The Board notes that the intention of the RSVA accounts is to keep the distributor and its customers whole in respect of commodity and associated commodity costs”.

# Requirement: No Profit/loss on Pass-through Costs in AFS or RRR

Revenue USoAs related to RSVA as of December 31, 2012		AFS	
4006 Residential Energy Sales	-\$ 7,661,000		
4010 Commercial Energy Sales	-\$ 2,000,000		
4015 Industrial Energy Sales	-\$ 6,000,000		
4020 Energy Sales to Large Users	-\$ 100,000		
4025 Street Lighting Energy Sales	-\$ 50,000		
4030 Sentinel Lighting Energy Sales	\$ -		
4035 General Energy Sales	-\$ 5,000		
4040 Other Energy Sales to Public Authorities	\$ -		
4050 Revenue Adjustment	\$ -		
4055 Energy Sales for Retailers/Others	-\$ 206,000		
4060 Interdepartmental Energy Sales	\$ -		
4062 Billed WMS	-\$ 12,000,000		
4066 Billed NW	-\$ 1,000,000		
4068 Billed CN	-\$ 900,000		
4075 Billed - LV	-\$ 50,000		
<b>Sum of Energy Sales</b>	<b>-\$ 29,972,000</b>	<b>Energy sales</b>	<b>\$ (29,972,000)</b>
Expense USoAs related to RSVA as of December 31, 2012			
4705 Power Purchased	\$ 11,922,000		
4707 Charges - Global Adjustment	\$ 4,100,000		
4708 Charges-WMS	\$ 12,000,000		
4710 Cost of Power Adjustments	\$ -		
4714 Charges-NW	\$ 1,000,000		
4716 Charges-CN	\$ 900,000		
4750 Charges - LV	\$ 50,000		
<b>Sum of Cost of Power</b>	<b>\$ 29,972,000</b>	<b>Cost of Power</b>	<b>\$ 29,972,000</b>
<b>Difference (Potential Profit/Loss on Cost of Power)</b>	<b>\$ 0</b>		<b>\$ 0</b>

# Example of No Profit/loss on Pass-through Costs in AFS or RRR

RRR 2.1.7 Trial Balance		
4006 Residential Energy Sales	-\$	861,822
4015 Industrial Energy Sales	-\$	89,792
4025 Street Lighting Energy Sales	-\$	6,469
4035 General Energy Sales	-\$	365,693
4055 Energy Sales for Retailers/Others	-\$	33,132
4062 Billed WMS	-\$	143,428
4066 Billed NW	-\$	122,373
4068 Billed CN	-\$	99,858
4075 Billed LV	-\$	118,263
<b>Sum of Energy sales</b>	<b>-\$</b>	<b>1,840,830</b>

4080 Distribution Services Revenue	-\$	445,608
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4705 Power Purchased	\$	896,908
4707 Charges - GA	\$	460,000
4708 Charges - WMS	\$	143,428
4714 Charges - NW	\$	122,373
4716 Charges - CN	\$	99,858
4750 Charges - LV	\$	118,263
<b>Sum of Cost of Power</b>	<b>\$</b>	<b>1,840,830</b>

**Difference between energy sales and cost of power** \$0

RRR 2.1.6 AFS - Format 1	
<b>Revenues</b>	
Energy	\$ 1,840,830
Distribution	445,608
	2,286,438
<b>Costs</b>	
Cost of power	1,840,830

RRR 2.1.6 AFS - Format 2	
<b>Revenues</b>	
	2,286,438
<b>Costs</b>	
Cost of power	1,840,830

→ **No Profit or loss on AFS**

→ **Profit or loss on AFS cannot be assessed from AFS, however, it can be assessed from the mapping document from RRR 2.1.13**

# Observation: Profit/loss on Pass-through Costs in AFS or RRR

- Common problems identified:
  - Accounting error in year end accrual causing misstatement of energy costs (e.g. posting year end accrual entry twice).
  - Not recording monthly variances in RSVA.
  - Although not noted, misstatement of energy revenues could also contribute to potential profit/loss.

# Requirements: Pro-rate Global Adjustment into RPP and non-RPP Portions in Account 1588 & Account 1589

- APH FAQ October 2009 Questions 11 & 12:
  - RPP portion of Global Adjustment should be reflected in Account 1588 RSVA Power.
  - Non-RPP portion of Global Adjustment should be reflected in Account 1589 Global Adjustment.

# Example of Prorating the IESO Global Adjustment Charges

## IESO Invoice received for the Month

0147 Global adjustment – Class A: \$100,000  
 0148 Global adjustment – Class B: \$360,000  
Total Global Adjustment: \$460,000

## The proration by Utility

RPP portion of GA: \$280,000  
Non-RPP portion of GA: \$180,000  
**Total Global Adjustment: \$460,000**

### Correct Accounting entries

1) To record global adjustment charged to the Utility related to RPP class of customers

<b>Dr. Account 4705, Cost of Power</b>	280,000	
Cr. Account 2256, Account Payable (IESO)		280,000

2) To record global adjustments charged to the Utility related to Non-RPP class of customers

<b>Dr. Account 4707, Charges – GA</b>	180,000	
Cr. Account 2256, Account Payable (IESO)		180,000

3) To record global adjustments billed to Non-RPP customers

<b>Dr. Account 1100, AR</b>	220,000	
Cr. Accounts 4006 -4055, Energy Sales, sub-account GA		220,000

4) To record variance in Account 1589 Global Adjustment

<b>Dr. Accounts 4006 - 4055, Energy sales, sub-account GA</b>	40,000	
Cr. Account 1589, GA		40,000

**Total  
IESO GA:  
\$460,000**

# Observation: No Pro-ration of RPP and Non-RPP portion in Account 1588 & Account 1589

- Global adjustment charges on IESO invoices were recorded in Account 1589 without the proration of RPP and non-RPP portions.



# Requirements Regarding Regulatory Accounting Procedures Impacting DVA Balances

## APH Article 490, Page 18:

- Account 4708, Charges – WMS. A distributor that is a wholesale Market Participant shall use this account to record the amounts charged by the IESO (based on the settlement invoice) for wholesale market service charge types specified by the Board. See Appendix A for the charge types applicable to this account.
- Account 4712, Charges - ONE-TIME. A distributor that is a wholesale Market Participant shall use this account to record the charges from the IESO (based on the settlement invoice) specified by the Board (these charges are not normally already incorporated in the Wholesale Market Service Rate). See Appendix A for the charge types applicable to this account.

# Requirements Regarding Regulatory Accounting Procedures Impacting DVA Balances

## APH Article 490, Appendix A:

- Charge Types 163, 164, 167 and 169 are listed among the charge types that should be recorded in Account 4708, Charges WMS;
- Administrative Penalties (e.g. late payment charges) should be recorded in Account 4712, WMS Charges – One –Time.

# Observation: Certain IESO Charge Types not Recorded in Correct Expense Account

- Charge Types 163, 164, 167 and 169 were recorded in Account 4712, WMS Charges – One –Time instead of Account 4708 Charges WMS;
- As a result, the expenses were incorrectly reflected in Account 1582 (one of the Group 2 accounts) instead of being reflected in Account 1580 WMS (one of the Group 1 accounts).

# Requirements Regarding Regulatory Accounting Procedures Impacting DVA Balances

- The revised APH dated January 1, 2012 for regulatory purposes no longer includes Account 1570 and Account 1571.
- Regarding Account 1570, Page 9 of APH Article 480 dated July 31, 2007 stated that any un-cleared amounts are to be charged to shareholder expense:
  - In the 2006 rate application process, the Board reviewed and approved eligible transition costs for distributors that filed applications. Inappropriately recorded or disallowed amounts were required to be written off.
- Regarding Account 1571, Page 29 of APH Article 220 dated July 31, 2007 stated that:
  - Amounts recorded in this account shall be restricted to the period starting January 1, 2001 and ending on the date prior to the opening of the electricity market in Ontario.

# Observations: Balances Reported in Discontinued Accounts

- Discontinued Account 1570 and Account 1571, were reported in the RRR 2.1.7.

# **Regulatory Accounting Procedures not Impacting DVA Balances**



# Requirements Regarding the Regulatory Accounting Procedures not Impacting DVA Balances

- Reducing the higher of revenue and expenses in recording variances.
- Including the revenues and expenses related to the RPP and non-RPP portions of Global Adjustment in regulatory reporting to the Board.

# Requirement: Reducing the Higher of Revenue and Expense in Recording Variances

- Accounting Procedures Handbook, Article 490, page 12:

## **Entry 3: Calculating the RSVA balance**

A comparison of the revenue/“Billed” accounts to the expense/“Charges” accounts will result in a journal entry which will reduce the higher of the revenue or expense account with an offsetting entry to the related RSVA Accounts.



# Requirement: Reducing the Higher of Revenue and Expense in Recording Variances

Energy sales	\$100,000
Cost of power	<u>80,000</u>
<b>RSVA variance</b>	<b>20,000</b>

## Scenario A (correct accounting)

### Journal entry to record energy sales and cost of power

DR A/R	100,000	
	CR Energy sales	100,000

DR Cost of power	80,000	
	CR A/P	80,000

### Adjusting journal entry required to reduce the higher of revenues and expenses

DR Energy sales	20,000	
	CR RSVA	20,000

### Impact to Income Statement:

Energy sales	80,000
Cost of power	<u>80,000</u>
	0

# Observation: Not Reducing the Higher of Revenue and Expense in Recording Variances

## Scenario B (incorrect accounting)

### Journal entry to increase expense instead of reducing revenue

DR Cost of power	20,000	
CR RSVA		20,000

### Impact to Income Statement:

Energy sales	100,000
Cost of power	<u>100,000</u>
	0

Energy sales and cost of power overstated by \$20,000

## Scenario C (incorrect accounting)

### Journal entry to record energy sales and cost of power

DR A/R	100,000	
CR Energy sales		100,000

DR RSVA	80,000	
CR A/P		80,000

DR Cost of power	100,000	
CR RSVA		100,000

### Impact to Income Statement:

Energy sales	100,000
Cost of power	<u>100,000</u>
	0

Energy sales and cost of power overstated by \$20,000

# Requirement: Including the Revenues and Expenses Related to the RPP and Non-RPP portions of Global Adjustment

- **RRR 2.1.7:** A distributor shall provide the Board annually, by April 30, a trial balance in uniform system of accounts format supporting the audited financial statements.
- Accounting Procedures Handbook FAQ dated October 2009, Q.11:

The charge type 146 “portions” the distributor submits to the IESO should be used as the basis of the accounting entries for the RPP portion posted to Account 4705, Power Purchased, and the non-RPP portion posted to Account 4705, Power Purchased, “Sub-account Global Adjustment.”
- Effective January 1, 2012, distributors should record non-RPP portion of GA to Account 4707 Charges – GA.

# Example: Including the Revenues and Expenses Related to the RPP and Non-RPP portions of Global Adjustment

## RRR

Revenue USoAs related to RSVA as of December 31, 2012		RRR balances
4006 Residential Energy Sales	-\$	7,661,000
4010 Commercial Energy Sales	-\$	2,000,000
4015 Industrial Energy Sales	-\$	6,000,000
4020 Energy Sales to Large Users	-\$	100,000
4025 Street Lighting Energy Sales	-\$	50,000
4030 Sentinel Lighting Energy Sales	\$	-
4035 General Energy Sales	-\$	5,000
4040 Other Energy Sales to Public Authorities	\$	-
4050 Revenue Adjustment	\$	-
4055 Energy Sales for Retailers/Others	-\$	206,000
4060 Interdepartmental Energy Sales	\$	-
4062 Billed WMS	-\$	12,000,000
4066 Billed NW	-\$	1,000,000
4068 Billed CN	-\$	900,000
4075 Billed - LV	-\$	50,000
<b>Sum of Energy Sales</b>	<b>-\$</b>	<b>29,972,000</b>

Expense USoAs related to RSVA as of December 31, 2012		RRR balances
4705 Power Purchased	\$	11,922,000
4707 Charges - Global Adjustment	\$	4,100,000
4708 Charges-WMS	\$	12,000,000
4710 Cost of Power Adjustments	\$	-
4714 Charges-NW	\$	1,000,000
4716 Charges-CN	\$	900,000
4750 Charges - LV	\$	50,000
<b>Sum of Cost of Power</b>	<b>\$</b>	<b>29,972,000</b>
<b>Difference (Potential Profit/Loss on Cost of Power)</b>	<b>\$</b>	<b>0</b>

## AFS

Income Statement	
<b>Revenues</b>	
Energy	\$ 29,972,000
<b>Costs</b>	
Cost of Power	29,972,000
<b>Difference</b>	<b>0</b>

Revenues related to Global Adjustment recorded in AFS and included in RRR in accounts 4006 to 4055

Expenses related to Global Adjustment recorded in AFS and included in RRR in account 4707

# Observation: Not Including the Revenues and Expenses Related to the RPP and Non-RPP portions of Global Adjustment

- Common mistakes:
  - Revenue and expense related to the RPP portion of Global Adjustment were excluded in RRR.
  - Revenue and expense related to the non-RPP portion of Global Adjustment were excluded in RRR.
  - Revenue and expense related to total Global Adjustment were excluded in AFS and RRR.

- **Electricity Distribution Licence, Section 14.1 Provision of Information to the Board:**
  - The Licensee shall maintain records of and provide, in the manner and form determined by the Board, such information as the Board may require from time to time.
- **RRR 2.1.7:** A distributor shall provide the Board annually, by April 30, a trial balance in uniform system of accounts format supporting the audited financial statements.

# Requirement: Proper Reporting of Account Balances in RRR

Revenue USoAs related to RSVA	RVSA Breakdown				
	1588 Power & GA	1580 Wholesale Market	1584 Network	1586 Connection	1550 Low Voltage
4006 Residential Energy Sales	-\$ 7,661,000				
4010 Commercial Energy Sales	-\$ 2,000,000				
4015 Industrial Energy Sales	-\$ 6,000,000				
4020 Energy Sales to Large Users	-\$ 100,000				
4025 Street Lighting Energy Sales	-\$ 50,000				
4030 Sentinel Lighting Energy Sales	\$ -				
4035 General Energy Sales	-\$ 5,000				
4040 Other Energy Sales to Public Authorities	\$ -				
4050 Revenue Adjustment	\$ -				
4055 Energy Sales for Retailers/Others	-\$ 206,000				
4060 Interdepartmental Energy Sales	\$ -				
4062 Billed WMS		\$ 12,000,000			
4066 Billed NW			-\$ 1,000,000		
4068 Billed CN				-\$ 900,000	
4075 Billed - LV					-\$ 50,000
<b>Sum of Energy Sales</b>	<b>-\$ 16,022,000</b>	<b>-\$ 12,000,000</b>	<b>-\$ 1,000,000</b>	<b>-\$ 900,000</b>	<b>-\$ 50,000</b>
Expense USoAs related to RSVA	1588 Power & GA	1580 Wholesale Market	1584 Network	1586 Connection	1550 Low Voltage
4705 Power Purchased	\$ 11,922,000				
4707 Charges - Global Adjustment	\$ 4,100,000				
4708 Charges-WMS		\$ 12,000,000			
4710 Cost of Power Adjustments	\$ -				
4714 Charges-NW			\$ 1,000,000		
4716 Charges-CN				\$ 900,000	
4750 Charges - LV					\$ 50,000
<b>Sum of Cost of Power</b>	<b>\$ 16,022,000</b>	<b>\$ 12,000,000</b>	<b>\$ 1,000,000</b>	<b>\$ 900,000</b>	<b>\$ 50,000</b>
<b>Difference</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>

# Observations: Incorrect Use of USoAs in RRR

- Common problems identified:
  - Recorded and reported non-RSVA costs in RSVA expense account.
  - Omitted revenues associated with Global Adjustment in the relevant RSVA revenue accounts 4006 to 4050.
  - Omitted unbilled revenues for RSVAs in the relevant RSVA revenue accounts.
  - Incorrectly included other revenues such as rental revenue from sentinel lighting in a power revenue account.



# Observations: Incorrect Use of USoAs in RRR

- Incorrect amounts entered in RRR 2.1.7 forms.
- Incorrectly reported Low Voltage billings in Account 4220 Other Electric Revenues instead of Account 4075 Billed – LV.
- Recorded net adjustments in Account 4050, Revenue Adjustment and did not allocate the adjustments to respective revenue accounts.
- Recorded net adjustments in Account 4705 Power Purchased or Account 4710 Cost of Power adjustments and did not allocate costs to respective cost accounts.

# Summary of APH and RRR Requirements noted from this Review

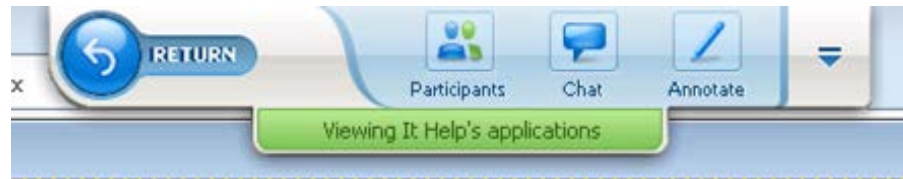
- Proper Application of Regulatory Accounting Procedures to DVAs.
  - No profit/loss on pass-through costs in AFS or RRR.
  - Pro-rate Global Adjustment into RPP and non-RPP portions in Account 1588 & Account 1589.
  - Certain IESO Charge Types should be recorded in Account 4708 Charges WMS and reflected in Account 1580 RSVA WMS.
  - Account 1570 Qualifying Transition Costs and Account 1571 Pre-market Opening Energy Variance were discontinued and should not be reported in RRR.
  - Reducing the higher of revenue and expenses in recording variances.
  - Including the revenues and expenses related to the RPP and non-RPP portions of Global Adjustment in regulatory reporting to the Board.
- Proper Reporting of Account Balances in RRR.

# Implications of Incorrect Application of Regulatory Accounting Procedures

- Incorrect DVA balances.
- May cause inaccurate disposition of account balances.
- Misstated net income.
- Inaccurate calculation of ROE for regulatory reporting on deemed basis (RRR 2.1.5.6) due to misstated net income.
- Inaccurate information regarding distributor's revenues, costs, profitability ratio, etc. published in the yearbook.

# Q & A Session

- To submit questions please use the “chat” feature.



# Next Steps

- Board staff will publish on the Board's website, under "Audit & Performance Assessment Webinars":
  - Presentation from today's webinar.
  - Answers to common questions arising from today's presentations.

# Thank You

Thank you for your interest and participation.

This concludes our webinar today.

