

# Memorandum

**TO:** Chairman's Executive Committee  
**FROM:** Darcy Mazurkewich, Utility Audit and Compliance Group  
**DATE:** December 5, 2005

**RE: REGULATORY AUDIT REPORT – ATCO GAS**

Attached is the audit report arising from the regulatory audit of ATCO Gas that we completed recently. Also attached is management's response to the audit report.

As noted in the report, we determined that ATCO Gas had effective processes for controlling the inter-affiliate transactions, capital projects and related capital expenditures. In addition, transactions with respect to these processes were complete and accurate, properly supported, timely, and in accordance with applicable regulatory requirements. There were several minor observations arising from the audit, which were discussed and cleared with management during the course of the audit. The observations were not sufficiently significant to warrant being included in the audit report.

As noted in the final paragraph, we received the full cooperation of ATCO Gas management and staff throughout the audit process.

If you have any comments about the attached, please give me a call at 297-7365.

*(original signed by)*

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Darcy Mazurkewich

Bob Heggie, Executive Manager, Utilities Branch  
Brian Bale, Vice President, Controller, ATCO Gas



December 2, 2005

Alberta Energy and Utilities Board  
Audit and Compliance Group  
Attention: Darcy Mazurkewich, CMA  
640 – 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta  
T2P 3G4

Dear Mr. Mazurkewich:

**RE: Regulatory Audit of the Capital Project and Cost Management  
Process and Inter-Affiliate Transactions**

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We have reviewed the draft audit report of your findings and agree with the information contained in the report. ATCO Gas would like to thank your group for their communication throughout this process, which enabled us to respond to information requests in an efficient manner. The audit process you have implemented is well laid out and allowed us to have a very good understanding of your objectives. Your professionalism and work ethic throughout the audit were appreciated by ATCO Gas' staff.

Sincerely,

A handwritten signature in cursive script that reads "B.R. Bale".

Brian Bale  
**Vice President, Controller**

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# ATCO Gas

## Regulatory Audit of the Capital Project and Cost Management Processes and Inter-Affiliate Transactions for the 12-Month Period Ended December 31, 2004

November 2005

**Audit Team:**

Darcy Mazurkewich  
Nick Iannone  
Lorena Ziegler

**ALBERTA ENERGY AND UTILITIES BOARD**

Regulatory Audit Report #2005-007: ATCO Gas  
Regulatory Audit of Capital Project and Cost Management Processes and  
Inter-affiliate Transactions

November 2005

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## Objectives and Scope

The overall objective of the assignment was to conduct a regulatory audit of the financial and operational controls over three key activities of ATCO Gas. The key activities that were the subject of this audit were the capital project management process, cost management process, and inter-affiliate transactions.

The audit included a review of the operations of these activities, the associated financial information and the related regulatory requirements. The audit covered sample transactions and reviews of the controls over the key components of each process for the 12-month period ended December 31, 2004. The audit resulted in the expression of an opinion on the effectiveness of the controls and procedures with respect to these key activities, as well as an indication of whether the activities conform with regulatory requirements.

This audit is the first of a series of annual audits that will be carried out at ATCO Gas as part of a three-year regulatory audit plan. The plan has been developed to audit key activities of utilities that are regulated by the Alberta Energy and Utilities Board (EUB) and that have been determined to be of interest to stakeholders in the regulatory process. The key objective of the audits is to instill greater confidence in the regulatory process on the part of all stakeholders through an independent, professional review of the selected activities. At the end of the three year period, a new plan will be developed to address the next three-year cycle.

The activities examined during this audit were selected following a review of financial information provided to the EUB by ATCO Gas, as well as a review of Decisions arising from applications made to the EUB by ATCO Gas during the two-year period ended December 31, 2004. During this period, ATCO Gas, and in some cases, other related entities, were involved in a very significant number of applications before the EUB. These applications dealt with deferral accounts and reserves, exchange fees, general rate applications, compliance filings, generic cost of capital, and Affiliate Code of Conduct issues.

The Audit and Compliance group of the EUB's Utilities Branch carried out the assignment between October 11<sup>th</sup> and November 7<sup>th</sup> 2005, when the closing meeting was held with management.

## Overview

ATCO Gas, division of ATCO Gas and Pipelines Ltd., is a member of the ATCO Group of Companies. ATCO Gas is Alberta based and provides province-wide natural gas distribution services to more than 914,000 municipal, residential, business and industrial customers in nearly 300 communities (approximately 80% of the province). ATCO Gas has 1,800 employees and owns and operates 34,900 kilometres of pipeline throughout Alberta.

## Audit Coverage

### Inter-Affiliate Operating Transactions

All transactions with affiliates are governed by the ATCO Group Inter-Affiliate Code of Conduct (Code) appended to Decision 2003-040, the Inter-Affiliate Code of Conduct Decision. The purpose of the Code, which became effective September 1, 2003, is to establish standards and conditions for interaction between ATCO Gas and its affiliates. ATCO Gas has developed

Master Services Agreements (“MSA”) or Master Services Contract (“MSC”) with each affiliate, designed to define the relationship between the entities that are parties to the agreements. All services with affiliates that the MSA/MSC applies to can be brought under that MSA/MSC by way of a schedule(s) to that MSA/MSC. These agreements have been modified, where necessary, as a result of the requirements arising from the EUB Decision 2003-040. For the period ending December 31, 2004 ATCO Gas had 128 active service agreements.

During 2004, ATCO Gas paid approximately \$100 million to related parties/affiliates for operating services that it received. The major costs that were charged to ATCO Gas for the services that it received included costs for transportation services, information technology services, billing and customer services and executive management services. In addition, ATCO Gas paid approximately \$217 million for the purchase of natural gas and \$42 million in interest charges to related parties for short and long term financing.

ATCO Gas recovered approximately \$35 million from affiliates for operating services that it had provided to them during 2004. The cost recoveries by ATCO Gas for the services that it provided consisted of costs related to storage services, operational services and rental recoveries.

A main focus of the audit work in this section was to test the effectiveness of the controls and procedures related to the transactions carried out in accordance with these agreements. In addition, the audit tested the completeness and accuracy of, and support for, these inter-affiliate operating transactions during the 12-month period to December 31, 2004, including whether they were based on a valuation approved by the EUB.

The following is a summary of the significant procedures tested and the audit work done.

- The key components, procedures, control points, issues, and risks associated with inter-affiliate operating transactions were identified.
- These items were reviewed to determine whether related procedures and controls were adequate and tests were conducted to determine their effectiveness in practice.
- A review was performed to determine whether management had adequate procedures to identify services that had been provided and whether the related costs were charged to the correct entity.
- Inter-affiliate service agreements were reviewed to determine whether they covered all of the services that were provided and whether they had been properly approved.
- EUB Decisions were reviewed and the related regulatory requirements were identified and built into the audit tests in this section.
- A sample of inter-affiliate transactions for the period was selected, and tests were carried out to verify that the selected items were complete, properly supported and accurate; were recorded in the correct entity and in the correct time period; had been properly authorized; and were in accordance with regulatory requirements.

The audit conclusion was that ATCO Gas has an effective process for controlling inter-affiliate operating transactions, and that inter-affiliate operating transactions were complete and accurate, properly authorized and supported, were priced appropriately, and were in accordance with regulatory requirements.

## Capital Project Management Process

ATCO Gas incurred significant capital expenditures in 2003 and 2004. ATCO Gas spent \$158.3 million on capital expenditures in 2004, roughly 15% of its Property, Plant and Equipment balance. It is anticipated that the capital project management activities of ATCO Gas will continue to be significant, given the combined need to replace aging assets and to upgrade or add assets to meet high customer growth.

In a given year, ATCO Gas manages up to 2,500 projects, including capital growth, maintenance and support projects. During the audit period, roughly 60% of the projects were under \$10,000 in size, with 70 projects having expenditures in excess of \$500,000. An example of a significant project which ATCO Gas is managing is the Meter Relocation and Replacement Program. This project approved and reviewed in Decisions 2003-072 and 2004-036, has a 10 year life span and is expected to cost approximately \$50 million over the test years 2003 and 2004.

The audit objective was to determine the effectiveness of the procedures and controls over the capital project management process and whether capital projects are being handled in compliance with regulatory decisions.

The following is a summary of the significant procedures tested and the audit work done.

- The key components, procedures, control points, issues, and risks associated with the capital project management process were identified.
- EUB Decisions were reviewed and the related regulatory requirements were identified and built into the audit tests in this section.
- A reconciliation of the data provided was performed against relevant capital schedules filed in the 2005 - 2007 ATCO Gas GRA application, #1400690.
- A sample of capital projects started in the audit period was selected, and tests were carried out to verify that the selected items were properly approved based on ATCO Gas' signing authority matrix, prior to initiating activity or incurring commitments or expenditures.
- A sample of completed capital projects was selected, and tests were carried out to verify that adequate closure procedures exist and were effectively used in a timely manner. The tests included a review of variance explanations, appropriate sign offs on performance and completion, and the use of project reviews.
- The procedures used for generating change orders to approved capital projects were evaluated and a sample of change orders was examined to determine if they were reviewed and approved appropriately.

The audit conclusion was that ATCO Gas has an effective process to manage its capital projects, as the capital projects tested were properly approved, assigned a manager, accurately reported, closed in a timely fashion, and complied with regulatory decisions.

## **The Cost Management Process**

A main focus of the audit work in this section was to test the effectiveness of the controls and procedures related to capital expenditure transactions, including the completeness, accuracy of, and support for, these transactions during the 12-month period to December 31, 2004.

The following is a summary of the significant procedures tested and the audit work done.

- The key components, procedures, control points, issues, and risks associated with capital expenditure transactions were identified.
- EUB Decisions were reviewed and the related regulatory requirements were identified and built into the audit tests in this section.
- A sample of invoices was selected, and tests were carried out to verify that the selected items were complete, properly supported and accurate; were recorded in the correct entity and in the correct time period; had been properly authorized; and were in accordance with regulatory requirements.
- A sample of completed capital projects was selected, and tests were carried out to verify that adequate closure procedures exist and were effectively used in a timely manner. The tests included a review to ensure that completed projects were moved from construction accounts to in-service accounts, that AFUDC ceased to be calculated and that the appropriate depreciation charge had been set up and expensed to the project, in a timely manner.

The audit conclusion was that ATCO Gas has an effective process for controlling capital cost transactions, and that capital expenditures were complete, accurate, properly authorized, supported, and were in accordance with regulatory requirements.

## **Principal Audit Findings and Overall Conclusion**

Overall, the financial and operational controls over the selected key activities of ATCO Gas were effective and the related transactions were in accordance with regulatory requirements. Some minor exceptions of a non-material amount were noted. These items were brought to the attention of management, who provided a response, including an appropriate timetable for dealing with the matters noted.

The audit fieldwork was carried out at a very busy time for management and staff in ATCO Gas. Nevertheless, they made time to provide the audit team with explanations and answers to our queries. We would very much like to thank the management and staff of ATCO Gas for their very valuable help and cooperation during the audit.