

# Memorandum

**TO:** Chairman's Executive Committee

**FROM:** Darcy Mazurkewich, Head, Utility Audit and Compliance Group

**DATE:** February 14, 2007

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

Please find attached the audit report arising from the recently completed regulatory audit of ATCO Pipelines, as well as management's response to the audit report.

This was the first audit to include in its scope the review and testing of a utility's compliance with its Inter-Affiliate Code of Conduct. The resulting conclusion of the Audit Team was that ATCO Pipelines follows the measures, policies, procedures and monitoring mechanisms in the Plan and has demonstrated a respect for the spirit and intent of the Inter-Affiliate Code of Conduct.

We also audited and determined that ATCO Pipelines has effective processes for controlling their Operating and Maintenance activity and that the transactions examined in this process were complete, accurate, properly supported, timely, and in accordance with applicable regulatory requirements.

Some minor observations were made during the audit, all were discussed and cleared with management. These observations were not of sufficient significance to warrant inclusion in the audit report.

As noted in the final paragraph of the report we received the full cooperation of ATCO Pipelines management and staff throughout the audit assignment.

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

*<Approved for distribution by>*

Darcy Mazurkewich

cc: Bob Heggie, Executive Manager, Utilities Branch  
R.J. Myles, President, ATCO Pipelines  
Bob Cerkiewicz, Vice President Commercial, ATCO Pipelines

February 8, 2007

Mr. Darcy Mazurkewich, CMA  
Head, Audit and Compliance Group  
Alberta Energy and Utilities Board  
640 5<sup>th</sup> Avenue SW  
Calgary, AB T2P 3G4

Dear Mr. Mazurkewich:

**Re: Regulatory Audit of the Inter-Affiliate Code of Conduct  
and Operations and Maintenance Cost Processes  
for the Year Ending December 31, 2005**

We have reviewed the EUB draft audit report of your findings and agree with the information and conclusions contained therein.

ATCO Pipelines is pleased that the audit findings confirm our strong commitment to ensuring our compliance with the Inter-Affiliate Code of Conduct, and to maintaining high quality and effective financial and operational processes and internal controls while adhering with regulatory requirements.

We would like to thank you for accommodating our internal schedules and express our appreciation for the professionalism of the EUB Audit Team throughout this process.

Sincerely,

(Original signed by)

R.J. Myles  
President



# ATCO Pipelines

Regulatory Audit of the Inter-Affiliate Code of Conduct  
and Operations and Maintenance Cost Processes for the  
Year Ended December 31, 2005

February 2007

**Audit Team:**

Darcy Mazurkewich  
Karen McCambly  
Nick Iannone  
Joel Thompson

**ALBERTA ENERGY AND UTILITIES BOARD**

Regulatory Audit Report #2007-001: ATCO Pipelines  
Regulatory Audit of the Inter-Affiliate Code of Conduct and  
Operations and Maintenance Cost Processes

February 2007

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## **Objectives and Scope**

The overall objective of the Audit and Compliance Group of the Utilities Branch, Alberta Energy and Utilities Board (EUB) was to conduct a regulatory audit of the financial and operational controls over two key activities of ATCO Pipelines. The key activities that were the subject of this audit were the Inter-Affiliate Code of Conduct (the Code) and Operations and Maintenance (O&M) Cost processes.

The scope of the audit included a review of the operations of these activities, the associated financial information and the related regulatory requirements, notably the Code for ATCO Pipelines. The audit procedures included the selection and examination of transactions samples and the review of the internal controls over the key components of each process for the year ended December 31, 2005. The audit resulted in this report, which expresses an opinion on the effectiveness of the internal controls and procedures with respect to these key activities; whether the activities conform to regulatory requirements, and ATCO Pipelines compliance with the Code.

This audit was the second one undertaken by the EUB on utility activities of ATCO Pipelines with the first having occurred in 2005 (see Audit Report 2005-004). The Audit Team carried out the field assignment between December 4 and December 20, 2006. A closing meeting was held with management on January 16, 2007.

## **Overview**

ATCO Pipelines is a division of ATCO Gas and Pipelines Ltd., which is a member of the ATCO Group of Companies. ATCO Pipelines operates over 8,300 kilometres of natural gas transmission facilities owned by ATCO Gas and Pipelines Ltd. As an integral part of the provincial gas transmission system, it provides transportation services to natural gas producers in the Western Canada Sedimentary Basin, to major industrial users in Alberta, and to gas distributors in Alberta, including ATCO Gas, which is also a division of ATCO Gas and Pipelines Ltd.

## **Audit Coverage**

### **Inter-Affiliate Code of Conduct**

In Decision 2003-040, the EUB approved the Code for the ATCO Group of Companies. After an iterative and consultative process between the ATCO Group of Companies and the EUB, Decision 2005-013 was released by the EUB approving the Compliance Plans for ATCO Pipelines, ATCO Electric Ltd. and ATCO Gas. ATCO Pipelines Compliance Plan (the Plan) details the measures, policies, procedures and monitoring mechanisms that ATCO Pipelines will employ to ensure its full compliance with the provisions of the Code by ATCO Pipelines, its directors, officers, employees, consultants, contractors and agents, and by Affiliates of ATCO Pipelines with respect to the interactions of the Affiliates with ATCO Pipelines.

This is the first audit and review of ATCO Pipelines' Code. It follows up on the EUB's intention as stated in Decision 2005-013 that "an independent audit following the first full year of

operation” of the Plan be conducted. The main focus of the work in this section was to test ATCO Pipelines adherence to the measures in the Plan and the accuracy of the quarterly and annual compliance reports it filed with the EUB for the 2005 reporting period.

The following is a summary of the significant audit and review procedures undertaken.

- Each measure in the Plan was reviewed using enquiry, analytical procedures and discussions related to information supplied by ATCO Pipelines.
- Where warranted, samples were taken and the samples were tested for completeness and compliance to the related measures in the Plan.

The Audit Team made a number of observations, all of which were considered to be of a minor nature. The findings were generally, but not exclusively, related to procedural oversight during the first year of having implemented the Plan. The Audit Team emphasizes the expectation that in the periodic compliance reports filed with the EUB, utilities accurately disclose issues and their impact in the next filing following the discovery of the issue.

The resulting conclusion was that ATCO Pipelines follows the measures, policies, procedures and monitoring mechanisms in the Plan and has demonstrated a respect for the spirit and intent of the Code. In the Audit Team’s opinion ATCO Pipelines has complied in all material respects with the criteria established by the Code.

## **Operations and Maintenance Costs**

During 2005, ATCO Pipelines incurred total O&M expenditures of \$59.3 million. This amount represents approximately 38% of ATCO Pipelines’ utility revenue requirement as included in its 2005 Operating and Financial reports filed with the EUB under Directive 014. In ATCO Pipelines’ 2003/2004 General Rate Application Second Compliance Filing (Decision 2004-059, Application 1347646, dated July 13, 2004), the O&M expenditures accounted for 40% of the approved utility revenue requirement.

The 2005 O&M expenditures can be broken down into the following major categories:

- \$19.3 million for transmission, pipeline, compressor and measurement and regulating,
- \$16.3 million for general and administrative,
- \$9.1 million for transportation by others,
- \$9.0 million for property taxes,
- \$3.7 million for natural gas supply and
- \$1.9 million for franchise fees.

The actual expenditures incurred were managed based on ATCO Pipelines’ approved 2005 Budget.

The O&M target amounts within ATCO Pipelines’ Business Plan are proposed by the Cost Center Group Leaders and firmed up through a process of reviews, discussions and approvals with the appropriate ATCO Pipelines Managers and Vice-Presidents. The Business Plan target amount for O&M is adopted as the Budget which is the main cost control mechanism for the O&M expenditures for the business cycle. The monthly O&M transactions are recorded, reported and controlled through systems of reviews and approvals, preset labor distributions,

purchase orders, time sheets, journal vouchers, sub-ledgers, clearing accounts and variance analysis reporting.

To allocate costs between its North and South regions, ATCO Pipelines uses a variety of allocation methods which are reviewed annually. Actual costs are tracked and charged accordingly whenever it is feasible. The allocation for O&M expenditures for services shared between the North and the South regions is in accordance with ATCO Pipelines Shared Services Policy. The cost allocation percentages utilized were based on the allocation percentages included in the 2003/2004 General Rate Application (Decision 2004-038, Application 1292783, dated April 30, 2004). This allocation resulted in O&M costs of \$38.9 million (65.5%) for ATCO Pipelines North and \$20.4 million (34.5%) for ATCO Pipelines South.

A main focus of the audit work in this section was to test the effectiveness of the internal controls and procedures related to the transactions carried out in accordance with the O&M expenditure process. In addition, the audit tested the completeness and accuracy of, and support for, the O&M transactions during the year ended December 31, 2005.

The following is a summary of the significant audit procedures undertaken.

- EUB Decisions and other related regulatory requirements were identified, reviewed and built into the audit tests.
- Financial information regarding Directive 014 requirements (Application number 1461179) was reviewed and built into the audit test.
- The key components, procedures, control points issues and risks associated with the operations and maintenance transaction processes were identified and reviewed to determine whether related procedures and controls were adequate and tests were conducted to determine their effectiveness.
- The procedures followed for authorizing, recording and processing the O&M transactions selected for the business cycle were reviewed in detail.
- A sample of O&M transactions were selected and tests were carried out to verify that the selected items were
  - complete, properly supported and accurate,
  - recorded in the correct entity and time period,
  - properly authorized, and
  - in accordance with regulatory requirements.

The resulting conclusion was that ATCO Pipelines has effective processes for controlling the O&M processes and related transactions, and that the transactions selected were complete, accurate, properly authorized, supported, and were in accordance with regulatory requirements.

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

Overall, the Audit Team found that the financial and operational controls over the selected activities of ATCO Pipelines were effective and that the transactions reviewed for compliance were in accordance with regulatory requirements in all material respects. Some minor exceptions 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 Team would like to express its appreciation to the management and staff of ATCO Pipelines for the cooperation given to us during the course of our audit.