

# Memorandum

**TO:** Chairman's Executive Committee  
**FROM:** Darcy Mazurkewich, Head, Utility Audit and Compliance Group  
**DATE:** May 7, 2007

**RE: REGULATORY AUDIT REPORT – ALTALINK LIMITED PARTNERSHIP**

Please find attached the audit report arising from the recently completed regulatory audit of AltaLink Limited Partnership (AltaLink), as well as management's response to the audit report.

We determined that AltaLink had effective processes for controlling Deferral and Reserve Accounts, and Operations, Maintenance and General Expenditure processes. In addition, transactions in these processes were complete, accurate, properly supported, timely, and in accordance with applicable regulatory requirements. There were no significant observations arising from the audit.

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

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

*<Approved for electronic distribution by>*

Darcy Mazurkewich

cc: Bob Heggie, Executive Manager, Utilities Branch  
Scott Thon, Chief Executive Officer, AltaLink Management Ltd.  
Richard McCabe, Chief Financial Officer, AltaLink Management Ltd.

# ALTALINK

May 7, 2007

Darcy Mazurkewich, CMA  
Head, Audit and Compliance Group  
Alberta Energy and Utilities Board  
640 – 5 Avenue SW  
Calgary, AB T2P 3G4

Dear Mr. Mazurkewich:

Re: AltaLink Limited Partnership Regulatory Audit Report

AltaLink has reviewed the draft regulatory audit report and we agree the report is complete and accurate. We are very pleased with the overall conclusions of the audit and believe that the results of the audit further confirm our commitment to strong operational and financial controls. Our commitment to controls represents a key component of our business strategy and culture.

AltaLink recognizes that complying with regulatory decisions and reporting all of its financial transactions accurately are important responsibilities for an electrical transmission company in Alberta committed to delivering value to ratepayers. And, we are dedicated to delivering safe, reliable and cost-effective electrical transmission to Albertans.

I would like to thank you for accommodating AltaLink's internal commitments around our year-end financial reporting. I would also like to commend the members of the audit team for their professionalism and hard work throughout the audit process.

Sincerely,



Scott Thon, P.Eng.  
President and Chief Executive Officer



# AltaLink Limited Partnership

Regulatory Audit of Deferral & Reserve Accounts  
and Operations, Maintenance and General Expenditures  
for the Year Ended December 31, 2006

May 2007

**Audit Team:**

Darcy Mazurkewich  
Nick Iannone  
Joel Thompson

**ALBERTA ENERGY AND UTILITIES BOARD**

Regulatory Audit Report #2007-002: AltaLink Limited Partnership  
Regulatory Audit of Deferral & Reserve Accounts and Operations,  
Maintenance & General Expenditures

May 2007

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## Background

AltaLink, LP (AltaLink) formed as a limited partnership in July 2001, owns and operates approximately 52% of the transmission facilities in Alberta. It is the principal transmission services provider to most major urban centres in Alberta. Additionally, it owns and operates the Alberta portion of the interconnection facilities that connect the Alberta network to the transmission system in British Columbia, which in turn provides connection to the power grid in the Pacific Northwest.

AltaLink's operations are managed by a General Partner, AltaLink Management Ltd. (AML). AltaLink has one limited partner, AltaLink Investments, L.P. (AILP). AILP has one limited partner, AltaLink Holdings, L.P. (AHLP). AHLP was formed as a limited partnership under the laws of Alberta on February 16, 2005. In Decision 2006-056 dated June 13, 2006, the Alberta Energy and Utilities Board (EUB) approved AltaLink's application to change its ownership structure. Under the new ownership structure, SNC-Lavalin Group Inc. through subsidiaries owns 76.92% of AltaLink, with Macquarie Transmission Alberta Ltd. owning the remaining 23.08% limited partnership interest.

## Objectives and Scope

The overall objective of the assignment was to conduct a regulatory audit of AltaLink's financial and operational controls over two key activities. The key activities that were the subject of this audit were the Deferral and Reserve Accounts, and Operations, Maintenance and General (O&M) expenditures.

The scope of the audit included a review of procedures used by AltaLink, related financial information and compliance with the regulatory process. The audit procedures included the examination of samples of transactions and reviews of the key components of each of the selected activities for the year ended December 31, 2006. The exception was the Direct Assigned Capital Deferral Account, for which AltaLink and the Audit Team agreed to restrict the review to the 2002 to 2004 amounts already approved by the EUB in Decision 2005-120. The Audit also followed up on the findings in the previous EUB audit of AltaLink (Utility Audit Report #2005-002). The audit resulted in this report which expresses an opinion on the effectiveness of AltaLink's system of internal controls and procedures with respect to these key activities as well as an indication of whether AltaLink has managed the activities in conformance with regulatory requirements.

The Audit Team carried out the field assignment between February 19, 2007 and March 16, 2007. A meeting was held with AltaLink's Financial Management team on the final day of the assignment to discuss the results of the field work.

## Audit Coverage

### Deferral and Reserve Accounts

The EUB's normal practice in setting rates for the provision of utility services is to use prospective ratemaking wherever possible. However, in certain cases, the level of risk, arising from uncertainty associated with forecasting revenues or costs, borne by one or more parties in the regulatory process may be such that it is more advisable to use a mechanism that protects both utilities and ratepayers from the potential impact of inaccurate forecasts. Deferral and reserve accounts are the main mechanisms that are used to provide this protection.

The EUB's practice has been to evaluate the use of deferral and reserve accounts on a case-by-case basis. As noted above, these mechanisms provide protection from uncertainty. However, there may also be negative impacts which arise from their use, including rate fluctuations and intergenerational inequity.

The typical criteria used in determining whether or not to approve the use of a deferral or reserve account are the materiality of the amount involved, the level of uncertainty regarding the accuracy of a forecast of the associated revenues or costs, the ability to control the factors affecting the forecast, and the resulting level of risk borne by the utility and the ratepayers.

AltaLink has a number of deferral and reserve accounts approved by the EUB in past decisions, including Decisions 2003-061 and 2005-019. AltaLink's reserve accounts represent amounts that are initially funded through an accrual approved in a EUB Decision. Actual costs incurred in relation to the respective reserve are charged against the reserve on the same basis as approved by the EUB. Differences between actual and forecast amounts would be filed for EUB's approval for recovery or refund as applicable in either AltaLink's next general tariff application (GTA) or in a stand alone application.

AltaLink's deferral accounts represent the variances between forecasts approved in EUB Decisions and actual costs or revenues incurred on the same basis as those forecasts. Deferral account balances are to be brought forward for review and approval in AltaLink's next GTA or in a stand alone application.

As at December 31, 2006, AltaLink had the following deferral and reserve accounts. In some cases these balances represent activity for the period May 1, 2004 to December 31, 2006.

- \$1.8 million           Hearing Cost Reserve
- \$2.7 million           Self Insurance Reserve
- \$(3.8) million        Pension Liability Account
- \$(0.4) million        Canada Revenue Agency (CRA) Reserve (Rainbow Pipeline)
- \$0.5 million           Direct Assigned Capital Deferral
- \$(1.7) million        Property Tax Deferral
- \$(2.0) million        Insurance Deferral
- \$(2.5) million        Debt Cost Deferral
- \$ 0.4 million         CRA Deferral (Rainbow Pipeline)

Concurrent with its 2007 / 2008 GTA, AltaLink applied for disposition of the 2005 balances in the Insurance, Property Tax and Debt Cost Deferral accounts. In addition, AltaLink had filed a separate application for the reconciliation of the Self Insurance Reserve account for the period May 1, 2004 to December 31, 2005. On July 13<sup>th</sup> 2006, the EUB, through a notice of application directed that the latter application be consolidated in the 2007 / 2008 GTA proceeding.

In Decision 2007-012 dealing with AltaLink's 2007 / 2008 GTA, the EUB approved the disposition of the Insurance, Property Tax and Debt Cost Deferral balances and the true up of the Self Insurance Reserve account. In addition, AltaLink was given approval to recover the balance in its Hearing Cost Reserve account as at December 31, 2006. AltaLink was directed to reflect such adjustments in the refile of the 2007 revenue requirement. The EUB, in its approval of the 2005 Debt Cost Deferral balance, directed AltaLink in its Refiling to compute the balance of the 2005 / 2006 Debt Cost Deferral Account as at December 31, 2006.

The Audit Team during its review of the Debt Cost Deferral account balance sought back up to support the December 31<sup>st</sup> 2006 ending balance. AltaLink provided the requested information and indicated that a computation of the 2005 / 2006 balance had been included in its March 23, 2007 compliance filing to Decision 2007-012 (application #1507819). As a consequence the Audit Team's review for compliance was preempted, since the panel adjudicating the application will determine AltaLink's compliance.

The main focus of the audit work in this section was to test the effectiveness of the controls and procedures related to the development and operation of the deferral and reserve accounts.

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 deferral and reserve accounts were identified.
- Business process documents were reviewed and discussed with management to determine whether related procedures and controls were adequate.
- Continuity schedules were reviewed and analyzed for completeness and accuracy.
- The accounts were analyzed and reconciled to AltaLink's management reports, financial statements and the operation reports filed for Directive 014 (Application number 1336421).
- Relevant EUB Decisions and Orders were reviewed and the related regulatory requirements and directives were identified and built into the audit tests.
- A sample of deferral and reserve account transactions for the audit 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 account and in the correct time period;
  - had been properly authorized; and
  - were in accordance with regulatory requirements and directives.

The resulting conclusion was that AltaLink has an effective process for controlling the transactions related to the deferral and reserve accounts, and that such transactions were complete and accurate, properly authorized and supported, and that the deferral accounts and reserves were in accordance with regulatory requirements and directives.

## Operation, Maintenance and General Expenditures

During 2006 AltaLink incurred regulated O&M expenditures of approximately \$66 million. O&M expenses include a variety of items necessary for the normal functioning of a business. Included in these are expenses such as salaries wages and benefits, contracted manpower, vegetation management, materials, tower payments, building and telecommunications charges, and other overheads.

The total O&M expenditures for 2006 can be classified into the following major categories.

- \$21.5 million Net Wages and Salaries
- \$15.9 million Expenditures Subject to Deferral and Reserve Treatment
- \$16.3 million Contracted Manpower
- \$11.9 million General Operating

Based on the EUB approved forecast, the annual O&M target amounts are proposed and established by management through the forecast and budget functions which occur during the year. The annual budget is established in November (based on the filed / approved GTA forecast) for the following year, with quarterly re-forecasts performed in March, June and September.

During the year the O&M transactions are incurred, recorded, reported and controlled through, among other things, the monthly management reporting and review process. Variance analyses are prepared monthly and variances over a predetermined tolerance are explained and reviewed by management.

The 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.

The following are the significant audit procedures undertaken.

- Relevant EUB Decisions and Orders were reviewed and the related regulatory requirements and directives were identified and built into the audit tests.
- The documented procedures and control matrices prepared for Bill 198 outlining controls around the O&M transactions were reviewed and the results of the testing of the controls were reviewed and discussed with management.
- The Risk control matrices for transactions reporting systems such as Procurement, Accounts Payable, Human Resources, Inventory Management and Financial Reporting which flow transactions into O&M were reviewed. These documents were prepared to comply with the regulatory requirements of Bill 198 and outline the control processes of the reporting systems. The functioning of the controls and the results of the review of their adequacy by the AltaLink Audit Team was discussed with management.
- We compared the actual expenses recorded in the General Ledger to the amounts in the approved EUB Forecast and Budget to check for any unusual items and also to verify whether they were managing the O&M charges to the levels set by the budget.
- The indirect labour and overhead charge transactions, which were included in our sample were reviewed and checked for accuracy and completeness. Also the allocation method



used for distributing these charges to the projects and cost centres were checked for accuracy.

- A sample of direct labour hours and charges was selected and traced through the system to ensure the accuracy, reasonableness of the transactions and to ensure that the recoveries on the charge-outs to the projects were accurate.
- The key components, procedures, control points issues and risks associated with the operations, maintenance & general expenditures were identified and reviewed to determine whether related procedures and controls were adequate and tests were conducted to determine their effectiveness.
- A sample of O&M transactions was 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 AltaLink has effective processes for controlling its operating, maintenance and general expenditures, and that the transactions selected were complete, accurate, properly authorized, supported, and were in accordance with regulatory requirements.

### **Follow Up from Last Audit**

During the last regulatory audit of AltaLink, the Audit Team made several minor observations to which Management responded by committing to take specific actions. In this audit, the Audit Team met with representatives from Management to review whether those actions were taken and the results of those actions.

Management provided evidence that they had completed, and in one case was in the process of completing, the committed action for these observations.

The resulting conclusion was that AltaLink has appropriately addressed the observations raised in the last audit.

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

Overall the Audit Team found that the financial and operational controls over the selected activities of AltaLink were effective and that the transactions reviewed for compliance were in accordance with regulatory requirements in all material respects.

The Audit Team would like to express its appreciation to the management and staff for the cooperation and assistance given to us during the course of our audit.