

Memorandum

August 17, 2009

TO: Willie Grieve, Chair, Alberta Utilities Commission

FROM: Darcy Mazurkewich, Manager Audit and Compliance

REGULATORY AUDIT OF FORTISALBERTA INC.

Please find attached the audit report resulting from the recently completed Regulatory Audit of FortisAlberta Inc. (FAI) plus management's response to it.

The Audit Team determined that FAI has effective controls and processes, has demonstrated regulatory compliance, and provided accurate information to the Commission for regulatory purposes.

As noted in the report, FAI management and staff provided us with their full cooperation throughout the audit.

If you have concerns about the attached, please call me at 403.592.4429.



Darcy Mazurkewich
Manager, Audit and Compliance
Rates Division

CC: Cynthia Johnston, Vice President, Regulatory & Legal, FortisAlberta Inc.
Bob Heggie, Chief Executive, Alberta Utilities Commission



Cynthia Johnston
Vice President,
Regulatory & Legal

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August 17, 2009

Filed via Email

Alberta Utilities Commission
Fifth Avenue Place
4th Floor, 425 - 1 Street SW
Calgary, Alberta T2P 3L8

Attention: Darcy Mazurkewich

Dear Mr. Mazurkewich:

**Re: Regulatory Audit of Activities Including the Operations, Maintenance and
General Expenses, and Capital Management for the Year Ended December 31,
2008**

This is to inform you that the management of FortisAlberta has reviewed the draft final audit report and we believe that the report is complete and accurately reflects the findings and observations as discussed at the closing meeting.

FortisAlberta would like to thank the AUC and AUC staff for accommodating the day to day operational commitments of FortisAlberta during the audit period allowing for minimal disruption of normal business. The professionalism of your staff was appreciated.

Please feel free to contact me directly at (403) 514-4587 if you have any questions or concerns.

Sincerely,

A handwritten signature in black ink, appearing to read "C Johnston", written over a faint, larger version of the signature.

Cynthia Johnston
Vice President
Regulatory & Legal



AUC

Alberta Utilities Commission

FortisAlberta Inc.

**Regulatory Audit of Activities Including the
Operations, Maintenance and General Expenses, and
Capital Management for the Year Ended December 31, 2008**

August 2009

Audit Group:

Nick Iannone
Joel Thompson
Darcy Mazurkewich



ALBERTA UTILITIES COMMISSION

Regulatory Audit Report #2009-002: FortisAlberta Inc.
Regulatory Audit of Activities Including the
Operations, Maintenance and General Expenses, and
Capital Management for the Year Ended December 31, 2008

August 2009

Published by

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Overview

FortisAlberta Inc. (FAI) owns and operates more than 108,400 kilometres of power lines, or close to 60 percent of Alberta's low voltage electricity distribution network. FAI provides electricity distribution services to over 470,000 rural and urban customers across southern and central Alberta.

FAI is a wholly-owned indirect subsidiary of Fortis Inc., which is the largest investor-owned distribution utility in Canada, serving almost two million gas and electricity customers.

2008 was a year of growth for FAI. Their customer base grew almost three percent, and revenues grew by approximately \$30 million to \$300 million as a result of the customer base increase and an increase in approved rates. FAI also spent in excess of \$290 million on capital expenditures to meet customer growth and replace aging assets.

In February 2008, the Alberta Energy and Utilities Board (predecessor to the Alberta Utilities Commission) approved FAI's 2008/2009 Phase I Distribution Tariff and Negotiated Settlement Agreement (NSA).¹

Objectives and Scope

The Audit and Compliance Group (Audit Group) of the Alberta Utilities Commission (AUC or the Commission) performed this audit.

The objective was to provide the Commission an opinion on the effectiveness of the controls and processes, regulatory compliance, and accuracy of information provided to the Commission by FAI.

The scope of the audit included two key activities of FAI for the year ended December 31, 2008. The key activities were the Operations, Maintenance and General Expense process and the Capital Management process.

To attain the objective, the Audit Group developed and applied an audit plan. Based on the results of applying the procedures in the audit plan and the materiality of any findings noted, the Audit Group can express an opinion.² The audit procedures applied are outlined in greater detail in the following sections of this report.

The audit work and this report adhere to professional standards, but may differ in certain respects with Generally Accepted Auditing Standards (GAAS) since it is a regulatory audit specifically intended to provide assurance to the Commission.

The Audit Group performed the fieldwork phase of the audit during the three week period from June 22, 2009 to July 10, 2009, at FAI's Head Office location in Calgary. Closing discussions were held with management on July 10, 2009.

¹ EUB Decision 2008-011 – FortisAlberta Inc. 2008/2009 Phase I Distribution Tariff and Negotiated Settlement Agreement (Application No. 1514140) (Released: February 12, 2008)

² The Commission is not bound by the findings of the Audit Group with respect to any future hearings or proceedings in which an issue is raised and which was the subject of a prior audit.

Operations, Maintenance and General Expenses

FAI's 2008/2009 NSA included OM&G expenses of \$123.6 million. In July 2008, the AUC approved FAI's application,³ which included a request to approve labour costs as a result of the ratification of the United Utility Workers' Association's collective agreement, initially held as a placeholder amount. This increased the OM&G expenses approved in the 2008/2009 NSA by \$0.8 million to \$124.4 million. The AUC directed FAI to defer recovery of the \$0.8 million to 2009 and to reflect it in an application that FAI was to file later in 2008 for rates to be implemented commencing January 1, 2009.

For the year ended December 31, 2008, FAI incurred OM&G expenses of \$129.7 million of which \$125.6 million pertained to its regulated activities. The OM&G expenses include a variety of costs for the delivery of safe, reliable and cost effective electricity services to its customers.

The following summarizes the major categories of OM&G expenses:

(\$ millions)	
110.2	Gross Loaded Labour
(61.0)	Salaries & Wages Charged Out

49.2	Net Salaries & Wages
18.0	Contracted Manpower
14.9	Brushing
28.0	General Operating Expenses
6.3	Other Expenses
(8.2)	Transfers to Capital

59.0	Operating Expenses
108.2	Total OM&G before Flow-Through Items
17.4	Flow Through Expenses (Linear Tax and Franchise Fees)

125.6	Total OM&G

During the year, the OM&G transaction costs are incurred through the normal operations of the business, and are reported and controlled through a system of management internal controls such as numbered transaction documents (e.g., Purchase Requisitions & Purchase Orders), expenditure authorization limits and transaction review and approval procedures, etc.

On a monthly basis, a "Budget to Actual" report is prepared for each operating group. This report includes actual to budget comparisons for the month and year-to-date and a comparison of the current annual estimate to the budget. Variance explanations provided by the individual operating groups are summarized into a Variance Analysis report and forwarded to all Vice Presidents for review and sign-off.

³ AUC Decision 2008-057 – FortisAlberta Inc. 2008/2009 Negotiated Settlement Refiling (Application No. 1568045) (Released: July 16, 2008)

The following are the significant audit procedures undertaken.

- Relevant AUC Decisions and Orders were reviewed and the related regulatory requirements and directives were identified and built into the audit tests.
- Documented procedures and control matrices prepared to comply with the regulatory requirements of C-SOX outlining the controls around the OM&G transactions were reviewed. This included risk control measures such as the authorization matrix, the reporting processes for areas of Budgeting, Purchasing, Inventory Control, Payroll, General Accounting, Financial Reporting and Accounts Payable.
- Compared actual expenses recorded in the trial balance to amounts in the approved NSA to check for any unusual items and to verify whether the OM&G expenses were managed to the levels included in the NSA.
- Reviewed FAI's Capitalized Overhead Internal Study of the capital activities in each cost center used to determine the methodology to allocate overhead to projects,
- Analyzed and reconciled FAI's accounts and financial statements to the schedules filed under AUC Rule 005 - *Annual Reporting Requirements of Operational and Financial Results*.⁴
- Selected and tested a sample of OM&G transactions to verify that the items were:
 - complete, properly supported, authorized and accurate,
 - costs were for utility business and had not been previously disallowed,
 - recorded in the correct entity, appropriate account, cost centre, and time period, and
 - in accordance with regulatory requirements.
- Reviewed a sample of FAI's 2008 operating programs to verify that they were not disallowed.

The resulting conclusion was that FAI has effective processes to manage its OM&G expenses, and that the transactions selected were complete, accurate, properly authorized, supported, and in compliance with regulatory requirements.

Capital Management

FAI incurred capital expenditures, before AESO contributions and customer contributions, of approximately \$294 million in 2008. It is anticipated that the capital project management activities of FAI will continue to be significant, given the combined need to replace aging assets and to upgrade or add assets to meet anticipated customer growth in the residential and commercial sectors. FAI capital expenditures can be subdivided into the following main categories.

- Customer Growth
- Capital Upgrades/Replacements
- Efficient Operations
- Planned Maintenance
- Distribution Capacity Increase/Improvements
- Facilities and Upgrades associated with new sub-stations
- Other

⁴ FortisAlberta Inc. 2008 Report of Finance and Operations, Application No. 1605054

In 2008, over half of the \$294 million of capital expenditures were driven by projects related to growth in customer demand as more than 12,000 new customers were connected to the FAI Distribution system. Another \$50 million in capital expenditures was directed towards projects to improve reliability, service and safety as over 4,000 deteriorated poles in the distribution system were replaced.

As part of FAI efforts to improve its efficiency of operations, 2008 capital expenditures also included the installation of more than 70,000 new automated meters as part of a three-year program which is expected to be completed in 2010.

The audit objective was to determine the effectiveness of the procedures and controls over the capital budgeting, project management process, test a sample of capital transactions for accuracy, completeness and proper account allocation, and to determine 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.

- Reviewed the capital budget process and controls.
- Identified the key components, procedures, control points, issues, and risks associated with the capital project management process.
- Reviewed the relevant AUC Decisions and identified and built into the audit tests the related regulatory requirements.
- Performed a reconciliation of the data provided against relevant AUC Rule 005 capital schedules filed in 2008.
- Selected a sample of capital projects started in the audit period and verified that the selected items were properly approved based on the FAI signing authority matrix, prior to initiating activity or incurring commitments or expenditures.
- Selected a sample of completed capital projects, verified that the charges were recorded properly, and checked that adequate closure procedures existed and were executed in a timely manner.
- Tested project invoices to verify that they were complete, properly supported and accurate; were recorded in the correct time period; had been properly authorized; and were in accordance with both FAI's capital policy and regulatory requirements.
- Reviewed a sample of completed projects to verify that the charges were moved from construction accounts to the appropriate fixed assets accounts. Also checked that the quarterly certification reports were properly prepared on a timely basis.
- Tested a sample of asset retirement transactions to check for proper depreciation and allocation treatment.
- Reviewed AFUDC to verify that it was calculated and applied correctly.
- Verified that in the monthly and quarterly report review process management discussed and examined the variances.
- Tested a sample of projects that were over budget to check for proper explanation, handling and authorization.

We noted that the capital projects tested were properly approved, assigned a manager to control costs, accurately reported, closed to the appropriate fixed asset account in a timely fashion, and complied with regulatory decisions. The resulting conclusion is that FAI has an effective process to initiate, manage and close its capital projects.

Conclusion

Based on the scope of the audit and the audit procedures set out above, the Audit Group is of the opinion that in all material respects, FAI has effective controls and processes, has demonstrated regulatory compliance, and provided accurate information to the Commission for regulatory purposes.

The Audit Group appreciates the cooperation and assistance provided by the management and staff of FortisAlberta Inc. during the course of the audit.