

Memorandum

October 26, 2009

TO: Willie Grieve, Chair, Alberta Utilities Commission

FROM: Darcy Mazurkewich, Manager Audit and Compliance

REGULATORY AUDIT OF DIRECT ENERGY REGULATED SERVICES

1. Please find attached the audit report resulting from the recently completed Regulatory Audit of Direct Energy Regulated Services as well as management's response to the audit report.
2. The Audit Team determined that Direct Energy Regulated Services has complied with the requirement of completing the monthly reconciliations of the north and south deferred gas accounts, and accurately calculated the amounts to be refunded to customers in its north and south service territories.
3. As noted in the report, Direct Energy Regulated Services management and staff provided us with their full cooperation throughout the audit.



Darcy Mazurkewich
Manager, Audit and Compliance
Rates Division

CC: Gary Newcombe, Vice President, Government & Regulatory Affairs Canada,
Direct Energy Marketing Limited
James McIntosh, Senior Director, Alberta Regulated Services,
Direct Energy Marketing Limited
Bob Heggie, Chief Executive, Alberta Utilities Commission
Mike Hagan, Executive Director, Rates Division, Alberta Utilities Commission



October 26, 2009

Mr. Darcy Mazurkewich, Manager, Audit and Compliance Group
and
Mr. Mike Hagan, Director Rates
Alberta Utilities Commission
Fifth Avenue Place
4th Floor, 425 – 1 Street SW
CALGARY, Alberta
T2P 3L8

Dear Sirs:

**Re: AUC Regulatory Audit Report #2009-003
DIRECT ENERGY REGULATED SERVICES (DERS) REGULATORY
AUDIT REVIEW OF DEFERRED GAS ACCOUNT RECONCILIATIONS
FOR THE PERIOD JANUARY 2008 TO APRIL 2009**

Direct Energy Regulated Services (DERS) having had an opportunity to review the AUC's Regulatory Audit Report #2009-003, hereby acknowledges the contents and the finding of compliance by the AUC. DERS will proceed with the inclusion of the PPA in the November GCFRs which will be filed with the AUC today. Should you have any additional concerns, please do not hesitate to contact James McIntosh, Senior Director, Alberta Regulated Business directly at 403.290.5394.

Direct Energy thanks the AUC audit management and staff for their cooperation in this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Gary D. Newcombe".

Gary D. Newcombe
Vice President, Government & Regulatory Affairs, Canada

Copy: James McIntosh

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Direct Energy Regulated Services

**Regulatory Audit
Review of Deferred Gas Account Reconciliations
For the Period January 2008 to April 2009**

October 26, 2009

Audit Group:

**Nick Iannone
Darcy Mazurkewich**

ALBERTA UTILITIES COMMISSION

Regulatory Audit Report #2009-003: Direct Energy Regulated Services
Review of Deferred Gas Account Reconciliations
For the Period January 2008 to April 2009

October 26, 2009

Published by

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Background

1. Direct Energy Regulated Services (DERS) is a regulated business unit of Direct Energy Marketing Limited which is a wholly-owned Canadian subsidiary of Centrica plc, a provider of energy in the United Kingdom and North America.
2. Since May 2004, DERS has acted as default supply provider in the service territories of ATCO Gas North and ATCO Gas South. In 2008, DERS supplied 151.0 petajoules of natural gas at a value of \$1.1 billion to 712,000 customers.
3. As the default supply provider, DERS is required to prepare default rate tariffs for the purpose of recovering costs associated with providing gas services to north and south customers. As a component of its default rate tariffs, DERS calculates a monthly gas cost flow-through rate¹ (GCFR) for the north and south service territories. The GCFRs are cost based rates administered through north and south deferred gas accounts (DGA) and are determined for an upcoming month using price and volume forecasts. The DGAs are used to reconcile differences between actual and forecast gas costs to ensure that customers pay no more and no less than the actual costs incurred by DERS. DERS files its proposed GCFRs on a monthly basis with the Alberta Utilities Commission (AUC or Commission) in accordance with approved DGA procedures.
4. During a regulatory audit conducted between April 20, 2009 and May 19, 2009 (see AUC Audit Report 2009-001²), the Audit Group found that DERS had not completed monthly reconciliations of its DGA balances with the related general ledger accounts for the 2008 calendar year. The Audit Group brought this finding to the attention of DERS and informed DERS that by not completing the monthly reconciliations, errors or omissions may go undetected, and customers may be charged more than or less than the actual costs incurred on their behalf. In response, DERS committed to re-implement the monthly reconciliation procedure as part of its monthly accounting cycle by the end of July 2009.³
5. On August 31, 2009, representatives of DERS met with the Audit Group to discuss the results of DERS' efforts to complete the monthly reconciliations of the DGA. As a result of its efforts, DERS had determined that a formula error had occurred in determining the monthly GCFRs during the period of May 2008 to August 2008. This error caused the GCFRs to be overstated during those four months. As a consequence its customers were overbilled by \$5.7 million in the north service territory and \$4.3 million in the south service territory.

Objective

6. Given the significance of the over-billed amounts and DERS' non-compliance with approved DGA procedures, the Audit Group undertook this follow-up audit in order to provide the Commission with an opinion on DERS' subsequent compliance with DGA procedures, which include the required reconciliations of the north and south DGAs, and on the accuracy of the overbilling and refund amounts calculated by DERS.⁴

¹ The gas cost flow-through rate is also known as the gas charge.

² Audit Report 2009-001 Direct Energy Regulated Services – Regulatory Audit of Activities Including the Gas Procurement Process, Operation, Maintenance & General Expenses, and Gas Code of Conduct Compliance for the Year Ended December 31, 2008 (Released June 22, 2009).

³ Later, the AUC agreed to DERS' request to delay this action until August 31, 2009.

⁴ 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.

Summary of the Audit Procedures

7. The following procedures and tests were followed:
- a review of Decisions [2002-034](#),⁵ [2002-035](#)⁶ and [2007-103](#);⁷
 - a review of the amounts DERS reported as having been overbilled for both the north and south service territories in the months of May 2008 through August 2008 to verify their accuracy and completeness;
 - an examination of the 2008 and 2009 prior-period adjustments reported in the monthly GCFR filings to verify that they were recorded in the general ledger; and
 - a review of the accuracy and completeness of the monthly DGA reconciliations prepared by DERS for the period January 2008 to April 2009 (April 2009 being the last month that reflected complete actual values at the time of the audit).
8. The Audit Group began its audit fieldwork on September 21, 2009. The closing discussion with DERS management was held on October 20, 2009.

Conclusion

9. Based on the objective of this follow-up audit and the audit procedures set out above, the Audit Group is of the opinion that DERS has in all material respects complied with the requirement of completing the monthly reconciliations of the north and south DGAs, and accurately calculated the amounts to be refunded to customers in its north service territory at \$5.7 million and \$4.3 million for its south service territory customers.
10. The Audit Group thanks DERS management and staff for the cooperation and assistance they provided during the course of the audit.

⁵ Decision 2002-034 - ATCO Gas South GCRR Methodology and Gas Rate Unbundling – Compliance Filing (Applications 1257245 and 1257515) (Released March 21, 2002).

⁶ Decision 2002-035 - ATCO Gas North GCRR Methodology and Gas Rate Unbundling – Compliance Filing (Applications 1257378 and 1257516) (Released March 21, 2002).

⁷ Decision 2007-103 - Direct Energy Regulated Services 2007/2008 Default Rate Tariff and Regulated Rate Tariff (Application No. 1492697) (Released December 20, 2007).