

Memorandum

TO: Chairman's Executive Committee

FROM: Richard McCabe, Head, Audit and Compliance Group

DATE: April 29, 2004

RE: REGULATORY AUDIT REPORT – ALTAGAS UTILITIES INC.

Attached is a copy of the audit report arising from the regulatory audit of AltaGas Utilities Inc. that we completed recently. Also attached is a copy of management's response to the audit report.

This was the first regulatory audit of a utility company conducted since the group was established. As such, it represents a significant milestone in the development of the group.

As noted in the report, we determined that AltaGas had strong controls over the activities that we selected for audit and that the transactions that we examined were in accordance with Decisions issued by the Board. In addition, as noted in the final paragraph, we received the full cooperation of AltaGas management and staff throughout the audit process.

If you have any comments about the attached, please give me a call at 7-2316.

Richard M. A. McCabe

Restricted Distribution:
Bob Heggie, Utilities Branch
Lorne Heikkinen (3 copies), President, AltaGas Utilities Inc.



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April 26, 2004

Richard M. A. McCabe, CA, MBA
Head, Audit and Compliance Group
Alberta Energy and Utilities Board
640 - 5 Avenue SW
Calgary, AB T2P 3G4

Dear Mr. McCabe:

Re: Regulatory Audit Report - AltaGas Utilities Inc.

Thank you for providing AltaGas Utilities Inc. the opportunity to comment on the Draft Regulatory Audit Report. It is our understanding that this response will be attached to the final version of the report so that the report will contain the conclusions of the Audit Group and the comments of the management of AltaGas Utilities Inc.

The management of the company has reviewed the draft copy of the audit report and we believe that the draft report is complete and accurately reflects the findings that were communicated to the Company during the audit and at the closing meeting. The Company constantly strives to deliver the highest level of compliance with regulatory decisions and to maintain controls and practices that ensure accurate recording of all financial transactions. AltaGas is pleased that the results of the audit provides evidence of our success in achieving these goals.

I wish to thank you for the kind comments about the management and staff of AltaGas. I also want to recognize the Audit Team for the professional manner in which they conducted the audit.

If you have any comments or questions regarding this matter, please contact me.

Yours truly,

AltaGas Utilities Inc.

<original signed by>

Lorne M. Heikkinen, CA
President

AltaGas Utilities Inc.

Regulatory Audit Report

April 2004

Audit Team:

**Richard McCabe
Ron Johnston
Balvir Dhillon**

Objectives and Scope

The overall objective of the assignment was to conduct a regulatory audit of the financial and operational controls over selected activities of AltaGas Utilities Inc. (AltaGas) and review the linkage between the operations of these activities and the related financial information and the regulatory process. The audit covered sample transactions and reviews of processes for the 24-month period ended December 31, 2003, resulting in the expression of an opinion on the effectiveness of the controls and processes with respect to these key activities as well as an indication of whether such controls conform with regulatory requirements.

The focus of a regulatory audit is similar in some ways to audits carried out by both internal and external auditors. However, it differs in some key respects. It is similar in that, among other things, the regulatory auditor examines a sample of transactions for completeness, accuracy, support, timeliness and authorisation. The differences lie in the depth and breadth of the coverage. Regulatory audits are generally more narrowly focused, i.e. they tend to focus on a small number of areas deemed to be of interest. In addition, they generally examine transactions and processes in these areas in much more depth than other audits. Finally, they determine whether all of the transactions examined are in accordance with regulatory requirements, as outlined in legislation or in Decisions issued by the Alberta Energy and Utilities Board (“Board”).

The activities examined during the audit were selected following a review of financial information provided to the Board by AltaGas, as well as a review of Decisions arising from applications made to the Board by AltaGas during the three-year period ended December 31, 2003. The activities selected to be audited were as follows: inter-affiliate transactions, capital transactions, deferral accounts, and operating, maintenance and general payments.

The Audit and Compliance group of the Board’s Utilities Branch carried out the assignment between March 22 and April 6, 2004, when the closing meeting was held with management.

Overview

AltaGas is engaged in the distribution and sale of natural gas in various communities within the Province of Alberta and is regulated by the Board. For the years ended December 31, 2002 and 2003, respectively, the company’s revenues were \$93 million and \$128 million and its assets at the end of each year were \$106 million and \$109 million. During 2002, the company had about 60,000 customers, 68% of whom were residential, 10% were commercial and most of the remainder were rural. Residential customers accounted for 35% of normalised total sales volumes, while commercial customers accounted for 27%, and rural customers accounted for 18%. A relatively small number of customers accounted for the remaining 20% of the normalised sales volumes.

During the three-year period ended December 31, 2003, AltaGas was involved in 13 applications before the Board. These applications ranged from the relatively simple, such as disposition of gas storage contracts, to more complex items, such as general rate applications. During this period, however, most of AltaGas's general rate applications were handled on a negotiated settlement basis and, as a result, the normal open review and testing of evidence pertaining to its finances and operations that would occur in a public hearing process did not take place.

Audit Coverage

Inter-Affiliate Transactions:

AltaGas had several types of inter-affiliate transactions, with amounts in the years ended December 31, 2002 and 2003 ranging from \$235,000 to \$3.7 million. These transactions included fees charged to AltaGas by affiliated companies for the provision of administration, management, financing and other services. They also included fees charged by AltaGas to affiliates for the provision of administration, management, transportation and other services.

Audit testing focused on the accuracy of, and support for, inter-affiliate transactions during 2002 and 2003, including whether they were based on a valuation approved by the Board. The audit also tested the effectiveness of the procedures used to control such transactions.

The audit conclusion was that inter-affiliate transactions of AltaGas for 2002 and 2003 were legitimate, properly authorised and supported, complied with related agreements, were priced appropriately, and were in accordance with related regulatory decisions.

Capital Transactions:

Capital assets were \$86 million at the end of 2002 and they had increased by \$10.7 million during the year. The audit examined a sample of capital acquisitions for 2002, including their recording in the accounting records, and the calculation of related depreciation. These items were also tested for compliance with related regulatory decisions, as well as the effectiveness of the procedures used to control the capital acquisitions process.

The audit conclusion was that capital transactions of AltaGas for 2002 were legitimate, properly authorised and supported, complied with related agreements, were priced appropriately, and were in accordance with related regulatory decisions.

Deferral accounts:

Analysis of the financial information provided to the Board revealed a number of deferred accounts, the most significant of which was the deferral for the cost of post employment benefits. The balance on this account at the end of 2002 was \$577,000. The audit tested the effectiveness of the procedures used to control these items, including whether any regulatory deferral accounts were approved by the Board.

The audit conclusion was that deferral account transactions of AltaGas for 2002 were legitimate, properly authorised and supported, complied with related agreements, were priced appropriately, and were in accordance with related regulatory decisions.

Operating, Maintenance and General Payments:

This was the second largest component of expense (after the cost of gas) for the company and amounted to \$14 million in 2002. The audit tested a sample of such payments for authorisation, support, timing, completeness and accuracy. It also included a testing of the effectiveness of key controls over the payments process. Where appropriate, payments were tested to determine whether they were in accordance with regulatory decisions.

The audit conclusion was that operating, maintenance and general payments of AltaGas for 2002 were legitimate, properly authorised and supported, complied with related agreements, were priced appropriately, and were in accordance with related regulatory decisions.

Principal Audit Findings and Overall Conclusion

Overall, the financial and operational controls over the selected key activities of AltaGas Utilities Inc. were strong and the related transactions were in accordance with regulatory requirements. Some minor errors were noted in a small number of transactions; however, each of these items had already been discovered and corrected by management in a timely manner.

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