

Memorandum

TO: Chairman's Executive Committee

FROM: Richard McCabe, Head, Utility Audit and Compliance Group

DATE: May 19, 2005

RE: REGULATORY AUDIT REPORT – EPCOR ENERGY SERVICES

Attached is the audit report arising from the regulatory audit of EPCOR Energy Services that we completed recently. Also attached is management's response to the audit report.

As noted in the report, we determined that EPCOR Energy Services had effective processes for controlling the electricity procurement and regulated customer billing processes. In addition, transactions in these processes were complete and accurate, properly supported, timely, and in accordance with applicable regulatory requirements. There were two minor observations arising from the audit, which were discussed and cleared with management during the course of the audit. The observations were not sufficiently significant that they required being included in the audit report.

As noted in the final paragraph, we received the full cooperation of EPCOR Energy Services management and staff throughout the audit process.

If you have any comments about the attached, please give me a call at 297-2316.

Richard M. A. McCabe

Bob Heggie, Utilities Branch
John Dunnett, Vice President, EPCOR Energy Services

10065 Jasper Ave
Edmonton AB T5J 3B1
Canada



May 17, 2005

Alberta Energy and Utilities Board
640-5th Avenue S.W.
Calgary, AB T2P 3G4

Attention: Mr. Richard McCabe
Head, Audit and Compliance Group

Dear Sir:

Subject: EPCOR Energy Services
Regulatory Audit Report #2005-003
Regulatory Audit of the Electricity Procurement Process
and the Customer Billing Process for the
12-Month Period Ended December 31, 2004

EPCOR Energy Services appreciates the opportunity to review and respond to the Regulatory Audit Report as conducted by the AEUB. We understand that this response will be appended to the above noted Audit Report #2005-003.

We have reviewed the Audit Report and are pleased with the results of the audit as it is a reflection of our commitment to the internal controls, operational processes and regulatory compliance standards to ensure energy is procured in accordance with the Energy Price Setting Plan and that customers receive accurate and timely bills. We will be reviewing those areas discussed at the closing meeting to determine an appropriate course of action in an effort to continually provide customers with high service levels.

We would like to thank the AEUB for their accommodation of our internal schedules and deadlines and commend the members of the Audit Team for their professional manner and conduct throughout the audit process.

Should you have any questions or concerns, please feel free to contact me at (780) 412-7719.

Sincerely,

<original signed by Ken Rowes>

Ken Rowes
Senior Vice President
EPCOR Energy Services



EPCOR Energy Services

Regulatory Audit of the Electricity Procurement Process
and the Customer Billing Process for the
12-Month Period Ended December 31, 2004

May 2005

Audit Team:

Richard McCabe
Darcy Mazurkewich
Balvir Dhillon

ALBERTA ENERGY AND UTILITIES BOARD

Regulatory Audit Report #2005-003: EPCOR Energy Services
Regulatory Audit of the Electricity Procurement Process and the
Customer Billing Process

May 2005

Published by

Alberta Energy and Utilities Board
640 – 5 Avenue SW
Calgary, Alberta
T2P 3G4

Telephone: (403) 297-8311
Fax: (403) 297-7040

Web site: www.eub.gov.ab.ca

Objectives and Scope

The overall objective of the assignment was to conduct a regulatory audit of the financial and operational controls over two key activities of EPCOR Energy Services. The key activities that were the subject of this audit were the Electricity Procurement process and the Customer Billing process.

The audit included a review of the operations of these activities, the associated financial information and the related regulatory requirements. The audit covered sample transactions and reviews of the controls over the key components of each process for the 12-month period ended December 31, 2004. The audit resulted in the expression of an opinion on the effectiveness of the controls and procedures with respect to these key activities, as well as an indication of whether the activities conform with regulatory requirements.

This audit is the first of a series of annual audits that will be carried out at EPCOR Energy Services as part of a three-year regulatory audit plan. The plan has been developed to audit key activities of utilities that are regulated by the Alberta Energy and Utilities Board (EUB) and that have been determined to be of interest to stakeholders in the regulatory process. The key objective of the audits is to instill greater confidence in the regulatory process on the part of all stakeholders through an independent, professional review of the selected activities. At the end of the three year period, a new plan will be developed to address the next three-year cycle.

The activities examined during this audit were selected following a review of financial information provided to the EUB by EPCOR Energy Services, as well as a review of Decisions arising from applications made to the EUB by EPCOR Energy Services during the two-year period ended December 31, 2004. These applications dealt with negotiated settlements with customer representatives, including the Energy Price Setting Plan for 2004 and 2005, continuation of the provision of regulated rate tariff service, energy and non-energy price components, and Code of Conduct issues.

The Audit and Compliance group of the EUB's Utilities Branch carried out the assignment between April 13 and May 6, 2005, when the closing meeting was held with management.

Overview

Edmonton Power Corporation was incorporated in 1995 and changed its name in 1996 to EPCOR Utilities Inc (EPCOR). The City of Edmonton is the sole shareholder of EPCOR Utilities Inc. Regulated energy services are provided by EPCOR Energy Inc. (EEI), and EPCOR Energy Alberta Inc. (EEAI), both of which are incorporated in Alberta and are wholly-owned subsidiary companies of EPCOR Utilities Inc. These entities are collectively referred to as "EPCOR Energy Services" in this report.

EEI provides regulated rate tariff (RRT) electricity service to residential and small commercial customers within the City of Edmonton service territory, and acts in a service provider role, providing call centre and billing services to other EPCOR subsidiaries for water, competitive natural gas, and electricity products. EEI also provides billing and collection services to the City of Edmonton Drainage and Waste Services and to Alberta Energy Savings L.P., which acquired the majority of EPCOR's competitive mass market energy contracts in Alberta, effective November 1, 2004.

EEAI provides RRT electricity service to residential, farm, oil and gas, and small commercial customers in the FortisAlberta Inc. service area and the Town of Ponoka, and provides default supply electricity service to customers in these service areas and the City of Edmonton.

RRT is a regulated power pricing option available to all eligible residential, farm and small commercial customers, which account for about 35% of all of the power consumed in Alberta. This option provides a “transition” or “hedged” rate to eligible customers until June 30, 2006. By hedging most of the RRT energy requirements, i.e. acquiring electricity in advance of customers consuming the energy, customers are provided with an opportunity to pay a relatively stable rate for energy within a given year.

Prior to September 1, 2004, regulated electricity services had been provided by EPCOR Energy Services Inc. (EESI) and EPCOR Energy Services Alberta Inc. (EESAI), which had also provided non-regulated services. Following EUB Decision 2004-074, the provision of RRT service was assigned by EESI and EESAI to EEI and EEAI, respectively.

Audit Coverage

The Electricity Procurement Process

EPCOR Energy Services acquires a supply of electricity to enable it to provide power to its RRT customers. It is allowed to recover its prudent costs of acquiring this supply, together with a reasonable rate of return. The mechanism that has been developed for the procurement process is referred to as the Energy Price Setting Plan (EPSP). The current EPSP, which covers 2004 and 2005, was developed in a negotiated settlement with customer representatives and was approved by the EUB.

For 2004, EPCOR Energy Services acquired almost 6.2 million megawatt hours of electricity on behalf of its RRT customers, at a cost of about \$344 million.

The first step in procurement is to prepare a forecast of the required regulated electricity load for the next quarter. The forecast consists of an estimate of hourly required load by customer class for each hour of the forecast period. Forecasts are prepared about six weeks ahead of each quarter. The initial estimates are adjusted for expected losses, such as distribution line losses and unaccounted for energy.

EPCOR Energy Services takes the adjusted load forecast and converts it into a hedging portfolio, consisting of a number of products that can be bought in the electricity marketplace. The typical products acquired are off-peak, on-peak and super-peak products. These products are acquired for varying time periods, the most common being annual, monthly and quarterly.

The objective is not only to acquire the electricity volumes that are needed, but also to develop a portfolio that will cause the least amount of unexpected spot trades, due to the additional costs that are usually associated with such occurrences.

The Alberta market for electricity products is not as liquid as other commodity markets, such as oil or natural gas. As a result, it can be difficult at times to buy certain products. This means

that suppliers are able to demand a premium for providing other than off-peak products. Such premiums can range from 25% to 40% of the value of off-peak products.

Customer representatives play a key role in the procurement process, working directly with EPCOR Energy Services staff to review and approve the hedging portfolio and the prices at which the related products are acquired.

A main focus of the audit work in this section was to test the effectiveness of the controls and procedures related to the electricity procurement process. In addition, the audit tested the completeness and accuracy of, and support for, a sample of electricity procurement transactions during the 12-month period to December 31, 2004.

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 electricity procurement process were identified.
- These items were reviewed to determine whether related procedures and controls were adequate and tests were conducted to determine their effectiveness in practice.
- The sources from which electricity for regulated customers was acquired were reviewed to determine whether electricity was being acquired at “normal” commercial terms and conditions.
- The procedures used for preparing the quarterly energy charge filings with the EUB were evaluated and the filings for EEI and EEAI for one quarter were reviewed in detail. The significant items in the filings were verified with supporting documentation, and it was determined whether the filings were in compliance with regulatory requirements.
- EUB Decisions were reviewed and the related regulatory requirements were identified and built into the audit tests in this section.
- A sample of electricity procurement transactions for the twelve-month period was selected, and tests were carried out to verify that the selected items were complete, properly supported and accurate; were acquired at the prevailing market price and at normal commercial terms and conditions; were recorded in the correct entity and in the correct time period; had been properly authorised; and were in accordance with regulatory requirements.

The audit conclusion is that EPCOR Energy Services has an effective process for controlling the regulated rate tariff electricity procurement process and related transactions, and that such transactions were complete and accurate, properly authorised and supported, were priced appropriately, and were in accordance with regulatory requirements.

The Customer Billing Process

EPCOR Energy Services faced numerous billing challenges with the introduction of customer choice for electricity providers, as well as acquiring the right to be the RRT billing provider for customers in the FortisAlberta service territory. To address those challenges, EPCOR Energy Services has undertaken significant enhancements to the various components of its billing system.

In the twelve-month period ended December 31, 2004, EEI and EEAI, combined, billed on average 605,000 RRT customer sites each month, with total RRT billed revenue in excess of \$575 million.

EPCOR Energy Services bills all of its customer sites and accounts on a monthly basis, with the exception of irrigation accounts, which are only billed twice a year. Bill statements are generated for each customer account, and may include charges for competitive electricity and non-electric services, as well as charges for the provision of RRT services. As a result, there is a single daily billing run, which combines the charges for all of the respective services into one bill statement for each customer account.

Each day EPCOR Energy Services receives and validates hundreds of thousands of transactions, which are used in the daily billing run. These transactions include meter readings, meter details, enrollments, energisation status changes, distribution tariff charges, and details regarding customer move-ins or move-outs.

The daily billing run has three main components. The first step in the process is to gather all of the input transactions required to calculate the bill for each scheduled customer account. These transactions cover the period from the last date that the customer was billed to two days prior to the run date. If there is no actual meter reading for the billing period, an estimate of the consumption is used.

In the second step of the billing process, the prices that have been established for each period are applied to the consumption recorded or estimated for the period. In addition, distribution tariff, other service, and fixed charges are applied to each bill statement.

The third step results in the generation of the bill statements, which are then mailed to the customers.

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 RRT customer billing process were identified.
- These items were reviewed to determine whether related procedures and controls were adequate and tests were conducted to determine their effectiveness in practice.
- Alberta Regulations, EUB Decisions, and EUB Directives were reviewed and the related regulatory requirements were identified and built into the audit tests in this section.
- A sample of RRT customer bill statements was selected covering the twelve-month period, and tests were carried out to verify that the selected items were complete, properly supported and accurate; were recorded in the correct entity and in the correct time period; had been properly reviewed; and were in accordance with regulatory requirements.
- A sample of transactions used as inputs to the billing process was selected, and tests were carried out to verify that the bill statements issued to customers were consistent with the original information.
- The validation and reconciliation controls, used by EPCOR Energy Services to ensure completeness of data inputs and completeness of billing results, were reviewed and tested for completeness, ownership, and timeliness.
- The Directive 003 reports pertaining to billing accuracy were reviewed for one month to verify compliance with the requirements of the Directive.

The audit conclusion is that EPCOR Energy Services has an effective process for controlling the regulated rate tariff customer billing process, and that billing transactions were complete and

accurate, properly reviewed and supported, generated on a timely basis, and were in accordance with regulatory requirements.

Principal Audit Findings and Overall Conclusion

Overall, the financial and operational controls over the selected key activities of EPCOR Energy Services were effective and the related transactions were in accordance with regulatory requirements. Some minor exceptions were noted in a small number of transactions. 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 fieldwork was carried out at a very busy time for management and staff in EPCOR Energy Services. Nevertheless, they made time to provide the audit team with explanations and answers to our queries. We would very much like to thank the management and staff of EPCOR Energy Services for their very valuable help and cooperation during the audit.