ENERGY EFFICIENCY AUDIT

SOUTHERN CALIFORNIA EDISON
PROGRAM YEAR 2016

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Table of Contents

Executive Summary

The California Public Utilities Commission (Commission) was established by Constitutional Amendment as the Railroad Commission in 1911. The Legislature passed the Public Utilities Act, expanding the Commission's regulatory authority to include natural gas, electric, telephone, and water companies as well as railroads and marine transportation companies in 1912. One of the Commission's duties is to oversee billions of dollars expended on the energy efficiency (EE) program and subprograms funded by California ratepayers. The EE program is predominantly administered by the four major Investor-Owned Utilities (IOUs) in California. They are Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company (SCG).[1] The primary purpose of the EE program is to develop programs and measures to meet energy savings goals and transform technology markets in California.

Pursuant to California Public Utilities Code (PUC) Sections 381 *et seq.*, and 454.5[2], the Commission is responsible to oversee the EE program, which is funded by California ratepayers. The Commission has statutory authority to inspect and audit the books and records of the IOUs to ensure that ratepayers' money is well spent, specifically, pursuant to PUC Section 314.5 and 314.6. Other relevant criteria can be found in Decision (D.) 13-09-023, Ordering Paragraph (OP) 17, Energy Efficiency Policy Manual (Version 5 dated July 2013), and other applicable PUC codes, directives, rulings, etc. For the audit on SCE's EE program for the year (PY) 2016, we reviewed the expenditures of the selected EE program and subprograms administered and implemented by SCE in accordance with Generally Accepted Government Auditing Standards (GAGAS) as required in PUC Section 314.6(b).

The scope of this audit covered the period January 1, 2016 to December 31, 2016 or PY 2016. The purpose of this audit was to ensure that SCE was following EE program rules and regulations and to determine whether its reported EE expenditures and commitments were accurate, allowable and verifiable. For the audit on SCE's EE program, expenditures of selected the EE program and subprograms administered and implemented by SCE for the period under audit were reviewed. The specific SCE EE program and subprogram areas audited are included in the scope section of this report. Based on the audit, the following findings were identified:

- Finding #1: Lack of Compliance with Accrual Policy and Procedures Respecting its EE Program Costs for PY 2016

- Finding #2: Overstatement of the Efficiency Savings and Performance Incentive (ESPI) Award Amount for PY 2016

- Finding #3: SCE overstated its Co-Funding Agreement Expenditures in PY 2016

- Finding #4: Lack of Reconciliation of Amounts Committed/Unspent Funds

[1] San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SCG) are affiliated subsidiaries of SEMPRA Energy.

[2] All statutory citations are the California Public Utilities Code, unless otherwise noted.

- Finding #5: SCE Allocated Marketing Cost to a Closed Program in PY 2016

- Finding #6: Lack of Adequate Monitoring and Oversight over its Accounting Policies and Procedures

- Finding #7: SCE Should Strengthen its Oversight over its Contractors

- Finding #8: SCE Could Not Justify its Cost-Share Percentage Methodology

- Finding #9: SCE Double Counted Costs to PY 2016 and 2017

Audit Report

BACKGROUND

Pursuant to California Public Utilities Code (PUC) Sections 381 et seq., and 454.5, the Commission is responsible to oversee the energy efficiency (EE) program which is principally administered and implemented by the four major Investor-Owned Utilities (IOUs) in California and funded by California ratepayers. We conducted this audit of Southern California Edison Company's (SCE's) 2016 EE program pursuant Public Utilities Code (PUC) Section 314.5 and Decision (D.) 13-09-023, Ordering Paragraph (OP) 17.

The major IOUs are Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company (SCG). To meet California's aggressive electricity and natural gas energy efficiency goals, the Commission authorized billions to the EE program, which is funded by electric and gas rates included in ratepayer bills.[3] The IOUs have greatly increased its costs and budgets through rate increases for administering and implementing the EE program over time. Prior to 2016, the Commission authorized the IOUs budgets for the EE program based on a three-year program cycle. In Rulemaking (R.) 13-11-005, the Commission contemplated moving away from authorizing the EE budgets on a triennial basis and towards authorizing the EE budgets on an annual "rolling" portfolio basis. However, the Commission recognized that the adoption of authorizing EE budgets on a "rolling" portfolio basis would not be completed on time for 2015 funding levels. As a result, in D.14-10-046, the Commission approved the 2015 EE funding levels and authorized the IOUs to use 2015 annual spending levels until the year 2025 or when the Commission issues a superseding decision on funding levels. Subsequently, on October 22, 2015, the Commission issued D.15-10-028 which, among other things, authorized the IOUs 2016 EE funding levels at 2015 annual spending levels.

The EE program spans a variety of sectors encompassing residential homes and commercial buildings, large and small appliances, lighting and heating, ventilation and air conditioning (HVAC), industrial manufacturers, and agriculture. Within those sectors, the EE program utilizes a variety of tools to meet energy savings goals, such as financial incentives and rebates, research and development for EE technologies, financing mechanisms, codes and standards development, education and public outreach, marketing and others. The Commission also adopted the Efficiency Savings Performance Incentive (ESPI) mechanism with the intent "to motivate the utilities to prioritize EE goals, while protecting ratepayers through necessary cost containment mechanisms."[4] In D.13-09-023, OP 15 and 16, the Commission authorized an incentive award to be paid to the IOUs as a management fee equal to 12% of authorized Codes and Standards (C&S) program expenditures and 3% of authorized non-resource

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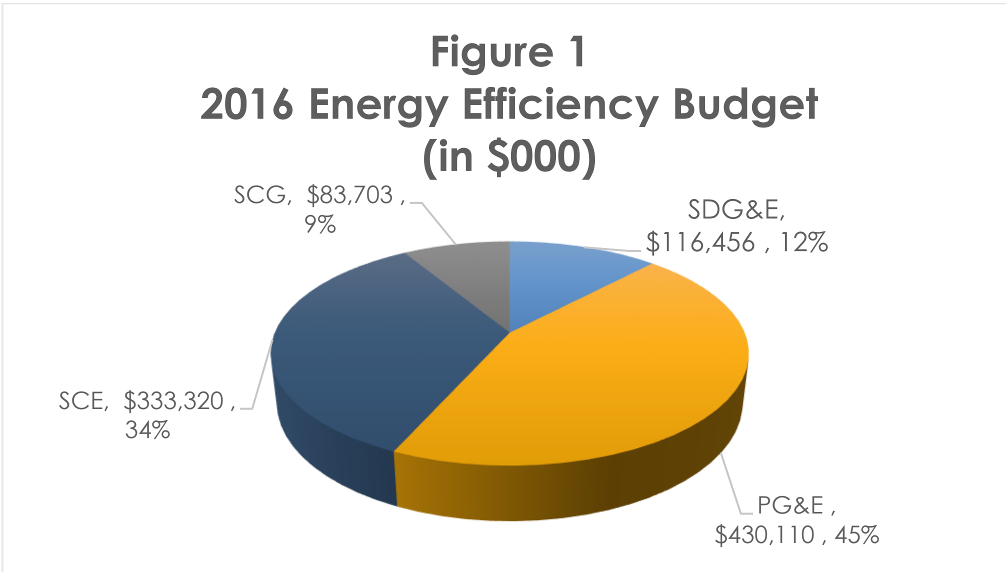
[3] Section 381 established a Public Goods Charge (PGC) that consumers pay on electricity consumption for cost-effective energy efficiency, renewable technologies, and public interest research. Section 900 established a natural gas surcharge to fund cost-effective energy efficiency and other public purpose programs.
[4] Decision 13-09-023, page 2

(NR) program expenditures, not to exceed authorized expenditures and exclusive of administrative costs.[5]

For program year (PY) 2016, the Commission issued D.15-10-028 which, among other things, authorized SCE a total budget amount of $333.3 million, which represents approximately 35% of the total $963.6 million EE program budget for all four IOUs for PY 2016. SCE's PY 2016 authorized budget also included $13.3 million for Evaluation, Measurement and Verification (EM&V) which is outside the scope of this examination. A chart reflecting SCE's portion of the total $963.6 million EE program budget authorized for PY 2016 is shown in the figure below.



SCE receives funding for the EE program through a Public Purpose Program (PPP) rate authorized by the Commission and included on customer billings.

SCOPE

Our audit objective was to ensure that SCE followed rules and regulations of the EE program and subprograms and to determine whether EE expenditures claimed by SCE were for allowable purposes and supported by appropriate documentation, such as invoices, contracts and relevant records, and were recorded appropriately in PY 2016.

In this audit, we examined the expenditures of the following EE program and subprograms:

1. Codes and Standards (C&S)
2. Non-Resource (NR)
3. Residential Energy Advisor (REA)
4. Commercial Energy Advisor (CEA)
5. Plug Load and Appliances (PLA)
6. Third-Party (TP)

[5] The C&S and Non-Resource programs support energy savings but do not provide direct energy savings.

In addition to examining the EE expenditures of the above selected EE program and subprograms, we also reviewed the EE commitments that SCE reported to the Commission and reviewed the monthly EE reports submitted by SCE and uploaded in the Commission's California Energy Efficiency Statistics (EEStats) website[6]. A follow-up review was also performed on its PY 2015 EE audit [7] recommendations to determine whether SCE has implemented the appropriate corrective actions.

METHODOLOGY

To address the audit objectives and assist the Commission in its oversight over the EE program, the following procedures were performed:

- Obtained an understanding of the EE program by reviewing relevant laws, rules, regulations, PUC codes, decisions, resolutions and advice letters.
- Obtained and reviewed SCE's accounting system, accounting policies, processes and procedures for recording, tracking, and monitoring EE program costs.
- Assessed whether the SCE's policies, procedures, and practices comply with the EE program requirements.
- Performed analysis of expenditure data to identify any anomalies or significant variances.
- From the SCE's accounting data, judgmentally selected expenditure transactions for review and testing.
- Requested and reviewed supporting documentation such as purchase orders, detailed invoices, contracts, receiving reports, timesheets and additional documentation as needed for the expenditure transactions selected for testing.
- Reviewed relevant contracts to determine if contract terms and provisions supported the EE programs.
- Traced expenditure samples recorded in SCE's accounting records to supporting documentation to determine whether costs were reasonable, allowable, verifiable, and relevant to the EE programs.
- Reviewed SCE's accrual entries and verified the cutoff of expenditure transactions to determine if proper expenditure amounts were recorded and reported in the proper accounting period.
- Reviewed SCE's commitments reported in EEStats and performed reconciliation of these reported amounts to SCE's records to determine whether these commitments were sufficiently justified and properly reported to the Commission.

FINDINGS AND RECOMMENDATIONS

FINDING 1: Lack of Compliance with Accrual Policy and Procedures Respecting its EE Program Costs for PY 2016

[6] This California Energy Efficiency Statistics (EEStats) is a repository of utility-submitted reports to the Commission and contains up-to-date savings, budgets, expenditures, and cost effectiveness results for each IOUs EE program.
[7] UAFCB report entitled *"Financial, Management, Regulatory, and Compliance Examination Report on Southern California Edison (SCE's) Energy Efficiency (EE) Program for the Period January 1, 2015 through December 31, 2015"*, dated July 31, 2017.

Condition:
SCE incorrectly recorded $955,973 in PY 2016 expenditures belonging to PY 2015, resulting in an overstatement of PY 2016 expenditures reported to the Commission.

Based on our review and testing, SCE improperly recorded and accrued $955,973 in expenditures to PY 2016 due to the inconsistent application of its own internal accrual policy and procedures. A detailed breakdown of expenditure amounts overstated by SCE for PY 2016 by program area is provided in **Appendix B, Table 1**.

Criteria:
PUC Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. PUC Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporations subject to regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

SCE's internal accrual accounting procedures require SCE to use the accrual basis of accounting to ensure expenditures are properly recognized in the period in which the services were rendered, or materials received.

Cause:
SCE inadvertently reported and recorded expenditures incurred in PY 2015 to PY 2016. When internal controls were not adequately enforced in combination with lack of proper training and supervision of employees, recording and reporting errors may occur.

Effect:
Failure to record accurate expenditures in a proper period and program year resulted in an overstatement of program costs reported to the Commission by $955,973 for PY 2016. It is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. Furthermore, an overstatement of expenditures may lead to a higher than anticipated authorized budget in future years since SCE develops its future year EE budget on prior year costs. This practice can result in an over-collection in ratepayer funds that subsidize the EE program through its balancing accounts.

Recommendation:
SCE should adhere to accrual basis of accounting when recording and reporting its EE program expenditures. SCE should reduce its PY 2016 EE program costs by a total amount of $955,973 based on the exception amounts identified in the audit for the EE program and subprogram areas listed in the scope section of this report.

It is our responsibility to bring this finding to the Commission and SCE's attention since an overstatement of EE program expenditures has been a repeated finding in prior Commission audits including, but not limited to, PY's 2013, 2014 and 2015.

FINDING 2: Overstatement of the Efficiency Savings and Performance Incentive (ESPI) Award Amounts for PY 2016

Condition:
In D.13-09-023, the Commission authorized the IOUs a new Efficiency Savings and Performance Incentive (ESPI) awards mechanism to promote achievement of EE goals. The ESPI mechanism offers each IOU incentive awards in four performance categories:

1. **Energy Efficiency Resource Savings**: A performance award for ex-ante locked down and ex-post verified net lifecycle resource programs (energy efficiency programs that are intended to achieve and report quantified energy savings) energy savings measured in MW, GWh, and MMTh.
2. **Ex-Ante Review (EAR) Process Performance**: A performance award for IOUs ex-ante review conformance.
3. **Codes and Standards (C&S)**: A management fee award for the IOUs advocacy of codes and standards.
4. **Non-Resource (NR) Programs**: A management fee award for implementing non-resource programs (an energy efficiency program that has no directly attributed energy saving but the programs support the energy efficiency portfolio through activities such as marketing or improved access to training and education.)

In D.13-09-023, Ordering Paragraph (OP) 15 and 16, the Commission authorized an incentive award to be paid to the IOUs as a management fee equal to 12% of authorized Codes and Standards (C&S) program expenditures and 3% of authorized non-resource (NR) program expenditures, not to exceed authorized expenditures and exclusive of administrative costs.[8] The decision also ordered verification of the C&S and NR program expenditures for the purposes of awarding the management fees.[9]

Based on its review and testing of the C&S and NR program expenditures, SCE overstated its ESPI award for PY 2016. Based upon its recalculation, it was determined that the revised ESPI base amount for calculating the C&S and NR program management fee incentive award amounts should be adjusted to $3,706,850 and $17,926,323, respectively. Consequently, SCE's incentive award amounts should be adjusted to $444,822 and $537,790 for the C&S and NR programs, respectively. A detailed recalculation of SCE's revised ESPI award amount for C&S and NR for PY 2016 is provided in the tables below.

C&S ESPI Recalculation	
Reported C&S ESPI Base	$ 5,054,236
Audit Exception	(1,347,386)
Revised C&S ESPI Base	$ 3,706,850
C&S Earnings Rate	12%
Revised ESPI Award	**$ 444,822**

8 The C&S and Non-Resource programs support energy savings but do not provide direct energy savings.
9 D.13-09-023, OP 17

NR ESPI Recalculation	
Reported NR ESPI Base	$ 20,838,263
Audit Exception	(2,911,940)
Revised NR ESPI Base	$ 17,926,323
NR Earnings Rate	3%
Revised ESPI Award Fee Amount	**$ 537,790**

Criteria:
Commission D.13-09-023 authorizes an incentive to be paid to each IOU as a management fee equal to 12% of authorized C&S program expenditures and 3% of NR program expenditures, not to exceed authorized expenditures in each program year, and excluding administrative expenditures.

Cause:
In AL 3655-E, SCE incorrectly included $1,305,201 and $2,910,610 for C&S and NR program Expenditures that belonging to PY 2015 or prior years, resulting in an overstatement of PY 2016 ESPI amount claimed. In addition, when SCE overstated its PY 2016 EE program costs in Findings #1 and #3, it also overstated its incentive awards for its C&S and NR programs.

Effect:
SCE overstated their C&S and NR program incentive award amounts filed in AL 3655-E. The proper incentive award amounts should be $444,822 and $537,790 for the C&S and NR programs, respectively.

Furthermore, it is critical to ensure that the savings claimed are accurate. The overstatements of incentive awards claimed by the IOUs can have negative consequences to ratepayers.

Recommendation:
Since SCE filed AL 3655-E to claim its C&S and NR program incentive awards for PY 2016, the Commission's Energy Division (ED) should adjust SCE's management fee incentive awards to $444,822 and $537,790 for the C&S and NR programs, respectively, when SCE's 2016 ex-post ESPI true-up AL is processed.

FINDING 3: SCE Overstated its Co-Funding Agreement Expenditures in PY 2016

Condition:
SCE's co-funding agreements are legal contract between SCE and one or more party to fund projects or studies on Energy Efficiency, Solar and Demand Response programs. Each party is responsible for its share of costs based on a predetermined percentage contained in the co-funding agreements. The lead Program Administrator (PA) of a co-funding agreement is responsible for creating the co-funding agreement, managing contracts, paying vendor invoices and issuing billings to other parties for any reimbursement of costs.

Based on our review and testing, instances were found in which SCE failed to abide by the provisions stipulated in the co-funding agreement and recorded the entire vendor invoice amount as PY 2016 EE expenditures. Specifically, based on the four sample transactions that related to co-funding agreements in which SCE was designated the lead PA, two samples (one for C&S and another for the REA program) showed that SCE recorded the entire amount of the invoice instead of its predetermined percentage amount based on the signed co-funding agreement. As a result, SCE overstated its PY 2016 expenditures by $22,287 and $257,330 for the C&S and REA programs, respectively.

In addition, instances were found in which SCE did not appropriately assign contract numbers to invoices from other lead PAs when it processed and paid the invoices.

Criteria:
PUC Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. PUC Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporations subject to regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

SCE's CP&S Managing Co-Funding Agreements and IOU Billing Procedures require SCE to track and record its costs and other party expenditures separately.

Cause:
SCE failed to follow its own CP&S Managing Co-Funding Agreements and IOU Billing Procedures when recording expenditures related to co-funding agreements. As lead PA, SCE recorded and reported 100% of the invoice amount instead of its predetermined percentage as stipulated in the provisions of the co-funding agreement. In addition, when internal controls were not adequately enforced in combination with lack of proper training and supervision of employees, recording and reporting errors may occur.

Effect:
Failure to follow its internal procedures and abide by the provisions stipulated in the co-funding agreement resulted in an overstatement of EE program costs reported to the Commission by a total of $278,619 for PY 2016. It is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. Furthermore, an overstatement of expenditures may lead to a higher than anticipated authorized budget in future years since SCE develops its future year EE budget on prior year costs. This practice can result in an over-collection in ratepayer funds that subsidize the EE program through its balancing accounts.

Furthermore, failure to assign contract numbers to co-funding agreements may lead to difficulties in tracking and monitoring costs and risk of exceeding the agreed upon budget amount.

Recommendation:
SCE should ensure that it adheres to its own internal CP&S Managing Co-Funding Agreements and IOU Billing Procedures policy and abide by the provisions stipulated in its co-funding agreements. SCE should reduce its PY 2016 EE program costs by a total amount of $278,619 based on the exception amounts identified in the audit for the EE program and subprogram areas listed in the scope section of this report.

In addition, SCE should provide proper training to staff on the recording and managing of co-funding agreement and strictly implement its internal control procedures to ensure that its co-funding costs are recoded accurately and reported appropriately.

FINDING 4: Lack of Reconciliation of Amounts Committed/Unspent Funds

Condition:
In the D.12-11-015, the Commission defines "committed funds as those that are associated with individual customer projects and/or are contained within contracts signed during a previous program cycle and associated with specific activities under the contract. All activities carried out under a contract and/or customer obligation during a specific program cycle need not be completed and funds need not be spent during that particular program cycle so long as there is an expectation that the activities will be completed."

The Commission's goal is to ensure that there are no stop/start periods associated with continuing activities and programs for purely administrative or contractual reasons. The Commission also refers to the EE Policy Manual that discusses long-term projects with long lead times and allows for certain authorization to be requested via advice letter if more than 20% of the budget for the current program cycle must remain encumbered for activities that will take place in the following program cycle.

During the audit, it was found to be difficult to reconcile SCE's reported commitment amounts due to inconsistent and conflicting information provided by SCE during the audit. When the initial reconciliation was performed between the figures provided by SCE in the first data request to the reported commitment amounts included in the December 2016 EEStats report, the auditor identified a discrepancy totaling $80,259,636. When prompted for an explanation in a subsequent request, SCE provided adjusted figures that reflected a variance in reported commitments totaling $4,779,652.

Criteria:
Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. Section 793 requires that accounts, records, and memoranda prescribed by the Commission for a corporation subject to the regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

Cause:
A weakness in internal controls over the monitoring of its commitment prevented SCE from accurately reporting its commitments to the Commission.

Effect:
Failure to report accurate commitment amounts to the Commission may lead to higher than anticipated authorized budgets in future years since SCE develops its future year EE budgets on prior year costs.

Recommendation:
SCE should enhance its internal control procedures to ensure that its commitments are recorded accurately and reported appropriately to the Commission.

FINDING 5: SCE Allocated Marketing Overhead Costs to a Closed Program in PY 2016

Condition:
SCE incorrectly allocated marketing overhead costs to the Appliance Recycling Program (ARP), despite the program being closed in March 2016.

Criteria:
PUC Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. PUC Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporation subject to regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

Cause:
SCE inadvertently allocated marketing overhead costs to the ARP from April through December 2016 despite the programs closure in March 2016.

Effect:
Failure to appropriately allocate overhead costs resulted in an overstatement of expenditures to the ARP and an understatement of expenditures to other EE programs. It is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. Furthermore, an overstatement of expenditures may lead to a higher than anticipated authorized budget in future years since SCE develops its future year EE budget on prior year costs. This practice can result in an over-collection in ratepayer funds that subsidize the EE program through its balancing accounts.

Recommendation:
SCE should develop and implement internal control procedures to ensure that its EE overhead costs are allocated properly and not assigned to any closed EE programs.

FINDING 6: Lack of Adequate Monitoring and Oversight over its Accounting Policies and Procedures

Condition:
During the audit, the following deficiencies were identified:

1. Instances were noted that SCE took advantage of purchase discounts when is paid supplier invoices but recorded the entire invoice amount to the EE program. Specifically, SCE accounted for the Managed Service Provider (MSP) fee and/or Early Pay Discount when it processed and paid the supplier invoice but recorded the entire supplier invoice amount in its accounting records. As a result, SCE overstated its PY 2016 expenditures reported to the Commission.

2. SCE did not consistently record expenditures in the proper accounting period in which services were rendered or material received.

3. SCE combined invoices that were for different accounting periods and vendors when it recorded costs in PY 2016.

4. SCE recorded the total invoice amount as customer incentive costs even though the invoice broke out the costs between customer incentives and labor.

5. SCE did not implement new IO numbers until April 2016 to track EE program cost and expenditures, which caused multiple errors in the accounting records.

6. When transferring costs to the new 2016 IO numbers, SCE made duplicate corrections which caused an overstatement of expenditures totaling $33,351 to the Commercial Energy Advisor (CEA) program.

Criteria:
PUC Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. PUC Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporation subject to regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

SCE's internal accrual accounting procedures require SCE to use the accrual basis of accounting to ensure expenditures are properly recognized in the period in which the services were rendered, or materials received.

Cause:
SCE's lack of oversight over its internal accounting practices and procedures caused a number of errors when it recorded EE expenditures in PY 2016. When internal controls are not adequately enforced in combination with lack of proper training and supervision of employees, recording and reporting errors may occur.

Effect:
Failure to comply with internal policy and procedures resulted in an overstatement of program costs reported to the Commission. It is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. Furthermore, an overstatement of expenditures may lead to a higher than anticipated authorized budget in future years since SCE develops its future year EE budget on prior year costs. This practice can result in an over-collection in ratepayer funds that subsidize the EE program through its balancing accounts.

Failure to record expenses in their proper accounting period could potentially lead to inaccurate monthly and quarterly reports. In particular, SCE's practice of combining several invoices in one transaction makes it difficult to track contract costs, payments to vendors, reconcile expenditures, and identify errors and mistakes.

Recommendation:
SCE should enhance its process in creating and implementing new IO numbers to ensure EE expenditures are recorded accurately and timely and in the proper program period. In addition, SCE should strictly implement its internal controls and oversight of its accounting policies and procedures.

SCE should reduce its CEA program expenditures by $33,351 for PY 2016 based on the exception amounts identified during the audits on each EE program and subprogram areas listed in the scope condition section of this report.

FINDING 7: SCE Should Strengthen its Oversight over its Contractors

Condition:
SCE is mandated by the Commission to have 20% of the EE portfolio administered by contractors or consultants, who are awarded a predetermined budget to pursue set measures and, in most cases, specific customer segments within which to work. In addition, SCE enters into agreements with outside contractors to carry out EE programs when SCE is unable to meet specialized needs for the programs. For example, SCE contracts its audit reviews to an outside engineering company to allow for the review to be more independent. SCE also uses contacted employees for specific periods of time for other needs. In particular, EE third-party programs are implemented through third-party contractors.

Based on our review and testing, instances were found in which SCE processed and paid vendor invoice for services performed after the contract expiration date, failed to adequately track and monitor the timeliness of services and deliverables by the expected due date, failed to ensure the timely submittal of vendor invoices for processing in the proper period, and failed to obtain appropriate supporting to support the charges invoiced.

Criteria:
PUC Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. PUC Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporation subject to regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

SCE's Master Services Agreements require that "Contractor shall complete the Services and Deliverables within the Authorized Amount and in accordance with the Services Schedule. Contractor shall give notice to the Procurement Agent and the Edison Representative at such time that it becomes reasonably apparent that the forecasted cumulative charges will exceed the Authorized Amount. Contractor shall not proceed with or be reimbursed for any Services performed or Deliverables provided either beyond the effective period of applicable Purchase Order, or exceeding the Authorized Amount, without the written authorization of the Edison Representative, which is to be followed-up by a Change Order issued by the Procurement Agent. Contractor shall submit Valid Invoices for its time and material costs on a monthly basis within ten days following the end of the month in which the Services were performed, or Deliverables were provided, and the Deliverables were accepted…"

Cause:
SCE did not appropriately manage and monitor its vendor contracts in according with the provisions of signed agreements.

Effect:
Contracts are legally binding agreements and failure to uphold contractual obligations can result in legal consequences and potentially void the contracts. Moreover, poor contract management may result in higher financial, credit, operational, legal and operational risk.

Recommendation:
SCE should strengthen its contract management oversights and adhere to its policies to ensure that provisions of signed vendor agreements are effectively monitored and adequately enforced. SCE should update its contracting manual, conduct a supervisory review of contracts, and require regular training for contract staff.

In addition, SCE should establish a depository to maintain and manage its contracts in a way that it should be able to provide how much funding is left for each EE contract as well as its specific expiration dates for each EE contract.

FINDING 8: SCE Could Not Justify its Cost-Share Percentage Methodology

Condition:
The public benefits charge (for electric utilities in California) is a state mandated requirement to collect a surcharge to be used for "public benefits" programs in four categories: (1) cost-effective demand-side management services to promote EE and energy conservation; (2) new investment in renewable energy resources; (3) research, development and demonstration projects, and (4) services provided for low-income electricity customers.

During our review and testing, SCE was unable to provide sufficient supporting documentation to justify how it determines its cost-share percentage among benefiting programs.

Criteria:
PUC Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. PUC Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporation subject to regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

CPUC General Order (GO) 28 requires that the utility preserve all records, memoranda, and papers supporting each and every entry so that this Commission may readily examine the same at its convenience.

Cause:
SCE elected not to provide adequate documentation to support how it determines its cost share percentage among benefiting programs, including the EE program. As an example, in one of its responses to a request, SCE stated that "Cost share represents the general cost allocated based on

benefitting sector. Prior to the award of the Request for Proposal (RFP) in 2014, the online audit tool (EEAT) RFP Project Team met with senior management to ensure we had adequate budget to cover the expected scope and 3-year cost of the contract. The meeting attendees included a mix of Demand Side Management (DSM) Subject Matter Experts and Leaders with Program budget awareness, and we were informed that there was adequate budget in the overall DSM Portfolio accounts to cover the project. Initially, the EEAT RFP project team was assigned 3 DSM Operation IO's to charge our time as follows 54% to Residential, 43% to C&I, and 3% to Demand Response"

Effect:
A lack of documentation to support its methodology on how it determines its cost-share percentage may lead to a misallocation of costs among the numerous "public benefits" programs. As a result, this may lead to difficulties in evaluating the efficiency and effectiveness of the EE program due to an over/under statement of costs allocated to the program.

Recommendation:
SCE should ensure that it preserves adequate documentation to support its methodology on how it determines the cost-share percentage for the programs subsidized by the public benefits charge.

FINDING 9: SCE Double Counted Costs to PY 2016 and 2017

Condition:
Based on its review and testing of Plug Load and Appliance program expenditures, SCE accounted for an expenditure transaction in both PYs 2016 and 2017. At the end of PY 2016, SCE recorded an accrual totaling $530,173 to PY 2016 Internal Order (IO) #619929. Subsequently, SCE reversed the accrual of $530,173 charged to 2016 IO #619929 in early 2017. When SCE received the actual invoice totaling $766,179 in 2017, SCE recorded and charged the actual invoice amount of $766,179 to PY 2017 IO #621643. Although SCE reversed the accrual of $530,173 recorded to 2016 IO #619929 in 2017, this transaction was not included when SCE reported 2016 and 2017 EE expenditures. As a result, SCE inadvertently accounted for the expenditure transaction in both 2016 and 2017. Below is an illustration on how SCE inadvertently accounted for the expenditure transaction in both 2016 and 2017.

IO Numbers	PY 2016	PY 2017
2016 IO - 619929	530,173	(530,173)
2016 IO - 619929	xxxxxx	(vvxxxx)
2016 IO - 619929	xxxxxx	(xxxxxx)
2017 IO - 621643		766,179
2017 IO - 621643		xxxxxx
2017 IO - 621643		xxxxxx

SCE reports the EE expenditures that are recorded in the PY 2016 with 2016 IO numbers. When SCE extracts expenditure information from its accounting system for PY 2016, only the highlighted amounts in blue will be reported as PY 2016 expenditures. Similarly, when SCE extracts expenditure information from its accounting system for PY 2017, only the highlighted amounts in green will be reported as PY 2017 expenditures.

Criteria:
PUC Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. PUC Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporation subject to regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program.

SCE's internal accrual accounting procedures require SCE to use the accrual basis of accounting to ensure expenditures are properly recognized in the period in which the services were rendered, or materials received.

Cause:
When internal controls were not adequately enforced in combination with lack of proper training and supervision of employees, recording and reporting errors can occur.

Effect:
Failure to record accurate expenditures in a proper period and program year resulted in an overstatement of program costs reported to the Commission by a total of $530,173. It is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. Furthermore, an overstatement of expenditures may lead to a higher than anticipated authorized budget in future years since SCE develops its future year EE budget on prior year costs. This practice can result in an over-collection in ratepayer funds that subsidize the EE program through its balancing accounts.

Recommendation:
SCE should make the appropriate correction to reduce its PY 2017 Plug Load and Appliance program costs by a total amount of $530,173 based on the exception amounts identified in the audit for the EE program and subprogram areas listed in the scope sections of this report.

In addition, SCE should provide proper training to staff to ensure that expenditures are recorded timely, accurately and to the proper accounting period.

CONCLUSION

In conducting our audit, we obtained a reasonable understanding of SCE's internal controls, which were considered relevant and significant within the context of our audit objectives. Deficiencies in internal control that were identified during the audit and determined to be significant are included in this report.

SCE's management is responsible for the development of its policies and procedures to ensure that expenditures and commitments of its EE programs were reported accurately and timely. The Commission is responsible to ensure the ratepayers' monies funding energy efficiency programs in California explicitly support the EE goals and strategies and protect ratepayers' funds against fraud and abuse.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to afford a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our limited audit objectives.

The report is intended solely for the information and use of the Commission and SCE and is not intended to be and should not be used by anyone other than these specified parties.

Barbara Owens, CIA, CISA, CGAP, CRMA
Director, Enterprise Risk and Utility Audits

Kevin Nakamura, Supervisor
Sang Soble, Auditor
Jeffrey Walter, Auditor

Appendices

APPENDIX A
Applicable Rules and Regulations

Rule/Regulation Types	Reference	Description
Public Utility Code	Section 314	Guidance providing the Commission the authority to conduct financial and performance audits consistent with Generally Accepted Government Auditing Standards (GAGAS), and to follow-up on findings and recommendations
	Section 381	Guidance mandating that the Commission to allocate funds spent on EE programs that enhance system reliability and provide in-state benefits including cost-effective EE and conservation activities.
	Section 581	Guidance providing the Commission the authority to require a utility to file complete and correct reports in prescribed form and detail
	Section 582	Guidance providing the Commission the authority to require a utility to timely provide applicable records
	Section 584	Guidance providing the Commission the authority to require a utility to furnish reports to the commission
Decisions & Rulemaking	D.09-09-047	Adopting Efficiency Savings and Performance Incentive Mechanism
	D.12-11-015	Approving 2013-2014 EE Programs and Budgets
	D.15-10-028	Establishing a “Rolling Portfolio” process for regularly reviewing and revising EE goals for 2016 and beyond
	D.14-10-046	Establishing EE Savings Goals and Approving 2015 EE Programs and Budgets (Concludes Phase I of R.13-11-005)
	R. 13-11-005	Establishing a proceeding in which to fund the current energy efficiency portfolios through 2015, implement energy efficiency "rolling portfolios", and address various related policy
Advice Letters	AL No. 3655-E	EE Incentive Award for PY 2015 and 2016

'

APPENDIX B

Table 1
Summary of UAFCB Audit Adjustments
PY 2016

Program Name	Cost Category			Total
	Administrative	Marketing	Direct Implementation	
Code and Standards	$ -	$ -	$ 19,898	$ 19,898
Non-Resource	$ -	$ -	1,130	1,130
Commercial Energy Advisor	$ -	$ -	25,925	25,925
Residential Energy Advisor	$ -	$ -	16,783	16,783
Plug Load and Appliances	$ -	$ -	892,037	892,037
Total			**$ 955,973**	**$955,973**

SCE's Responses

SOUTHERN CALIFORNIA
EDISON
An EDISON INTERNATIONAL® Company

Jill C. Anderson
Vice President
Customer Programs and Services

July 19, 2018

Barbara Owens – Division Chief
Utility Audit, Finance and Compliance Branch
California Public Utilities Commission
455 Golden Gate Avenue, 7th Floor
San Francisco, CA 94102-7016

Dear Ms. Owens:

Southern California Edison Company (SCE) appreciates the opportunity to review and provide clarifying comments on the draft *Energy Efficiency Audit Report on Southern California Edison Company's (SCE's) Energy Efficiency Program For the Period January 1, 2016 through December 31, 2016* (Draft Report), issued on July 9, 2018 by the California Public Utilities Commission's Utility Audit, Finance and Compliance Branch (UAFCB).

SCE's comments to the Draft Report are attached to this letter and are intended to provide additional clarification and information related to the findings in the Draft Report. SCE appreciates UAFCB's audit review of the Energy Efficiency Program, as SCE is committed to continuous improvement and uses the feedback received from these audits to implement those improvements.

If you have any questions about SCE's comments, or would like to set up a meeting to discuss the information provided, please contact Mary Beth Quinlan at 626-302-2026.

Thank you,

Jill C. Anderson

Jill C. Anderson
Vice President, Customer Programs and Services

Attachment

cc: Alice Stebbins, CPUC Executive Director
Maryam Ebke, CPUC, Deputy Executive Director
Edward Randolph, CPUC Energy Division Director
Kevin Nakamura, UAFCB
Jeffrey Waller, UAFCB
Sang Soble, UAFCB

P.O. Box 800
2244 Walnut Grove Ave.
Rosemead, CA 91770

SCE's Comments to the Draft Report in UAFCB's Audit of SCE's Energy Efficiency Programs for the Year Ended December 31, 2016

The following are SCE's comments to the Draft Report prepared by the UAFCB based on its audit of SCE's 2016 Energy Efficiency (EE) Programs. With the exception of the comments below, SCE believes that the Draft Report accurately reflects the information that SCE provided to the auditors during the audit. Thus, these comments provide updated information, as necessary, and/or explain where SCE disagrees with a finding or portion thereof.

1. <u>Lack of Compliance with Accrual Policy and Procedures Respecting its EE Program costs for PY 2016</u>

Draft Finding 1: *SCE incorrectly recorded $1,298,068 in PY 2016 expenditures belonging to PY 2015, resulting in an overstatement of PY 2016 expenditures reported to the Commission. … A detailed breakdown of expenditure amounts overstated by SCE during PY 2016 by program area is provided in the Appendix B, Table 2.*

Draft Recommendation 1: *SCE should adhere to accrual basis of accounting when recording and reporting its EE program expenditures. SCE should reduce its PY 2016 EE program costs by a total amount of $1,298,068 based on the exception amounts identified in the audit for the EE program and subprogram areas listed in the scope section of this report. It is our responsibility to bring this finding to the Commission and SCE's attention since an overstatement of EE program expenditures has been a repeated finding in prior Commission audits including, but not limited to, PY's 2013, 2014 and 2015.*

<u>SCE Comments to Draft Finding 1</u>

SCE disagrees with this finding and recommendation and believes the finding should be removed. In Appendix B of the Draft Report, the UAFCB identifies six (6) program categories in which it asserts that SCE overstated expenditures for 2016 by a total of $1,298,068. However, during the audit SCE provided documentation demonstrating that $361,993 of this total were properly accrued in PY 2015, properly reversed in PY 2016, and corresponding correcting journal entries were recorded to transfer such costs to the appropriate period's Internal Order accounts (see attached Exhibit 1 for supporting documentation). Additionally, SCE believes that an additional $44,038 of the noted total were likewise properly accrued, reversed, and corrected. SCE provided a document request response days before issuance of the Draft Report with clarifying documentation and therefore it may have been too late to be reflected in the Draft Report, but should be reflected in the Final Report.

For the remaining portion of the claimed expenditure overstatement (the amount related to the Plug Load and Appliance program), the major component of the claimed overstatement is an invoice from the Southern California Gas Company (SCG) in the amount of $857,939.69. This invoice was for SCE's purchase of electric savings in Q4 of 2015. The installation of the measures were completed by SCG in 2015 pursuant to a co-funding agreement with SCE. Under that agreement, SCE is not obligated to pay for these savings until after it reviews and approves potential measure savings. Due to the nature of this process and billing delays, SCE was not aware of any potential savings until after SCG completed the 2015 Q4 claims submittal on March 1, 2016. In Resolution E-4897, p. 15, the Commission specifically recognized that it will allow an exception for joint SCG/SCE projects installed in 2015, but claimed in 2016, due to a delay in the exchange of information.

If the UAFCB recommends a downward adjustment for 2016 based on the theory that the costs at issue should have been expensed in 2015, then it should also recommend an upward adjustment, or offset, for the 2015 ESPI Award. In Resolution E-4897, p.31, the Commission held that adjustments could be made to prior years' ESPI awards if there was an error in the submissions. Specifically, the Commission stated, *". . . [A]s discussed previously, staff may correct erroneous utility submissions therefore we do not find it [adjusting prior year's ESPI award] out of scope of the current resolution."* Because the ESPI Codes & Standards and Non-Resource Program Management Fee percentages are the same each year, any downward adjustments to for the 2016 ESPI may properly be offset by an upward adjustment for 2015, when the funds should have been expended.

The UAFCB also notes that this finding has been made in prior audits. However, even if UAFCB's position is completely accurate (which SCE does not believe it is), the claimed error represents less than a 0.5% error rate, given that SCE recorded approximately $276 million in PY 2016 costs. Still, it is SCE's goal to have all expenditures correctly recorded in the appropriate accounting period and proper year-end accruals are key to that objective. SCE is unsatisfied with any missed accruals and will continue to reemphasize to all program personnel the importance of capturing and recording costs in the correct accounting period as part of SCE's annual accrual training that will be conducted prior to year-end 2018. SCE wishes to note that in response to recommendations from the UAFCB's 2011-2012 Audit of SCE's EE Programs, SCE developed a Revised Internal Controls Plan (Plan) using the COSO (Committee of Sponsoring Organizations of the Treadway Commission) model for its EE programs. As part of the Plan, (Areas C.1.3 and D.2.1 of the Plan), SCE improved its year-end accrual procedures and accrual training just prior to year-end 2014. The UAFCB acknowledged and commended such strengthening of SCE's accrual policy and procedures as part of the 2015 Draft Report's Observation 35.

Lastly, the effect noted in this finding is greatly exaggerated and SCE strongly disagrees with the statement that, this practice could result in an over-collection of "billions" in these EE programs through its balancing accounts. Draft Report, p. 6. If the UAFCB does not strike the entire Finding 1, as requested, SCE respectfully requests that at least this statement be stricken from the final Audit Report as it is inaccurate and misleading.

2. **<u>Overstatement of Efficiency Savings and Performance Incentive (ESPI) award amount PY 2016</u>**

> **Draft Finding 2:** *... SCE overstated its ESPI award for PY 2016. Based upon its recalculation, it was determined that the revised ESPI base amount for calculating SCE's C&S and NR program management fee incentive award amounts are $3,512,546 and $17,865,891, respectively. Consequently, SCE's incentive award amounts should be adjusted to $421,506 and $535,977 for the C&S and NR programs respectively....*
>
> **Draft Recommendation 2:** *Since SCE filed AL 3655-E to claim its C&S and NR program incentive awards for PY 2016, the Commission's ED should adjust SCE's management fee incentive awards to $421,506 and $535,977 for the C&S and NR programs, respectively, when SCE's 2016 ex-post ESPI true-up AL is processed.*

<u>SCE Comments on Draft Finding 2</u>

SCE disagrees with this recommendation. SCE strictly followed and relied on Energy Division's direction related to which costs were eligible expenditures for earnings (see attached Exhibit 2 of this response). SCE provided copies of the instructions to UAFCB. The bulk of the costs in these two categories were for the completion of studies or demonstrations related to Codes and Standards or Emerging Technology activities committed during prior program years. The costs UAFCB proposes to remove were for activities completed in 2016, even though some of the costs were committed in 2015 or prior. The appropriate practice is to include completion commitments in subsequent years as such inclusion encourages the continued pursuit of long term studies and demonstration projects which provide valuable benefits to EE. Management of these programs, which is the basis for the specific management fees, includes the management of commitments from prior years.

3. <u>SCE overstated of Co-Funding agreement expenditures in PY 2016</u>

Draft Finding 3: *SCE's co-funding agreements are legal contract between SCE and one or more party to fund projects or studies on Energy Efficiency, Solar and Demand Response programs. Each party is responsible for its share of costs based on a predetermined percentage contained in the co-funding agreements. The lead Program Administrator (PA) of a co-funding agreement is responsible for creating the co-funding agreement, managing contracts, paying vendor invoices and billing other parties for any reimbursement of costs.* *Based on its review and testing, instances were found in which SCE failed to abide by the provisions stipulated in the co-funding agreement and recorded the entire vendor invoice amount as PY 2016 EE expenditures. Specifically, based on four sampled transactions that related to co-funding agreements in which SCE was designated the lead PA, two samples (one for C&S and another for the REA program) where SCE recorded the entire amount of the invoice instead of its predetermined percentage amount based on the co-funding agreement. As a result, SCE overstatement its PY 2016 expenditures by $22,287 and $257,330 for the C&S and REA programs, respectively.* *In addition, instances were found in which SCE did not appropriately assign contract numbers on a few co-funding Agreements lead by other parties.* **Draft Recommendation 3:** *SCE should ensure that it adheres to its own internal CP&S Managing Co-Funding Agreements and IOU Billing Procedures policy and abide by the provisions stipulated in its co-funding agreements. SCE should reduce its PY 2016 EE program costs by a total amount of $278,619 based on the exception amounts identified in the audit for the EE program and subprogram area listed in the scope section of this report.* *In addition, SCE should provide proper training to staff on the recording and managing of co-funding agreement and strictly implement its internal control procedures to ensure that its co-funding costs are recoded accurately and reported appropriately.*

<u>SCE Comments to Draft Finding 3</u>

SCE agrees that it experienced some challenges in 2016 with Co-Funding Agreements and IOU Billing Procedures as identified in the Finding, and SCE does not dispute the substance of Finding 3. SCE has recognized this challenge and applied an enhancement to our processes in 2017, wherein SCE implemented quarterly meetings with Co-Funding Agreement lead personnel to address any open reporting issues and to facilitate timely billing practices. Additionally SCE commenced an enhanced monthly review and monitoring process for IOU billing activity.

SCE is concerned, however, that the effect noted in this finding is greatly exaggerated and SCE strongly disagrees with the statement that, this practice could result in an over-collection of "billions" in these EE programs through its balancing accounts. SCE respectfully requests that this statement be stricken from the final Audit Report as it is inaccurate and misleading.

4. **Lack of Reconciliation of Amounts Committed/Unspent Funds**

> **Draft Finding 4:** *… During the audit, it was found to be difficult to reconcile SCE's reported commitment amounts due to inconsistent and conflicting information requested and provided by SCE. When the initial reconciliation was performed between the figures provided by SCE in the first data request to the reported commitment amounts included in the December 2016 EEStats report, the auditor identified a discrepancy totaling $80,259,636. When prompted for an explanation in a subsequent request, SCE revised the commitment amounts as reported in the EEStats report and adjusted the figures initially provided in its response to the first data request.*
>
> **Draft Recommendation 4:** *SCE should enhance its internal control procedures to ensure that its commitments are recorded accurately and reported appropriately to the Commission.*

SCE Comments on Draft Finding 4

During SCE's review, SCE did discover some minor errors in commitment reporting and subsequently provided the corrected data in a document request response. SCE is working on improving the tracking and reconciling of commitments. However, SCE disagrees with the assertion that there was an $80 million discrepancy in our data as the corrected data supplied by SCE indicated only a $1.4 million discrepancy, which was thereafter corrected. SCE believes that the determination that there was an $80 million discrepancy was the result of a UAFCB error during its initial review of reports and data provided by SCE and this recommendation should be adjusted to reflect the $1.4 million.

5. Marketing Overhead Costs charged to a Closed Program in PY 2016

Draft Finding 5: *SCE incorrectly allocated marketing overhead costs to the Appliance Recycling Program (ARP), despite the program being closed in March 2016.*

Draft Recommendation 5: *SCE should develop and implement internal control procedures to ensure that its EE overhead costs are allocated properly and not assigned to any closed EE programs.*

SCE Comments on Draft Finding 5

SCE agrees that it applied the marketing overhead costs incorrectly to the Appliance Recycling Program. However, SCE disagrees with the effects asserted by the UAFCB in the Draft Report. These costs would have been reallocated to other programs and no program would have been impacted enough to alter the performance review of the program. SCE demonstrated to the auditors that if the allocation error had not been made, the proper allocation of the overhead costs would have resulted in a small amount of additional earnings to SCE and not a negative impact on ratepayers. SCE disagrees with UAFCB's assertion that this would impact future budget development as SCE uses a zero-based budgeting approach for program budgets and therefore historical expenditures don't generally impact development of the budget. Additionally, overhead costs are allocated based on program budgets during the budgeting process and therefore the prior allocations of those costs are not relevant. To eliminate the General and Administrative (G&A) cost allocation to the closed program, beginning January 1, 2018, SCE implemented a new G&A allocation method wherein the monthly recorded G&A expense is allocated based on program spend, instead of program budget.

Lastly, the effect noted in this finding is greatly exaggerated and SCE strongly disagrees with the statement that, this practice could result in an over-collection of "billions" in these EE programs through its balancing accounts. SCE respectfully requests that this statement be stricken from the final Audit Report as it is inaccurate and misleading.

6. <u>SCE should strengthen its oversight over its Accounting Policy and Procedures</u>

Draft Finding 6: *During the audit, the following deficiencies were identified:*

1. *Instances were noted that SCE took advantage of purchase discounts when is paid supplier invoices but recorded the entire invoice amount to the EE program. Specifically, SCE accounted for the Managed Service Provider (MSP) fee and/or Early Pay Discount when it processed and paid the supplier invoice, but recorded the entire supplier invoice amount in its accounting records. As a result, SCE overstatement its PY 2016 expenditures reported to the Commission.*
2. *SCE did not consistently record expenditures in the proper accounting period in which services were rendered or material received.*
3. *SCE combined invoices that were for different accounting periods and vendors when it recorded cost in PY 2016.*
4. *SCE recorded the total invoice amount as customer incentive costs even though the invoice broke out the costs between customer incentives and labor.*
5. *SCE did not implement new IO numbers until April 2016 to track EE program cost and expenditures, which caused multiple errors in the accounting records.*

Draft Recommendation 6: *SCE should enhance its process in creating and implementing new IO numbers to ensure EE expenditures are recorded accurately and timely and in the proper program period. In addition, SCE should strictly implement its internal control and oversight of the accounting policies and procedures. SCE should reduce its CEA program expenditures by $33,351 for PY 2016 based on the exception amounts identified during the audits on each EE program and subprogram area listed in the scope condition section of this report.*

<u>SCE Comments on Draft Finding 6</u>

SCE disagrees with this recommendation and believes that current Accounting Policies and Procedures are appropriate. With regard to the establishment and monitoring of SCE's EE internal orders, SCE believes the issues that arose in 2016 are not applicable moving forward. Establishing the internal orders after the start of the year was a result of the delay in the EE budget approval and the finalization and communication of corresponding reporting requirements. Discussions with Energy Division as to whether 2016 was a stand-alone year or was to be included with 2013-2016 program cycle were not completed until several months after the year had begun. Unless there are changes to the accounting and reporting requirements in Phase III of the EE OIR (expected in Q1 of 2019) that require SCE to adjust its cost tracking, the current accounting will be utilized until at least the end of the approved funding in 2025.

Also, the effect noted in this finding is greatly exaggerated and SCE strongly disagrees with the statement that, this practice could result in an over-collection of "billions" in these EE programs through its balancing accounts. SCE respectfully requests that this statement be stricken from the final Audit Report as it is inaccurate and misleading.

7. <u>SCE should strengthen its oversight over its Contractors</u>

> **Draft Finding 7:** *… instances were found in which SCE processed and paid vendor invoice for services performed after the contract expiration date, failed to adequately track and monitor the timeliness of services and deliverables by the expected due date, failed to ensure the timely submittal of vendor invoices for processing in the proper period, and failed to obtain appropriate supporting to support the charges invoiced.*
>
> **Draft Recommendation 7:** *SCE should strengthen its oversights over contract management by updating its contracting manual, conduct a supervisory review of contracts, and require regular training for contract staff. In addition, SCE should establish a depository to maintain and manage its contracts in a way that it should be able to provide how much funding is left for each EE contract as well as its specific expiration dates for each EE contract.*

<u>SCE Comments on Draft Finding 7</u>

SCE agrees with the recommendation to strengthen contract oversight. SCE currently utilizes a database called Purchase Order Manager (PO Man) that serves as a central repository for all contracts. PO Man provides several data points, including contract funding levels and expiration dates. At the purchase order (PO) level, the system currently sends out automated PO expiration notifications at 90/60/30 day pre-expiration date intervals. To enhance and strengthen the system, a similar notification protocol will be created at the Contractor Work Assignment (CWA) level. In addition, at the corporate level SCE currently provides periodic mandatory contract management training for employees responsible for managing contracts. To supplement such training for employees involved with EE contracts, SCE plans to develop and provide periodic contract management training focusing in part on the CWA process.

8. SCE double counted costs to PY 2016 and 2017

Draft Finding 9: … *Based on its review and testing of Plug Load and Appliance program expenditures, SCE accounted for an expenditure transaction in both PYs 2016 and 2017. At the end of PY 2016, SCE recorded an accrual totaling $530,173 to PY 2016 Internal Order (IO) #619929. Subsequently, SCE reversed the accrual of $530,173 charged to 2016 IO #619929 in early 2017. When SCE received the actual invoice totaling $766,179 in 2017, SCE recorded and charged the actual invoice amount of $766,179 to PY 2017 IO #621643. Although SCE reversed the accrual of $530,173 recorded to2016 IO #619929 in 2017, this transaction was not included when SCE reported 2016 and 2017 EE expenditures. As a result, SCE inadvertently accounted for the expenditure transaction in both 2016 and 2017....*

Draft Recommendation 9: *SCE should make the appropriate correction to reduce its PY 2017 Plug Load and Appliance program costs by a total amount of $530,173 based on the exception amounts found during testing of the PY 2016 EE program and subprogram areas listed in the scope section of this report. In addition, SCE should provide proper training to staff to ensure that expenditures are recorded timely, accurately and to the proper accounting period.*

SCE Comments on Draft Finding 9

SCE disagrees with this finding. UAFCB did not audit the 2017 expenditures and SCE has not submitted any claim based on the 2017 expenditures; therefore, UAFCB should not make any assumptions as to how SCE would claim these costs. In addition, if SCE follows the Energy Division instructions as it did for the previous earnings claim, the actual program year order for which the costs are included is irrelevant. SCE appropriately accrued the expenses in the year the costs were incurred and applied a credit for that accrual in the subsequent year against the actual invoices paid.

Evaluation of Responses

SCE's responses to the draft report have been reviewed and incorporated into the final report. In evaluating SCE's response, we provide the following comments:

FINDING 1: Lack of Compliance with Accrual Policy and Procedures Respecting its EE Program Costs for PY 2016

SCE stated: "…during the audit SCE provided documentation demonstrating that $361,993 of this total were properly accrued in PY 2015, properly reversed in PY 2016, and corresponding correcting journal entries were recorded to transfer such costs to the appropriate period's Internal Order accounts (see attached Exhibit 1 for supporting documentation)."

CPUC regulations required SCE to provide adequate documents during the reviewing period. During the audit, we had difficulties to obtain documentation from SCE. We gave SCE many opportunities to provide supporting documentation by continuingly sending several follow-ups for the same samples. In this instance, SCE did not provide the sufficient supporting documents even after we sent out four follow-ups requests. SCE's above statement is inaccurate because SCE admitted in its response that "… SCE's further research into accounting corrections indicated that the invoices in question were initially and appropriately charged to 2015 IO(s) but were erroneously identified as needing accounting corrections and were thusly charged to 2016. SCE will take steps to correct these invoice charges back to 2015 IO(s)". However, SCE took a contradictory position after the exit meeting and provided additional supporting documentation for the questioned amount of $361,993. On June 27, 2018, which 15 days after the exit meeting, SCE sent 20 files with hundred pages' documents to us. This delay has caused a lot of difficulties to identify exceptions and issues, impacted our audit timeline and leaded to audit findings. After reviewing additional documents, we found that SCE did not provide sufficient documents for an invoice of 19,898 for October 2015 services. Therefore, we made a one-time exception as a courtesy to reduce the amount of $342,095 (361,993 – 19,898) in the final report. However, we remind SCE that accepting additional supporting documents of hundred pages after the exit meeting and a few days before the draft report is issued is not a practice in audit. In the future, SCE should ensure to provides adequate documentation during the audit to save time for both parties and avoid such findings.

SCE stated: "In Resolution E-4897, p. 15, the Commission specifically recognized that it will allow an exception for joint SCG/SCE projects installed in 2015, but claimed in 2016, due to a delay in the exchange of information."

We find that SCE's explanation is erroneous because the above exception for SCG/SCE project was applied for claiming savings only, not expenditures. SCE should have noticed that Resolution E-4897, p.16 stated "Aligned with prior Commission direction, we excluded ***savings for measures that had installation dates***, identified in the official claims in the IOUs' quarterly data submissions, prior to January 1, 2016 with the below exceptions. However; this year we did not exclude pre-2015 installed measures from the 2015 ex-post award calculation. This is to give the IOUs a similar timeline we granted for the ex-ante measures to align with the Commission direction. Beginning next year, we will apply these adjustments to both ex-ante and ex-post measures as directed by the previous resolutions. Both SCE and SCG requested that staff allow counting pre-2016 installations for some specific justifications. Among the requested exceptions were projects that were jointly paying customer incentives (SCE for electric savings and SCG for gas savings) as the exchange of information on these projects between the two utilities is delaying the claims submissions. The Commission will allow this exception for this year but only for projects installed in 2015 and not those installed earlier than 2015."

Furthermore, the Commission made it clear that savings and expenditures were separate issues. Resolution E-4807, P.47 stated: "Commission staff expects the IOUs, after the close of a calendar year, to close its books on savings for that year expeditiously and accurately just as is expected for fiscal and expenditure accounting processes. The expenditure accounting process and the savings accounting process are separate issues and the accounting of the two is separate. Program costs related to a specific project are paid and those costs reported over time in most instances and are not held to project closeout. ***Payments to implementers and partial incentive payments to customers are paid and those costs reported over time in the year they occur**."*

In addition, Resolution E-4897 Order # 5 stated "Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company shall only make claims on funds spent in the respective program year. ***Claims must exclude all funds reported as spent in previous years*** and all committed expenditures for activities in future years.

In conclusion, we find that SCE's interpretation to Resolution E-4897 is inaccurate and misleading.

SCE stated: "If the UAFCB recommends a downward adjustment for 2016 based on the theory that the costs at issue should have been expensed in 2015, then it should also recommend an upward adjustment, or offset, for the 2015 ESPI Award. In Resolution E-4897, p.31, the Commission held that adjustments could be made to prior years' ESPI awards if there was an error in the submissions. Specifically, the Commission stated, ". . . [A]s discussed previously, staff may correct erroneous utility submissions therefore we do not find it [adjusting prior year's ESPI award] out of scope of the current resolution."

Once again, we find that SCE's reference is inaccurate, and its explanation is unjustified. SCE's quotation was from the Commission's comments for "2013-2014 adjustments" in Resolution E-4897. To clarify, utilities incorrectly reported and claimed savings reward in 2013 – 2014, staff did not find the errors in saving measurement in 2013-2014 period, but the later year. Therefore, the Commission addressed and explained carefully why it was appropriate for utilities to make necessary adjustments for the errors in the previous reports and claims even though the mistakes were not found until the current claim. Resolution E-4897, p. 34, stated "For those measures or parameters that the Commission has not been able to evaluate we have passed through the ex-ante values as reported by the IOUs, based on the presumption, that the utilities have used the correct Commission adopted values in their submissions. This is why, as noticed by SCE and SDG&E, ***the error was not detected and hence not corrected in the ex-post evaluation statements.*** Furthermore, although we agree that it is not preferable to correct erroneous reported claims from 2013-2014, as discussed previously, staff may correct erroneous utility submissions therefore we do not find it out of scope of the current resolution.

We do not find it an appropriate use of ratepayers' funds to reward utilities based on incorrect reported savings values."

Commission directives above are irrelevant and inapplicable to SCE's suggestion for upward ESPI adjustments in prior year for this finding. We find that SCE improperly construed the Commission's languages of "correct erroneous utility submissions" in Resolution E-4897 and interpreted that SCE can record expenditures in whatever year it chooses when it freely offset, or upward its ESPI reward for expenditures of prior years. Consequently, we disagree with SCE's interpretation and proposal. A utility should not be awarded the for expenditures that were incorrectly recorded and improperly accounted for. Therefore, we withstand the adjustment amount of $955,973 ($1,298,068 – $342,095) for this finding.

SCE stated: "The UAFCB also notes that this finding has been made in prior audits. However, even if UAFCB's position is completely accurate (which SCE does not believe it is), the claimed error represents less than a 0.5% error rate, given that SCE recorded approximately $276 million in PY 2016 costs."

We find that SCE's assertion is puzzling when SCE denies the facts that our office has continuingly identified issues related to accruals in every audit from 2011. Furthermore, SCE made a statement that the claimed error represents less than 0.5% error rate but did not provide further explanation of how it calculated the error rate. We believe that SCE's rate is inaccurate and understated. We did not test 100% of the expenditures population. The audit adjustments only included exception amounts based on selected samples for testing. In fact, the overall error rate is much higher than 0.5%. However, this assertion is irrelevant as Sections 581, 582, and 584 requires SEC to provide timely, complete and accurate data to the Commission. We remind SCE that it is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. When SCE reports incorrect costs, it can have negative impacts on ratepayers' funds. An overstatement of expenditures leads to an overpayment in incentive awards and consequently to a higher than anticipated authorized budget in future years.

FINDING 2: Overstatement of Efficiency Savings and Performance Incentive (ESPI) Award Amounts for PY 2016

SCE stated: "SCE disagrees with this recommendation. SCE strictly followed and relied on Energy Division's direction related to which costs were eligible expenditures for earnings (see attached Exhibit 2 of this response) … The costs UAFCB proposes to remove were for activities completed in 2016, even though some of the costs were committed in 2015 or prior."

SCE's statement is inaccurate. In AL 3655-E, SCE incorrectly included 2015 and prior year expenditures ($1,305,201 and $2,910,610 for C&S and NR program) to claim 2016 ESPI reward. SCE should follow the Commission's directives in Resolution E-4897 Order # 5 "Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company shall only make claims on funds spent in the respective program year. ***Claims must exclude all funds reported as spent in previous years*** and all committed expenditures for activities in future years."

With the spirit of the Resolution, we request SCE to adjust its management fee incentive awards to $444,822 and $537,790 for the C&S and NR programs, respectively, in its next ex-post ESPI true-up filing with the Commission.

FINDING 4: Lack of Reconciliation of Amounts Committed/Unspent Funds

SCE stated: "SCE discovered some minor errors in commitment reporting and subsequently provided the corrected data in a document request response. SCE disagrees with the assertion that there was an $80 million discrepancy in our data as the corrected data supplied by SCE indicated only a $1.4 million discrepancy, which was thereafter corrected."

SCE's statement is inaccurate. During our initial review of SCE's reported committed funds, we identified a discrepancy of $80 million between the amounts of the SCE's records and those of the EEStats reports. When we requested an explanation, SCE admitted that "Several input and formula errors in the calculation of the committed amount in the monthly report were discovered by SCE, and SCE also discovered some committed dollars that were reported in the December report are not that same as what was provided was in Data Request 2016 EE Audit CPUC-SCE-001-Q.34." In the new response, SCE completely revised its initial responses and provided a new figure of $5.3 million. However, we were still unable to reconcile this amount. We strongly recommend that SCE strengthens its internal controls and reporting process to ensure accurate and traceable transactions for the committed/unspent funds.

FINDING 5: SCE Allocated Marketing Overhead Costs to a Closed Program in PY 2016

SCE stated: "SCE agrees that it applied the marketing overhead costs incorrectly to the Appliance Recycling Program. However, SCE disagrees with the effects asserted by the UAFCB in the Draft Report."

The final report will include the following effects:

"Failure to allocate accurate expenditures to ARP program resulted in an overstatement of expenditures for ARP program, and an understatement of expenditures for other EE programs. As results, it may lead to reporting inaccurate ESPI reward for those programs, higher or lower anticipated budget for programs when SCE develops its future budgets based on prior year costs. Additionally, recording and reporting inaccurate expenditures among the EE programs and subprograms may lead to incorrectly evaluate the efficiency and effectiveness of the programs".

FINDING 6: Lack of Adequate Monitoring and Oversight over its Accounting Policies and Procedures

SCE stated: "SCE disagrees with this recommendation and believes that current Accounting Policies and Procedures are appropriate."

SCE misinterpreted our finding. We did not make a comment that SCE current Accounting Policies and Procedures were inappropriate. Based on the instances we found during the audit, we recommended SCE to strengthen its oversight over its Accounting Policy and Procedures by implementing effective internal controls over its accounting processes to ensure that EE expenditures are recorded accurately and reported correctly to the Commission. It is important for SCE to implement our recommendation in it accounting practice. We want to emphasize the effects on failures to apply the best accounting practice and oversight over its Accounting Policies and Procedures:

1. Failure to record accurate expenditures resulted in an overstatement of program costs reported to the Commission. It is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. When SCE reports incorrect costs, it can have negative impacts on ratepayers' funds. An overstatement of expenditures leads to an overpayment in incentive awards to SCE. Furthermore, an overstatement in expenditures may lead to higher anticipated budget in a future year when SCE develops its future budgets based on prior year costs. This practice results in an over-collection in these EE programs through its balancing accounts.

2. Failure to record expenses in their proper accounting period could potentially lead to inaccurate monthly and quarterly reports. SCE's practice of combining several invoices in one transaction makes it difficult to track contract costs, payments to vendors, reconcile expenditures, and identify errors and mistakes.

FINDING 9: SCE Double Counted Costs to PY 2016 and 2017

SCE stated: "SCE disagrees with this finding. UAFCB did not audit the 2017 expenditures and SCE has not submitted any claim based on the 2017 expenditures; therefore, UAFCB should not make any assumptions as to how SCE would claim these costs."

SCE misinterpreted our finding. We neither assumed how SCE claim 2017 costs to the Commission nor indicated that SCE over claimed its 2017 expenditures. During the audit, we identified that SCE double counted its expenditures for both PY 2016 and 2017 when reviewing supporting documents and accounting records. Even though SCE has not filed a claim for its 2017 ESPI reward, it is our responsibility to bring this issue to SCE's and the Commission's attention and request SCE to make necessary adjustments in its accounting records before filing its 2017 ESPI reward.

SCE stated: "In addition, if SCE follows the Energy Division instructions as it did for the previous earnings claim, the actual program year order for which the costs are included is irrelevant."

When SCE made the statement "the actual program year order", we interpreted it as the actual program year internal order numbers". With that interpretation, we found SCE statement contradicted with its explanation of internal order numbers during the audit. SCE explained that it uses internal orders to track the program years in its accounting system, and changes internal order numbers each year for the EE programs. In addition, SCE uses the internal numbers to plan, track, collect and settle the EE costs for each program year in its accounting system and to meet regulatory requirements. We are concerned with SCE's statement that "the actual program year order for which the costs are included is irrelevant". SCE appears to disregard the Commission's directives related to the accuracy of the EE program. As SCE's argument has no basis, we continue to request SCE to reduce its PY 2017 Plug Load and Appliance program costs by a total amount of $530,173.