



# BALANCING ACCOUNT EXAMINATION

SOUTHWEST GAS CORPORATION  
FOR YEAR ENDED DECEMBER 31, 2017

Utility Audit, Finance and Compliance Branch

April 30, 2019



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**Thanks to:**  
**Angie Williams, Raymond Yin, Mabel Wu, and Bixia Ye**

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# Executive Summary

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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 the balancing accounts administered by the energy 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), Southern California Gas Company (SCG), Southwest Gas Company (SWGAs), Pacific Power, Bear Valley Electric Service (BVES), and Liberty Utilities (CalPeco Electric), LLC (Liberty).<sup>1</sup> The primary purpose of balancing accounts is that they are used as a mechanism to track specific costs and/or related revenue to provide a fair settlement for the ratepayers and the IOUs.

Pursuant to California Public Utilities Code (PUC) Section 792.5<sup>2</sup>, whenever the Commission authorizes any change in rates reflecting and passing through to customers specific changes in costs, the Commission shall require as a condition of the order that the public utility establish and maintain a balancing account reflecting the balance, whether positive or negative, between the related costs and revenues, and the Commission shall take into account by appropriate adjustment or other action any positive or negative balance remaining in the balancing account at the time of any subsequent rate adjustment. The Commission shall ensure the transactions recorded in the balancing accounts are for allowable purposes and are supported by appropriate documentation. The Commission has statutory authority to inspect and audit the books and records of the utilities to ensure that ratepayers' money is well spent, specifically, pursuant to PUC Sections 314.5, 314.6, 581, 582, and 584. Utility Audit, Finance, and Compliance Branch (UAFCB) conducted the examination of SWGAs' balancing accounts for year ended December 31, 2017 in accordance with applicable auditing standards.

The scope of this examination covered, but was not limited to, the period from January 1, 2017 to December 31, 2017. The overall objective of this examination was to determine whether SWGAs complied with the Commission's requirements and directives in recording appropriate activities in its balancing accounts. In addition, UAFCB evaluated SWGAs' effectiveness of internal controls over compliance and recording of balancing accounts. Based on our examination, the following findings were identified:

- **Finding 1:** SWGAs did not use accrual basis of accounting to record revenues and expenditures in its balancing accounts.
- **Finding 2:** SWGAs overstated the total expenditure recorded in the Conservation and Energy Efficiency Balancing Account (CEEBA) by \$91,123 as of December 31, 2017.

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<sup>1</sup> San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SCG) are affiliated subsidiaries of SEMPRA Energy.

<sup>2</sup> All statutory citations are the California Public Utilities Code (PUC), unless otherwise noted.

- Finding 3: The interests were calculated incorrectly in the Greenhouse Gas Balancing Account (GHGBA) – Cost, and GHGBA – Revenue.
- Finding 4: SWGas did not timely settle the ending balances of Public Interest Research & Development Balancing Account (R&DBA).
- Finding 5: In developing the Energy Savings Assistance (ESA) Program PPP Component Rate effective January 1, 2018, SWGas incorrectly used \$906,770 as the over-collection balance for ESABA as of September 30, 2017, instead of using the correct over-collection balance of \$2,050,331. As a result, the ESA PPP Component Rate was overstated by \$0.00881 per therm, from \$0.01192 per therm to \$0.02073 per therm.
- Finding 6: In developing the Conservation and Energy Efficiency (CEE) Program PPP Component Rate effective January 1, 2018, SWGas incorrectly used \$1,862,125 as the over-collection balance for CEEBA as of September 30, 2017, instead of using the correct over-collection balance of \$1,707,346. As a result, the CEE PPP Component Rate was off by \$0.00119 per therm, which was the difference between the correct refund rate of \$0.00545 per therm and the original refund rate of \$0.00664 per therm.



# Examination Report

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## BACKGROUND

Pursuant to California Public Utilities Code (PUC) Section 792.5<sup>3</sup>, whenever the Commission authorizes any change in rates reflecting and passing through to customers specific changes in costs, the Commission shall require as a condition of the order that the public utility establish and maintain a balancing account reflecting the balance, whether positive or negative, between the related costs and revenues, and the Commission shall take into account by appropriate adjustment or other action any positive or negative balance remaining in the balancing account at the time of any subsequent rate adjustment. The Commission shall ensure the transactions recorded in the balancing accounts are for allowable purposes and are supported by appropriate documentation. Utility Audit, Finance, and Compliance Branch (UAFCB) conducted the examination of Southwest Gas Corporation's (SWGAS') balancing accounts for the year ended December 31, 2017 pursuant to PUC Sections 314.5, 314.6, 581, 582, and 584.

Before setting up a balancing account, utilities must file and obtain a Commission-approved Preliminary Statement, which specifies the purpose of the balancing account and the types of costs and/or revenue that are to be tracked in the account. A Preliminary Statement also details the specific accounting procedures that the utility must follow to record transactions in the balancing account.

A balancing account is a tracking mechanism to protect ratepayers and utilities by identifying and settling the differences between two elements consisting of any two elements of the following: revenue, incurred cost, preliminary authorized revenue requirement, and adopted authorized revenue requirement. Depending on the purpose of a balancing account, the combination of the two elements varies.

Base on the recovery level or limit, every balancing account is classified under one of these two categories: one-way or two-way balancing account. A one-way balancing account matches actual expenditures against a spending target (or authorized revenue requirement). Often, one-way balancing account limits recovery to the lower of actual expenditures or the amount authorized; shareholders are at risk for amounts spent over authorized amounts. A two-way balancing account compares revenue and expenses, or actual revenue to authorized revenue; and allows over-collections to be refunded and under-collections to be recoverable through rates. A two-way balancing account does not provide for a limit or cap on expenditures. In general, the balance in a one-way or two-way balancing account can either be over- or under-collected, depending on the difference between the components recorded in the balancing account. Unless approved otherwise, a balancing account accumulates monthly interest at a rate equal to one-twelfth of the most recent month's interest rate on three-month Commercial Paper published by the Federal Reserve.

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<sup>3</sup> All statutory citations are the California Public Utilities Code (PUC), unless otherwise noted.



SWGas is a distinct registrant that is a wholly-owned subsidiary of Southwest Gas Holdings, Inc.<sup>4</sup> SWGas is a multi-jurisdictional public utility,<sup>5</sup> and it is engaged in the retail transmission, distribution, transportation, and sale of natural gas for domestic, commercial, agricultural, and industrial uses to approximately 1.8 million customers in the states of California, Arizona, and Nevada.<sup>6</sup> In California, SWGas serves approximately 185,000 customers in its three ratemaking jurisdictions: (1) Southern California; (2) Northern California; and (3) South Lake Tahoe.<sup>7</sup> As a regulated public utility under the Commission, among other things, SWGas is required to comply with and adhere to the Commission's directives, including but not limited to, pertinent rulings and guidelines related to balancing accounts and the related programs.

SWGas collects and records four kinds of revenues in its balancing accounts: (1) Margin Revenue, the revenue from Service Charge per meter, Margin Rate and Adjustment Rate for each different tier level per therm; (2) Revenue from the Purchased Gas Cost Rate; (3) Surcharges, which come from the Commission Utilities Reimbursement Account User Fees and Public Purpose Programs (PPPs) Surcharge; and (4) Greenhouse Gas Revenue, which is from the consignment of a minimum percentage of allocated greenhouse gas allowances for sales in California Air Resources Board (ARB)'s allowance auctions in compliance with the Cap-and-Trade regulations.

The Margin Revenue and Purchased Gas Cost Revenue are grouped together as SWGas' total operating revenue. The PPP surcharges are used to fund SWGas' four PPPs including: 1) California Alternate Rates for Energy (CARE) Program, 2) Energy Savings Assistance (ESA) Program, 3) Conservation and Energy Efficiency (CEE) Program, and 4) Public Interest Research & Development (R&D) Program. Per decision (D.) 04-08-010, dated August 19, 2004, SWGas is required to remit the collected PPP surcharges to California Department of Tax and Fee Administration (CDTFA)<sup>8</sup> quarterly, and SWGas is authorized to obtain the refund from CDTFA for these remitted surcharges in time, except for R&D funds and/or other administration costs or deductions.

Historically, SWGas received approval for its rate structure on a five-year General Rate Case (GRC) cycle (one test year followed by four attrition years). D.14-06-028, dated June 12, 2014, authorized SWGas' rates effective January 1, 2014 until December 31, 2018 (five-year cycle). However, D.17-06-006, dated June 15, 2017, extended the cycle years until 2020 and directed SWGas to file its next GRC filing by September 1, 2019, with a 2021 test year.

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<sup>4</sup> SWGas' Form 10-K 2017 Annual Report submitted to U.S. Securities and Exchange Commission (SEC).

<sup>5</sup> Commission's decision (D.) 17-06-006, which authorized SWGas to extend the General Rate Case (GRC) cycle until 2020.

<sup>6</sup> SWGas' GRC Application (A.) 12-12-024 for rate increase effective January 1, 2014.

<sup>7</sup> Ibid, D.17-06-006.

<sup>8</sup> Effective July 1, 2017, California Board of Equalization was restructured under the Taxpayer Transparency and Fairness Act of 2017 and broken up into three separate entities – California State Board of Equalization (BOE), California Department of Tax and Fee Administration (CDTFA), and Office of Tax Appeals (OTA). As a result, the duty of collecting the PPP surcharges from gas utilities was transferred to CDTFA from BOE.

Table 1 below summarizes SWGas' authorized balancing accounts with their reported balances as of December 31, 2017.

**Table 1. Summary of SWGas' Balancing Accounts with Ending Balances and Authorized Revenue Requirements**

Item No.	Name of Balancing Account	Ending Balances as of 12/31/2017 - Under-collection/ (Over-collection)	2017 Authorized Revenue Requirements	References
1.	Fixed Cost Adjustment Mechanism (2009) (FCAM – Margin)	(\$2,051,808)	Southern California: \$70,928,030 (Adjusted Attrition \$71,104,409); Northern California: \$19,167,418; South Lake Tahoe: \$9,574,372.	D.14-06-028; AL 1024; AL 1025
2.	Fixed Cost Adjustment Mechanism Balancing Account (FCAM – 191)	\$839,891	\$17,812,477	D.14-06-028; AL 1060
3.	Purchase Gas Cost Balancing Account (PGA)	(\$256,511)	\$52,061,548	D.14-06-028; AL 1060
4.	Intrastate Transportation Cost Adjustment Mechanism Balancing Account (ITCAM)	\$740,044	\$4,200,651	D.14-06-028; AL 1060
5.	Infrastructure Replacement/Reliability Adjustment Mechanism (IRRAM)	(\$8,811)	\$0	N/A
6.	Pension Balancing Account (PBA)	(\$3,178,388)	Pension in Cash Basis: \$4,389,345; Pension related Rate Base: \$371,417.	D.14-06-028
7.	Mobilehome Park Conversion Balancing Account (MHPCBA) – To the Meter	\$9,410	Not applicable since SWGas had not included the program into rate.	D.14-03-021
8.	Mobilehome Park Conversion Balancing Account (MHPCBA) – Beyond the Meter	\$865,227	Not applicable since SWGas had not included the program into rate.	D.14-03-021
9.	Greenhouse Gas Balancing Account (GHGBA) – Cost	\$9,175,875	Not applicable since SWGas had not included the program into rate.	D.15-10-032; D.16-04-013; D.18-03-017
10.	Greenhouse Gas Balancing Account (GHGBA) – Revenue	(\$8,573,826)	Not applicable since SWGas had not included the program into rate.	D.15-10-032; D.16-04-013; D.18-03-017
11.	Public Interest Research & Development Balancing Account (R&DBA)	\$201,638	\$298,955	Correspondences between Energy Division and SWGas
12.	California Alternate Rates for Energy Balancing Account (CAREBA)	\$2,214,120	\$9,073,620	D.14-11-005
13.	Energy Savings Assistance Balancing Account (ESABA)	(\$484,492)	\$3,172,692	D.14-11-005
14.	Conservation and Energy Efficiency Balancing Account (CEEBA)	(\$1,864,659)	\$1,000,000 per year, for a total of \$5,000,000 from 2014 through 2018.	D.14-06-028



## SCOPE

The scope of the examination covered, but was not limited to, the period from January 1, 2017 to December 31, 2017. The overall objective of the examination was to determine whether SWGas complied with the Commission's requirements and directives in recording appropriate activities in its balancing accounts.

For the Mobilehome Park Conversion Balancing Account (MHPCBA) – To the Meter, we noted that SWGas included the costs of construction in the amount of \$1,117,388 in its 2017 Mobilehome Park Utility Upgrade Program Annual Status Report filed with the Commission; however, the examination scope did not cover the testing of these construction costs because they were not recorded into MHPCBA – To the Meter as of December 31, 2017.

For the Pension Balancing Account (PBA), since the calculation and allocation methodology of pension costs among affiliates were submitted to the Commission in SWGas' GRC Application (A.) 12-12-024, which was approved by the Commission on June 12, 2014 in D.14-06-028, we excluded the testing of such methodology from the scope of this examination.

## METHODOLOGY

To determine SWGas' compliance with the requirements established in the Commission directives and to assess SWGas' internal controls over its balancing accounts, UAFCB obtained sufficient and appropriate evidence and analyzed it to address the examination objectives. The specific procedures performed during this examination included, but were not limited to, the following:

1. Reviewed applicable Commission directives and SWGas' internal policies and procedures;
2. Reconciled ending balances on the tracking statements to general ledger and Annual Balancing Account and Memorandum Account Reported submitted to the Commission;
3. Interviewed key personnel at SWGas to obtain an understanding of the accounting and reporting processes relating to balancing accounts, billing process, rate development and adjustment process, and regulatory filing process;
4. Evaluated SWGas' internal control over its balancing accounts;
5. Reviewed SWGas' independent CPA audit report on the annual financial statements to identify risks potentially affecting the UAFCB's examination on SWGas' balancing accounts;
6. Performed risk assessment pertaining to the examination of the balancing accounts;
7. Obtained an understanding of SWGas' methodology for recording the month-end revenues and expenditures.
8. Sample-tested SWGas' customer billings to ensure that SWGas complied with the Commission's directives and SWGas' internal billing policies and procedures, and to ensure that SWGas properly billed its customers by using the Commission-approved tariffs.

9. Judgmentally selected and verify recorded revenues to the supporting documents to determine if revenues were accurately recorded or allocated to the monthly tracking statements of each balancing account.
10. Judgmentally selected and verified the expenditures recorded in the balancing accounts to the supporting documents to determine the accuracy and legitimacy of those expenditures.
11. Evaluated whether the year-end over-collection and/or under-collection were properly and timely settled.
12. Determine if the SWGas properly computed and recorded monthly interest in accordance with the Preliminary Statements of the respective balancing accounts.
13. Determine if authorized revenue requirement were accurately recorded.
14. Determine other items such as adjustments and transfers were recorded in accordance with Commission directives.

## **FINDINGS AND RECOMMENDATIONS**

### **Finding 1: SWGas did not use accrual basis of accounting to record revenues and expenditures in its balancing accounts.**

#### **Condition:**

SWGas did not record revenues and expenditures in the balancing accounts on accrual basis of accounting in accordance with generally accepted accounting principles (GAAP) and the Uniform System of Accounts (USOA) of the Federal Energy Regulatory Commission (FERC). For example, the gas costs were recorded into the balancing accounts of Purchase Gas Cost Balancing Account (PGA), Fixed Cost Adjustment Mechanism Balancing Account (FCAM – 191), and Intrastate Transportation Cost Adjustment Mechanism Balancing Account (ITCAM) in the month of payment or settlement instead of in the month when the costs were incurred. Gas costs were paid or settled a month after they were incurred. SWGas tracked the gas purchased in detail in its system and was able to estimate the purchased gas costs in the month the costs incurred. However, it was SWGas' practice to not accrue purchased gas costs for the purpose of balancing account recording. To correspond with the one-month lag in recording gas procurement costs, SWGas also delayed the recording of related revenues by one month. Therefore, the revenues recorded in aforementioned three balancing accounts of current month were collections from the prior month.

In addition, SWGas did not consistently use the same accounting basis in preparing accounting records. SWGas did not use accrual basis of accounting to record activities in its balancing accounts which are supported by the Activities Reports. However, it used accrual basis of accounting to record and report program expenditures in its program annual reports filed with the Commission. For the ESA Program in the 2017 Low-Income Assistance Programs Annual Report, for example, UAFCB performed a reconciliation of the 2017 ESA Program expenditures from the Annual Report to the internal Activities Report, and noted the following discrepancies as shown in Table 2 below:



**Table 2. SWGas' 2017 ESA Program Expenditures**

Description	2017 ESA Program Annual Report	2017 ESA Program Internal Activities Report	Variances
Weatherization Costs	\$2,116,161	\$1,915,452	\$200,709
Admin Costs	\$258,869	\$214,436	\$44,433
<b>Total</b>	<b>\$2,375,030</b>	<b>\$2,129,888</b>	<b>\$245,142</b>

SWGas explained the above noted variances in its response to UAFCB's Question 4 of Data Request (DR) 016 that, *"The amounts above are not intended to match because Southwest Gas reports on program year activity in the Company's annual report and the ESABA includes accounting activities. For example, if an invoice for the 2017 program was received and processed in early 2018, it would have been reported on in the 2017 Program Annual Report but included under 2018 ESABA activity."*

**Criteria:**

The General Instructions of FERC USOA states that *"The utility is required to keep its accounts on the accrual basis. This requires the inclusion in its accounts of all known transactions of appreciable amount which affect the accounts. If bills covering such transactions have not been received or rendered, the amounts shall be estimated and appropriate adjustments made when the bills are received."*

**Cause:**

SWGas provided in its response to UAFCB's Item 1 of DR 017 that, *"In accordance with both FERC general guidelines and Accounting Principles Generally Accepted in the U.S.... Southwest Gas does maintain its records overall on the accrual basis of accounting. While this takes place on an overall basis, certain individual accounts, taken on a standalone basis, may not reflect an accrual method, and for appropriate reason."* SWGas clarified that the *"appropriate reason"* for SWGas in this response is the *"cost benefit reasons."*

**Effect:**

Using non-accrual basis of accounting to record revenues and expenditures did not reflect the most accurate balancing account activities. The practice could distort the ending balances in the balancing accounts, resulting in incomplete and/or inaccurate information provided to the Commission and the public.

**Recommendation:**

SWGas should use accrual basis of accounting to record revenues and expenditures in its balancing accounts.

**Finding 2: SWGas overstated the total expenditure recorded in the Conservation and Energy Efficiency Balancing Account (CEEBA) by \$91,123 as of December 31, 2017.**

**Condition:**

The reported over-collection balance of \$1,864,659 for the CEEBA as of December 31, 2017 in its 2017 Annual Balancing and Memorandum Accounts Report was based on the CEEBA

Activities Report. In the CEEBA Activities Report, SWGas recorded a prepayment of \$175,000 to its contractor in 2014 when its CEE Program commenced. The prepayment was used to facilitate the contractor to pay rebates to its customers. As of December 31, 2017, \$91,123 of the prepayment had not been spent and was still deposited in the contractor's account. Consequently, the reported over-collection balance of \$1,864,659 in the CEEBA as of December 31, 2017 was over-stated by \$91,123. The correct balance should have been \$1,773,536.

SWGas indicated in its response to UAFCB's Item 9 of DR 017 that, "*SWG will make an adjustment in 2019 for the difference in the over-collection from December 31, 2017.*"

**Criteria:**

SWGas' CEEBA Preliminary Statement states, under the Accounting Procedures section, in part, that, "*On a monthly basis, a debit entry equal to the Company's actual CEE program costs, including outreach, administrative, and program audit costs; ...*" Therefore, only the actual CEE Program costs incurred on accrual basis of accounting should have been recorded in the CEEBA.

**Cause:**

SWGas explained in its response to UAFCB's Item 2 of DR 017:

1. "*Since the programs were the first of their kind for Southwest Gas' California territories, it was difficult to estimate participation levels.*" Therefore, "*the amount expended was greater than the amount, known after the fact, to have been necessary.*"
2. "*Southwest Gas did not believe it was reasonable to establish a prepaid asset separate and aside from the account specifically designated for this program. The amount paid was not material to the financial statements as a whole, ...*"
3. "*Further, had the amount not been included in the regulatory account for this specific program, there could have been more administrative complexity in tracking ... Without those detailed processes, there would have been risks to ensuring the costs related solely to this program were adequately captured.*"

**Effect:**

SWGas overstated the CEEBA expenditures since 2014. As of December 31, 2017, the reported CEEBA total expenditure was overstated by \$91,123. As a result, the reported over-collection balance of \$1,864,659 as of December 31, 2017 was over-stated by the same amount. The correct CEEBA balance should have been \$1,773,536 as of December 31, 2017.

**Recommendation:**

SWGas should record and report all CEE program expenditures, including payments to its contractors, on accrual basis of accounting.



**Finding 3: The interests were calculated incorrectly in the Greenhouse Gas Balancing Account (GHGBA) – Cost, and GHGBA – Revenue.**

**Condition:**

SWGas recorded interests of \$121,354 and (\$113,477) for the GHGBA – Costs, and GHGBA – Revenues, respectively, for Year 2017. Our review of SWGas' interest calculation disclosed that the calculation contained a formula error. SWGas has corrected the error after UAFCB brought the matter to SWGas' attention. SWGas stated in its response to UAFCB's Item 3 of DR 017 that, *"Southwest Gas made an adjusting journal entry in the fourth quarter of 2018, to the affected accounts adjusting the interest from the establishment of the GHGBA in 2015 through October 2018. The GHGBA Cost account was decreased (\$984.00) for 2015, (\$9,981.17) for 2016, (\$40,060.37) for 2017 and (\$65,959.39) for 2018, totaling (\$116,984.93). The GHGBA Revenue Account was increased \$1,289.98 for 2015, \$10,554.75 for 2016, \$37,596.96 for 2017 and \$53,668.12 for 2018, totaling \$103,109.81, resulting in a net difference of (\$13,875.12) over the 4-year period. These adjustments will be reflected in the balance used to calculate the January 1, 2020 rates."*

**Criteria:**

Section 12B of SWGas' GHGBA Preliminary Statement states, in part, that *"Interest will accrue monthly to the Balancing Accounts as set forth in this Preliminary Statement. The calculation will be based on the average of the beginning and ending balance in such accounts at the rate of 1/12 of the most recent month's interest rate on Commercial Paper (prime, 3-month), published in the Federal Reserve Statistical Release, H.15. ..."*

**Cause:**

SWGas stated in its response to UAFCB's Item 3 of DR 017 that, *"there was a typographical oversight (a missing parenthesis) in the formula of the calculation of interest for these two accounts."*

**Effect:**

According to SWGas' response to UAFCB's Item 3 of DR 017, the interest expense recorded in the GHGBA – Cost account was overstated by \$51,026 (\$984 for 2015, \$9,981 for 2016, and \$40,060 for 2017) as of December 31, 2017. Likewise, interest revenue in the GHGBA – Revenue account was understated by \$49,442 (\$1,290 in 2015, \$10,555 in 2016, and \$37,597 for 2017) as of December 31, 2017.

**Recommendation:**

SWGas should improve its internal control over the accounting and reporting of its balancing accounts to ensure the accuracy of information submitted to the Commission.

**Finding 4: SWGas did not timely settle the ending balances of Public Interest Research & Development Balancing Account (R&DBA).**

**Condition:**

SWGAs reported under-collection balances in the R&DBA from 2008 through 2017. However, SWGAs did not incorporate the balances of R&DBA to adjust the Public Purpose Program (PPP) Surcharge Rates during these years when it filed advice letters (ALs) for adjusting the PPP rates. The under-collection balance for the R&DBA was \$201,638 as of December 31, 2017. SWGAs acknowledged the error and corrected it in AL 1082 by incorporating the balance of the R&DBA in determining the PPP Surcharge Rate effective January 1, 2019. SWGAs filed the AL 1082 on October 31, 2018 and the Commission approved it on December 4, 2018.

**Criteria:**

Ordering Paragraph (OP) 22 of D.04-08-010, issued on August 19, 2004, ordered that, *"Respondent utilities shall file annual ALs, with proposed surcharge rates, by October 31, with a requested effective date of January 1 of the next year."*

**Cause:**

SWGAs explained in its response to UAFCB's Question 2 of DR 003 that, *"Southwest Gas did not settle the under-collection in the R&DBA due to an oversight wherein the R&DBA balance was not amortized into the PPP surcharge rates."*

**Effect:**

Since the R&D Program is part of PPPs, the ending balances in the R&DBA would affect the aggregate PPP Surcharge Rates. Not timely settling the ending balances of the R&DBA resulted in incorrect tariff PPP Surcharge Rates billed to the ratepayers since 2009.

**Recommendation:**

SWGAs should establish adequate internal controls to ensure that the ending balances of its balancing accounts are periodically reviewed and timely settled.

**Finding 5: In developing the Energy Savings Assistance (ESA) Program PPP Component Rate effective January 1, 2018, SWGAs incorrectly used \$906,770 as the over-collection balance for ESABA as of September 30, 2017, instead of using the correct over-collection balance of \$2,050,331. As a result, the ESA PPP Component Rate was overstated by \$0.00881 per therm, from \$0.01192 per therm to \$0.02073 per therm.**

**Condition:**

When filing AL 1054 with the Commission to establish the ESA PPP Component Rate effective January 1, 2018, SWGAs inadvertently used \$906,770 as the ESABA over-collection balance as of September 30, 2017. The correct balance should have been \$2,050,331.

**Criteria:**

OP 10 of D.14-05-004, issued on May 1, 2014, states, in part, that *"Southwest Gas Corporation, ... are authorized to make annual adjustments to the Public Purpose Program surcharge via advice letter to adjust the Energy Savings Assistance Program surcharges to reflect current activity with the initial advice letter to be filed within 60 days of this decision. Subsequent Public Purpose Program surcharge*



*adjustment advice letters, if any, may be filed annually by October 31 with a requested effective date of January 1 of the following year."*

**Cause:**

The accrued liabilities to CDTFA from January 2017 through June 2017 were inadvertently queried twice in the historic CDTFA activities that were excluded from the ESABA balance during the September 2017 rate making process.

**Effect:**

The developed ESA Program PPP Component Rate effective January 1, 2018 was incorrect. The ESA PPP Component Rate effective January 1, 2018 should have been \$0.01192 per therm, instead of \$0.02073 per therm. The over-collection during 2018 from higher rate was corrected and included in the ESA PPP Component Rate effective January 1, 2019.

**Recommendation:**

SWGAs should strengthen its internal control to ensure accurate balancing account balances were used in its PPP rate development.

**Finding 6: In developing the Conservation and Energy Efficiency (CEE) Program PPP Component Rate effective January 1, 2018, SWGas incorrectly used \$1,862,125 as the over-collection balance for CEEBA as of September 30, 2017, instead of using the correct over-collection balance of \$1,707,346. As a result, the CEE PPP Component Rate was off by \$0.00119 per therm, which was the difference between the correct refund rate of \$0.00545 per therm and the original \$0.00664 per therm.**

**Condition:**

When filing AL 1054 with the Commission to establish the CEE PPP Component Rate effective January 1, 2018, SWGas inadvertently used \$1,862,125 as the CEEBA over-collection balance as of September 30, 2017. SWGas inadvertently included \$154,778 of the CDTFA activities in the CEEBA account balance. The correct balance should have been \$1,707,346.

SWGAs stated in its response to UAFCB's Item 5 of DR 017 that *"Upon reviewing the question regarding the CEEBA surcharge component of the PPP surcharge by the CPUC Audit group, the Company noticed that the CEEBA Balancing Account did not remove the BOE activity similar to ESABA and CAREBA. The CEE Balancing Account when updated with the removal of BOE activity will have a new balance ... The Company has recalculated the 2019 CEE PPP Component and the rate will change from \$ (0.00453) to \$0.00022... Southwest Gas will submit an Advice Letter by no later March 20, 2019, updating the PPP surcharge rates, effective May 1, 2019."* The AL 1098 has been filed and included the updated rate in the CEE PPP Rate effective May 1, 2019.

**Criteria:**

Section 16G.2 – CEEBA ADJUSTMENT in SWGas' CEEBA's Preliminary Statement states that, *"The balance in the CEEBA will be amortized into rates by dividing the balance in the account at the end of the most recent available month by the three-year average (consecutive 36-month period) based on the most recently available billed gas volumes."*

OP 22 of D.04-08-010, which was issued on August 19, 2004, states that, “*Respondent utilities shall file annual ALs, with proposed surcharge rates, by October 31, with a requested effective date of January 1 of the next year.*”

**Cause:**

Due to oversight in determining the correct true-up amount in PPP rate development, SWGas inadvertently included \$154,778 of the CDTFA activities adjustment in the CEEBA account balance. The balance should have been an over-collection of \$1,707,346 after a CDTFA activities adjustment of \$154,778.

**Effect:**

The developed CEE Program PPP Component Rate effective January 1, 2018 was incorrect. The CEE PPP Component Rate effective January 1, 2018 should have been the refund of \$0.00545 per therm, instead of \$0.00664 per therm.

**Recommendation:**

SWGas should strengthen its internal control to ensure accurate balancing account balances were used in its PPP Rate development by properly and consistently excluding CDTFA activities.

## CONCLUSION

In conducting our examination, UAFCB obtained a reasonable understanding of SWGas’ internal controls, which were considered relevant and significant within the context of our examination objectives. UAFCB does not provide any assurance on SWGas’ internal control. Deficiencies in internal control that were identified during the examination and determined to be significant were communicated to SWGas’ management.

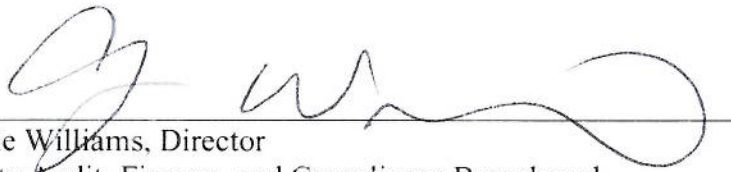
SWGas’ management is responsible for the development of its policies and procedures to ensure that its balancing accounts were reported completely, accurately, and timely. The Commission reviews whether the transactions recorded in the balancing accounts are for allowable purposes and supported by appropriate documentation.

UAFCB conducted this examination in accordance with applicable auditing standards. Those standards require that we plan and perform the examination to obtain sufficient, appropriate evidence to afford a reasonable basis for our findings and conclusions based on our examination objectives. UAFCB believes that the evidence obtained provides a reasonable basis for our findings and conclusions based on our limited examination objectives.

UAFCB determined that, except for the items noted in the Findings and Recommendations section, SWGas has complied, in all material respects, with the recording and reporting requirements for its balancing accounts during the examination period of January 1, 2017 to December 31, 2017.



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



Angie Williams, Director  
Utility Audit, Finance, and Compliance Branch and  
Enterprise Risk Compliance Officer

cc: Ed Randolph, Director, Energy Division  
Simon Baker, Deputy Director, Energy Division  
Dorothy Duda, Manager, Energy Division  
Elizabeth Echols, Director, Public Advocates Office  
Raymond Yin, Supervisor, UAFCB  
Mabel Wu, Auditor, UAFCB  
Bixia Ye, Auditor, UAFCB

# Appendices

## APPENDIX A Applicable Rules and Regulations

Rule/Regulation Types	Reference	Description
Public Utility Code	Section 314.5	Guidance providing the Commission the authority to inspect and audit the books and records for regulatory and tax purposes.
	Section 314.6 (b)	The commission shall complete any audit in a timely manner consistent with the Generally Accepted Government Auditing Standards.
	Section 451	Guidance mandating that all charges demanded or received by any public utility shall be just and reasonable.
	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 provide applicable records timely.
	Section 584	Guidance providing the Commission the authority to require a utility to furnish reports to the Commission.
	Section 792.5	Guidance providing the Commission the authority to review a utility's balancing accounts to ensure that transactions recorded in the balancing accounts are for allowable purposes and are supported by appropriate documentation.
Decisions (D.)	D.14-06-028	Decision approves SWGas' general rate increases for GRC cycle 2014-2018.
	D.17-06-006	Decision granting petition to modify D.14-06-028 and extend GRC cycle of 2014-2018 to 2014-2020.
	D.14-11-005	Decision adopting month-to-month bridge funding starting from January 1, 2015 for SMJUs' Energy Savings Assistance Program and California Alternate Rates for Energy Program.
	D.04-08-010	Decision establishing a natural gas surcharge to fund gas related public purpose programs (PPP).
	D.14-03-021	Decision approves a three-year pilot program to incentivize voluntary conversions from mobilehome parks and manufactured housing communities (collectively, MHPs) with master-metered natural gas and electricity to transfer to direct utility service.
	D.15-10-032	Determines the cost recovery issue for the costs in compliance with Cap-and-Trade regulations.
	D.16-04-013	Vacated the orders of D.15-10-032 related to the cost recovery and refund from the proceed for 2015-2017.
	D.18-03-017	Made a final decision regarding the settlement of the cost recovery and proceed the refund in compliance with Cap-and-Trade regulations.
Advice Letters (ALs)	AL 1024-G	To adjust rates to recover 2017 Post Test-Year Margin Revenue.
	AL 1025-G	Attrition adjustments for Margin rates effective January 1, 2017.
	AL 1060-G	To update procurement charges applicable to Schedule No. GCP - Gas Procurement for Core Customers and Transportation Franchise Fee (TFF) Surcharge and Transportation Distribution System (TDS) Surcharges applicable to core and noncore customers.
	AL 1020-G	Update PPP Surcharge Rates effective as of January 1, 2017.
	AL 1054-G	Update PPP Surcharge Rates effective as of January 1, 2018.
	AL 1082-G	Update PPP Surcharge Rates effective as of January 1, 2019.
Federal Energy Regulatory Commission's (FERC) Uniform System of Accounts (USOA)	General Instruction #11. A	Requires the utility to keep its accounts on the accrual basis.



## APPENDIX B

### Summary of Reported Ending Balances of SWGas' Balancing Accounts from Year 2008 through 2017 <sup>1</sup>

Account Name	2008 EOY	2009 EOY	2010 EOY	2011 EOY	2012 EOY	2013 EOY	2014 EOY	2015 EOY	2016 EOY	2017 EOY
Fixed Cost Adjustment Mechanism (2009) (FCAM – Margin)	N/A	\$5,846,046	\$5,386,859	\$1,468,203	\$7,974,415	\$8,128,970	\$19,585,744	\$11,043,403	(\$3,668,217)	(\$2,051,808)
Fixed Cost Adjustment Mechanism Balancing Account (FCAM – 191)	(\$2,301,059)	\$367,214	\$1,790,696	\$906,688	\$2,594,112	\$3,306,039	\$4,683,531	\$3,109,456	\$666,216	\$839,891
Purchase Gas Cost Balancing Account (PGA)	\$1,809,496	\$2,707,046	(\$1,959,425)	\$616,725	\$3,423,501	\$2,755,750	\$3,102,369	\$704,042	\$2,452,760	(\$256,511)
Intrastate Transportation Cost Adjustment Mechanism Balancing Account (ITCAM)	(\$1,610,322)	(\$1,052,154)	\$524,368	\$799,875	\$13,287	\$431,903	\$785,803	(\$222,629)	(\$511,465)	\$740,044
Infrastructure Replacement/Reliability Adjustment Mechanism (IRRAM)	N/A	N/A	N/A	N/A	N/A	N/A	(\$1,173)	(\$4,545)	(\$8,259)	(\$8,811)
Pension Balancing Account (PBA)	N/A	N/A	N/A	N/A	N/A	N/A	(\$494,657)	(\$1,363,375)	(\$2,283,665)	(\$3,178,388)
Mobilehome Park Conversion Balancing Account (MHPCBA) – To the Meter	N/A	N/A	N/A	N/A	N/A	N/A	\$2,081	\$4,755	\$5,912	\$9,410
Mobilehome Park Conversion Balancing Account (MHPCBA) – Beyond the Meter <sup>2</sup>	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$865,227
Greenhouse Gas Balancing Account (GHGBA) – Cost <sup>3</sup>	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$1,816,252	\$3,828,866	\$9,175,875
Greenhouse Gas Balancing Account (GHGBA) – Revenue <sup>3</sup>	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(\$4,469,371)	(\$8,573,826)
Public Interest Research & Development Balancing Account (R&DBA)	\$95,457	\$88,554	\$98,642	\$118,288	\$111,883	\$121,800	\$350,792	\$148,967	\$173,420	\$201,638
California Alternate Rates for Energy Balancing Account (CAREBA)	(\$522,828)	\$845,935	\$3,016,410	\$2,173,141	(\$243,435)	(\$3,087,113)	(\$2,111,497)	\$893,515	(\$882,922)	\$2,214,120
Energy Savings Assistance Balancing Account (ESABA)	\$489,505	\$466,946	\$606,728	(\$120,064)	(\$901,913)	(\$1,551,051)	\$676,863	\$3,288,176	\$1,520,170	(\$484,492)
Conservation and Energy Efficiency Balancing Account (CEEBA) <sup>4</sup>	N/A	N/A	N/A	N/A	N/A	N/A	(\$258,931)	(\$655,090)	(\$1,774,219)	(\$1,864,659)

**Notes:**

1. Negative amounts denote over-collection and positive amounts denote under-collection.
2. MHPCBA - Beyond the Meter: The ending balances shown in the table is not the under-collection amount as of December 31, 2017. SWGas will incorporate these costs into GRC Application for GRC cycle 2021-2025, and these costs will be recovered in ten-year period.
3. GHGBA - Cost and GHGBA - Revenue: These amounts were the reported amounts, which have not included the audit adjustment for the error stated in Finding 3. SWGas stated in its response to UAFCB's Item 3 of DR 017 that, "Southwest Gas made an adjusting journal entry in the fourth quarter of 2018, to the affected accounts adjusting the interest from the establishment of the GHGBA in 2015 through October 2018."
4. CEEBA: As of December 31, 2017, the reported ending balance of CEEBA included the overstated expenditures by \$91,123 described in Finding 2, but the table does not include the examination adjustment. SWGas states in its response to UAFCB's Item 9 of DR 017 that, "SWG will make an adjustment in 2019 for the difference in the over-collection from December 31, 2017."

## APPENDIX C

### Purpose of SWGas' Reported Balancing Accounts

Item No.	Description of Balancing Account	Purpose
1.	Fixed Cost Adjustment Mechanism (2009) (FCAM – Margin)	The purpose of the FCAM is to balance the difference between authorized levels of Southwest Margin, recorded Upstream Storage Charges, and Interstate Reservation/Firm Access Charges with recorded revenues intended to recover these costs. This FCAM Preliminary Statement covers two balancing accounts, which are FCAM – Margin and FCAM – 191. The FCAM – Margin tracks the authorized margin with revenue collected, and the FCAM – 191 tracks recorded Upstream Storage Charges and Interstate Reservation/Firm Access charges with revenue collected.
2.	Fixed Cost Adjustment Mechanism Balancing Account (FCAM – 191)	
3.	Purchase Gas Cost Balancing Account (PGA)	The purpose of the PGA Balancing Account is to balance the actual cost of purchased gas incurred by the company with the gas costs recovered through the sales rates.
4.	Intrastate Transportation Cost Adjustment Mechanism Balancing Account (ITCAM)	The purpose of the ITCAM Balancing Account is to balance recorded upstream intrastate variable transportation cost recovery from both the core and noncore markets with the actual intrastate variable transportation costs incurred by the Company for the upstream transportation of gas on Southern California Gas Company's system.
5.	Infrastructure Replacement/Reliability Adjustment Mechanism (IRRAM)	The purpose of the IRRAM is to balance the difference between the revenue requirements associated with Commission-approved programs with recorded revenues to recover these costs.
6.	Pension Balancing Account (PBA)	The purpose of this two-way balancing account is to balance the difference between authorized and actual amounts associated with the Company pension fund that are allocable to California.
7.	Mobilehome Park Conversion Balancing Account (MHPCBA) – To the Meter	The MHPCBA is a two-way balancing account for the purpose of recording and recovering the incremental revenue requirement associated with converting submetered residents at mobile home parks from master-metered natural gas service to direct utility service. SWGas maintains two separate subaccounts in the MHPCBA for its costs up to and including the customer's meter ("to the meter" costs) and for the reimbursable costs for work performed beyond the Company's meter ("beyond the meter" costs).
8.	Mobilehome Park Conversion Balancing Account (MHPCBA) – Beyond the Meter	
9.	Greenhouse Gas Balancing Account (GHGBA) – Cost	The GHGBA is a two-way balancing account for the purpose of tracking and recording costs incurred to comply with the California Air Resource Board's (ARB) natural gas supplier Cap-and-Trade Program and revenues from consignment of the Company's natural gas supplier GHG allowances for auction under the Cap-and-Trade Program. SWGas maintains two separate subaccounts in the GHGBA for costs incurred to comply with the ARB's natural gas supplier Cap-and-Trade Program and for revenues received from consignment of allowance for auction.
10.	Greenhouse Gas Balancing Account (GHGBA) – Revenue	
11.	Public Interest Research & Development Balancing Account (R&DBA)	The purpose of the two-way balancing account is to balance the Company's allocated share of the State's annual R&D budgeted costs, including any Commission and CDTFA administrative costs, with the PPP Surcharge revenue that recovers these costs.
12.	California Alternate Rates for Energy Balancing Account (CAREBA)	The purpose of the two-way balancing account is to balance the Company's CARE program costs, including rate discounts, outreach, administrative, and program audit costs, with the PPP Surcharge revenue that recovers these costs.
13.	Energy Savings Assistance Balancing Account (ESABA)	The purpose of the ESABA is to balance the Company's Commission authorized ESA program costs, including outreach, administrative, and program audit costs, with the PPP Surcharge revenue that recovers these costs. The ESABA is a one-way balancing account; any actual program costs in excess of amounts authorized by the Commission are not recoverable.
14.	Conservation and Energy Efficiency Balancing Account (CEEBA)	The purpose of the CEEBA is to balance the difference between the Company's Commission authorized CEE program costs, including outreach, administrative, and program audit costs, with the PPP Surcharge revenue collected to recover these costs. The CEEBA is a one-way balancing account; any actual program costs in excess of amounts authorized by the Commission are not recoverable.



# SWGAs' Responses

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**SOUTHWEST GAS CORPORATION**

April 23, 2019

*via Electronic Mail*

Ms. Angie Williams

[angie.williams@cpuc.ca.gov](mailto:angie.williams@cpuc.ca.gov)

Director, External Audits and Enterprise Risk Compliance  
Utility Audit, Finance and Compliance Branch  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102

Subject: Draft Report - Compliance Examination of the 2017 Balancing Accounts of Southwest Gas Corporation

Dear Ms. Williams:

Southwest Gas Corporation (Southwest Gas or Company) appreciates the opportunity to review and provide comments on the "Balancing Account Examination on Southwest Gas Corporation for Year Ended December 31, 2017" Draft Report (Draft Report) issued by the Utility Audit, Finance and Compliance Branch (UAFCB) on April 10, 2019.

Southwest Gas appreciates working with UAFCB over the last several months during the review of its regulatory balancing accounts. UAFCB determined that, except for the six Findings and Recommendations, the Company has complied with the recording and reporting requirements for its balancing accounts during the examination period of January 1, 2017 through December 31, 2017.

Southwest Gas provides the following responses to UAFCB's findings.

***Finding 1: SWGas did not use accrual basis of accounting to record revenues and expenditures in its balancing accounts.***

**Southwest Gas Response:** The Company disagrees with this finding. In accordance with both FERC general guidelines and Accounting Principles Generally Accepted in the U.S. ("U.S. GAAP"), Southwest Gas does maintain its records *overall* on the accrual basis of accounting. While this takes place on an overall basis, certain individual accounts, taken on a standalone basis, may not include specific accruals for amounts that may be finalized or settled the following month, yet at the same time, they comply with the Company's approved California Tariff Preliminary Statement. These tariff provisions include specific balancing account accounting procedures with the intent to provide customers with accurate rates reflective of the Company's actual costs (and authorized carrying charges thereon). For example, the Purchased Gas Cost Balancing Account (PGA; Preliminary Statement 7, Section E), the Intrastate Transportation Cost Adjustment

5241 Spring Mountain Road / Las Vegas, Nevada 89150-0002  
P.O. Box 98510 / Las Vegas, Nevada 89193-8510 / (702) 876-7011  
[www.swgas.com](http://www.swgas.com)



Mechanism (ITCAM; Preliminary Statement 8, Section F), and the Fixed Cost Adjustment Mechanism (FCAM-191; Preliminary Statement 9, Section F), indicate the accounts should reflect actual gas costs settled in cash with the suppliers and transmission pipelines net of actual recovery amounts billed, and those actual charges and credits are the basis for interest imputation. The Company follows these requirements. Then at least each calendar quarter, Southwest Gas makes accruals in its payable accounts, reflective of differences between tariff energy rates and estimates of commodity and transmission costs, the latter of which is subject to estimation. Southwest Gas also recognizes offsetting amounts in a temporary balancing account for U.S. GAAP reporting purposes. This combined entry reverses the following month, when the Company applies its actual costs for settled commodity and transmission costs and actual amounts for billed recoveries. While the Company also makes temporary estimates of unbilled revenue (intended to include the period from the last cycle billing date to the end of the month) in its general purpose financial statements, it does not have the means with existing resources and systems to collect month-end reads for all of its customers in order to determine specific recoveries and precise revenue as of a month-end date. Unbilled revenue accrual estimates are updated monthly.

By these collective means, Southwest Gas ensures the material accuracy of its financial information overall at each quarterly reporting date, while at the same time, applying actual gas cost expenditures and actual billed recoveries to the noted regulatory accounts. Interest carrying charges, as noted, are assessed based on these actual amounts settled in cash with our suppliers and interstate pipelines, through customary validation and tie out procedures, and amounts recovered through actual customer billing procedures. By the collective means, the regulatory accounts are reflective of actual settled transactions while the financial statements overall capture accrual accounting. The financial statements, taken as a whole, are subject to annual independent audits.

With regard to Public Purpose Program balancing accounts, i.e., California Alternate Rates for Energy Balancing Account (CAREBA), while activity posting to the account for low-income discounts from the Company's Customer Service System (CSS) are noted as "accruals", that is just the line item description for the posting. Those amounts reflect discounts provided on a cycle billing basis, similar to the recovery revenues. In addition, actual program costs, outreach, administrative and audit costs are recorded on a monthly basis, as provided for in the Company's California Preliminary Statement 16, Section E.3.

Southwest Gas believes its processes are appropriate to capture primarily settled transactions and actual cycle billed recoveries, with interest thereon within certain balancing accounts as approved by the CPUC. These are the parameters for the Company's decades-long historic rate development when billed volume is the factor used in the denominator in rate determination. However, the Company does true up significant line items in its published financial statements and other regulatory reporting by means of estimated accruals/methodologies to reflect financial information that is accurate in all material respects, which aligns with the requirements of U.S. GAAP and the concepts of FERC guidelines.





***Finding 2: SWGas overstated the total expenditure recorded in the Conservation and Energy Efficiency Balancing Account (CEEBA) by \$91,123 as of December 31, 2017.***

**Southwest Gas Response:** The Company does not dispute this finding. This item relates to when Southwest prefunded its rebate processing contractor \$175,000 at the time CEE programs were initially implemented. At the time, the Company funded at a level hoping to avoid insufficient prefunding, which could have otherwise resulted in potential delays in rebates under the program. Since the programs were the first of their kind for Southwest Gas' California territories, it was difficult to estimate participation levels. Now that the programs have been in place for several years, Southwest Gas can better estimate participation levels using historical data. Moving forward, the Company will prefund its rebate processing contractor, which is the same contractor subject to the initial payment, at a level that more precisely reflects estimated annual rebates but by the same means. In addition, Southwest Gas will request a partial refund of the current prefunded balance to the extent it exceeds annual rebate estimates.

***Finding 3: The interests were calculated incorrectly in the Greenhouse Gas Balancing Account (GHGBA) – Cost, and GHGBA – Revenue.***

**Southwest Gas Response:** The Company does not dispute this finding. Southwest Gas agrees that there was a typographical oversight (a missing parenthesis) in the formula of the calculation of interest for the GHGBA Cost account and the GHGBA Revenue accounts. Southwest Gas made an adjusting journal entry in the fourth quarter of 2018, to the affected accounts adjusting the interest from the establishment of the GHGBA in 2015 through October 2018. The GHGBA Cost account was decreased (\$984.00) for 2015, (\$9,981.17) for 2016, (\$40,060.37) for 2017 and (\$65,959.39) for 2018, totaling (\$116,984.93). The GHGBA Revenue Account was increased \$1,289.98 for 2015, \$10,554.75 for 2016, \$37,596.96 for 2017 and \$53,668.12 for 2018, totaling \$103,109.81, resulting in a net difference of (\$13,875.12) over the 4-year period. These adjustments will be reflected in the balance used to calculate the January 1, 2020 rates.

Southwest Gas has robust internal procedures, including reviews of all monthly journal entries by a Gas and Regulatory Accounting (GARA) Supervisor or above, helping to ensure that material errors do not occur; however, Southwest Gas will enhance review procedures to address this particular area of inadvertent oversight.

***Finding 4: SWGas did not timely settle the ending balances of Public Interest Research & Development Balancing Account (R&DBA).***

**Southwest Gas Response:** The Company does not dispute this finding. Upon learning of this oversight, the Company in its most recent PPP surcharge rate adjustment submitted on October 31, 2018 for rates effective January 1, 2019 (Advice Letter No. 1082), included the R&D balancing account balance in the R&D PPP Component of the PPP filing. The Commission's Energy Division approved Advice Letter on December 4, 2018. The Company will take steps to not only ensure that the R&D balancing account balance is



included in the R&D PPP Component of the annual PPP surcharge adjustment moving forward, but also that balancing account ending balances are settled timely.

***Finding 5: In developing the Energy Savings Assistance (ESA) Program PPP Component Rate effective January 1, 2018, SWGas incorrectly used \$906,770 as the over-collection balance for ESABA as of September 30, 2017, instead of using the correct over-collection balance of \$2,050,331. As a result, the ESA PPP Component Rate was overstated by \$0.00881 per therm, from \$0.01192 per therm to \$0.02073 per therm.***

**Southwest Gas Response:** The Company does not dispute this finding. Southwest Gas agrees that the 2018 ESA component of the PPP Surcharge should have been \$0.01192 per therm instead of \$0.02073 per therm. In turn, the September 30, 2018 ESABA balance used to calculate Southwest Gas' ESA component of the PPP Surcharge, effective January 1, 2019, reflected a larger credit balance than may have otherwise been the case, resulting in lower 2019 PPP Surcharges. This relates to the attribution of amounts paid to the California Board of Equalization ("BOE"), and then returned by the BOE, for PPP programs. Southwest Gas believes that any over-collections during 2018 will be returned to customers in 2019, resulting in zero net impact to customers. The Company will strengthen its process to ensure that the appropriate balance is used to calculate rates of the specific programs and/or components related thereto.

***Finding 6: In developing the Conservation and Energy Efficiency (CEE) Program PPP Component Rate effective January 1, 2018, SWGas incorrectly used \$1,862,125 as the overcollection balance for CEEBA as of September 30, 2017, instead of using the correct overcollection balance of \$1,707,346. As a result, the CEE PPP Component Rate was off by \$0.00119 per therm, which was the difference between the correct refund rate of \$0.00545 per therm and the original \$0.00664 per therm.***

**Southwest Gas Response:**

The Company does not dispute this finding. The Conservation and Energy Efficiency (CEE) Program PPP Component Rate effective January 1, 2018, did not remove the History to Date BOE activity of \$154,779 from the CEE ending balance in development of the associated customer rate. While remittances are required to be paid by Southwest to the BOE (with filings then made to facilitate their return), the practice is to adjust for such activity on an interim basis prior to the return of amounts in developing rates. The Company will strengthen its process, including removal of History to Date BOE activity, in calculating/updating rates. In addition, the Company has updated its recently approved 2018 PPP filing (now effective May 1, 2019) to include the removal of History to Date BOE activity from the CEE balancing account balance used in the CEE rate portion of the PPP Surcharge.





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Southwest Gas 2017 Compliance Exam – Draft Report  
April 23, 2019  
Page 5

In summary, Southwest Gas appreciates UAFCB's overall determination that the Company has complied, in all material respects, with the recording and reporting requirements for its balancing accounts during the examination period of January 1, 2017 through December 31, 2017. As noted above, Southwest Gas only disputes Finding 1, and has taken corrective actions with respect to Findings 2 through 6.

Respectfully submitted,

Valerie J. Ontiveroz  
Regulatory Manager/California

c: UAFCB:  
Raymond Yin  
[Raymond.Yin@cpuc.ca.gov](mailto:Raymond.Yin@cpuc.ca.gov)

Mabel Yu  
[Mabel.Yu@cpuc.ca.gov](mailto:Mabel.Yu@cpuc.ca.gov)

Bixia Ye  
[Bixia.Ye@cpuc.ca.gov](mailto:Bixia.Ye@cpuc.ca.gov)

Southwest Gas:  
Catherine M. Mazzeo  
[Catherine.Mazzeo@swgas.com](mailto:Catherine.Mazzeo@swgas.com)

# Evaluation of Responses

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SWGas' responses to UAFCB's draft report have been reviewed and incorporated into our final report. In evaluating SWGas' responses, we noted that SWGas did not dispute our Audit Findings 2 through 6. Therefore, we devoted our responses to address SWGas' comments pertaining to Audit Finding 1. In addition, UAFCB further clarifies its Audit Finding 2 herein.

## **Finding 1: SWGas did not use accrual basis of accounting to record revenues and expenditures in its balancing accounts.**

UAFCB disagrees with SWGas' statement that: "*...certain individual accounts, taken on a standalone basis, may not include specific accruals for amounts that may be finalized or settled the following month, yet at the same time, they comply with the Company's approved California Tariff Preliminary statement[s] ....[These statements] indicate the accounts should reflect actual gas costs settled in cash...*"

Section E of PGA Preliminary Statement 7 allows the recording of "*A debit entry equal to the actual cost of purchased gas for the month.*" Section F of ITCAM Preliminary Statement 8 refers the recorded costs as "*actual cost.*" Section F of FCAM-191 Preliminary Statement 9 allows the recording of "*A debit entry equal to the actual cost of reservation/firm access charges and storage charges for the month.*"

These Tariff Preliminary Statements of PGA, ITCAM, and FCAM-191 do not refer "actual gas costs" as "costs settled in cash." In its responses, SWGas repeatedly cited the term "actual costs," as if it meant "cash basis," to justify for using non-accrual basis of accounting. "Actual cost" is a term used to measure the value of goods, while "accrual basis of accounting" is an accounting methodology for recording costs incurred. That is, "accrual basis of accounting" measures the timing of recording a transaction rather than the value of a good. Equating "actual costs" to "cash basis" is conceptually incorrect. In addition, we noted that significant transactions (in terms of dollar value and/or volume) were recorded into most balancing accounts. The application of accrual basis of accounting provides a uniform, consistent, and comparable treatment for deriving accurate ending balances of the balancing accounts.

SWGas' response pertaining to CAREBA did not address the issue we stated in this finding.

For reasons stated above, UAFCB's Audit Finding 1 remains unchanged.

## **Finding 2: SWGas overstated the total expenditure recorded in the Conservation and Energy Efficiency Balancing Account (CEEBA) by \$91,123 as of December 31, 2017.**

SWGas did not dispute this finding. However, SWGas stated in its response to Audit Finding 2 that "*Since the programs were the first of their kind for Southwest Gas' California territories, it was difficult to estimate participation levels. ... Moving forward, the Company will prefund its rebate processing contractor, which is the same contractor subject to the initial payment, at a level that more precisely reflects estimated annual rebates but by the same means.*"

To help SWGas better understand Audit Finding 2, UAFCB further clarifies this Audit Finding that only the CEE Program costs incurred should have been recorded into the CEEBA as we cited SWGas'



CEEBA Preliminary Statement under the Criteria section of this finding. When SWGas prefunded its contractor, SWGas should not have recorded the prefund as an expenditure in its CEEBA. Only when the prefund is used for incurred rebate transactions, the related costs could then be recorded into CEEBA.