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Marc L. Ulrich, Ph.D.
Vice President
Customer Programs and Services

July 7, 2014

Kayode Kajopaiye
Utility Audit, Finance and Compliance Branch
California Public Utilities Commission
505 Van Ness Ave., 3rd Floor
San Francisco, CA 94102

Dear Mr. Kajopaiye:

Southern California Edison Company (SCE) appreciates the opportunity to review and provide comments on the draft *Energy Efficiency (EE) Financial Compliance Examination Report of Southern California Edison (SCE) For the Period January through December 31, 2012* (Draft Report), issued by the California Public Utilities Commission's (Commission) Division of Water and Audit's Utility Audit, Finance and Compliance Branch (UAFCB) dated June 9, 2014.

SCE's comments to the draft observations and recommendations are attached. The attachments that accompany SCE's comments will be provided to the UAFCB via overnight mail. SCE appreciates the opportunity to strengthen it employee training programs and internal controls, while continuously improving the overall administration and operation of the EE programs.

Consistent with previous audits, SCE will provide the Commission with comprehensive responses to each of the recommendations and findings that are included in the final audit report and offer appropriate corrective actions, where appropriate.

If you have any questions about SCE's comments, attachments, or would like to set up a meeting to discuss the information provided, please contact Susan Reed at 626-302-1965.

Thank you,

Marc L. Ulrich, Ph.D.
Vice President of Customer Programs & Services
Southern California Edison Company

Enclosure

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EXECUTIVE SUMMARY

Southern California Edison Company (SCE) appreciates the opportunity to provide comments on UAFCB's Draft Audit Report (Draft Report). SCE takes potential claims of material errors, lack of documentation, lax internal controls, inaccurate and unreliable reporting, and violations of law very seriously. SCE highlights areas of the Draft Report with significant errors that should be revised before the final report is issued. Specific comments to each draft observation and recommendation follow.

SCE strongly disagrees with the Rule 1.1 violation alleged in draft observation 6 and recommends this allegation be removed in the final report. SCE did not inflate an invoice or manipulate data. The proposed $500,000 reduction to the 2012 energy efficiency (EE) incentive calculation is without merit. In 2012, SCE approved a vendor invoice for $1.492 million after inspecting the installations, and appropriately counted the energy savings associated with the installed measures. However, SCE prudently withheld $500,000 from its payment to this vendor to account for damages SCE expected to, and did in fact, incur because of quality and safety related issues with the vendor's prior installations. The $500,000 withhold had nothing to do with the installations included in the $1.492 million invoice; rather the $500,000 withhold was done to mitigate SCE's risk of damages arising from the vendor's previous work. At no time did SCE employees "intentionally manipulate data to mislead the Commission," as the Draft Report alleges. The matter simply does not rise to a Rule 1.1 violation, and that allegation should be removed in the final audit report.

SCE's labor accounting system is reliable and auditable and labor should not be discounted by an arbitrary 10%, or $3,493,080. SCE would appreciate the opportunity to continue to work with the California Public Utilities Commission's (CPUC's) Utility Audit, Finance and Compliance Branch (UAFCB) to demonstrate, through testing, that SCE's labor accounting system is recording labor accurately. The use of Standard Labor Costing is a best practice in labor accounting, used by other utilities, including PG&E.[1]

SCE has a valid accrual methodology and does not agree that $6,298,371[2] should be removed from 2012 EE program costs. The validity of the $6,298,371 EE expenditures has not been disputed by the UAFCB and all valid EE expenditures are subject to the 2012 EE incentive calculation. The draft UAFCB report unreasonably recommends that SCE record accruals when

[1] The following are examples of other utilities that use the Standard Labor functionality in SAP: Pacific Gas & Electric Company, Tampa Electric Company, Public Service Electric and Gas Company, Florida Power & Light, and National Grid. While both SCE and PG&E use the Standard Labor methodology, PG&E burdens its labor costs with other employee related costs, while SCE does not.

[2] The sum of the recommended reduction in 2012 EE program costs for Observations 3, 5, 8, and 13.

SCE is not aware of such future expenses at the close of the year. In accordance with accounting principles generally accepted in the United States, SCE uses an accrual method as its basis of accounting for all accounting transactions throughout the Company. SCE keeps its accounts on the accrual basis by requiring inclusion in its accounts of all known transactions of appreciable amounts. Further, SCE's accrual methodology is consistent with the Uniform System of Accounts Prescribed for Public Utilities reinforcing the validity of these expenditures.

SCE does not agree that $5,674,218[3] should be removed from 2012 EE program costs for inadequate supporting documentation. SCE is able to substantiate the services provided by [redacted] for the $2,434,561 paid in 2012 under the "pay for performance" component of the contract. In addition, the supporting documentation provided for an invoice of $3,239,657 did contain a period identifying the work performed was in 2012 and properly accrued.

SCE COMMENTS ON THE DRAFT REPORT

The following are SCE's comments on the Draft Report prepared by the UAFCB in its audit of SCE's 2012 Energy Efficiency Programs. The draft observations and recommendations are grouped into common topics to facilitate the comments.

1. <u>**Overstatement of Expenditures: Draft Observation 6**</u>

Draft Observation 6: *SCE reported that it paid an invoice amount totaling $1,492,676 instead of $992.676 that SCE actually paid in order to claim the full savings associated with the invoice. As a result, the EE program total expenditures were overcharged by $500,000.*

Draft Recommendation 6: *In determining SCE's 2012 incentive amount, the Commission should remove $500,000 from SCE's EE expenses before and after calculating the incentive for not having strengthened internal controls to avoid such employee's conduct. SCE should strengthen its policies and procedures that provide consequences for employees that intentionally manipulate data to mislead the Commission and ratepayers. The Commission should determine whether SCE should be fined for not properly monitoring the conduct of its employees.*

Draft observation 6 is incorrect that "SCE reported to the Commission that it paid the full invoice amount of $1,492,676" rather than the $992,676 SCE actually paid the vendor. SCE did not misreport its payment or overcharge the program total expenditures by $500,000. As explained in detail below, SCE appropriately approved the vendor's invoice for $1.492 million after inspecting the installations, and counted the energy savings associated with the installed measures. However, SCE prudently withheld $500,000 from its final payment to the vendor under the purchase order to account for damages SCE expected to incur because of quality and

[3] The sum of the recommended reduction in 2012 EE program costs for Observations 9 and 11.

safety related issues with the vendor's prior work in 2011 and 2012.[4] At no time did SCE employees "intentionally manipulate data to mislead the Commission," as the Draft Report alleges. The matter simply does not rise to a Rule 1.1 violation, and that allegation should be removed in the final audit report.

SCE concedes that the documentation supporting SCE's $500,000 withhold from the vendor's final payment could have been clearer, and may have led to some confusion on the auditor's part. Among other things, the documentation could have more clearly explained that the $500,000 withhold had nothing to do with the installations in the $1.492 million invoice – which were inspected and the energy savings properly counted – but rather the $500,000 withhold was done to mitigate SCE's risk of remediation costs from the vendor. Nevertheless, the documentation does not establish a Rule 1.1 violation.

The invoice referred to in the Draft Report was submitted by the vendor for $1.492 million worth of installations through SCE's Public School Energy Efficiency Program. After reviewing and approving the invoice, but prior to payment, SCE determined that it would have financial claims against the vendor for prior work, and was in the process of remediating the problems with that prior work. This prior work related to previously paid invoices under the same purchase order.[5] To mitigate the risk of recovery of the remediation costs from the vendor, SCE decided to withhold $500,000 from its final payment to the vendor for the vendor's final invoice of $1.492 million.

At that time, SCE had just begun using its internal Customer Relationship Management (CRM) system, which tracks, among other data, customer applications, project status, and invoices. The situation in which SCE seeks to set-off costs from one invoice for issues associated with work under a previous invoice is rare. SCE staff understood that the only way to process the $1.492 million invoice, report all of the installations associated with the invoice, and withhold the $500,000 from the final payment was to: (a) include the total dollar amount of the invoice in CRM; and (b) perform a set-off through a credit memo in SAP (the accounts payable system that processes check production and delivery to vendors).[6] This set-off amount is reflected in the file provided to the auditor as an SAP credit memo.[7] SCE also noted the set-off of $500,000

[4] These damages are documented in detail in Attachment [redacted] hereto, and have amounted to over $600,000 to date.

[5] SCE began receiving complaints about this vendor in November 2010; however, SCE issued a Stop Work order in January 2011 and required the vendor's full Quality Control and Assurance plan be improved, updated and acknowledged by all employees. Subsequent inspections of the vendor's installations were increased to 50% and closely monitored. After a period of consistently successful inspections, SCE decreased the inspection rate consistent with the improvements made. Then, in May 2012, SCE was informed of a significant safety complaint related to this vendor, and began the analyses that led to the withholding of $500,000 from this final invoice payment.

[6] The installations included in this particular invoice were subject to increased inspection rates to ensure the recorded energy savings were appropriate.

[7] See Attachment [redacted]

from the final payment in its CRM system in the notes section of the screen.[8] SCE has since explored CRM's ability to address this type of situation and discovered that CRM can record a set-off directly using the "Adjustment" field, which allows SCE to adjust the total dollar amount to be paid under the invoice without removing any particular installations or affecting the energy savings reported. With this functionality in CRM, SCE can in most instances avoid creating the SAP credit memo to record set-offs in the future.[9]

Notwithstanding this future process improvement, the costs and installed energy savings associated with the $1.492 million invoice were accurately reported. SCE's system reports invoices as they are accrued. Therefore, in November 2013 when SCE approved the invoice of $1.492 million, the system accounted for the accrued invoice in SCE's November reports, which were submitted to the Energy Division in December 2013. The check to the vendor was not processed until December 2013, at about the time SCE decided to withhold $500,000 from its final payment to the vendor for remediation of errors in the vendor's previous work. SCE withheld $500,000 and processed the payment for the balance of $992,676. At the same time that the payment of $992,676 was processed, SCE issued a credit memo for the $500,000. The result is the same as receiving a refund or a reward of damages of $500,000 for previous payments to the vendor, but SCE found it more efficient for protecting ratepayer interests to withhold $500,000 from its final payment to the vendor, rather than pursue a refund or an award of damages from the vendor. SCE's December reporting contained the $500,000 credit memo related to the accrued $1.492 million invoice, and SCE's reporting to the Commission was accurate.

For the foregoing reasons, the Rule 1.1 allegation should be removed from the final audit report because SCE did not overcharge ratepayers or mislead the Commission. SCE agrees to include improvements and changes to its internal processes related to recording and documenting set-offs as part of SCE's internal controls report SCE will provide UAFCB within 90 days of the issuance of the UAFCB Final Report.

2. Labor Accounting Methodology: Draft Observations 1, 2, and 20

Draft Observation 1: *SCE did not produce adequate source documentation to support the sampled labor costs.*

Draft Recommendation 1: *SCE should discontinue its policies and procedures for recording labor costs and implement other methods that would allow the UAFCB to effectively verify each amount listed as a labor cost. To mitigate the potential of overstatement of its total labor cost, SCE total labor cost reported at $34, 930,800 should be discounted by at least 10%.*

[8] SCE imprecisely noted in CRM that this was a short-pay of the invoice, rather than a set-off against prior work unrelated to this particular invoice.

[9] In instances where time is off the essence and there is not time to resubmit the Service Entry Sheet for approval, SCE may still need to use a credit memo and otherwise accurately document the necessary transactions.

UAFCB recognizes that the 10% discount is arbitrary. However, the Commission should consider discounting SCE's labor charges because it is the only major energy company that the UAFCB could not verify its labor charges to any auditable documentation.

***Draft Observation 2:** Of the Distribution Cost Center (DCC) charges of $360,242 sampled by UAFCB, $126,385 was allocated using DCC allocation factors. SCE reported the $126,385 or 35% of the total sample as actual LGP administrative expenses. However, the $126,385 reported DCC charges also included estimated labor charges.*

***Draft Recommendation 2:** SCE should strengthen its policies and procedures that would ensure that each amount listed as cost for each specific cost center is based on actual cost and can be readily examined and verified by the Commission.*

***Draft Observation 20:** ...Labor costs captured in PEEBA were estimated.*

SCE appropriately records labor costs and correctly accounts for labor in the Procurement Energy Efficiency Balancing Account (PEEBA). Thus, SCE's method for recording labor should not be discontinued, nor should SCE's reported labor costs be discounted by 10%.

SCE's SAP accounting system records labor using accepted industry practices that rely on a Standard Labor Costing methodology. Under the Standard Labor Costing methodology, a standard rate is applied to all time worked by employees within the same group (i.e., Home Cost Center or HCC) and job classification. Standard rates represent the average rate of actual pay for the group of employees in a particular job classification, and within a specific HCC. When an employee records their time, the appropriate cost object is charged for the associated work activity. At the end of each month, any difference between actual payroll (representing actual labor rates) and the costs charged to the cost objects (representing Standard Labor Rates) is trued up using the recalculation/revaluation (recalc/reval) process. At the conclusion of this process, the difference between actual payroll and the labor costs recorded in the cost objects is zero.[10] The Standard Labor Costing methodology is a standard functionality in SAP and is used by other utilities including PG&E.[11]

While Standard Labor Costing is more complex than basic labor accounting methodologies, it is a preferable method because it maintains the confidentiality of employee salaries, and, perhaps more important, it allows SCE to charge programs for the value of labor, as opposed to the salary of any particular employee. For example, if two programs require analysts of the same level, the Standard Labor Costing methodology charges both programs the same labor cost, irrespective of the specific program staffing. The difference between standard rates and actual

[10] Because of system rounding, there may be an immaterial variance in this calculation up to +/-$0.30.

[11] The following are examples of other utilities that use the Standard Labor methodology in SAP: Tampa Electric Company, Public Service Electric and Gas Company, Pacific Gas & Electric, Florida Power & Light, and National Grid. While both SCE and PG&E use the Standard Labor methodology, PG&E burdens its labor costs with other employee related costs, while SCE does not.

labor rates is distributed across all of the work performed from that group of employees for the month through the recalc/reval process, thereby levelizing labor costs across the programs.

a. SCE's Accounting for Labor Does Not Overstate Labor Costs

At SCE, Payroll is charged to HCCs based on actual labor costs. Timesheet labor is charged to Cost Objects at Standard Labor Costs when the timesheet is entered and trued up using the recalc/reval process every month to reflect the difference between actual payroll costs and standard labor costs. When Payroll is recorded in the HCCs, SAP posts those charges to SCE's audited financial statements. SCE has a Sarbanes Oxley (i.e., SOX) control ensuring that each month after the timesheet postings and the recalc/reval process is performed there is no remaining balance in the HCCs. This control confirms that the same amount that was paid to employees through Payroll is what is reported to the Cost Objects. Because what goes into HCCs (actual labor) is the same amount that goes out of HCCs (standard labor + recalc/reval) and because this is the amount that records to SCE's balancing account Cost Objects, there is no opportunity to overstate labor costs as alleged by the auditor.[12] SCE can demonstrate that the recalc/reval adjustment works by proving that the variance between actual Payroll and Labor recorded in the Cost Objects is always zero.[13]

b. SCE's Labor Charges are Reliable and Are Not Estimates

The Draft Report confuses several fundamental principles of SCE's accounting system and discounts the supporting documentation SCE provided during the testing phase of the audit. As a result, the Draft Report erroneously concludes that SCE's accounting system is unreliable.

The Draft Report correctly describes SCE's standard labor rates as "estimated costs,"[14] however, it fails to recognize that the Standard Labor Cost methodology trues up the labor charged to the Cost Objects to actual Payroll each month through the recalc/reval process. When the timesheets are processed, an estimate of the labor costs using the standard labor rate is charged to the Cost Object. However, at the end of each month, the recalc/reval process adjusts these estimates to actual costs by recording to the cost object the differences between the sum of the standard rates charged and the sum of the actual pay received by the employees within the job classification for work performed. Thus, for each group of employees assigned a standard rate, the actual cost of their labor is distributed across all of the work performed by that group during the month. Because the recalc/reval process adjusts standard to actual pay at the group level, there is no employee-specific residual value in SCE's labor accounting system.[15] While SCE's accounting system does use estimated labor charges as an interim step,

[12] See Draft Report, p.A-2.
[13] See fn. 10 *supra*.
[14] See Draft Report p. A-2 and p. A-19.
[15] The draft report is accurate in stating that SCE did not provide specific employee residual values. See Draft Report, p. A-2.

every month it adjusts these estimated costs to actual labor costs. Thus, SCE's accounting system does reflect actual labor costs.

c. SCE's Labor Accounting is Auditable

In response to draft observation 5 of the 2011 EE Audit Report, SCE offered to work with UAFCB to develop an effective method to verify labor costs in future audits. On December 12, 2013, in advance of the auditor's site visit, SCE proposed a labor testing plan that would have allowed the auditor to verify that SCE's labor costs were accurate and reflected actual labor costs. During the site visit, SCE demonstrated (1) how SCE's accounting system works generally, (2) how SCE's accounting system calculates labor for an employee within the auditor's sample group, and (3) how the recalc/reval process is calculated in SAP. On December 19, 2013, SCE inquired whether the auditor needed any additional information in order to verify the recorded labor costs. In response, the auditor requested copies of the presentations from the site visit to be used as work papers, but did not request any additional information. After the site visit, SCE provided the auditor the remaining supporting documentation requested in Data Request 11, Question 2, which asked for approved employee timesheets and proof of actual labor cost/salary. SCE received no follow-up data requests from the auditor, and the auditor did not request to test any other aspects of SCE's labor accounting system.

Although SCE has not received any follow-up data requests, SCE has taken the initiative to compile additional work papers relating to the 129 samples for the 15 employees, which are provided with these comments. The documentation demonstrates: (a) SCE is accurately charging labor on an actual (not estimate) basis, and (b) SCE's labor charging process is auditable. Below is a summary of the documentation provided as part of this response:

- An overview of SCE's labor accounting, which includes a diagram of labor costing cost flows, labor accounting terms, and sample calculations along with an explanation of the following[16]:
  - Effective Labor Rate
  - Standard Labor Rate
  - Recalc/reval Calculation
  - How the recalc/reval adjustment makes the variance between Payroll in HCCs and Labor in the Cost Objects which ties to the Balancing Accounts to always be zero.[17]
- A spreadsheet for each sampled employee for the month sampled. These 22 spreadsheets show how each of these expenditures flows through SCE's labor accounting system.[18] The work papers show that for each month, the variance between the actual Payroll which ties to the audited General Ledger and the Labor in Cost Objects

[16] See Attachment 2.1.
[17] See fn. 10 *supra*.
[18] See Sample Attachments 1-22 on SCE Payroll and Labor Flow.

is always zero.[19] In addition, a narrative[20] is provided that steps the reader through each of the spreadsheets and explains how the series of spreadsheets verifies that SCE is correctly recording actual labor.

In sum, SCE accurately records labor costs, and correctly accounts for labor costs to the balancing account (i.e., PEEBA). As such, SCE's use of the Standard Labor Costing methodology should not be discontinued nor should SCE's reported labor costs be discounted by 10%. SCE would appreciate the opportunity to continue to work with the UAFCB to demonstrate through testing that SCE's labor accounting system is recording labor accurately.

3. Year-end Accruals: Draft Observations 3, 5, 8, and 13

Draft Observation 3: *SCE reported 2010 and 2011 LGP Administrative expenses totaling $59,394 as 2012 expenses. The $59,394 represented 16.25% of the $360,242 that the UAFCB sampled.*

Draft Recommendation 3: *In determining SCE's 2012 incentive amount, the Commission should remove $59,394 from SCE's EE 2012 expenses before calculating the incentive. SCE should strengthen its policies and procedures that would eliminate or significantly reduce the inclusion of prior year's expenses in future year's expenses.*

Draft Observation 5: *SCE reported 2008, 2009, 2010 and 2011 TP administrative expenses totaling $20,239 as 2012 expenses. The $20,239 represented about 2% of the $1,260,276 that the UAFCB sampled.*

Draft Recommendation 5: *In determining SCE's 2012 incentive amount, the Commission should remove $20,239 from SCE's EE 2012 expenses before calculating the incentive. SCE should strengthen its policies and procedures that would eliminate or significantly reduce the inclusion of prior year's expenses in current year's expenses.*

Draft Observation 8: *SCE over reported its 2012 direct implementation expenses by at least $4,357,681 because the amount reported as EE 2012 expenses included expenses pertaining to the 2011 budget year.*

Draft Recommendation 8: *In determining SCE's 2012 incentive amount, the Commission should remove $4,357,680.70 from SCE's EE 2012 expenses before calculating the incentive. SCE should strengthen its policies and procedures that would eliminate or significantly reduce the inclusion of prior year's expenses in future year's expenses*

UAFCB believes that the Internal Audit (IA) Department of SCE should include this matter in its next scope of audit to clean up this recurring problem.

[19] See fn. 10 *supra*.
[20] See Attachment 2.2

Draft Observation 13: *SCE did not make timely adjustments to its 2011 expenses for MFEER, resulting in SCE overstating its MFEER expense in 2012 by at least 31% or by $1,861,057 of the 6,061,917 that the UAFCB sampled.*

Draft Recommendation 13: *In determining SCE's 2012 incentive amount, the Commission should remove $1,861,057 from SCE's EE 2012 expenses before calculating the incentive. SCE should strengthen its policies and procedures that eliminate or significantly reduce the inclusion of prior year's expenses in subsequent year's expenses*

SCE disagrees with UAFCB recommendations to remove valid EE expenditures before calculating SCE's shareholder earnings incentives. The UAFCB does not dispute that the EE expenditures associated with draft observations 3, 5, 8 and 13 are valid. If the Commission adopts the UAFCB recommendation, SCE will not be able to claim earnings on valid EE expenditures.

The UAFCB disagrees with SCE's accrual methodology and disagrees with the year in which SCE reports expenses that are not known by year end or that are known but not appreciable. In accordance with accounting principles generally accepted in the United States, SCE uses an accrual method as its basis of accounting for all accounting transactions throughout the Company. SCE's business processes and systems are designed to meet these general accounting principles and are applied consistently across the Company. SCE keeps its accounts on the accrual basis by requiring inclusion in its accounts of all known transactions of appreciable amounts.[21]

While SCE is in compliance with Commission requirements related to accruals, SCE agrees to assess and, if appropriate, enhance its policies and procedures for receipting and tracking year end EE expenses. SCE will describe any changes to its policies and procedures for receipting and tracking EE expenses in the Internal Controls Report due to the UAFCB 90 days after the issuance of the Final Report.

In addition to the incorrect suggestion that SCE's current accrual policies and practices are non-compliant, SCE is concerned that draft observations 3, 5, 8, and 13 each contain errors that should be corrected before UAFCB issues its final report, and before the Commission considers removing EE expenditures in the calculation of program year 2012 incentive claim. SCE's response to each individual observation follows.

Draft observation 3 is incorrect because $47,792 of the $59,394 exceptions included in the Draft Report were properly accrued 2011 expenses and SCE accounted for these as expenses in

[21] As described by the UAFCB in the Energy Efficiency (EE) Financial Compliance Examination Report of Southern California Edison (SCE) For the Period January through December 31, 2011, The FERC Uniform Standards of Accounts (USOA) requires that utilities keep its accounts on the accrual basis, requiring the inclusion in its accounts of all known transactions of appreciable amounts. 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. In 2012, SCE's had a $5,000 threshold for accruing known expenses.

2011.[22] In addition, $862 of the $59,394 alleged exceptions were correcting journal entries made in 2012, which corrected the program being charged for the expenditures. Since a correcting journal entry is not a new expense, the $862 remained accurately recorded as 2011 expenses. Therefore, the unknown 2011 year end expenses that SCE reported in 2012 are $10,740[23] and not $59,394 as calculated in the Draft Report.

Draft observation 5 is incorrect because $716 of the $20,239 alleged exceptions was a correcting journal entry made in 2012 that corrected the program being charged for the expenditures. Since a correcting journal entry is not a new expense, the $716 remained accurately recorded as a 2011 expense. Therefore, the unknown 2011 year end expenses that SCE reported in 2012 are $19,532[24] and not $20,239 as calculated in the Draft Report.

Draft observation 8 is incorrect because $2,203,749 of the $4,357,680 alleged exceptions were properly accrued 2011 expenses and SCE accounted for these as expenses in 2011.[25] Therefore, the unknown 2011 year end expenses that SCE reported in 2012 are $2,153,931[26] and not $4,357,680 as calculated in the Draft Report.

Further, Table A-1, on page A-8 has two errors. First, it does not accurately reflect the total invoices sampled for all direct implementation contracts and therefore overstates the percent of the sample that the auditor identifies as an exception. Second, the table includes the $2,203,749 of 2011 expenses that were properly accrued and accounted for in 2011. Revised Table A-1 is presented below that (1) includes all invoices sampled in Data Request 10 - Parts 1 and 2; and, (2) removes the 2011 expenses that were accrued and reported in 2011.

[22] See Attachment 3.1.

[23] $59,394 - $47,792 - $862 = $10,740 (includes invoices received for 2011 expenses received from January 2012-May 2012 and invoice amounts may have fallen below SCE's threshold for accruing).

[24] $20,239 - $716 = $19,523.

[25] See Attachment 8.1.

[26] $4,357,680.70 - $2,203,749 = $2,153,931.70.

Revised Table A-1

Purchase Order	Data Request	Total Sample	Exception	% of Sample
[redacted]	DR 010 - Part 2	$ 132,731	$ 56,400	42.5%
[redacted]	DR 010 - Part 1	441,516	-	0.0%
[redacted]	DR 010 - Part 2	225,132	-	0.0%
[redacted]	DR 010 - Part 2	85,217	-	0.0%
[redacted]	DR 010 - Part 1	207,603	144,479	69.6%
[redacted]	DR 010 - Part 1	407,678	-	0.0%
[redacted]	DR 010 - Part 1	6,641,577	-	0.0%
[redacted]	DR 010 - Part 1	2,715,308	113,205	4.2%
[redacted]	DR 010 - Part 1	3,618,979	-	0.0%
[redacted]	DR 010 - Part 1	4,685,376	-	0.0%
[redacted]	DR 010 - Part 1	1,144,012	164,632	14.4%
[redacted]	DR 010 - Part 1	7,853,943	1,193,825	15.2%
[redacted]	DR 010 - Part 1	1,908,593	-	0.0%
[redacted]	DR 010 - Part 2	567,030	-	0.0%
[redacted]	DR 010 - Part 2	1,830,714	-	0.0%
[redacted]	DR 010 - Part 2	90,185	-	0.0%
[redacted]	DR 010 - Part 2	6,363,236	481,389	7.6%
[redacted]	DR 010 - Part 2	284,975	-	0.0%
[redacted]	DR 010 - Part 2	1,449,273	-	0.0%
[redacted]	DR 010 - Part 2	816,612	-	0.0%
[redacted]	DR 010 - Part 2	138,778	-	0.0%
[redacted]	DR 010 - Part 1	4,215,551	-	0.0%
[redacted]	DR 010 - Part 1	228,389	-	0.0%
[redacted]	DR 010 - Part 1	717,947	-	0.0%
[redacted]	DR 010 - Part 1	235,486	-	0.0%
		$ 47,005,843	**$ 2,153,931**	**4.6%**

Invoices properly accrued in 2011 were removed from Exception Amount. (Totaled - $2,203,749)

SCE will provide its internal Audit Services Department (ASD) a copy of the final report and will request that observation 8 be considered in ASD's annual risk assessment which is one of the determinants used to establish the schedule of internal audits for the year.

Draft observation 13 includes $1,861,057 of alleged acceptations. However, $111,703 of these exceptions were properly accrued 2011 expenses and SCE accounted for these as expenses in 2011.[27] An additionally, $271,117 of the $1,861,057 alleged exceptions were for projects installed in 2012 and, therefore, properly recorded as 2012 expenses.[28] Thus, the correct starting point for any discussion on SCE's Multi-family Energy Efficiency Rebate (MFEER)

[27] See attachment 13.1.
[28] See attachment 13.2.

program alleged accruals exceptions is $1,478,237,[29] and not $1,861,057 as described in the Draft Report.

The $1,478,237 in alleged accrual errors is based on UAFCB's recommendation that SCE should change its accrual methodology for MFEER program. SCE only accrues for MFEER measures that have been confirmed as installed through an inspection. The UAFCB recommends SCE accrue for the measures based on customer applications without confirming the measures were installed. However, because the UAFCB has not applied its methodology consistently at the beginning of the year and the end of the year, the $1,478,237 alleged accrual error is overstated and should be $651,386.[30]

4. <u>Lack of Supporting Documents: Draft Observation 9</u>

> ***Draft Observation 9:*** *SCE paid more than $2,434,561 to one of its vendors without substantiation of the service provided.*
>
> ***Draft Recommendation 9:*** *In determining SCE's 2012 incentive amount, the Commission should remove the $2,434,561 from SCE's EE 2012 expenses before calculating the incentive since the amount could not be traced to any specific installation services rendered by* [redacted] *If SCE is not able to substantiate the services provided by* [redacted] *to the UAFCB's satisfaction or unable to recover the money from* [redacted] *SCE should refund the EE program the amount.*

SCE disagrees with the UAFCB recommendation that the Commission remove $2,434,561 from SCE's EE 2012 expenses before calculating SCE's program year 2012 EE incentive claim. SCE did substantiate the services provided by its vendor, [redacted] for their services provided. SCE can also substantiate the services provided by [redacted] to the UAFCB and is submitting additional documentation for the UAFCB's review (please see Attachments 9.1 – 9.6 described below). [redacted] was not contracted to provide any specific installation services. The $2,434,561 was paid to [redacted] under the "pay for performance" portion of the contract for their role as the Program Implementer. [redacted] was hired to perform three categories of services. The contract outlines the three components to [redacted] contract as Program Implementer for the [redacted] program:[31]

- Pay for Performance – the fixed cost per ton to implement the program
- Incentive Payments – the actual rebate per unit paid to the Distributor
- Processing Fee – the amount it costs [redacted] to process the incentive payment

SCE is providing a sample of the deliverables provided by [redacted] for the pay for performance portion of the contract ($2.4 million) and reviewed by SCE to substantiate the work [redacted] was contracted to perform. The pay for performance fee is paid to [redacted] on a dollars-per-ton basis

[29] $1,861,057 - $111,703 -271,117 = $1,478,237.00.
[30] See Attachment 13.3.
[31] Provided in 2011-2012 EE Audit DWA-CPUC-SCE-Email-030.

once air conditioning distributors are enrolled, participating, and submitting requests for rebates. Therefore, pay for performance work was billed and paid when the actual energy savings and demand reduction goals were achieved. These deliverables were not included in the invoice packages reviewed by the UAFCB as they were received and reviewed by SCE prior to distributors applying for rebates (these tasks are described in the Purchase Order under "Tasks 1, 2 and 5" referenced in footnote 27 below"). Therefore, if no customers ever purchased qualifying [redacted] units and the respective distributors never applied for rebates, [redacted] would not be paid this "pay for performance" amount.

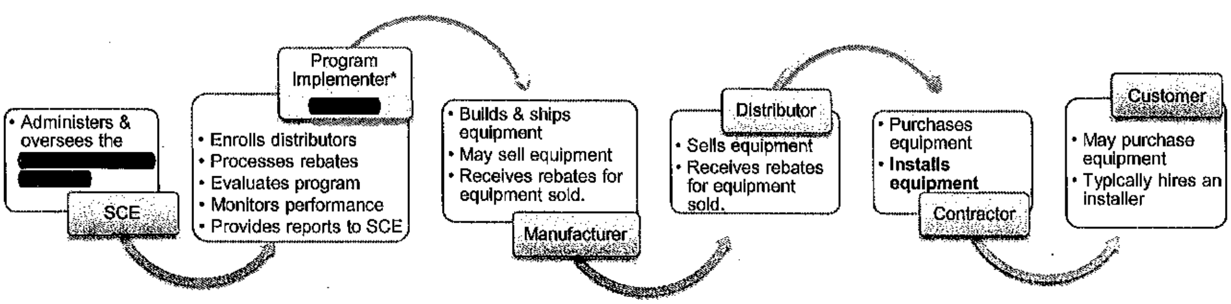
The Draft Report observation in Appendix A contains several errors in the condition, effect, and rebuttal statements. These inaccuracies lead to an incorrect conclusion for this program and its implementer. The following sections provide a summary of how this program works and address the inaccuracies that should be corrected in the final report.

a. [redacted] does not provide installation services

SCE did substantiate the services provided by [redacted] relating to the "pay for performance" portion of the contract. [redacted] is the program implementer for the [redacted] Program. In this upstream program, the program implementer does not *install* equipment but rather incents the air conditioning distributor to stock and sell efficient air conditioners. As a result, payment to [redacted] should not be traced to any specific installation service rendered by [redacted] The following graphic explains how the upstream program works with the [redacted] supply chain:

Illustration 1:

The [redacted] supply chain & [redacted] program key stakeholders



1. ***UAFCB condition***: *SCE reimburses [redacted] for incentive payments to distributors without requesting or verifying any invoice that the distributors submit to [redacted]*

SCE does not reimburse [redacted] for incentive payments to distributors without verifying the invoice submitted by [redacted] In accordance with the contract, SCE "may, in its sole discretion, require [redacted] to provide such other reports or documentation that SCE deems appropriate or necessary [including invoices submitted to [redacted]." In lieu of distributors' invoices, SCE has processes in place to review the invoice, perform inspections, and monitor program performance.

Upon receipt of the invoice, SCE validates customers are SCE customers with an active service account. SCE also reviews equipment information to verify it qualifies for the program, matches with the information provided into the program database by the Distributor (e.g. serial number, equipment model), and has the correct energy savings associated with the related measure. In addition, SCE contracted with an independent vendor to conduct post-installation verification for SCE's [redacted] Program. This vendor is tasked with visiting customer sites to ensure the energy efficient equipment reported by the distributors was actually installed at the sites selected for inspection. Specifically, field technician is sent to a customer's location to verify the unit is at the location, matches the serial number provided by the distributor, and a picture is taken of the unit and nameplate. SCE has the right to request invoices from the distributors at any time. However, SCE primarily relies on physical inspections to substantiate installation. These inspections verify that the equipment and customer exist, are valid (e.g. serial numbers match), and all information agrees with the invoice submitted by [redacted] Lastly, SCE monitors the work performed through performance metrics such as, but not limited to, installed tons of [redacted] equipment compared to projected, cost effectiveness of the program, and total kWh/kW energy savings compared to forecasted energy savings.

*2. **UAFCB condition:** "In addition, SCE paid [redacted] $2,434,561 as "pay for performance." The agreement between SCE and [redacted] defines "pay for performance payments as "payments subject to the satisfactory completion by consultant of the installation of projects/measures." SCE explained to UAFCB that "the pay for performance payment is the actual cost of installing the equipment. However, after UAFCB's analysis determined that [redacted] never installed any equipment and that there was no justification for SCE to pay [redacted] the amount for installation of equipment as performance fees, SCE revised its explanation...*

At one point during the audit, SCE did incorrectly explain to the UAFCB that "the pay for performance payment is the actual cost of installing the equipment."[32] In a follow-up discussion with the auditor, it was apparent that the response submitted was in error. SCE reviewed the information submitted and discovered an incorrect attachment in the data

[32] In April 2014, UAFCB requested further clarification of how to review [redacted] invoice package. In response, SCE answered UAFCB's questions through interviews and provided documents to demonstrate the process (DATA REQUEST SET 2011-2012 EE Audit DWA-CPUC-SCE-Email-030, Questions 1 and 2). SCE provided one document that contained an incorrect definition of pay for performance (DATA REQUEST SET 2011-2012 EE Audit DWA-CPUC-SCE-Email-030, Question 2).

response. SCE amended the response the following day with the corrected statement, "The Pay for Performance Payment is the fixed cost per ton to deliver the program."[33]

Pay for Performance payments are subject to the satisfactory completion of actual energy savings and demand reduction goals per the established milestones. SCE pays [redacted] the pay for performance fee (only after the [redacted] distributors have delivered equipment to the marketplace and [redacted] has reimbursed the distributor) for "program implementation", which encompass the activities listed in the summary table below, and described in more detail as follows (and as outlined in the SCE purchase order with [redacted]:[34]

- Develop and maintain technical documentation, which includes analyzing historical program performance and [redacted] product availability, setting performance tiers, determining appropriate incentive levels, assessing the potential for new measures, and maximizing program cost effectiveness. (See Attachment 9.1)

- Prepare information and training materials to make sure key stakeholders, such as SCE personnel or [redacted] equipment distributors understand the program features, including the statewide database, and can communicate them to Contractors/Customers. (See Attachments 9.2.1 – 9.2.2.)

- Develop/expand its relationships with [redacted] distributors to establish industry buy-in and educate them on the program, qualifying technologies, incentives levels, and eligibility requirements. (See Attachment 9.3)

- Enroll Distributors into the Program through the execution of a Program Participation Agreement,[35] assist with the application process, and educate them using the training materials developed in the first bullet. (See Attachments 9.4.1 – 9.4.3)

- Maintain the online database, www.CAinstantrebates.com, to ensure Distributors can apply, enter sales (and related measure) information, enter customer data, and the program implementer can run reports to measure program performance. (See Attachment 9.5)

- Track program performance, such as distributors who decide to opt out of the program, Distributor sales of eligible measures, Incentives paid, and Distributor complaint resolution. (See attachments 9.6.1 – 9.6.3)

[33] SCE submitted the correct document, explained the mistake, and provided the correct definition of pay for performance. Please refer to Data Request Set 2011-2012 EE Audit DWA-CPUC-SCE-Email-030 Amendment.

[34] Please refer to P[redacted] Change Order 3, sections 1, 2 and 5 provided in 2011-2012 EE Audit DWA-CPUC-SCE-010.

[35] Distributor agreements were provided to UAFCB in 2011-2012 EE Audit DWA-CPUC-SCE-010.

b. Summary

The purpose of the [redacted] Program is to provide incentives to high efficiency [redacted] equipment distributors to utilize their strategic locations at the beginning of the supply chain and their ability to move significant quantities of [redacted] equipment to the marketplace. In addition, the program is designed to create a channel of communication from the Distributor to the Contractor to the Customer on the benefits of high efficiency [redacted] equipment. Under a contracted arrangement, the vendor is subject to a payment structure, which includes three components to [redacted] performance based payments:[36]

- Pay for Performance – the fixed cost per ton to deliver the program
- Incentive Payments – the actual rebate per unit
- Processing Fee – the amount to process the incentive payment

The following table summarizes the [redacted] contract with a brief description of the services provided:

Table 1: Summary of [redacted] contract components:

	Contract Components		
3 "fee" arrangements	**1. Pay for Performance Fees**	**2. Incentive Fees**	**3. Processing Fees**
Calculation of Fee Paid	$/ton	$/measure	Fixed % of incentive amount
Description of work performed	Develop Technical documentation Educate and Train key stakeholders Enroll distributors Establish industry buy-in Assist with/review applications Maintain www.CAinstantrebates.com Track & report on program performance	SCE reimburses [redacted] for rebates calculated based on an approved measure list, defined in Appendix I of the P.O.	SCE reimburses [redacted] for the following: Processing incentive payments Prepare equipment summaries and provide program data

SCE will evaluate whether additional internal controls can be added to improve overall management of the program. Any additional internal controls will be included in the plan provided under observation 23.

[36] Provided in 2011-2012 EE Audit DWA-CPUC-SCE-Email-030.

5. Lack of Supporting Documentation: Draft Observation 11

Draft Observation 11: *SCE provided less than adequate supporting documentation to justify the accrual of an invoice totaling $3,239,657 at the end of 2012.*

Draft Recommendation 11: *SCE should make sure that amounts accrued are supported by information that can be verified.*

SCE disagrees with the UAFCB's draft observation that SCE provided less than adequate supporting documentation to justify an accrual of an invoice totaling $3,239,657 at the end of 2012. SCE did confirm that amounts accrued were supported by information that could be verified. SCE provided the invoice and supporting documents it had received prior to December 31, 2012, which is the support detailing why this expense was appropriately accrued (that is, it was a known expense of appreciable amount). At December 31, 2012, SCE did not have the final invoice, but accrued this invoice based on the information provided in the preliminary invoice package, which stated the period for when the work was performed (December 2012). In a follow-up data request, SCE referred the UAFCB to the areas of the invoice package indicating the work was performed in 2012.[37] In January 2013, SCE's accounting system automatically reversed all accruals. In 2013, SCE received the final invoice from this vendor and at that time SCE recorded the invoice payment. UAFCB did not request the supporting documents for the 2013 expense; therefore, SCE did not provide the final invoice. SCE has compiled additional work papers to support what was paid in 2013. In 2013, SCE received the "Project Completion Detailed Summary" for each project being invoiced, which was needed to process the final invoice. SCE has included these documents with this response as Attachment 11.1.

6. Fixed Price Contracts: Draft Observations 4 and 7

Draft Observation 4: *Of the $1,260,276 3P administrative costs that the UAFCB sampled, 53.6% or $675,528 were either inaccurate or were not adequately substantiated by supporting documents.*

Draft Recommendation 4: *The Energy Division should meet with SCE to discuss its contracting practices and how 3P invoices for fixed price or performance contracts should be presented to SCE for reporting purposes. The Commission can also decide the matter in the current motion before it with input from the UAFCB and SCE. A Commission hearing may be needed to resolve the issue.*

Draft Observation 7: *Out of $47 million of the direct implementation contract costs that the UAFCB selected, 46% or $21.5 million were either inaccurate or not adequately substantiated by supporting documents and were likely misclassified.*

[37] See Follow-up DR to DR10 & 11 Q2d.

Draft Recommendation 7: *The Energy Division should meet with SCE to discuss its contracting practices and how 3P invoices for fixed price or performance contracts should be presented to SCE for reporting purposes. The Commission can also decide the matter in the current motion before it with input from the UAFCB and SCE. A Commission hearing may be needed to resolve the issue.*

SCE agrees with UAFCB that the Energy Division should meet with SCE to discuss its contracting practices and how third party program implementer invoices for fixed price (a.k.a., performance) contracts should be presented by SCE for reporting purposes. Following the issuance of the 2011 Final EE Audit Report, SCE initiated a series of discussions with Energy Division regarding the issue, and in May 2014 SCE filed a motion requesting Commission clarification regarding the appropriate use of fixed price contracts. As the UAFCB notes, this motion is still pending, and to date, the IOUs have not received additional guidance or clarification. SCE continues to report costs for fixed price contracts in the same manner, until further clarification is received from the Commission.

Notwithstanding this recognized need to for clarification, as explained in SCE's Response to the 2011 UAFCB Audit Report, SCE has complied with all reporting requirements to the extent possible given the nature of fixed price contracts. The Commission has consistently directed IOUs to increase the use of fixed-price contracts recognizing the resulting benefits to ratepayers.[38] SCE made best efforts to comply with Commission direction to implement such contracts while still following Commission mandated cost allocation reporting requirements. SCE reports cost allocations individually and uniquely for each fixed price contact. The fixed-price contract structure is fundamentally incompatible with the UAFCB's desire to individually verify the components of that fixed cost. SCE looks forward to working with the Energy Division to resolve these questions.

7. **Misclassification of Costs: Draft Observation 10**

Draft Observation 10: *SCE over reported its direct implementation cost by at least $65,329 or 8% of the sample selected in the amount of $816,612.*

Draft Recommendation 10: *SCE should provide additional training to employees or non-employees entering the data in its systems to ensure that they are able to input the correct data into the systems.*

SCE agrees with draft observation 10 and will make correcting entries to transfer the appropriate amount to the correct reporting categories.

SCE agrees to provide the UAFCB an internal controls report describing improvements and changes to internal controls for energy efficiency programs within 90 days of the issuance of the Final Report.

[38] See D.12-05-015, p.154.

8. On Bill Financing Loan Balance and Billing: Draft Observations 12

Draft Observation 12: *SCE did not properly account for its OBF funds and provided UAFCB with data associated with the $32 million OBF revolving loan pool that was inaccurate.*

Draft Recommendation 12: *SCE should provide supporting documentation to UAFCB to verify that the customer accounts with overbilling did in fact receive the appropriate credit. In addition, SCE should strengthen its policies and procedures to eliminate these types of errors.*

UAFCB believes that the Internal Audit (IA) Department of SCE should include this matter in its next scope of audit to clean up this recurring problem.

SCE is providing supporting documentation that verifies that the customer accounts with the overbillings did in fact receive the appropriate credit.[39] SCE implemented a new procedure after the September 30, 2013 Audit Report was issued.

SCE agrees to provide the UAFCB with an internal controls report describing improvements and changes to internal controls for energy efficiency programs within 90 days of the issuance of the Final Report.

SCE will also provide its internal Audit Services Department (ASD) a copy of the Final Report and will request observation 12 be included in ASD's annual risk assessment, which is one of the determinants used to establish the schedule of internal audits for the year.

SCE believes Tables A-3 and A-4 on page A-13 contain incorrect information:

- Table A-3 Loan #[redacted]contains incorrect total payments as of December 31, 2012. The revised amount should be $55,092.73, based on an error of one monthly payment of $9,239.01, not two as stated in the Draft Report.
- Table A-4 Loan #[redacted]contains outdated values. Although SCE provided updated amounts to the UAFCB during discovery,[40] the original (incorrect) value remains. SCE updated the "Reported Outstanding" value as of December 31, 2012 to be ($216.01).

9. Corrections to Fund Shifting Reports: Draft Observations 14, 15, 16, 17, & 18

Draft Observation 14: *SCE shifted $4.8 million into On Bill Financing (OBF) without filing an advice letter with the Commission as required by it. In addition, SCE incorrectly reported the $4.8 million shifted as funds authorized when authorization was not granted by the Commission.*

[39] See Attachments 12.1, 12.2, and 12.3.
[40] See data request 5, Question 3 Amendment.

Draft Recommendation 14: *SCE should strengthen its policies and procedures in place to ensure compliance with Commission directives.*

Draft Observation 15: *In its first quarter 2012 EEGA Report, SCE incorrectly reported that Resolution E-4474 authorized fund shifts totaling $29,000,000.*

Draft Recommendation 15: *SCE should exercise due diligence to ensure that its reports are accurate before submitting them to the Commission and posting them to EEGA.*

The Energy Division should provide the necessary guidance to the reporting utilities on where and how to reflect prior corrections to monthly, quarterly, and annual reports in EEGA

Draft Observation 16: *In its second quarterly fund shift report for 2012, SCE reported a shift of $14.8 million from the Commercial Deemed Incentive sub- program to the Industrial Calculated Incentive sub program instead of reporting the $14.8 million from the Industrial Calculated Incentive sub- program to the Commercial Deemed Incentive sub-program as provided by Resolution E-4474.*

Draft Recommendation 16: *SCE should exercise due diligence to ensure that its reports are accurate before submitting them to the Commission and posting them to EEGA.*

The Energy Division should provide the necessary guidance to the reporting utilities on where and how to reflect prior corrections to monthly, quarterly, and annual reports in EEGA.

Draft Observation 17: *SCE reported a negative balance of ($2,822,212) in its Commercial Utility building Efficiency (CUBE) program during the second and third quarter 2012 without filing an advice letter.*

Draft Recommendation 17: *SCE should ensure that its reports are accurate before submitting them to the Commission and posting them to EEGA.*

The Energy Division should provide the necessary guidance to the reporting utilities on where and how to reflect prior corrections to monthly, quarterly, and annual reports in EEGA.

Draft Observation 18: *During the second and third quarter of 2012, SCE incorrectly reported a total fund shift of $6,661,492 previously authorized and that it already shifted in 2011.*

Draft Recommendation 18: *SCE should exercise due diligence to ensure that its reports are accurate before submitting them to the Commission and posting them to EEGA.*

The Energy Division should provide the necessary guidance to the reporting utilities on where and how to reflect prior corrections to monthly, quarterly, and annual reports in EEGA.

SCE believes it is in compliance with the Commission policies regarding CPUC reporting requirements. Because SCE's EE monthly and quarterly reports are inception-to-date (ITD) reports, when an error is caught and corrected in an ITD report, the correction is made in the most current ITD report. It is impractical to go back and restate all past reports. As explained to the UAFCB in a December 20, 2013 letter describing corrective actions from the 2011 EE Audit Report, SCE has revised its reporting procedures and now includes footnotes on all ITD reports indicating changes to prior reports. SCE welcomes any guidance from the Energy Division on where and how to reflect prior corrections to monthly and quarterly reports submitted to the Commission.

SCE agrees that there were five fund-shifting reporting errors that were caught and corrected by SCE during 2012, prior to the UAFCB audit, demonstrating the effectiveness of SCE's self-monitoring detective control environment.

SCE agrees to provide the UAFCB an internal controls report describing improvements and changes to internal controls for energy efficiency programs within 90 days of the issuance of the Final Report.

SCE disagrees with the UAFCB assertion on page A-15, that "SCE's comments contradict its own records and previous statements." The statements of "a $20.8 million fund shift to OBF loan budget provided the funding necessary to clear the 2011 wait list and allowed the program to accept additional projects for 2012" and "$4.8 million was not needed because the level of demand did not materialize" are not contradictory. At the time of the fund shift, the expectation of program demand was that the $20.8 million would be needed to fund all loans requested. That expected demand did not materialize. SCE was able to fund all projects that existed on the wait list at the time of the fund shift, and due to the absence of demand, no further loans were placed on a wait list, which SCE reported to UAFCB on July 10, 2013 as stated in the report.[41]

10. <u>Balancing Accounts: Draft Observations 19 and 20</u>

Draft Observation 19: *SCE did not demonstrate compliance with §§ 581 and 584. SCE's 2012 On Bill Financing balancing account contains inaccurate data.*

Draft Recommendation 19: *SCE should follow Commission's directives. In addition, SCE should strengthen its policies and procedures to eliminate or substantially reduce the level of errors included in its reports.*

Draft Observation 20: *SCE's 2012 Procurement Energy Efficiency Balancing Account (PEEBA) and Public Purpose Program Adjustment Mechanism (PPPAM) did not include accurate data. SCE did not reflect the revised annual authorized amount for OBF in the PPPAM. Labor costs captured in PEEBA were estimated.*

Draft Recommendation 20*: SCE should follow Commission's directives by complying with the authorized preliminary statements for the approved regulatory accounts.*

[41] See data request 5, question 6.

SCE disagrees with draft observation 19 because it is incorrect and should be removed from the final audit report.

On page A-18, the Draft Report states that "SCE's OBF authorized funding as of March 8, 2012 was increased to $32 million for its 2010-2012 cycle," and that "In 2012 SCE failed to update its annual OBF authorized funding after the increase from $16 million to $32 million."[42]

The Draft Report misinterprets what the Commission ordered in Resolution E-4473. The Commission did not order the authorized funding to be increased by $16 million, but rather required SCE to "...transfer $16 million in pre-2010 unspent, uncommitted energy efficiency funds to support additional OBF loans for commercial, industrial and government/institutional non-partners."[43] An authorized shift/transfer of funds is not the same as an authorized increase in revenue requirement for additional funds. SCE's Preliminary Statement DDD (On Bill Financing Account) allows SCE to make a debit or credit entry, as appropriate, to record transfer of amounts to or from other accounts as approved by the CPUC (which SCE did, correctly, as demonstrated in the next paragraph). Because SCE was never authorized to increase OBF funding by an additional $16 million through an increase in the revenue requirement, but only to transfer previously collected unspent funds, the calculation using a $32 million authorized budget shown in footnote 9 on page A-19 is incorrect.

In compliance with Resolution E-4473, SCE transferred $16 million from the Procurement Energy Efficiency Balancing Account (PEEBA) (i.e. uncommitted energy efficiency funds) to the OBF Balancing Account (OBFBA) in June 2012. In doing so, this achieved the Commission's objective to have more funds available to support additional OBF loans. SCE followed the direction of Resolution E-4773 and increased the funds available for the OBF loan program. In compliance with Resolution E-4473, SCE filed Advice Letters 2710-E and 2710-E-A, which among other things, confirmed the transfer of $16 million of uncommitted energy efficiency funds to the OBF balancing account for use to fund additional loans. These advice letters were approved by the Energy Division and made effective on May 25, 2012. As such, Commission directives were followed and approved by the Energy Division.

Finally, the draft observation states that SCE's 2012 OBFBA is wrong because it "1) does not reflect the adjustment that SCE discovered during the reconciliation of its OBF transactions and 2) it does not reflect overbilling errors to several customers during 2012 that did not correct until 2013." This is precisely why the Commission establishes balancing accounts. From time to time, there are adjustments, such as the adjustments discovered during SCE's reconciliation, which need to be made to entries that have previously been recorded in a balancing account. When an adjustment must be made, the company does not go back and "restate" the balancing

[42] The Draft Report cites Resolution E-4473 in footnote 8 on page A-18 as the reason for the increase in SCE's OBF funding by $16 million.

[43] See OP No. 1 of Resolution E-4473

account, but rather records correcting entries in the account once the need for the adjustment is known.

SCE disagrees with draft observation 20 that states SCE has errors in PPPAM and PEEBA. First, the data included in PPPAM is accurate. As mentioned in the response to draft observation 19 above, there was no need to reflect updated authorized funding in the PPPAM because the $16 million was a Commission-approved fund shift (i.e. transfer) of pre-2010 unspent, uncommitted energy efficiency funds from the PEEBA to the OBFBA. This transfer was made in June 2012 as approved by Resolution E-4473 and Advice Letters 2710-E/2710-E-A. The authorized amounts for PEEBA and OBFBA remained unchanged until the Commission issued D.12-11-015 for the 2013-2014 authorized funding levels.

Second, the labor data included in PEEBA was not estimated. As described in the response to draft observations 1, 2, and 20 regarding labor, SCE does not record estimated labor costs. SCE records the amount that goes out of HCCs (standard labor + recalc/reval) to SCE's Cost Objects which tie to balancing accounts. This amount is equal to what goes into HCCs (actual labor) which ties to SCE's audited General Ledger.

11. <u>Internal Audit Reports: Draft Observation 21</u>

Draft Observation 21: *In its Internal Audit reports, dated March 14, 2012; April 25, 2012 and February 12, 2013, UAFCB noted that each internal report revealed control weaknesses. The observations associated with the control weaknesses as indicated in its internal reports for the year 2011 and 2012 are similar to observations UAFCB noted during its examination of 2011-12 EE accounting, recording, reporting activities, including directives from the Commission and SCE's policies, processes, and procedures.*

Draft Recommendation 21: *SCE should exercise due diligence to ensure that its reports are accurate before submitting them to the Commission and posting them to EEGA.*

SCE has processes in place to ensure that reports submitted to the Commission are accurate before submitting and posting them to EEGA.[44] SCE continuously reviews and improves reporting processes on an ongoing basis, as needed.

The internal audit reports referenced in draft observation 12 conclude that the processes and controls in place were sufficient to provide reasonable assurance that energy savings and program expenditures generally complied with CPUC program guidelines and company policies.[45]

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[44] In 2014, the California Energy Efficiency Statistics (EEStats) went live, replacing EEGA. See Attachment 21.1

[45] See SCE internal audit reports titled: 2011 Energy Efficiency (EE) Programs and Savings Review, dated March 14 2012; 2011 Energy Efficiency (EE) Programs Balancing Accounts, dated April 25, 2012; 2012 Energy Efficiency (EE) Savings Review, dated February 7, 2013; and 2012 Energy Efficiency (EE) Programs Balancing Accounts Review, dated February 12, 2013.

The March 14, 2012 internal audit report for the 2011 Energy Efficiency Savings Review found small discrepancies due to human error that SCE corrected prior to preparing the 2011 CPUC EE Annual Report filed in 2012. SCE's ASD did not observe that "SCE inadvertently reported inaccurate energy savings data to the Commission's Energy Division" as stated in the Condition section to draft observation 21. In addition, the 2012 Internal Audit Energy Efficiency Savings Review, issued on February 7, 2012, identified no control weaknesses relating to reported energy savings and commended EE management and personnel for implementing recommendations from the prior audit.

Further, as described in SCE's response to draft observation 6, the allegation that SCE intentionally reported inaccurate energy savings to the Commission is inaccurate. This allegation should be removed in the final report.

SCE agrees to provide the UAFCB an internal controls report describing improvements and changes to internal controls for energy efficiency programs within 90 days of the issuance of the Final Report.

12. UAFCB Audit Reports: Draft Observation 22

Draft Observation 22: *SCE demonstrates compliance with the UAFCB's recommendations from prior two examinations except for some as discussed below.*

Draft Recommendation 22: *SCE should work on strengthening its internal controls for recording and reporting its EE to prevent future misreporting and misclassifications of SCE's EE, and exercise due diligence in reviewing and approving all invoices to ensure that the EE expenditures are accurately classified and properly recorded in its accounting system.*

SCE agrees to provide the UAFCB an internal controls report describing improvements and changes to internal controls for energy efficiency programs within 90 days of the issuance of the Final Report.

13. Internal Controls: Draft Observation 23

Draft Observation 23: *As shown throughout this report, SCE did not demonstrate compliance with the Commission's EE reporting requirements, its own policies and procedures, the USOA, GO 28, §§ 581 and 584 and accounting best practices. As demonstrated in previous observations, SCE does not adequately control its data for EE reporting and record keeping.*

Draft Recommendation 23: *Within 90 days from the date of this report, SCE should strengthen its internal controls for recording and reporting its EE to prevent future misreporting and misclassifications of SCE's EE, and provide UAFCB a copy of its revised internal controls. In addition, SCE should describe how it will monitor and vigorously enforce its controls to improve its recording and reporting. While a small percentage of errors can be tolerated, SCE should* *improve its controls to minimize recording and reporting errors and thereby eliminate the widespread errors occurring throughout the recording and reporting of SCE's EE activities.*

SCE agrees to provide the UAFCB an internal controls report describing improvements and changes to internal controls for energy efficiency programs within 90 days of the issuance of the Final Report.

Appendix A: Summary of Attachments

1. Overstatement of Expenditures: Observation 6
[redacted]
[redacted]
2. Labor: Observation 1, 2, and 20
Attachment 2.1
Sample 1 - SCE Payroll and Labor Flow
Sample 2 - SCE Payroll and Labor Flow
Sample 3 - SCE Payroll and Labor Flow
Sample 3 - SCE Payroll and Labor Flow
Sample 4 - SCE Payroll and Labor Flow
Sample 5 - SCE Payroll and Labor Flow
Sample 6 - SCE Payroll and Labor Flow
Sample 7 - SCE Payroll and Labor Flow
Sample 8 - SCE Payroll and Labor Flow
Sample 9 - SCE Payroll and Labor Flow
Sample 10 - SCE Payroll and Labor Flow
Sample 11 - SCE Payroll and Labor Flow
Sample 12 - SCE Payroll and Labor Flow
Sample 13 - SCE Payroll and Labor Flow
Sample 14 - SCE Payroll and Labor Flow
Sample 15 - SCE Payroll and Labor Flow
Sample 16 - SCE Payroll and Labor Flow
Sample 17 - SCE Payroll and Labor Flow
Sample 18 - SCE Payroll and Labor Flow
Sample 19 - SCE Payroll and Labor Flow
Sample 20 - SCE Payroll and Labor Flow
Sample 21 - SCE Payroll and Labor Flow
Sample 22 - SCE Payroll and Labor Flow
Attachment 2.2
3. Year End Accruals: Observations 3, 5, 8, and 13
[redacted]
[redacted]
[redacted]
[redacted]
[redacted]

4. Lack of Supporting Documents: Observation 9
[redacted]
5. Lack of Supporting Documents: Observation 11
[redacted]
6. Misclassification of Costs: Observation 10
No Attachments
5. Fixed Price Contracts: Observations 4 and 6
No Attachments
8. On Bill Financing: Observation 12
[redacted]
9. Corrections to EEGA Fund Shifting Reports: Observations 14, 15, 16, 17, & 18
No Attachments
10. Balancing Accounts: Observations 19 and 20
No Attachments
11. Internal Audit Reports: Draft Observation 21
Attachment 21.1