State of California

Memorandum

Date: September 19, 2013

To: Michelle Cooke
Deputy Director, Operations and Budget

From: **Public Utilities Commission — San Francisco**
Kayode Kajopaiye, Branch Chief
Division of Water and Audits

Subject: **Energy Efficiency Programs (EE) Financial Compliance Examination Report of Southern California Gas Company (SCG) For the Period January 1, 2011 through December 31, 2011**

Except for the issues discussed below, SCG demonstrated to a reasonable degree compliance with respect to accounting, recording, and reporting of its 2011 EE portfolio transactions examined by the Utility Audit, Finance and Compliance Branch (UAFCB), when it conducted a Financial Compliance Examination of SCG's EE portfolio expenditures. UAFCB did not find any reported costs that SCG should not have its incentives calculated on.

UAFCB conducted this examination pursuant to Decision (D.) 12-12-032.[1] UAFCB's examination was limited in scope and included SCG's, Third Party (TP), and Local Government Partnership (LGP) Administrative Costs related to the programs, Contracts, On-Bill Financing (OBF), and Multi-Family Energy Efficiency Rebates (MFEER).

This report only addresses observations that pertain to reporting misstatements or inaccuracies. The report excludes any management or regulatory compliance issues for program year 2011 that did not directly result in misstatements or inaccuracies in the program expenditures as reported by SCG. UAFCB will address other management or regulatory compliance issues pertaining to 2011 in its subsequent report, covering program years 2011-2012.

A. Summary of Examination, Observations, and Recommendations

The following is a brief summary of UAFCB's observations and recommendations resulting from its examination. A detailed description of UAFCB's analysis and observations is included in Appendix A.

Observation 1: SCG failed to demonstrate compliance with Public Utilities Code (PUC) §§ 581 and 584. SCG reported Non-IOU Third Party and Local Government Administrative costs totaling $3.26 million in the Marketing cost category as shown in its cumulative report in Table 3 of the 2011 Annual Report.

[1] In D.12-12-039, on page 40, the Commission discussed that it anticipates relying on public versions of UAFCB's examination reports when determining the amount of each utility's incentives. In Conclusion of Law (COL) No. 9, the Commission indicated that upon completion, UAFCB shall serve a notice of availability of its report on the service list in R.12-01-005, or its successor.

Recommendation: The Energy Division should provide a separate line item in Table 3 for utilities to present accurate and proper reporting as recommended in the examination memo report for 2010. The present reporting requirement does not allow for accuracy in reporting and not in compliance with D09-09-047, Ordering Paragraph (OP) 13 a and b.

Observation 2: SCG failed to demonstrate compliance with PUC §§ 581 and 584 and the Commission's reporting directives.[2] With respect to the sample selected for substantive testing of Administrative Costs for Third Party, SCG misclassified Marketing and Direct Implementation costs totaling $162,125 as Non-IOU Third Party Administrative costs.

Recommendation: SCG should pay attention to how it classifies its costs to different cost categories to avoid future misclassifications.

Observation 3: UAFCB did not find any exceptions during its examination of SCG's payments to Third Party Contractors for direct implementation charges. SCG disbursements and Third Party contractor billings complied with the set pricing for measure/installation, tasks/deliverables, and hourly rates specified on the contracts. SCG charged expenses to the approved budget and complied with the contract terms.

Recommendation: None

Observation 4: UAFCB did not find any exceptions during its examination of invoices and supporting documentation for administrative, marketing and direct implementation expenses that SCG charged to the 2011 OBF program. In addition, during its review of selected files for loans created in 2011, UAFCB found that SCG's non-residential customers met the OBF eligibility requirements. SCG calculated loan amounts and payback terms consistently for loans generated and disbursed to qualifying customers.

Recommendation: None

Observation 5: UAFCB did not find any exceptions during its review of invoices and supporting documentation for administrative, marketing and direct implementation expenses and rebates charged to the MFEER program. In addition, during its review of selected inspection reports, UAFCB observed that inspectors confirmed that the installation/equipment indicated on the rebate application form was installed at the address indicated on the form, matched the supporting invoice/receipt, and was operational at the time of inspection.

Recommendation: None

B. Examination Process

Based on consultation with the Energy Division, UAFCB's prior experience in examining Southern California Gas' programs, and the results of UAFCB's risk assessment, UAFCB focused its examination on the areas mentioned above and evaluated compliance with accounting, recording, and

[2] ALJ Gottstein's Ruling in R.01-08-028, dated February 21, 2006, addressed and listed allowable costs and delegated authority to Energy Division to provide further clarification to the reporting requirements and list of costs. ED's memo, dated October 22, 2009, expanded cost definitions and defined how costs should be treated.

reporting program expenses during 2011 and the associated controls and procedures in place to safeguard such activities. Pertinent information about SCG's EE is found in Appendix B.

UAFCB provided a copy of its analysis, observations and recommendations to SCG for its comment. UAFCB summarized SCG's comments, including UAFCB's rebuttal to those comments in Appendix A.

C. Conclusion

Except for the items discussed above, SCG demonstrated compliance with respect to accounting, recording, and reporting EE program expenses for 2011 in the limited areas the UAFCB examined.

If you have any questions on UAFCB's examination, please contact Kayode Kajopaiye.

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Appendix A
Analysis and Findings

A.1 Introduction

Except for the issues discussed below, Southern California Gas Company (SCG) demonstrated to a reasonable degree its compliance with respect to accounting, recording, documentation maintenance, and reporting of its 2011 Energy Efficiency program (EE) portfolio transactions examined by the Utility Audit, Finance and Compliance Branch (UAFCB).

UAFCB's examination was limited in scope. UAFCB limited the areas it tested and for those areas it tested, it did not test 100 percent of the recorded costs. UAFCB included the following cost categories in its examination:

1. SCG Statewide (Investor Owned Utility, IOU), Third Party (TP), and Local Government Partnership (LGP) Administrative Costs;
2. EE Contracts;
3. On-Bill Financing (OBF); and
4. Multi-Family Energy Efficiency Rebates (MFEER)

This report only addresses observations that pertain to reporting misstatements or inaccuracies. The report excludes any management or regulatory compliance issues for program year 2011 that did not directly result in misstatements or inaccuracies in the program expenditures as reported by SCG. UAFCB will address other management or regulatory compliance issues pertaining to 2011 in its subsequent report, covering program years 2011-2012.

On September 5, 2013, the UAFCB submitted a copy of its draft report to SCG for its review and comments. The draft report included UAFCB's observations and recommendations for the specific areas reviewed during the examination. SCG provided its comments on September 10, 2013. UAFCB includes a summary of SCG's comments and UAFCB's rebuttal in the following sections.

A.2 Administrative Costs

Observation 1: SCG failed to demonstrate compliance with Public Utilities Code (PUC) §§ 581 and 584. SCG reported its Non-IOU Third Party and Local Government Administrative costs totaling $3.26 million in the Marketing cost category as shown in its cumulative report in Table 3 of the 2011 Annual Report.

> **Criteria:** PUC §§ 581 and 584 require that utilities provide complete and accurate data to the Commission.
>
> **Condition:** SCG's 2011 Management Workbook (Program-To-Date) shows that $3.26 million is the 2011 cumulative expenditures (2010 and 2011) for Non-IOU administrative costs that SCG classified as marketing costs in Table 3 of the 2011 Annual Report.

In the following table, UAFCB shows a detailed breakdown of the $3.26 million Non-IOU cumulative administrative costs for 2010 and 2011.

Table A-1
SCG 2011 Cumulative Non-IOU Administrative Costs

Program	2010	2011	Total
Statewide	$ 0	$ 0	$ 0
Third Party	1,481,316	1,482,938	2,964,254
LGP	221,109	72,573	293,682
Total	**$1,702,425**	**$1,555,511**	**$3,257,936**

Cause: SCG combined the Non-IOU administrative cost of $3.26 million with marketing cost of $6.88 million and reported a total of $10.14 million under the Marketing/Advertising/ Outreach Cost Category in Table 3 of its 2011 Annual Report. This could be due to the lack of a separate line item for Non-IOU administrative costs in Table 3.

Effect: The misclassification overstates the Marketing/Advertising/Outreach/ Cost Category by $3.26 million and the Non-IOU Administrative Cost Category is understated by the same amount. The misclassification does not have any effect on the total portfolio expenditures for 2011.

SCG's Comments: SCG will work with Energy Division to address any modifications needed to the existing reporting requirements.

UAFCB Rebuttal: None.

Recommendation: The Energy Division should provide a separate line item in Table 3 for utilities to present accurate and proper reporting as recommended in the examination memo report for 2010. The present reporting requirement does not allow for accuracy in reporting and not in compliance with D09-09-047, Ordering Paragraph (OP) 13 a and b.

Observation 2: SCG failed to demonstrate compliance with Public Utilities Code (PUC) §§ 581 and 584 and the Commission's reporting requirements. [1] With respect to the sample selected for substantive testing of Administrative Costs for Third Party, SCG misclassified Marketing and Direct Implementation costs totaling $162,125 as Non-IOU Administrative costs.

Criteria: PUC §§ 581 and 584 require that utilities provide complete and accurate data to the Commission. ALJ Gottstein's Ruling and Energy Division specified how costs are to be properly accounted for and categorized.

[1] See ALJ Gottstein's Ruling in R.01-08-028, dated February 21, 2006, which addressed and listed allowable costs and delegated authority to Energy Division to provide further clarification to the reporting requirements and list of costs. ED's memo, dated October 22, 2009, expanded cost definitions and defined how costs should be treated.

Condition: Non-IOU administrative cost for Third Party is overstated by $162,125. SCG misclassified Direct Implementation costs of $161,580 (net of retention) and Marketing costs of $545 in two invoices as Non-IOU administrative costs under the Administrative Cost Category. The misclassifications are reflected in SCG's November and December 2011 workbooks. SCG should have only recorded $7,533 in administrative costs instead of $169,658, the combined invoice total. Below is a breakdown of expenses for both invoices by cost category:

Table A-2
2011 Invoices with Misclassified Costs

Program ID/Name	Ref Doc No./ Invoice No.	Admin	Mkt	DI	Retention	Total
SCG3674-Upstream Gas Water Htr	5660017906 / M1006-7	$2,263	$545	$ 31,780	$ 0	$ 34,588
SCG3676-Portfolio of the Future	5660017823 / 340978	5,270	0	135,616	(5,816)	135,071
Total		$7,533	$545	$167,396	$(5,816)	$169,659

Cause: SCG misclassified the Direct Implementation and Marketing costs at the workbook level which eventually rolled up to the 2011 Management Workbook (Program-To-Date). The workbook was used as the basis for reporting costs by category in Table 3 of the 2011 Annual Report.

Effect: The $162,125 Non-IOU administrative cost is overstated while the combined Direct Implementation and Marketing costs are understated by the same amount.

SCG's Comments: SCG reviewed and acknowledged the misclassification of the two invoices. SCG continues to strengthen its internal processes by providing training courses to ensure accurate recording and reporting of expenditures, and utilizing feature automation to enhance management oversight and control.

UAFCB Rebuttal: None.

Recommendation: SCG should pay attention to how it classifies its costs to different cost categories to avoid future misclassifications.

A.3 Energy Efficiency Contracts

Observation 3: UAFCB did not find any exception in the examination of the sample of SCG's payments to Third Party Contractors' direct implementation charges. SCG disbursements and Third Party contractor billings complied with the set pricing for measure/installation, tasks/deliverables, and hourly rates specified on the contracts. SCG charged expenses to the approved budget and complied with the contract terms.

Criteria: SCG's contract policies and procedures establish the contractors' approved Budget and Compensation Schedule that sets pricing for Tasks/Deliverables, Measure, Contractor Labor Rate and/or Staffing Plan that sets hourly rates.

Condition: SCG and contractors complied with the set rates on the contract. Also, contractor invoices included expense-to-date tracking of cumulative costs to monitor the contracted budget balance during the contract period.

Recommendation: None

A.4 On-Bill Financing (OBF)

Observation 4: UAFCB did not find any exceptions in its examination of invoices and supporting documentation for administrative, marketing and direct implementation expenses charged to the 2011 OBF program. UAFCB's review of selected files for loans created in 2011 disclosed that non-residential customers met the OBF eligibility requirements. SCG calculated loan amounts and payback terms consistently for loans generated and disbursed to qualifying customers.

Criteria: General Order (GO) No. 28 requires that "every public utility … preserve all records, memoranda and papers supporting each and every entry." SCG developed its own criteria to qualify customers and projects for the OBF program.

Condition: SCG provided adequate supporting documentation for non-labor charges as well as satisfactory explanation and documentation of labor charges. Customer loan files reviewed included all paperwork required to qualify for OBF loan. SCG was consistent in calculating loan amounts and terms for all loans disbursed.

Recommendation: None

A.5 Multi-Family Energy Efficiency Rebate (MFEER)

Observation 5: UAFCB did not find any exceptions in its review of invoices and supporting documentation for administrative, marketing and direct implementation expenses and rebates charged to the MFEER program. During its review of selected inspection reports, UAFCB observed that inspectors confirmed that the installation/equipment indicated on the rebate application form was installed at the address indicated on the form, matched the supporting invoice/receipt, and was operational at the time of inspection.

Criteria: General Order (GO) No. 28 requires that "every public utility … preserve all records, memoranda and papers supporting each and every entry."

Condition: SCG provided adequate documentation for expenditure and rebate transactions examined.

Recommendation: None

Appendix B
Program Compendium

B.1 Introduction

On September 24, 2009, the California Public Utilities Commission (Commission) issued Decision (D.) 09-09-047 in which, among other things, the Commission authorized SCG a total budget of $285 million in ratepayer funds to administer and implement its Energy Efficiency programs (EE) for the years 2010 through 2012. This represents about 9.1% of the $3.1 billion total funds the Commission authorized for 2010 -2012 EE budget cycle. In addition, The Commission set energy savings goals, established cost-effectiveness requirements, placed a cap of 10 percent on utility administrative costs, authorized types of programs, and set targets for certain program administrative costs.

B.2 EE Funding Components

Of the $285 million authorized budget, the Commission dedicated $275 million of the funds to administer and implement SCG's EE and set aside the remaining $10 million to fund the Evaluation, Measurement and Verification (EM&V) portion of the program portfolio. For the year 2011, excluding EM&V expenditures, SCG spent $57.4 million, or 21%, of its total authorized budget for the 2010 -2012 budget cycle. In the following table, UAFCB shows the amount carried forward, authorized budget, funds available for spending, actual expenditures during 2011, and the amount carried forward to 2012.

Table B-1
Summary of 2011 Ratepayer Funded EE Programs
(Excluding EM&V)

Description	Amount
Amounts Brought Forward - 2010	$ 41,318,047
Authorized Budget	91,424,990
Available for Spending	132,743,037
Actual 2011 EE Expenditures	(57,381,476)
Amount Carried Forward to 2012	$75,361,561

B.3 Administrative Costs

Administrative costs incurred by SCG in direct implementation of the EE programs are classified as investor owned utilities (IOU) and Non-IOU administrative costs. IOU Administrative costs include labor (management, clerical/technical and agency), employee travel, consulting services and other services provided by contractors, materials, vacation and sick leaves, payroll taxes and allocated overhead. Also included in SCG's administrative costs are charges for services cross-billed by San Diego Gas & Electric. These include labor, payroll taxes, leaves, pension and benefits. Non-IOU administrative costs are incurred by Third Party contractors as well as government agencies participating in Local Government Partnership programs. These entities are the major implementers of the programs beside SCG.

In the following table, UAFCB presents a breakdown of SCG administrative cost cap and targets and the expected targets for the Non-IOU administrative costs.

Table B-2
Energy Efficiency Administrative Cost Cap and Expenditures For 2011

Expense Category	Amount	% to Total Budget	% Cap	% Target
Third Party & Partnership Programs - IOU Admin	$ 855,448	0.9%		10%
Local (Core & Non-Resource) Programs IOU Admin	301,363	0.3%		10%
Statewide Programs IOU Admin	4,311,532	4.7%	10%	
Total IOU Admin (Excluding EM&V)	$ 5,468,343	5.9%		
2011 Revised Operating EE Budget (Excluding EM&V)	$91,424,990			

In Ordering Paragraph (OP) 13a of D. 09-09-047, the Commission requires that the administrative costs for the utility energy efficiency programs (excluding Third Party and/or Local Government Partnership budgets) be limited to 10% of total energy efficiency budgets. SCG's IOU administrative costs were 4.7% of the 2011 Revised Operating Budget.

B.4 Energy Efficiency Contracts

The Commission requires that 20% of the energy efficiency portfolio budget, including administration, marketing, and Evaluation, Measurement, and Verification (EMV) should be administered by contractors or consultants. To comply with this requirement, SCG maintains four types of contracts. Each contract type is designed to serve specific program portfolios.

Contracts that are associated with Third Party programs generally target stand-alone programs. A distinct feature of Third Party program contracts is that the contractors are responsible for administering all aspects of the program including, administration, marketing and implementation.

On the other hand, a second type of contract involves contractors working directly to assist or supplement SCG's in-house expertise. These contractors provide specific services or product on behalf of SCG and are not necessarily responsible for administering all aspects of the program.

The third contract type consists of programs that are related to LGP programs. The focus of the LGP is to build capacity by implementing program activities within the local government area. The LGP is responsible for administering all aspects of the programs.

The fourth contract type consists of contracts between SCG and "Other Contractors or Vendors." The vendor or contractor reaches out directly or through SCG to assist customer with EE projects to access rebate or incentive programs.

B.5 On Bill Financing

In its Program Implementation Plan (PIP) SCG states that OBF is not an actual program, but rather a funding mechanism for facilitating energy savings and they are claimed via core programs as well as Partnership (local and Statewide) and Third Party Programs.

The OBF program offers zero-interest financing to facilitate the purchase and installation of qualified energy efficiency retrofit measures to non-residential customers who might not otherwise be able to act given capital constraints and/or the administrative and time burdens involved in obtaining traditional project financing. Only energy efficiency measures which qualify for rebates and/or incentives in SCG portfolio are qualified for the OBF program. The program includes Institution and Non-Institution customers such as commercial, industrial, and agricultural and tax-payer funded customers.

SCG requires that the OBF applicants meet the following requirements:

- Must be an existing non-residential SCG customer (including government accounts) or owner of residential multifamily units who does not live on the premises.
- Must have been a SCG customer for at least twenty-four (24 months) prior to the start of participation in the OBF Option and with a minimum of twelve (12) months of natural gas usage history at the current meter.
- Must be in good credit standing as determined by SCG.
- Participate in at least one (1) of the energy efficiency programs offered by SCG or an eligible Third Party Program.

SCG's OBF budget for the 2010-2012 EE program cycle was $2.6 million as set forth in Commission D.09-09-047. The budget provides for operating expenses funded by Public Goods Charge (PGC). A separate budget of $3.5 million provides for a revolving fund loan pool funded by non-PGC revenues per Commission's approval of Advice Letter No. 4035.

In 2011, SCG spent $303,603 for the OBF program of which it charged 75% to Direct Implementation. In D.09-09-047, page 50, the Commission allows for non-resource programs such as OBF to treat as Direct Implementation those costs associated with activities that are a direct interface with the customer or program participant or recipient. In the following table, UAFCB shows the OBF expenditures by type.

Table B-3
2011 On-Bill Financing Program Expenditures

Expenditure Type	Labor	Non-Labor	Allocated Overheads	Total
Admin-IOU	$ 32,499	$ 45	$13,871	$ 46,416
Marketing/Outreach	22,689	6,641	0	29,330
Direct Implementation	219,528	8,330	0	227,858
Total Expenditures	**$274,716**	**$15,016**	**$13,871**	**$303,604**

SCG states that none of its 2011 loan disbursements were included in the recorded 2011 EE portfolio expenditures[1]. As discussed earlier, SCG disbursed only seven loans in 2011 totaling $210,218.

SCG developed its own criteria for customer and project qualifications, and formulas for loan amounts and terms. SCG's OBF underwriting guidelines include verification of customer's project cost; project eligibility for other EE rebate/ incentive program(s); and customer's utility bill payment history. The OBF loan process includes calculation of project's energy savings; post-installation inspection and project cost adjustments; calculation of loan term, loan amount (net of rebate/incentives), and monthly loan payment. In order to collect customer payments, the OBF billing is tied to SCG's utility billing system. An outstanding bill which remains unpaid for more than 145 days will be considered in default and written off to Bad Debt.

B.6 Multi-Family Energy Efficiency Rebates

The Multi-Family Energy Efficiency Rebate Program (MFEER) offers prescribed rebates for energy efficient products to motivate multifamily property owners/managers to install energy efficient products in both common and dwelling areas of multifamily complexes and common areas of mobile home parks and condominiums. The desired outcome of MFEER implementation is to realize long-term energy savings. Property owners and managers of existing residential multifamily complexes with two or more dwellings may qualify.

SCG incurred $1.04 million of various expenditures on its MFEER program in 2011. SCG recorded $ 612,421 of 58.9% in operating costs and paid customers $427,887 or 41.1% in rebates. A detailed summary of SCG's 2011 MFEER expenses and list of rebates paid are shown in the following tables.

Table B-4
2011 MFEER Program Expenditures

Expenditure Type	Labor	Non-Labor	Rebates/ Incentives	Allocated Overheads	Total
Admin-IOU	$ 115,084	$ 24,440	$ 0	$46,722	$ 186,246
Marketing/Outreach	21,616	82,631	0	0	104,247
Direct Implementation	186,539	135,389	427,887[2]	0	771,055
Total Expenditures	**$323,239**	**$242,460**	**$427,887**	**$46,722**	**$1,040,308**

Table B-5 shows the Summary of 2011 MFEER Rebate Payments including the 2010 accruals.

[1] Per response to SCG EE1112-DR011
[2] Rebate reported in SCG's 2011 Budget & Expenditure workbook of $427,887 does not include Dec 2010 accrual adjustment of $21,240. UAFCB did not include the adjustment in Table B-4.

Table B-5
Summary of 2011 MFEER Rebate Payments

Measure	Amount
Attic Insulation Total	$ 5,127
Central gas Furnace 92% AFUE	1,000
Central Natural Gas Water Heater	149,470
Dishwasher-Energy Star Tier II EF=0.68+	62,700
Energy Star Dishwasher EF=.65 -.67	10,050
Natural Gas Boilers - Water Heating Only	45,000
Natural Gas Storage Water Htr EF>= 0.62	1,830
Palm Desert Pool Heater - Early Replacement	3,000
W/H Cntrlr (>=30) Post 1970 (Digital)	1,500
W/H Cntrlr (>=30) Pre 1970 (NonDigtl)	750
W/H-Boiler Controllers = < 34 Units	60,900
W/H-Boiler Controllers = > 35 Units	107,800
Total 2011 MFEER Rebate	**$449,127**