California Public Utilities Commission

Division of Water and Audits

Financial & Management Audit
of
The Energy Efficiency Public Programs
of
San Diego Gas & Electric Company (U-0902-E)
And
Southern California Gas Company (U-0904-G)

For the Year Ended
December 31, 2007

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September 30, 2008

PUBLIC UTILITIES COMMISSION

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STATE OF CALIFORNIA

Financial and Management Audit
Energy Efficiency Programs

San Diego Gas & Electric Company and Southern California Gas Company

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Commission Staff Independent Audit Opinion

Pursuant to Commission Decision (D.) 05-01-055, 05-09-043 and 05-11-011, the Utility Audit, Finance and Compliance Branch (UAFCB), of the Commission's Division of Water and Audits, performed a financial and management audit of the energy efficiency programs administered by San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SCG). SDG&E's and SCG's management are responsible for compliance with the requirements of the aforementioned Commission Decisions.

The responsibility of the UAFCB is to express an opinion on SDG&E's and SCG's compliance with the aforementioned regulations based on its examination of SDG&E's and SCG's records. The UAFCB's examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence concerning SDG&E's and SCG's compliance with the requirements noted above and performing such other procedures as we considered necessary in the circumstances. The UAFCB audit staff believes that its examination provides a reasonable basis for an opinion. The examination does not provide a legal determination on SDG&E's and SCG"s compliance with specified requirements.

In the opinion of the UAFCB, SDG&E and SCG complied, in all material respects, with the aforementioned requirements for the year ended December 31, 2007.

This report is intended solely for the information and use of the California Public Utilities Commission and the company being examined, and is not intended to be and should not be used by anyone other than the specified parties.

Kayode Kajopaiye, Chief
Utility Audit, Finance and Compliance Branch
September 30, 2008

Financial and Management Audit
Energy Efficiency Programs

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Financial and Management Audit
Energy Efficiency Programs

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I. Executive Summary[1]

This report presents the results of the Utility Audit, Finance and Compliance Branch's (UAFCB's) audit of San Diego Gas & Electric Company's (SDG&E's) and Southern California Gas Company's (SCG's) energy efficiency programs for calendar year 2007.[2] The UAFCB was given authority to conduct this audit by Commission Decision (D.) 05-11-011, Ordering Paragraphs (OP) 1 and the Administrative Law Judge's (ALJ) Ruling, dated February 21, 2006, Ruling Paragraph 5.

The objectives of UAFCB's audit were to ensure that expenditures were properly booked to accounts and that the expenditures were properly reported. In order to accomplish the audit objectives, UAFCB staff segregated the audit into four major categories: (1) Program Accounting and Reporting; (2) Program Processes and Controls; (3) Program Implementation and Costing; and (4) Oversight and Management.

For 2007, SDG&E had an authorized budget of $84.6 million, to administer and implement its energy efficiency programs, including those conducted in partnership with other entities and those performed under contract with third parties.[3] SDG&E spent $77.7 million, of its authorized budget in 2007, or 91.7% of the authorized budget. In 2006, SDG&E had an authorized budget of $75.1 million and only spent $34.0million, or 45.2% of its authorized budget. In total, SDG&E spent $111.6 million on the energy efficiency programs for 2006 and 2007, or 69.9% of the total authorized budget of $159.8 million for the two-year period.[4]

For SCG, its 2007 authorized budget for administering and implementing its energy efficiency programs was $56.6 million. SCG spent $42.5 million, of the authorized budget in 2007, or 75%. In 2006, SCG had an authorized budget of $44.3 million and only spent $19.7 or 44.5% of its authorized budget. In total, SCG spent $62.2 million on the energy efficiency programs for 2006 and 2007, or 61.6% of the total authorized budget of $100.9 million for the two-year period.

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[1] Appendix A describes the abbreviations and acronyms used in this decision.

[2] The energy utilities also offer a special energy efficiency program to their income-qualified low-income customers through a program referred to as the Low Income Energy Efficiency Program (LIEE). The UAFCB uses the term energy efficiency programs throughout this report to refer exclusively to non-LIEE energy efficiency services.

[3] These budgets and amounts expended for SDG&E and SCG do not include amounts for evaluation, measurement and verification procedures or processes, nor do they include amounts for any administrative or oversight expenditures recovered in a general rate case.

[4] In D.05-09-043, the Commission, among other things, adopted fund shifting guidelines that allow the utilities the flexibility to carry over or carry forward funds from on program year to the next.

The UAFCB determined that both SDG&E and SCG had controls in place for ensuring compliance with Commission rules and decisions. The UAFCB, however, makes a few recommendations in the Summary of Audit Recommendations Section of this report to improve reporting of expenditures and that attention is paid to other matters of importance.

II. Summary of Audit Recommendations

Program Accounting and Reporting

1. The UAFCB discovered instances where both SDG&E and SCG provided inaccurate monthly and quarterly expenditure reports on the EEGA website. SDG&E and SCG provided updated monthly expenditure reports to the audit staff during the audit, but failed to post the revised reports to the EEGA website. For its quarterly expenditures, SDG&E failed to include $3,951,559, and SCG failed to report $3,084,647, in its Statewide Marketing & Outreach programs. Both SDG&E and SCG should implement additional procedures and controls to ensure reports are accurately posted to the EEGA website.

2. The UAFCB discovered instances where both SDG&E and SCG provided incomplete quarterly narrative reports to the EEGA website. In addition, the UAFCB also found several instances where SDG&E failed to provide quarterly narrative reports on the EEGA website. Both SDG&E and SCG should implement additional procedures and controls to ensure reports are accurately posted to the EEGA website.

3. The UAFCB reviewed and tested a sample of journal entry transactions of both SDG&E and SCG for program year 2007 and found that journal entry authorization forms submitted for the journal entries were either different in format and information or not included in the supporting documentation. Both SDG&E and SCG should develop a standardized General Ledger Checklist Authorization form for personnel to use when preparing any journal entries.

Program Implementation and Costing

The UAFCB found instances where SCG spent energy efficiency funds on entertainment and promotional activities that appear unrelated to the programs. For the samples tested, the expenditure amounts for such entertainment and promotional activities are immaterial and do not warrant a disallowance. However, such expenditures appear unrelated to energy efficiency programs and should be borne by Sempra Energy Corporation (Sempra) for promoting its image and goodwill.

Follow-up to UAFCB's Audit Recommendations on the 2006 Energy Efficiency Programs

1. In its audit report on the 2006 programs, the UAFCB recommended that SDG&E and SCG be reimbursed for interest earned on the money remitted to the BOE since 2001 in conformance with the rules for gas surcharge remittances in D.04-08-010. SDG&E and SCG should continue to seek to be reimbursed for this interest. Based on the ninety day commercial paper rate, SDG&E estimates it is owed $1.1 million in interest earned on the Gas Surcharge Fund, while SCG estimates that it is owed $6 million in interest.

2. In its audit report on the 2006 programs, the UAFCB found that Energy and Environmental Analysis, Inc.'s (EEA), in contract with SCG for technical services in support of the Local Business Energy Efficiency Program (BEEP) and Express Efficiency Rebate Program (EER), charged management labor rates for performing program tasks that should have been billed at a lower professional staff rate. The UAFCB recommended that all future third-party contracts include standard stipulations that limit the number of hours that can be charged at each billable rate. The EEA's contract for support of the BEEP and EER programs continued to charge SCG the higher management rates in 2007, while performing technical services that should have been billed at a lower rate. All future third-party contracts should include standard stipulations that limit the number of hours that can be charged at each billable rate.

III. Background

The development of energy efficiency programs in California has evolved over many years. In the early 1970s, the Oil Embargo of 1973 and the Organization of the Petroleum Exporting Countries' (OPEC) control of the petroleum market brought about long lines at the gas pump and eventually abrupt rises in electricity prices. These price increases concerned consumers in California who had grown used to low energy bills and decades of falling electricity prices. In response to consumer concerns regarding high electric bills in California, the Commission ordered California's investor owned utilities or IOUs to begin offering energy efficiency programs.

Early energy efficiency programs primarily focused on providing residential customers with energy efficiency options to reduce their bills. These early programs, known as conservation programs, offered suggestions to customers such as turning off lights in unoccupied rooms and turning down the thermostat.

By the early 1980s, energy conservation programs were starting to be replaced by a new concept termed demand-side management programs. This term, coined by the Electric Power Research Institute in mid-1983, was used to describe efforts by the IOUs to encourage consumers to modify their level and pattern of electricity usage by the use of energy efficiency products, services and practices.

Under the demand-side management, the utilities could both reduce and build load, depending on their demand-side management program and performance goals. In California, the IOUs used four different types of demand-side management programs: (1) energy efficiency programs; (2) load management programs; (3) fuel substitution programs; and (4) load building programs.
In the mid-1980s, oil and gas prices fell significantly. In addition, efforts to develop demand-side alternatives languished significantly in California, in large part because of excess generating capacity in the state. Subsequently, utilities and consumers were no longer as concerned about energy conservation and/or energy efficiency programs.

In the early 1990s, the Commission, in collaboration with other government agencies, the IOUs, and public interest groups, joined together to consider ways to revitalize the demand-side management and promote energy efficiency in California again. This group, termed the California Collaborative, developed an incentive structure that paid the utilities for every measured British Thermal Unit (BTU) or kilowatt hour saved. As a result, the utilities found energy efficiency programs profitable and initiated energy efficiency programs statewide. Under this structure, the IOUs were responsible for the administration and implementation of energy efficiency programs, subject to Commission oversight.

In the mid-1990s, with the restructuring of the electric energy industry due to deregulation, the Commission determined that the administration of ratepayer-funded energy efficiency programs also needed to be restructured. In its restructuring, the Commission pursued a structure for energy efficiency programs that included: (1) administration of the programs by an independent, non-profit organization and (2) working towards achieving market transformation. Market transformation was intended to reduce or eliminate the need for ratepayer-funded subsidies of energy efficiency programs. The Commission's goal for market transformation was to privatize the provision of cost-effective energy-efficient products and services so that customers would seek and obtain these products and services in the private, competitive market. The Commission anticipated that public funding would be needed only for a short time period while causing the market to be transformed.

In D.97-02-014, the Commission created an advisory board called the California Board of Energy Efficiency (CBEE), to help with the transition from utility administration of energy efficiency programs to independent administration and to advise the Commission on setting energy efficiency policy guidelines.

Following the creation of the CBEE in 1997, the Commission continued the IOU's administration and implementation responsibilities on an interim basis. The Commission directed the CBEE to develop and submit a Request for Proposal (RFP) entailing policy and program guidelines for a newly restructured independent administration of energy efficiency programs. In D.98-07-036, the Commission authorized the RFP submitted by the CBEE, but then encountered numerous obstacles while trying to implement the RFP.

First, the California State Employees Association (CSEA) asserted that work performed by contractors hired by the CBEE violated requirements that state agencies use civil servants for completing tasks traditionally performed by the state. Then, while the CSEA challenge was pending, the California Attorney General's office raised additional legal issues regarding the Commission's authority to create and use the CBEE.

The Commission, recognizing its plan for independent administration of energy efficiency programs faced insurmountable obstacles, cancelled the RFP in D.99-03-056 and extended interim utility administration of the energy efficiency programs through December 31, 2001. Throughout this time frame, the Commission continued to focus on restructuring energy efficiency, especially by working towards achieving market transformation, which would effectuate energy efficiency through the independent actions of individual customers and suppliers.

In D.00-02-045, the Commission determined that the policy changes to effectuate market transformation had been incorporated into the energy efficiency programs. The Commission found that CBEE had essentially fulfilled its role and that CBEE's legal structure was cumbersome. Consequently, in this decision, the Commission abolished CBEE. At this time, the Commission also determined that there was a continuing need for substantial regulatory oversight.

In the summer of 2000, the state began to face huge energy price hikes and supply shortages that marked the beginning of California's energy crisis. This energy crisis prompted the Commission to revise its policy of promoting market transformation in favor of reducing energy consumption and achieving energy load reductions. Often referred to as the Summer 2000 Energy Efficiency Initiative (Summer Initiative), the Commission, in D.00-07-017, requested the IOUs to submit proposals that would bring about large reductions in electric demand and usage in the shortest amount of time.[5] The Commission ordered that the utility program proposals be ready to implement by September 1, 2000. In a joint Assigned Commissioners and Administrative Law Judge's (ALJ) Ruling, dated August 21, 2000, the Commission ordered the IOUs to implement their energy efficiency program proposals, designed to provide maximum energy and demand reduction.

The Commission's adoption of the Summer Initiative marked the beginning of a new administrative structure for energy efficiency programs. The Commission's Energy Division was assigned the responsibility of reviewing program applications and making recommendations on energy efficiency program selections for each funding cycle, for approval by the Administrative Law Judge (ALJ). In addition, the Energy Division, with the ALJ delegated authority to approve some of these functions, had oversight over program plans, budgets, expenditures, and portfolio management. The Energy Division also had the responsibility of reviewing plans to evaluate, measure, and verify (EM&V)

[5] See D.00-07-017, page204 and Ordering Paragraph(s) 86

energy efficiency program performance, with ultimate approval authority delegated to the ALJ.[6]

On August 23, 2001, the Commission opened an Order Instituting Rulemaking (OIR or R.) 01-08-028 to examine the future of energy efficiency policies, administration, and programs. In R.01-08-028, the Commission identified a set of principles that would be used in developing criteria for energy efficiency programs in 2002 and beyond. Based on the principles identified in the OIR, the Commission established the Energy Efficiency Policy Manual, which was adopted in D.01-11-066, on November 29, 2001. This policy manual established, among other things, new policy rules and criteria covering the following topics:

1) Program goals and objectives;
2) Program design guidelines and eligibility;
3) Standard definitions;
4) Cost-effectiveness rules and definitions;
5) Budgets and compensation;
6) EM&V requirements; and
7) Structure of the Commission's review process.

In D.01-11-066, the Commission also adopted new rules for the energy efficiency programs that allowed non-utilities to compete with the utilities for the energy efficiency funding.

In May 2003, the Commission, in collaboration with the California Energy Commission (CEC) and the California Consumer Power and Conservation Financing Authority (CPA), released their Energy Action Plan (EAP), which identified cost-effective energy efficiency as the resource of first choice of six critical components for reducing energy use per capita in California.[7] The other five components for reducing per capita energy use included:

1) Ensuring reliable, affordable, and high quality power supply for customers in all regions in the state by building sufficient new generation;
2) Accelerating the state's goals for renewable resource generation to 2010;
3) Upgrading and expanding the electricity transmission and distribution infrastructure and reduce the time before needed facilities are brought on-line;
4) Promoting customer and utility owned distributed generation; and
5) Ensuring a reliable supply of reasonably priced natural gas.

[6] EM&V is a formal process to review energy efficiency program achievements with Commission authorized protocols, which are updated before each program cycle.

[7] A copy of the Energy Action Plan is available on the Commission's website at http://docs.cpuc.ca.gov/published/Report/28715.htm.

In August 2003, the Commission issued D.03-08-067, where it ordered the solicitation of energy efficiency proposals from the utilities and non-utility parties for 2004 and 2005. In this decision, the Commission continued to address policy and program process changes for the ratepayer-funded energy efficiency programs. Among the items addressed in this decision, the Commission:

1) Allocated PGC funding to include statewide utility programs, programs proposed by non-utilities, and 10% to statewide marketing, outreach and EM&V;
2) Awarded funding to entities and programs that were likely to fulfill energy savings goals and meet public policy and EM&V goals;
3) Allowed utilities to submit proposals to continue administering their current programs as long as they satisfied the Commission's criteria; and
4) Modified program selection criteria for 2004-05 to include cost-effective, long-term energy savings.

In D.03-12-060, the Commission approved statewide and local energy efficiency programs for a two-year period, 2004-05.

In D.04-09-060, the Commission continued to reflect on the critical importance of reducing energy use per capita in California by establishing numerical savings goals for electricity and natural gas savings for the four IOUs. In order to meet the electric and natural gas savings goals, the Commission authorized a three-year program implementation and funding cycle and directed the IOUs to develop energy efficiency plans and funding levels for the 2006-2008 program cycle.

By D.05-01-055, the Commission further clarified its expectations regarding the development of the 2006-2008 energy efficiency plans and adopted an administrative structure for the energy efficiency programs funded by ratepayer dollars. In this decision, the Commission reassigned the lead administrative role in energy efficiency program selection and portfolio management to the IOUs. As energy efficiency program selectors, the IOU's responsibilities include selecting activities and implementers and allocating ratepayer dollars to those activities. As portfolio managers, the IOU's responsibilities include reviewing and approving program implementation plans, overseeing contracts with implementers, tracking the costs and performance of the programs selected, identifying and making improvements to programs design and implementation, reviewing and approving invoices from implementers, and generating required reports to regulators. To ensure that program results are accurate and that ratepayer funds are spent and managed in a responsible manner, the Commission pointed out that it maintains a policy oversight role and holds the final decision-making authority.

In D.05-01-055, the Commission also established an advisory group structure, competitive bidding requirements and a ban on affiliate transactions to ensure that the program selection process would not favor programs designed and implemented by the IOUs over those designed and implemented by third-parties. In addition, the

Commission established the administrative structure for the EM&V of this cycle's energy efficiency program performance. For EM&V, the Commission assigned its Energy Division the management and contracting responsibilities for all EM&V studies for the purposes of: (1) measuring and verifying energy and peak load savings; (2) generating data from savings estimates and cost-effectiveness inputs; and (3) evaluating whether programs goals are being met. In addition, the Commission's Energy Division was assigned the task of performing research and developing recommendations to assist in the development of energy efficiency policy goals and priorities, evaluating remaining potential to achieve additional energy or peak savings, and other research activities needed to support the Commission's policy oversight.

In April 2005, following the establishment of energy efficiency goals and the development of the administrative framework for guiding energy efficiency programs funded by the ratepayers of California's four largest IOUs, the Commission, in D.05-04-051, provided guidance for the development of energy efficiency program portfolios for 2006 and beyond. In D.05-04-051, the Commission also adopted updates to the Energy Efficiency Policy Manual.

Among the updated policy rules, the Commission described the threshold requirements for the cost-effectiveness of energy efficiency programs, described how to calculate and present cost-effectiveness results, described the process for updating the Energy Efficiency Policy Manual in the future, provided a guide to reference documents and included a list of common terms and definitions.

In D.05-04-051, the Commission directed the IOUs to submit their applications for the 2006-2008 program cycle, by June 1, 2005. The Commission described its expectations regarding the information that the IOUs would file with their applications. In addition, the Commission directed the IOUs to include in their applications a placeholder funding level equal to 8% of the program funding for EM&V.

On June 1, 2005, the IOUs filed their applications with their energy efficiency plans and proposed funding levels for the 2006-2008 program cycle, as required in D.05-04-051. Shortly after the filing of the applications, a prehearing conference (PHC) was held at the Commission in San Francisco on June 22, 2005, which led to the issuance of an Assigned Commissioner's Ruling and Scoping Memo on June 30, 2005. In the scoping memo, the Commissioner determined that the proceedings addressing issues related to the 2006-2008 energy efficiency plans and funding levels and the activities pertaining to EM&V plans for 2006-2008 energy efficiency activities be bifurcated into separate phases.

On September 22, 2005, in Phase 1 of the 2006-2008 program cycle, following the filing of comments from interested parties and requests for interim authorizations from the IOUs, the Commission issued D.05-09-043. In this decision, the Commission, among other things, determined that the IOU's 2006-2008 energy efficiency plans and funding levels for non-EM&V activities met the Commission's threshold requirements for cost-effectiveness per the policy rules set forth in Energy Efficiency Policy Rules adopted by the Commission in D.05-04-051. In D.05-09-043, the Commission also addressed, among other things, evaluation criteria for the competitive bidding process, authorized the IOUs to expend 2006 monies to fund activities in 2005 that have a long start-up period, adopted fund shifting rules and approved the 2006-2008 program budgets for PG&E, SDG&E, SCE and SCG.

In October, 2005, the Commission and the CEC jointly released the Energy Action Plan II (EAP II).[8] The EAP II described a coordinated implementation plan for state energy policies by expanding the scope of the original EAP. Among the actions incorporated in the EAP II, the Commission and the CEC:

1) Identified the fuels used in the transportation of California's goods and population as a third energy sector;
2) Further described research, development and demonstration activities that are critical in realizing energy goals;
3) Described the priority sequence for actions addressing increasing energy needs; and
4) Identified measures to increase outreach to consumers by providing improved education and services regarding energy efficiency, demand response, rates, climate change, and opportunities to reduce the environmental impacts of energy use.

On November 18, 2005, the Commission issued D.05-11-011, its Phase 2 decision for the 2006-2008 program cycle. In D.05-11-011, the Commission, among other things, approved a Joint Staff Request for EM&V Budget Authorization and EM&V Fund Shifting Authority, submitted by staff from the Commission and the CEC.[9] That submittal, adopted by the Commission, included provisions and a budget for Energy Division to carry out its EM&V studies.[10]

Shareholder Incentives

In the late 1980s, the Commission realized that utilities were facing a financial conflict when promoting energy efficiency and conservation. Through the rate of return mechanism, utilities earned an incentive for building additional capacity. Consequently, the IOUs were more inclined to strive to increase load in order to build additional capacity. To address this conflict, the Commission provided the IOUs with an opportunity to earn on cost-effective energy efficiency measures.

[8] A copy of the Energy Action Plan II is available on the Commission's website at http//www.cpuc.ca.gov/published/report/.htm.51604.htm.
[9] See D.05-11-011, Ordering Paragraph 1 and Attachment 3 of that decision.
[10] Ibid., Attachment 3.

Initially, the Commission offered an experimental incentive.[11] This incentive shared savings between ratepayers and shareholders, but the mechanism varied among the utilities. Under the shared savings mechanism, the utilities had the opportunity to earn a fixed percentage of the net savings to ratepayers (energy savings minus costs) after a threshold level of savings was achieved. However, these initial mechanisms did not require that the forecasted per unit savings be adjusted based on the results of the program's implementation. Measurement studies of post-installation savings were conducted only to refine or update savings estimates on a prospective basis.

The potential for utility profits under these earlier mechanisms was much lower than the shared savings mechanism adopted for later program years. However, under these earlier mechanisms, the utilities received their incentive payments in the first year after providing the energy efficiency programs and the utilities were not subject to financial penalties if the programs did not prove to be cost-effective.

The Commission continued to find that these incentives contributed to the utilities' revitalized interest in promoting energy efficiency, for least-cost energy resource planning and procurement. The Commission determined that offering energy efficiency shareholder incentives yielded significant benefits to all ratepayers. However, the Commission was interested in refining the mechanism to account for the degradation of some measures and for the fact that some measures did not remain working or installed for as long as originally intended.

In D.93-05-063, the Commission established EM&V protocols for measuring per unit load savings after program installation for both the first and subsequent years (ex post review). These protocols required the utilities to conduct one degradation study up to four years after implementation and two retention studies up to nine years after implementation. Consequently, under the new protocols, savings were paid out over a ten-year period, over four installments, for any one program year.

The Commission established the Annual Earnings Assessment Proceeding (AEAP) as the forum for evaluating the utilities' earnings claims for energy efficiency and LIEE programs, commencing in 1994. Subsequently, the Commission continued to focus on a shared-savings mechanism with an ex post review and made refinements to the mechanism.

In D.94-10-059, the Commission adopted, among other things, refinements to the mechanism that shared savings for program years 1995 through 1997, with a savings rate of 30% for shareholders. In addition, in this decision, the Commission, among other things, standardized the process across utilities, allowed the utilities to increase earnings only if they increased the net benefits (savings less costs) to ratepayers and required the utilities to share in the risks associated with achieving cost-effectiveness of the programs.

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[11] The focus of this section is on the shared-savings mechanisms for energy efficiency programs, rather than the "management fee" incentive mechanism for LIEE.

In D.97-02-014, the Commission found that although shareholder incentives were designed to offset disincentives, the utilities continued to face significant disincentives to promoting energy efficiency in the competitive energy environment brought about by, among other things, Assembly Bill (AB) 1890.[12] However, in recognition of the Commission's plans to work towards energy efficiency market transformation and to transition energy efficiency to independent administration, the Commission, in D.97-12-013, among other things, reduced the 30% shared-savings percentage for programs such as the direct rebate program and placed an overall cap on utility earnings.

In subsequent decisions, for program years 1999, 2000 and 2001, the Commission, among other things, decided to reduce the potential conflicts between the utilities role in the energy services market and their continued role as administrator for the energy efficiency programs. The Commission accomplished that by directing implementation activities away from the utilities towards other market participants. In addition, the Commission continued to refine the achievement milestones and overall funding caps.

In D.01-11-066, and confirmed by D. 02-03-056, the Commission discontinued shareholder incentives for energy efficiency programs altogether. Thus, while the Commission continued to process AEAP from previous years, beginning with the 2002 program year, all incentive payments for energy efficiency programs ceased.

In D.07-09-043, the Commission adopted a shareholder risk/reward incentive mechanism for post-2005 energy efficiency programs. The Commission designed this mechanism to provide both a meaningful level of shareholder earnings and an estimated return *of over 100%* on ratepayers' investment in energy efficiency. The Commission pointed out that the return of the investment will represent the substantial cost savings created by displacing more expensive supply-side alternatives with energy efficiency, which will result in lower utility revenue requirements and lower customer bills.

The Commission's adopted incentive mechanism protects ratepayers' financial investment, ensures that program savings are real and verified, and imposes penalties for substandard performance:

- The mechanism provides a meaningful opportunity to the utilities to earn for the shareholders.
- Earnings to shareholders only accrue when there are positive net benefits (savings minus costs) for ratepayers.
- Earnings only accrue as the utilities meet and surpass the Commission's savings goals.
- Earnings are greatest when savings performance is superior.
- There are no earnings or penalties within a deadband range of performance; i.e., greater than 65% and less than 85% of goal achievement.

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[12] AB 1890, the Electric Utility Industry Restructuring Act, became law on September 23, 1996.

- All net benefits and achievements are independently verified by the Commission's Energy Division.
- Ratepayers receive the vast majority of the economic benefits.
- Financial penalties are imposed for substandard performance in achieving savings goals.
- If portfolio costs exceed the verified savings, shareholders are obligated to pay ratepayers back for those negative net benefits.
- Both potential earnings and penalties are capped at $450 million.

For the 2006-2008 program cycle, the Commission, in D.07-09-043, estimated that the total verified net benefits, if utilities achieve 100% of the savings goals, would be $2.7 billion, with $2.4 billion (88%) of those net benefits going to ratepayers and $323 million (12%) going to shareholders.

The Commission, in D.07-09-043, established an earnings claim and recovery process, with two interim claims during each three-year cycle and one final true-up claim after the program cycle is completed. The Commission ordered a holdback of 30% of the estimated payouts for any interim payout of earnings. In addition, the Commission indicated that authorized earnings will be recovered in electric distribution and gas transportation rates, pursuant to D.98-03-063.

Lastly, in D.07-09-043, the Commission established a schedule for revisiting the adopted mechanism and directed the Energy Division to prepare an evaluation report for the Commission's consideration by February 1, 2011, in time for the Commission to consider any changes to the mechanism in time for the 2012-2014 program cycle.

In D.08-01-042, the Commission modified D.07-09-043, based on the utilities and parties' assertions that the adopted interim payment process could, under certain conditions, result in a utility losing all the earnings that had already been paid to it in the two interim payments. The utilities and parties argued that this potential refunding could cause certain problems with respect to the utilities' financial reporting and ultimately result in the utilities not being able to book the interim payments until the final adjustments have been determined. This uncertainty, the parties argued could result in a higher cost of financing and cause the utilities to not receive the full benefit of the shareholder incentives from the financial markets. Consequently, the Commission adopted changes to the true-up provisions. The Commission increased the holdback from 30% to 35% and clarified the source of load impact estimates that are used to calculate the interim incentives for the 2006-2008 program cycle.

Energy Efficiency Funding

In the past, the funding mechanism for the utilities' energy efficiency programs was provided out of utility rates. Typically, General Rate Cases (GRC) were performed every three years, with the first year's budget set at the beginning of each cycle. The utilities then submitted annual advice filings to the Commission each October to provide program and budget updates between GRC.

AB 1890, among other things, established Public Utilities (PU) Code Section 381, which, among other things, provides minimum funding provisions for electric public interest programs, including energy efficiency, and required funds to be collected from ratepayers for these programs via a non-by-passable electric surcharge through December 31, 2001. In September 2000, AB 995 became law which, among other things, extended the mandated electric surcharge through January 1, 2012. Natural gas energy efficiency programs continued to be funded in rates.

In September 2000, AB 1002 became law, which among other things, added PU Code Section 890. PU Code Section 890 required the Commission to establish a surcharge on all natural gas consumed in California to fund certain low-income assistance programs, cost-effective energy efficiency and conservation activities, and public interest research and development.

In D.04-08-010, the Commission implemented PUC Section 890, establishing a natural gas surcharge to fund gas-related public purpose program (PPP). The natural gas surcharges are first directed to the State Board of Equalization (BOE), before being used to reimburse the utilities for natural gas program costs.

Every quarter, the utilities send three months of gas surcharge collections to the BOE, for deposit into the Gas Surcharge Fund. Soon thereafter, the utilities make a request to the Commission for reimbursement. Generally, within 30 days of the request, a refund is received by the utilities, less BOE administrative fees. The utilities have not been receiving interest for the time the surcharge collections are in the Gas Surcharge Fund.

Consequently, energy efficiency programs, among others, are currently funded by ratepayers through the PPP rates on customers' electric bills and a surcharge on natural gas customers' bills.[13] The PPP and gas surcharges collected from customers are allocated to individual program balancing accounts, based on rates set in the annual PPP and surcharge update filings.[14]

[13] Entities, listed in PUC Section 896, are exempt from paying the natural gas surcharge.
[14] Some of the utilities may refer to certain components of the PPP as a public goods charge (PGC).

Energy Efficiency Budgets

PU Code Section 381, as established by AB 1890 in 1996, required, among other things, minimum yearly funding levels for energy efficiency for years 1998-2001. Those funding levels are shown in the table below. AB 995, chaptered in 2000, among other things, extended mandatory funding of energy efficiency programs through 2012.

Table I
Yearly Electric Energy Efficiency Minimum Funding Levels Established by AB 1890

Year	Minimum Electric Budget Per Year			
	PG&E	SCE	SDG&E	Total
1998, 1999 & 2000	$106,000,000	$90,000,000	$32,000,000	$228,000,000
2001	$106,000,000	$50,000,000	$32,000,000	$188,000,000

For the year 2001, in D.01-01-060, the Commission authorized the IOUs a statewide funding level of $321.8 million for energy efficiency, which included $259.2 million in electric funds and $62.6 million in gas funds. Of the $259.2 million authorized for electric energy efficiency, the Commission granted $188 million in 2001 PGC with the remaining $71.2 million coming from a carry-over of previously unspent funds from 2000. The $62.6 million for gas energy efficiency programs were authorized through rates set in the utilities' GRC.

Of the $170.5 million proposed funding for statewide programs in 2002, the Commission, in D.01-11-066, set aside $10 million for competitive solicitation by utilities and non-utilities. In D.01-11-066, the Commission also set aside $100 million of energy efficiency funding available for 2002-03 local programs for non-IOUs and $25 million for IOUs-funded local programs.

In D.02-03-056, the Commission selected the year 2002 statewide energy efficiency programs and authorized $160 million in PGC funds for 2002. In this decision, the Commission approved funding for 16 statewide programs, in which fourteen were implemented by the IOUs and two by third parties.

In May 2002, in D.02-05-046, the Commission approved the spending of $109.7 million of the $125 million in total local program funding made available in D.01-11-066. In this decision, the Commission authorized the selection of local energy efficiency programs that totaled $102 million in PGC funds. In addition, $2.8 million was authorized for local programs that were already implemented in 2002. The remaining $4.9 million in funding was allocated to cover administrative fees that the IOUs incurred while administering the contracts for third party local energy efficiency program.

In January 2003, to prevent any service disruption, the Commission issued D.03-01-038 which authorized the IOUs, whose programs were set to expire at the end of 2002, to continue implementing their energy efficiency programs through March 31, 2003, using PGC funds authorized for 2002 in D.02-03-056 and D.02-05-046.

In D.03-04-055, the Commission approved statewide and local energy efficiency programs for 2003. This decision authorized $226 million for statewide energy efficiency programs and $249.5 million in local programs, funded by PGC collections in 2003 and amounts carried over from previous years.

In D.03-12-060, the Commission approved 2004-2005 energy efficiency funding levels of $493.86 million and an additional $15.71 million for measurement and evaluation studies of utilities programs. This total of $509.57 million authorized for 2004-05 included funding from PGC funds collected in 2004-2005 and amounts carried over from previous years.

In D.05-09-043, the Commission approved 2006-2008 energy efficiency funding levels. and a 2006-2008 energy efficiency program budget totaling almost $2 billion for non-EM&V activities. The total yearly amounts are shown in the following table.

Table II
Total Non-EM&V Budgets for Years 2006-2008

IOUs	Yearly Budgets			
	2006	2007	2008	Total
PG&E	$244,653,750	$279,428,777	$343,385,716	**$867,468,243**
SCE	216,574,075	225,111,946	233,145,977	**674,831,998**
SCG	44,322,946	56,582,684	68,016,003	**168,921,633**
SDG&E	75,135,490	84,665,039	97,740,036	**257,540,565**
Total	**$580,688,267**	**$645,790,453**	**$742,289,740**	**$1,968,762,439**

In addition, a detailed breakdown of the amounts budgeted for each utility and program area are summarized in the tables that follow.[15]

[15] See D.05-09-043, Attachment 4.

Table III
PG&E 2006-2008 Program Budget

PG&E Proposed Program Portfolio	Budget 2006	2007	2008	Total 2006-08
Programs with Reported Savings				
Mass Market	$120,460,077	$148,674,656	$181,793,391	$450,928,124
Industrial	$ 38,789,723	$ 40,178,257	$ 42,872,399	$121,840,379
Agriculture and Food Processing	$ 13,986,001	$ 14,861,500	$ 18,675,630	$ 47,523,131
Commercial (Office Buildings)	$ 10,510,686	$ 11,342,972	$ 15,045,397	$ 36,899,055
Medical	$ 7,575,132	$ 7,925,714	$ 12,918,178	$ 28,419,024
Retail	$ 5,148,264	$ 5,667,321	$ 8,053,199	$ 18,868,784
High Technology	$ 4,870,934	$ 5,136,153	$ 9,330,136	$ 19,337,223
Schools, Colleges, and Universities	$ 4,510,204	$ 4,448,700	$ 9,432,966	$ 18,391,870
Hospitality	$ 1,581,996	$ 1,860,632	$ 2,532,844	$ 5,975,472
Residential New Construction	$ 9,944,239	$ 11,690,504	$ 14,411,324	$ 36,046,067
Programs without Reported Savings				
Statewide Marketing and Information Program	$ 8,982,794	$ 8,982,794	$ 8,982,794	$ 26,948,382
Emerging Technologies	$ 3,672,000	$ 3,745,440	$ 3,842,937	$ 11,260,377
Education and Training	$ 13,117,200	$ 13,379,544	$ 13,897,857	$ 40,394,601
Codes and Standards	$ 1,504,500	$ 1,534,590	$ 1,596,664	$ 4,635,754
Total PG&E Program Budget	**$244,653,750**	**$279,428,777**	**$343,385,716**	**$867,468,243**

Table IV
SCG 2006-2008 Program Budget

SCG Program	Budget 2006	2007	2008	Total 2006-08
Program Reporting Energy and Demand Savings				
Multi-Family Rebate Program	$ 2,500,000	$ 3,000,000	$ 4,000,000	$ 9,500,000
Advanced Home Program	$ 2,250,000	$ 3,000,000	$ 3,500,000	$ 8,750,000
Third-Party Programs*	$ 8,864,589	$11,316,537	$13,603,201	$ 33,784,327
Education and Training Programs	$ 1,800,000	$ 2,300,000	$ 2,350,000	$ 6,450,000
Express Energy Efficiency Rebate Program	$ 5,308,050	$ 7,678,996	$ 9,114,191	$ 22,101,237
Local Business Energy Efficiency Program	$ 6,137,264	$ 9,324,108	$11,385,568	$ 26,846,940
Home Efficiency Rebate Program	$ 4,500,000	$ 6,000,000	$ 9,000,000	$ 19,500,000
Savings By Design SCG SCE Program	$ 1,500,000	$ 2,500,000	$ 3,500,000	$ 7,500,000
Savings By Design SCG Muni Program*	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 3,000,000
Sustainable Communities Demo/City of Santa Monica*	$ 300,000	$ 300,000	$ 300,000	$ 900,000
Programs without Reported Savings				
Home Energy Efficiency Survey	$ 600,000	$ 600,000	$ 700,000	$ 1,900,000
Codes and Standards Program	$ 300,000	$ 300,000	$ 300,000	$ 900,000
Energy Efficiency Delivery Channel Innovation Program*	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 3,000,000
Emerging Tech Program	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 3,000,000
Statewide Marketing and Outreach*	$ 2,013,043	$ 2,013,043	$ 2,013,043	$ 6,039,129
On-Bill Financing for Energy Efficiency Equipment*	$ 1,250,000	$ 1,250,000	$ 1,250,000	$ 3,750,000
Partnership Programs	$ 4,000,000	$ 4,000,000	$ 4,000,000	$ 12,000,000
Total SCG Program Budget	**$44,322,946**	**$56,582,684**	**$68,016,003**	**$168,921,633**

* New Programs for 2006-2008

Table V
SDG&E 2006-2008 Program Budget

SDG&E Program	Budget			
	2006	2007	2008	Total 2006-08
Programs without Reported Savings				
Codes and Standards Program	$ 400,000	$ 400,000	$ 400,000	$ 1,200,000
Emerging Tech Program	$ 1,363,000	$ 1,363,000	$ 1,363,000	$ 4,089,000
Statewide Marketing and Outreach*	$ 2,794,410	$ 2,794,410	$ 2,794,410	$ 8,383,230
On-Bill Financing for Energy Efficiency Equipment*	$ 1,250,000	$ 1,250,000	$ 1,250,000	$ 3,750,000
Residential Customer Education & Information*	$ 791,308	$ 724,900	$ 682,000	$ 2,198,208
Partnership Programs				
IOUs/Community College Partnership*	$ 2,000,000	$ 2,000,000	$ 2,000,000	$ 6,000,000
CA Department of Corrections Partnership*	$ 400,000	$ 400,000	$ 400,000	$ 1,200,000
IOUs/UC/CSU Partnership	$ 2,000,000	$ 2,000,000	$ 2,000,000	$ 6,000,000
City of Chula Vista Partnership*	$ 731,075	$ 731,075	$ 731,075	$ 2,193,225
City of San Diego Partnership*	$ 920,000	$ 981,884	$ 981,884	$ 2,883,768
SDREO Energy Resource Center Partnership*	$ 1,353,297	$ 1,352,212	$ 1,426,072	$ 4,131,581
County of San Diego Partnership*	$ 314,000	$ 330,000	$ 345,000	$ 989,000
San Diego Water Authority Partnership*	$ 725,000	$ 704,000	$ 708,000	$ 2,137,000
Programs Reporting Energy and Demand Savings				
Savings By Design	$ 3,323,540	$ 4,225,467	$ 6,050,932	$ 13,599,939
Energy Savings Bid	$11,733,071	$16,367,338	$22,842,880	$ 50,943,289
Express Energy Efficiency Rebate Program	$ 3,082,498	$ 3,313,685	$ 3,562,212	$ 9,958,395
Small Business Super Saver	$ 9,579,085	$10,297,516	$11,069,830	$ 30,946,431
Standards Performance Program	$ 3,382,612	$ 3,636,308	$ 3,909,031	$ 10,927,951
Third Party Programs*	$15,027,098	$16,933,008	$19,548,007	$ 51,508,113
Upstream Lighting Program	$ 5,144,767	$ 5,625,425	$ 6,107,671	$ 16,877,863
Advanced Home Program*	$ 2,213,250	$ 2,213,250	$ 2,213,250	$ 6,639,750
Sustainable Communities Program	$ 394,909	$ 573,936	$ 725,985	$ 1,694,830
Lighting Exchange and Education	$ 500,000	$ 516,730	$ 533,600	$ 1,550,330
Limited Income Refrigerator Replacement	$ 1,090,520	$ 1,090,520	$ 1,090,520	$ 3,271,560
Multi-Family Rebate Program	$ 2,155,159	$ 2,258,557	$ 2,364,428	$ 6,778,144
Single Family Rebate Program	$ 2,466,891	$ 2,581,818	$ 2,640,249	$ 7,688,958
Total SDG&E Program Budget	**$75,135,490**	**$84,665,039**	**$97,740,036**	**$257,540,565**

* New Programs for 2006-2008

Table VI
SCE 2006-2008 Program Budget

SCE Programs	Budget			
	2006	2007	2008	Total 2006-08
Programs Reporting Energy and Demand Savings				
Appliance Recycling	$ 12,301,351	$ 13,291,900	$ 14,292,700	$ 39,885,951
Residential Energy Efficiency Rebates	$ 21,096,248	$ 22,698,565	$ 23,506,844	$ 67,301,657
Multifamily Rebates	$ 17,819,229	$ 17,651,334	$ 17,694,803	$ 53,165,366
Home Energy Efficiency Surveys	$ 2,318,380	$ 1,818,100	$ 1,828,800	$ 5,965,280
Integrated Schools	$ 1,544,858	$ 1,638,300	$ 1,805,000	$ 4,988,158
CA New Homes	$ 6,021,673	$ 6,125,343	$ 6,185,143	$ 18,332,159
Comprehensive HVAC - Residential	$ 4,471,302	$ 4,471,302	$ 4,471,302	$ 13,413,906
Comprehensive HVAC - Non-Residential	$ 15,744,580	$ 15,744,580	$ 15,744,580	$ 47,233,740
Retro-commissioning	$ 1,548,850	$ 5,107,850	$ 5,099,350	$ 11,756,050
Industrial Processes	$ 13,271,370	$ 13,127,530	$ 14,136,215	$ 40,535,115
Agriculture Energy Efficiency	$ 10,133,550	$ 11,515,264	$ 16,414,020	$ 38,062,834
Small Business Direct Install	$ 16,133,486	$ 16,133,486	$ 16,133,486	$ 48,400,458
Savings By Design	$ 8,618,503	$ 10,327,770	$ 11,986,498	$ 30,932,771
Sustainable Communities	$ 1,331,060	$ 1,418,185	$ 1,679,905	$ 4,429,150
Business Incentive Program	$ 36,243,641	$ 35,868,746	$ 33,810,917	$105,923,304
Partnerships	$ 14,830,350	$ 14,830,350	$ 14,830,350	$ 44,491,050
IDEEA	$ 10,887,353	$ 10,887,353	$ 10,887,353	$ 32,662,059
InDEE	$ 1,926,953	$ 1,926,953	$ 1,926,953	$ 5,780,859
Programs without Reported Savings				
Flex Your Power/Marketing Outreach	$ 6,737,838	$ 6,737,838	$ 6,737,838	$ 20,213,514
Education Training and Outreach	$ 8,025,500	$ 8,025,500	$ 8,025,500	$ 24,076,500
Emerging Technologies	$ 3,729,000	$ 3,794,000	$ 3,907,240	$ 11,430,240
Codes and Standards Advocacy	$ 1,839,000	$ 1,971,697	$ 2,041,180	$ 5,851,877
Total SCE Program Budget	**$216,574,075**	**$225,111,946**	**$233,145,977**	**$674,831,998**

The Commission, in D.05-11-011, approved an overall funding level of $162,794,829 for EM&V activities for the 2006-2008 program cycle, which represents approximately 7.6% of the total energy efficiency budgets authorized in D.05-09-043 and D.05-11-011.[16] A detailed breakdown of the approved funding levels for EM&V is provided in the table below.

[16] $1,968,762,439 in program budgets authorized in D.05-09-043 plus $162,794,829 for EM&V authorized in D.05-11-011 equal a total amount of $2,131,557,268 authorized for energy efficiency for program years 2006-2008.

Table VII
EM&V Budget for 2006-2008 Program Cycle

EM&V Planned	BUDGET 2006	2007	2008	2006-2008
Joint Staff Managed Projects				
EM&V Management, Quality, Assurance, and Implementation Support	$6,917,887	$6,085,387	$6,790,387	$19,793,661
Program and Portfolio Evaluation. Studies	$18,570,000	$26,755,000	$42,125,000	$87,450,000
Overarching and Policy Support Studies	$2,745,000	$4,912,500	$3,127,500	$10,785,000
Subtotal:	$28,232,887	$37,752,887	$52,042,887	***$118,028,661***
IOUs-Managed Evaluation Projects				
PG&E				$20,593,000
SCE				$14,846,000
SDG&E				$5,665,892
SCG				$3,661,276
Subtotal:				***$44,766,168***
Total EM&V Budget:				**$162,794,829**

With the inclusion of EM&V, the total budget for energy efficiency programs for the four utilities' 2006-2008 three-year program cycle is $2,131,557,268.

Fund Shifting

In 2005, the Commission's Office of Ratepayer Advocates (ORA) proposed fund shifting rules be added to the energy efficiency administrative structure adopted by the Commission in D.05-01-055. ORA's proposal included specific fund shifting rules that would define how much flexibility the IOUs should have to shift funds from one energy efficiency program to another during the 2006-2008 program cycle. In D.05-04-051, the Commission ordered that the IOUs and advisory groups develop fund shifting rules for the Commission's consideration and that the IOU submit them for review when filing their 2006-2008 program plans.

In D.05-09-043, the Commission adopted fund shifting guidelines that allow the IOUs the flexibility to shift approved program funds among all programs within the same category, across program categories, carry over or carry forward funds from one program year to the next, as well as to discontinue underperforming programs or add new programs within the 2006-2008 program cycle and beyond. In this decision, the Commission presented its fund shifting rules in Attachment 3, Table 8. In addition, the Commission ordered that Table 8 be appended to Appendix A of the Energy Efficiency Policy Manual (Version 3), adopted by the Commission in D.05-04-051.

Reporting Requirements

Historically, the Commission ordered utilities to report on their demand-side management activities using a Reporting Requirements Manual (RRM), approved by the

Commission. This manual was initially prepared by Commission staff, in conjunction with the utilities and staff from the CEC and was updated or revised over the years on an as needed basis.

For reporting on program years 2006 and beyond, the Commission initiated a process to develop new reporting requirements.[17] Preliminary monthly and quarterly reporting requirements for portfolio monitoring were approved in the ALJ's Ruling on Reporting Requirements, dated February 21, 2006. In her ruling, the ALJ described that portfolio monitoring (also referred to as Regulatory Reporting Requirements) are essentially standardized status reports that program administrators, and in turn program implementers, are required to provide on program expenditures, activities, energy savings/demand reduction achievements and other program-related information. The Portfolio Reporting Requirements were presented in the Attachment to the ruling.

The ALJ pointed out that the portfolio management reporting requirements content and format will need to be modified over time, particularly in the first year and that the annual reporting requirements information, yet to be adopted, should be accumulated through the monthly and quarterly reporting requirements.

The type of data and information required to be reported on a monthly basis includes energy efficiency program cost and impact data, program changes/new program information, and portfolio summary of costs and impacts. The type of information required to be reported on a quarterly basis includes portfolio benefit/costs metrics (cumulative to date), measure list for each energy efficiency program, expenditures by allowable cost categories, achievements towards the Green Building Initiative goals, and program narratives for each program describing program activities during the quarter.

In the February 21st ruling, the ALJ directed the staff from the Energy Division and the CEC (Joint Staff) and their consultant to further revise the EM&V Draft Protocols. These EM&V Protocols are used by evaluators to conduct their evaluation studies.

Lastly, in her February 21, 2006 ruling, she ordered that the utilities and implementers continue to use the listing of allowable costs developed by the Energy Division to ensure that the expenditures are properly allocated and reported. This list was attached to the ruling.

Annual reporting requirements for energy efficiency, including report structure, content and filing requirements, were adopted in the ALJ's Ruling Adopting Annual Reporting Requirements for Energy Efficiency and Addressing Related Reporting Issues, dated August 8, 2007. These requirements are contained in the RRM and spreadsheet template posted at http://www.cpuc.ca.gov/PUC/energy/electric/Energy+Efficiency/Programs/ under "Reporting Rules."

[17] Assigned Commissioners' Ruling Soliciting Comments on Reporting Requirements, in R.01-08-028, dated December 6, 2005.

The annual reports are due each year on May 1, with the exception of the report on 2006 which the ALJ ordered to be filed by October 31, 2007. Among the requirements to be included in the Annual Reports of the IOU's include energy savings, emissions reductions, expenditures, cost effectiveness, bill payer impacts, Green Building Initiative goals, shareholder incentives, and savings by end-use, and commitments.

In order to assist the Energy Division in fulfilling its responsibilities in monitoring and evaluating the energy efficiency programs, the Commission authorized the expenditure of PGC funds for the creation of a data management system known as the Energy Efficiency Groupware Application (EEGA).[18] The purpose of this system is to ensure energy efficiency reporting is organized, accurate, consistent and useful to the public, the Commission and others are charged with ensuring that California's energy needs are met.[19] The Commission maintains this website for posting the monthly, quarterly and annual energy efficiency reports at http://eega2006.cpuc.ca.gov. In addition, the utilities post their energy efficiency program plans and Energy Division posts summary information on the energy efficiency programs on this website.

Audit of Energy Efficiency Ordered By Commission

In D.05-01-055, the Commission, among other things, described its overall quality assurance and policy oversight responsibilities with respect to the energy efficiency programs, including that it would perform a number of functions to ensure that program results are accurate and that ratepayer funds are being spent and managed in a responsible and productive manner.[20] The Commission explained that one of the tools it may use for this purpose is an audit of the administrators and their program implementers, conducted by Commission staff, or by consultants under contract with the Commission. The Commission indicated that it will determine and prescribe what action is to be taken by the IOUs in response to the audit findings and recommendations. Further, the Commission noted that it may establish the frequency of these audits as part of the 2006 program planning process, by Assigned Commissioner's ruling, or by other means as appropriate.

In D.05-11-011, the Commission, among other things, approved a Joint Staff Request for EM&V Budget Authorization and EM&V Fund Shifting Authority, submitted by staff from the Commission and the CEC.[21] That filing, approved by the Commission, included a provision of $3.5 million for financial and management audits of program years 2006-2008, to assist the Commission in ensuring that ratepayer funds are satisfactorily accounted for and spent for their intended purposes.[22]

[18] See D.05-01-055, page 123.
[19] *Ibid.*
[20] See D.05-01-055, pages 130-131 and Ordering Paragraph 15.
[21] See D.05-11-011, Ordering Paragraph 1 and Attachment 3 of that decision.
[22] *Ibid.* Attachment 3, pp 5 and 15.

In the ALJ's Ruling on Reporting Requirements, dated February 21, 2006, the ALJ ordered that program administrators/ the utilities and program implementers should use the listing of allowable costs, and associated definitions, in the RRM to ensure they allocate and report expenditures properly.[23] The ALJ in this ruling indicated that the financial audits ordered in D.05-11-011 should verify that energy efficiency expenditures are being properly booked to accounts and accurately reported.[24]

In early 2007, the Commission's Energy Division requested that the UAFCB perform these audits, with the UAFCB submitting its audit report each year on August 1, on the previous year's program.

In July, 2008, the UAFCB requested a 60-day extension to submit its audit report on program year 2007. On July8, 2008, the Commission's Executive Director approved the UAFCB's 60-day extension request to submit its audit report on program year 2007 on October 1, 2008.

IV. Audit Scope

The audit by the UAFCB focused on reviewing energy efficiency expenditures and covered the period from January 1, 2007 to December 31, 2007.

Examination of the energy efficiency expenditures included the areas of:
- Program Accounting and Reporting
- Program Processes and Controls
- Program Implementation and Costing
- Program Oversight

The UAFCB did not review the EM&V or share-holder incentives processes as these areas were beyond the scope of the audit.

SDG&E

The UAFCB staff selected the following seven (7) energy efficiency programs for examination, totaling $30.8 million, representing 43.56% of SDG&E's total 2007 energy efficiency expenditures. The seven programs reviewed include:

- Energy Savings Bid
- KEMA HVAC Training, Installation & Maintenance
- Mobile Energy Clinic (Third party contractor)
- Multi Family Rebate Program

[23] See February 21, 2006 ALJ Ruling, page 11 and Ruling Paragraph #5.
[24] *Ibid*, page 11.

- Single family Rebate
- Small Business Super Saver
- Sweetwater Schools (Third party contractor)

SCG

The UAFCB selected the following eight (8) energy efficiency programs for examination, totaling $17.5 million and representing 41.13% of SCG's total 2007 energy efficiency expenditures. The eight programs reviewed include:

- Constant Volume Retrofit Program (Third party contractor)
- VESM Advantage (Third party contractor)
- Advanced Home Program
- Energy Coalition – Direct Install
- Express Efficiency Rebate Program
- Multi-Family Rebate Program
- Local Business Energy Efficiency Program
- Savings by Design

V. Objectives and Goals

The objectives of UAFCB audit were to: (1) ascertain that expenditures were properly charged against 2007 program funds and (2) ascertain that the expenditures were properly reported. To accomplish the audit objectives, the UAFCB organized the audit into four areas, with the following audit goals:

To accomplish the audit objectives, the UAFCB organized the audit into four areas, with the following audit goals:

1. Program Accounting and Reporting
   - Obtain an understanding of SDG&E and SCG's accounting systems and policies related to the energy efficiency programs and examine how program expenditures are tracked;
   - Ascertain with reasonable assurance that program expenses are properly recorded and reported;
2. Program Processes and Controls
   - Determine that policies and procedures of SDG&E and SCG for ensuring energy efficiency charges are well supported and documented with respect to customer enrollment, measure installations and costs, financial incentive payments and inspection procedures; and
   - Examine and document that the processes for the administration of the energy efficiency programs of SDG&E and SCG are properly functioning as designed.

3. Program Implementation and Costing
    - Determine that the energy efficiency programs are properly implemented in compliance with policies and procedures described in the PU Code (Sections 381 and 890) and Commission Decisions (D.05-01-055 and D.05-09-043);
    - Determine that SDG&E and SCG have adequate processes in place for the administration of contracts between the company and contractors; and
    - Test on a sample basis the reasonableness of recorded expenses.
4. Program Oversight
    - Determine if SDG&E and SCG have an effective program oversight and monitoring process in place.

In addition, the UAFCB followed up on its prior findings and recommendations from its audit report on program year 2006, to ensure that SDG&E and SCG had incorporated and implemented the its recommendations[25] as promised by them.

VI. Audit Standards and Procedures

The UAFCB audit was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA) and accordingly, included examining, on a test basis, evidence about SDG&E and SCG's compliance with Commission directives and performing such other procedures as considered necessary in the circumstances.

Auditing Procedures Applied

The UAFCB performed the following procedures in its audit:

<u>Pre-audit Procedures</u>

- Become familiar with the utility's energy efficiency programs; i.e., types of programs, program processes and operations.
- Reviewed pertinent Commission decisions (D.05-01-055 and D.05-09-043), resolutions and applicable rules and regulations, including, PUC Code Sections 381 and 890.
- Reviewed prior audit reports and working papers for current audit planning purposes and discussed prior findings and recommendations with the previous UAFCB audit members.
- Contacted utility regulatory personnel to set up current audit logistics and protocols.

[25] Refer to UAFCB's reports entitled "Financial & Management Audit of San Diego Gas & Electric Company U-0902-E Energy Efficiency Public Programs For the Year Ended December 31, 2006" and "Financial & Management Audit of Southern California Gas Company U-0904-G Energy Efficiency Programs For the Year Ended December 31, 2006," both issued on July 27, 2007.

Energy Efficiency Program Processes Review

- Interviewed utility program personnel to gain information and understanding of the utility's energy efficiency programs' operations and processes, in connection with customer enrollment, program administration, and management oversight.
- Reviewed utility program policy and process manuals for compliance with regulatory directives and decisions.
- Conducted on-site visits to energy efficiency program centers to observe program operations and test for compliance with program policies and objectives.
- Compared actual expenditures to budget program data for variances and analyzed such variances for reasonableness and allowances.

Energy Efficiency Revenue and Expenditures

- Reviewed utility accounting manual and procedures on the proper recording of program revenue and expenditures.
- Evaluated utility internal control procedures on revenue and expenditures for effectiveness and deficiencies; implemented additional audit procedures to assess and resolve any deficiencies.
- Verified program revenue and expenditures, on a sample basis, to supporting documents and sources to determine accuracy and reasonableness.
- Reviewed the utility's competitive bidding process and examined sample contracts for program compliance.
- Reconciled program databases to general ledger systems.
- Formulated audit findings, conclusions and recommendations.
- Provided appropriate audit opinion upon completion of engagement.

VII. Audit Findings

1. Program Accounting and Reporting:

Audit Goal No.1

Obtain an understanding of SDG&E and SCG's accounting systems and policies related to the energy efficiency programs and examine how program expenditures are tracked.

Auditor Conclusion: The UAFCB did not find any reportable material weaknesses in the accounting systems, policies, and procedures used in 2007 by SDG&E and SCG for tracking energy efficiency expenditures.

SDG&E and SCG both use Sempra's System Applications and Products in Data Processing (SAP) for their company-wide accounting system. Both utilities also use additional feeder operation operating systems that interface with SAP to help administer and manage the energy efficiency programs. Although both utilities use the same Sempra-wide accounting system and data processing software, the data are segregated by the utilities in SAP and for each of the Sempra-wide feeder systems.

One of the Sempra-wide operating systems interfacing with SAP is called the Energy Efficiency Tracking System (EETS). The EETS is used for processing energy efficiency customer applications, documents program measure reservations and installations, tracks and selects inspections, and verifies and maintains documentation for energy efficiency rebates and incentives. The data and information included in EETS is transferred and uploaded into the SAP accounting system on a daily basis

Both SDG&E and SCG also use a separate operating system for labor charges called Workforce Information Tracking Systems (WITS). WITS is used for tracking energy efficiency labor expenditures. Sempra and all its subsidiaries, including its regulated subsidiaries SDG&E and SCG, use the WITS system, as it is a company-wide labor cost tracking system. The WITS system also interfaces with the SAP accounting system and data associated with payroll information is uploaded into SAP on a daily basis.

Another Sempra-wide operating system, the Enterprise Contract Management (ECM) system, is used by SDG&E and SCG to administer and manage their service and materials contracts. Implemented in February 2005, this operating system handles all contracts and requisitions for both SDG&E and SCG and is also linked to the SAP accounting system to ensure payments to contractors do not exceed the total value of the contracts and provides advanced notices to utility staff when the expiration dates of the contracts are approaching.

SCG also uses an operating system called Marketing Analysis System (MAS). The MAS operating system is used for processing rebates for SCG's Express Energy Efficiency Program and for processing incentives for its Business Energy Efficiency Program. Data and information included in MAS is transferred into EETS on a monthly basis. .

During the audit, SDG&E and SCG informed the UAFCB that Sempra is currently working on developing a new tracking system called the Customer Relation Management (CRM) system. Once the Sempra-wide CRM system is developed, it will replace the current EETS and MAS operating systems. Both SDG&E and SCG will incorporate the CRM system into their operations. The projected implementation date of CRM is estimated to be mid-2008.

SDG&E and SCG both adhere to the same accounting policies established by Sempra for recording energy efficiency program expenditures. SDG&E and SCG track energy efficiency expenditures in the SAP accounting system by using Internal Order (I/O) numbers which are created specifically for each energy efficiency program. In addition, SDG&E and SCG have I/O numbers created specifically for sending and receiving billings from each other.

Audit Goal No.2

Ascertain with reasonable assurance that program expenses are properly recorded and reported.

Auditor Conclusion: The UAFCB did not find any major reportable deficiencies in the accounting processes and procedures used by SDG&E and SCG in 2007 for recording energy efficiency expenditures. However, the UAFCB recommends that both SDG&E and SCG develop a standardized General Ledger Checklist Authorization Form when preparing any journal entries to improve timely reporting to EEGA.

While the UAFCB understands that the Commission does not expect the monthly reports to be precise, reconciled or trued-up, the UAFCB recommends that both SDG&E and SCG implement additional procedures and controls to ensure that the monthly and quarterly energy efficiency expenditure reports posted to EEGA are accurate and posted in a timely manner. Without updated and reliable reports, the Commission and other interested parties cannot rely on the information posted to the EEGA website.

The UAFCB randomly tested a sample of journal entry transactions from each utility for a review of appropriate supporting documentation, segregation of duties, and conformance with procedures and corporate policies. Both SDG&E and SCG appear to be properly processing their journal entries in accordance with their General Ledger Journal Entry Transaction Policy, but authorization forms submitted with each journal entry were either different in format and information, or were not included with the supporting documentation.

On a monthly basis, the Policy and Support group e-mails each Program Manager, for their review and comments, the monthly reports containing SAP dumps, labor detail reports, customer commitments, and draft monthly expenditure reports (that include allocated overheads).[26] The Program Managers review the charges to ensure the expenditures are classified and charged to the appropriate I/O number and energy efficiency program. The Program Managers either agree to the charges reflected in the monthly reports or provides comments and feedback to the Policy and Support group. Based on the Program Managers' comments and feedback, the Policy and Support personnel make any corrections and/or adjustments via adjusting journal entries, if necessary. Once any corrections or adjustments are made, the Policy and Support Staff group then prepares the monthly/quarterly expenditure reports in accordance with PUC reporting requirements.

During the audit, the UAFCB found that both SDG&E and SCG appear to be, for the most part, appropriately recording their energy efficiency expenditures and reporting their respective monthly/quarterly reports in accordance with the protocols established in

[26] Provided in response to Data Request SCG-EE07-010, Question 56 and SDG&E-EE07-010, Question 57.

the February 21, 2006, ALJ Ruling in R.01-08-028, Attachment A.[27] However, the UAFCB found instances where both SDG&E and SCG posted inaccurate monthly expenditure reports and quarterly expenditure reports to the EEGA website:

1. SDG&E made revisions to the February, May and December 2007 monthly expenditure reports but did not yet post those updated monthly expenditure reports to EEGA.

2. SDG&E failed to report a combined $3,951,559 in expenditures for its Statewide Marketing & Outreach Program (Program Number SDGE3013), in their quarterly expenditure reports.

3. SDG&E submitted its quarterly narrative reports with the word "Draft" on the reports regarding its Community College Partnership Program (SDGE3001), during the 1st and 4th quarter of 2007. In addition, SDG&E failed to post numerous energy efficiency program quarterly narrative reports regarding several of its energy efficiency programs to the EEGA website.

4. SCG failed to report a combined $3,084,647, in expenditures for its Statewide Marketing & Outreach Program (Program Number SCG3508), in their quarterly expenditure reports.

5. SCG made revisions to ten of the twelve monthly expenditures reports for 2007 and such revisions were not posted to the EEGA website until July 2008. In addition, SCG provided a revised monthly expenditure report to the UAFCB audit staff for the month of February 2007, but SCG has not yet posted the updated monthly expenditure report to EEGA.

6. In several of SCG's quarterly narrative reports, SCG did not provide reasons why certain programs were falling short of program goals.

[27] In the February 21, 2006, ALJ Rulings in R.01-08-028, Attachment A.II. Monthly Reports, it is noted that the Energy Division expects to use the monthly reports as a means to acquire updates on program implementation status rather than a means to establish a record of reported program accomplishments, which ED expects will be accomplished via the quarterly reports, annual reports and report true-ups. The monthly reports, therefore, are not expected to be completely precise, reconciled or trued-up.

2. <u>Program Processes and Controls:</u>

Audit Goal No. 1

Determine that policies and procedures of SDG&E and SCG for ensuring energy efficiency charges are well supported and documented with respect to customer enrollment, measure installations and costs, financial incentive payments and inspection procedures.

Auditor Conclusion: The UAFCB did not find any reportable material weaknesses in the policies and procedures of SDDG&E and SCG used in 2007 for ensuring that charges to the energy efficiency program are well supported for customer enrollment, measure installations and costs, financial incentive payments and inspections.

Both SDG&E and SCG provided the UAFCB documentation to support their program processes and controls. The documents included customer enrollment procedures, qualification information for measure installation and the associated costs, financial incentive payment requirements, pre and post inspection guidelines, policy addressing management level approvals and corporate accounting policies covering energy efficiency programs.

The UAFCB reviewed the above policies provided during the audit and observed SDG&E and SCG personnel following the required procedures when inputting customer applications. In addition, UAFCB tested the utilities' application of their procedures when processing rebates and incentive payments for propriety, accuracy and completeness.

After examining the utilities' policies and analyzing the implementation of SDG&E and SCG's energy efficiency procedures in the above areas, the UAFCB did not find any exceptions for appropriate documentation with respect to customer enrollment, measure installations and costs, financial incentive payments and inspection policies and procedures for their energy efficiency programs.

Audit Goal No. 2

Examine and document that the processes for the administration of the energy efficiency programs of SDG&E and SCG are properly functioning as designed.

Auditor Conclusion: The UAFCB did not find any reportable weaknesses in the processes used by SDG&E and SCG in 2007 for the administration of their energy efficiency programs.

The UAFCB reviewed the design and structure of SDG&E's and SCG's processes for the administration of their energy efficiency programs in 2007

The energy efficiency programs for both SDG&E and SCG are organized under the umbrella of Customer Programs Division, which is further organized into two major departments:

(a) Program Management and
(b) Program Support

The **Program Management Department** for SDG&E is segregated into six broad program segments, while SCG is segregated into five program segments. For both SDG&E and SCG, the energy efficiency program segments are:

(a) Residential,
(b) Nonresidential – Commercial/Industrial/Agriculture,
(c) New Construction,
(d) Partnerships,
(e) Codes and Standards, and
(f) Emerging Technologies.

For SCG, the Residential and the Nonresidential –Commercial/Industrial/Agriculture segments are organized into one segment, giving them only five, instead of six segments.

The **Program Support Department** is designed and structured to provide general support to the Program Management Department. This department is organized into three major segments:

(a) Planning and Analysis, which provides market analysis and planning support.

(b) Engineering/Technical Support, which provides technical and engineering support.

(c) Policy and Support, which provides regulatory support as it relates to the development and preparation of regulatory filings, development of program policy to implement regulatory policies in accordance with Commission decisions, rulings, etc., and to ensure compliance.

Each energy efficiency segment under the Program Management Department is administered and managed by a Segment Manager who is responsible for the management of all energy efficiency programs/measures under the respective segment. In general, the Segment Managers' responsibilities include reviewing and approving expenditures, monitoring program performance and goals, reviewing expenditure reports, and providing day-to-day administrative oversight for their respective programs. The Segment Managers also have one or several supervisors that report directly to them, who are responsible for specific energy efficiency programs/measures that assigned to them.

The Director of Customer Programs provides oversight and management of the Segment Managers.

The UAFCB interviewed the Segment Managers and also met with the Director of Customer Programs to discuss the Emerging Technologies segment and general administrative oversight procedures for SDG&E and SCG's energy efficiency programs.

During its interview with the five Segment Managers and the Director of Customer Programs, the UAFCB discussed,

1. How each energy efficiency program under the respective segment is Implemented;
2. The description of the energy efficiency program's application process;
3. The explanation of the outreach efforts and specifically, how customers are contacted; and
4. An overview of the energy efficiency program manuals and guideline (copies were provided).

Additionally, SDG&E and SCG furnished documentation and presented information that explained and confirmed that controls were in place to safeguard the process for administering their energy efficiency programs. Among the controls in place, the utilities have operating system management approval level restrictions for expenditures and contracts; inspection polices to ensure installation of appropriate measures; and corporate internal control policies to ensure management directives are carried out.

Based on the meetings with the Segment Managers and the Director of Customer Programs, and reviewing the energy efficiency program manuals and guidelines, the UAFCB determined that the processes of SDG&E and SCG for administering their energy efficiency programs are functioning well as designed.

3. <u>Program Implementation: and Costing</u>

Audit Goal No. 1

Determine that the energy efficiency programs are properly implemented in compliance with the utilities' policies and procedures as related to the Commission's guidelines and PU Code.

Auditor Conclusion: The UAFCB did not find any major reportable deficiencies with SDG&E's and SCG's implementation of their energy efficiency programs in 2007.

For its review of SDG&E's and SCG's policies and procedures used for implementing the 2007 energy efficiency programs, the UAFCB focused on the following areas: fund shifting; competitive bidding; affiliate transactions; allowable costs; third-party contracts; and revenues.

The UAFCB reviewed the supporting documentation and administrative processes, tested expenditure transactions recorded in the allowable cost categories, analyzed overhead allocation methods, and reviewed the systems used for managing contacts.

Based on its assessment of the utilities' policies and procedures, review of supporting documentation, testing of expenditures, analysis of overhead allocation methods, the UAFCB concluded that SDG&E and SCG properly implemented their energy efficiency programs during 2007.

Audit Goal No.2

Ascertain that SDG&E and SCG have adequate processes in place for the administration of contracts between themselves and the contractors.

Auditor Conclusion The UAFCB did not find any major reportable weakness in the processes used by SDG&E and SCG during 2007 for the administration of contracts between the utilities and their contractors.

The UAFCB met with the Portfolio Manager of Supply Management to discuss the process used for administering contracts between the companies and their contractors. SDG&E and SCG indicated that they use the Enterprise Contract Management (ECM) operating system for maintaining company contracts. ECM handles all contracts and requisitions for both SDG&E and SCG. The ECM system contains information that includes total value, effective dates, and other contract information. It tracks contracts in progress and is linked to the SAP accounting system in order for the user to have updated information to track payments made on the contracts. Management approval levels for contracts are also maintained in the ECM system. ECM also provides information such as the dollar limit restrictions for each person associated with the contracts. For example, the Portfolio Manager is authorized to approve contracts up to $750,000.

Based on the information gathered during its meeting with the Portfolio Manager of Supply Management and assessment of the ECM system for managing contracts, the UAFCB concluded that SDG&E and SCG had adequate processes in place for the administration of contracts between themselves and their contractors in 2007.

Audit Goal No.3

Test on a sample basis the reasonableness of recorded expenses.

Auditor Conclusion: The UAFCB found that the samples tested had adequate documentation, such as invoices, calculations, and approvals, to support the recorded expenditures. However, during testing, it found the following exception based on principle and not on materiality.

> SCG spent energy efficiency funds on entertainment and promotional activities that appear to be unrelated to energy efficiency activities and should be borne by Sempra rather than by funds dedicated to energy efficiency programs.

A detailed summary of energy efficiency programs tested for SDG&E and SCG during the 2007 energy efficiency audit is provided in the following tables.

Table VIII
2007 SDG&E Energy Efficiency Programs Selected for Testing

Program ID	SDG&E - 2007	
	Program Name	**Program Expenses**
SDGE3010	Energy Savings Bid	11,815,131.37
SDGE3043	KEMA HVAC Training, Install, & Maintenance	1,395,220.50
SDGE3039	Mobile Energy Clinic (3P)	610,819.76
SDGE3017	Multi-family Rebate Program	3,215,315.01
SDGE3024	Single Family Rebate	3,573,277.52
SDGE3020	Small Business Super Saver	10,059,288.44
SDGE3037	Sweetwater Schools (3P)	113,088.47
	Total Expenditures of Programs Selected for Testing	**$30,782,141.07**
	Total 2007 Energy Efficiency Expenditures	**$70,666,677.64**

Table IX
2007 SCG Energy Efficiency Programs Selected for Testing

Program ID	SCG - 2007	
	Program Name	**Program Expenses**
SCG3536	3P Constant Volume Retrofit Program (CVRP)	$343,604.34
SCG3535	3P VESM Advantage	$205,936.21
SCG3502	Advanced Home Program	$2,377,426.14
SCG3525	EC4 Energy Coalition - Direct Install	$69,913.11
SCG3507	Express Efficiency Rebate Program	$6,205,639.06
SCG3510	Multi-family Rebate Program	$1,353,978.31
SCG3513	NRF4-Local Business Energy Efficiency Program	$4,926,725.42
SCG3542	Savings By Design	$1,976,429.94
	Total Expenditures of Programs Selected for Testing	**$17,459,652.53**
	Total 2007 Energy Efficiency Expenditures	**$42,453,114.71**

The UAFCB randomly selected transactions from the energy efficiency programs it selected for testing. It tested these transactions incurred by SDG&E and SCG for sufficient supporting documentation, proper recording and approvals, and reasonableness of expenditure.

The UAFCB found that SCG spent energy efficiency funds on entertainment and promotional activities that appear to be unrelated to energy efficiency activities and should be borne by Sempra rather than by ratepayers. These expenditure included gift certificates, National Basketball Association (NBA) tickets, Christmas Party expenditures benefiting select utility employees, Cinema tickets, and iTunes cards for a business on-line survey. These expenditures identified during testing of SCG's expenditures totaled $8,947. The UAFCB however, could not expand its review in order to determine the extent of using the energy efficiency funds to promote the company's image or goodwill.

4. <u>Program Oversight:</u>

Audit Goal No.1

Determine if SDG&E and SCG have effective program oversight and monitoring processes in place for their energy efficiency programs.

Auditor Conclusion: The UAFCB did not find any major reportable weaknesses in SDG&E's and SCG's system of controls in place for the oversight and monitoring of their 2007 energy efficiency programs. Both utilities assess their internal controls on an annual basis to determine whether the management of their energy efficiency programs is complying with corporate internal control policies and the Sarbanes-Oxley Act of 2002, Sections 202, 404 and 960.

Direct oversight and management of SDG&E and SCG's energy efficiency programs are performed by Segment Managers and the Director of Customer Programs Division. The President and Chief Executive Officer (CEO) of Sempra's California-regulated utilities SDG&E and SCG provides oversight and management over the Director of Customer Programs.

The UAFCB reviewed internal management reports on the program year 2007 provided by the Director of Customer Programs Division, reviewed corporate internal control policies, analyzed recent internal audits and reviewed 2007 corporate filings and found these to be in accordance with the Sarbanes-Oxley Act of 2002, Sections 202, 404 and 906.

The UAFCB found that SDG&E and SCG followed their management and oversight practices and internal controls of Sempra, and the Sarbanes-Oxley Act of 2002, Sections 202, 404 and 906 during 2007.

It also reviewed the results of an internal audit of Sempra's Accounts Payable process for the period January 1 through May 30, 2007 that was performed by Sempra's Audit Services group which determined that the payment process appears to have adequate business controls over company expenditures.

2006 Audit Issues

Auditor Conclusion: The UAFCB recommends that both SDG&E and SCG continue to pursue being reimbursed for interest earned on the money remitted to BOE since 2001 in conformance with the rules for gas surcharge remittances pursuant to D.04-08-010. Both SDG&E and SCG still have not been paid interest on gas surcharge funds remitted to the BOE in accordance with Commission rules governing gas surcharges. According to SDG&E, using the three month commercial paper rate for actual interest earned on the Gas Surcharge Fund, SDG&E estimates it is due approximately $1.1 million in interest. SCG estimates that it is owed approximately $6 million in interest for gas surcharges remitted to the BOE, excluding any interest on funds collected by the BOE from interstate pipelines.

Similar to the recommendations from UAFCB's audit of SCG's 2006 energy efficiency programs, the UAFCB recommends that all future third-party contracts include standard stipulations that limit the number of hours that can be charged at each billable rate and enforce those limitations.

During its audit of SCG's energy efficiency programs for the period January 1, 2006 through December 31, 2006, the UAFCB found that SCG was being billed higher management labor charges for work performed that could have been performed by a technician, at a technician's lower labor charges by Energy and Environmental Analysis, Inc.(EEA). EEA was under contract with SCG to perform services for the Local Business Energy Efficiency Program (BEEP) and Express Energy Efficiency Rebate Program (EER).

While SCG informed the UAFCB that the contract with EEA was terminated in 2007, the UAFCB found payments were made to EEA during 2007 (and as late as August 2007) for services EEA provided but billed at the higher management labor charge, rather than at the lower rate charged by technical personnel, who could have performed the tasks.

VIII. Comments On The Draft Report

On September 9, 2008, UAFCB submitted a copy of its draft report to SDG&E and SCG for their review and comment. Included in the copy of the draft report were draft Sections I through VI., as well as the UAFCB's draft audit findings, as contained in Section VII. Subsequently, the UAFCB made changes to its draft report, as appropriate, based on comments received from the utilities or to clarify the report.

Sempra, on behalf of SDG&E and SCG, provided timely comments to the draft report on September 24, 2008. SDG&E did not dispute any of the audit findings included in the draft audit report and thus did not provide any comments. SCG provided comments limited to page 33 of the draft report which addressed entertainment and promotional expenditures that appear unrelated to energy efficiency activities. SCG agreed to make a journal entry to transfer expenditures associated with the Christmas event and NBA tickets to operating and maintenance expenditures (O&M). However, SCG contends that the iTunes cards and Cinema tickets are appropriate energy efficiency program expenditures since they were part of a marketing campaign to incent customers to participate in an on-line audit that assisted customers with understanding their energy usage and providing opportunities to improve their energy efficiency. Sempra's comment letter, in its entirety, is included as Appendix B.

IX. Staff Rebuttal

The UAFCB concurs with SCG that the expenditures associated with the Christmas event and NBA tickets be transferred and recorded to O&M. With regard to SCG's energy efficiency expenditures for gift certificates, iTunes cards and Cinema tickets, the UAFCB reserves the right to further examine such expenditures during the Financial and Management Audit of SDG&E and SCG for the year ended December 31, 2008.

Appendix A

Abbreviations and Acronyms

AB	Assembly Bill
AEAP	Annual Earnings Assessment Proceeding
AICPA	American Institute of Certified Public Accountants
ALJ	Administrative Law Judge
BEEP	Local Business Energy Efficiency Program
BOE	Board of Equalization
BTU	British Thermal Unit
CBEE	California Board of Energy Efficiency
CEC	California Energy Commission
Commission	California Public Utilities Commission
CPA	California Consumer Power and Conservation Financing Authority
CRM	Customer Relation Management System
CSEA	California State Employees Association
D.	Decision
EAP	Energy Action Plan
ECM	Enterprise Contract Management System
EEGA	Energy Efficiency Groupware Application Website
EER	Express Energy Efficiency Rebate Program
EETS	Energy Efficiency Tracking System
EM&V	Evaluation, Measurement and Verification
GAAS	Generally Accepted Auditing Standards
GRC	General Rate Cases
IOUs	Investor Owned Utilities
LIEE	Low Income Energy Efficiency Program
MAS	Market Analysis System

Appendix A (Continued)

OIR	Order Instituting Rulemaking
OP	Ordering Paragraph
OPEC	Organization of the Petroleum Exporting Countries
ORA	Commission's Office of Ratepayer Advocates
PG&E	Pacific Gas and Electric Company
PGC	Public Goods Charge
PHC	Prehearing Conference
PPP	Public Purpose Programs
PU Code	Public Utilities Code
R.	Order Instituting Rulemaking
RFP	Request for Proposal
RRM	Reporting Requirements Manual
SAP	System Applications and Products in Data Processing
SCE	Southern California Edison
SCG	Southern California Gas Company
SDG&E	San Diego Gas & Electric Company
Sempra	Sempra Energy Corporation
Summer Initiative	Summer of 2000 Energy Efficiency Initiative
UAFCB	Utility Audit, Finance and Compliance Branch

SDGE Southern California Gas Company

Sempra Energy utilities

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September 24, 2008

R. 06-04-010

Kayode Kajopaiye – Chief
California Public Utilities Commission
Utility Audit, Finance and Compliance Branch
505 Van Ness Avenue
San Francisco, CA 94102

Re: SDG&E and SoCalGas Response to CPUC Draft Report – Energy Efficiency 2007 Programs

Dear Mr. Kajopaiye:

San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) have reviewed the draft report entitled, "Financial & Management Audit of The Energy Efficiency Public Programs of San Diego Gas & Electric Company (U-902-E) and Southern California Gas Company (U-904-G)." Our comments are limited to discussion on page 33 of the draft report regarding SoCalGas energy efficiency expenditures on ".. entertainment and promotional activities that appear to be unrelated to energy efficiency activities…goodwill."

SoCalGas Response: Upon review, SoCalGas will make a journal entry to transfer expenditures associated with the Christmas event and NBA tickets to O&M. However, SoCalGas believes the ITunes & Cinema tickets are appropriate program expenditures as these were part of a marketing campaign to incent customers to participate in the energy efficiency online audits. The audits assist customers with understanding their energy usage and identify opportunities they have to improve their energy efficiency.

Sincerely,

Mark Gaines

Mark Gaines
Director – Customer Programs

cc: Joy Yamagata – SDG&E/SoCalGas
Central Files