

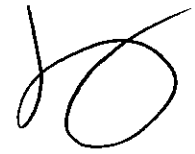
Memorandum

Date: September 30, 2013

To: Michelle Cooke
Deputy Executive Director Operations and Budget

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

Subject Energy Efficiency (EE) Financial Compliance Examination Report of
Southern California Edison (SCE) For the Period January through December 31,
2011



The Utility Audit, Finance and Compliance Branch (UAFCB) discovered some material errors when it sampled and tested Southern California Edison's (SCE) data associated with amounts SCE reported spent in 2011 for its energy efficiency program (EE) in the areas that UAFCB examined.¹ Due to the proportionality of the errors to the sample and the lack of some source documentation, as described in the following observations, UAFCB deems SCE's 2011 reports less than accurate and reliable.² In addition, UAFCB observed certain recordkeeping deficiencies and other lack of compliance. In determining SCE's 2011 incentive amount, the Commission should first remove \$818,092 from SCE's EE expenses before calculating its incentive.³

In total, UAFCB discovered \$30,796,647 of potential recording and reporting discrepancies.⁴ Of those, SCE agreed in principle with \$25,544,138. Initially in its comments on UAFCB's draft report, SCE agreed to \$261,493 of UAFCB's exceptions. In subsequent meetings, SCE agreed with another \$25,282,645 of UAFCB's exceptions.

UAFCB conducted this examination pursuant to Decision (D.) 12-12-032.⁵ UAFCB's examination was limited in scope and included examining SCE's EE costs and reporting related to: a) administrative costs, including SCE's, Third Party (TP), and Local Government Partnership (LGP); b) EE Contracts; c) On-Bill Financing (OBF); and d) Multi-Family Energy Efficiency Rebates (MFEER).

UAFCB's examination only addressed reporting misstatements or inaccuracies. Consequently, UAFCB does not address any management or regulatory compliance issues for program year 2011 that did not directly result in misstatements or inaccuracies in the program expenditures as reported by SCE. UAFCB will address other management or regulatory compliance issues pertaining to 2011 in its subsequent report, covering program years 2011-2012.

¹ UAFCB considers its observations material because of the (a) small size of UAFCB's sample, (b) that SCE didn't provide adequate source substantiation for a number of the costs in UAFCB's samples and (c) the frequency and multiple types of errors.

² SCE's 2011 reports can be found on the Energy Efficiency Groupware Application website (EEGA) at <http://eega.cpuc.ca.gov/>.

³ \$818,092.22 = \$733,603 + \$8,263 + \$76,223.

⁴ Not including variances detected during reconciliations between the quarterly reports and SCE's recorded data.

⁵ In D.12-12-039, on page 40, the Commission discussed that it anticipates relying on public versions of UAFCB's examination reports when determining the amount of each utility's incentives. In Conclusion of Law (COL) No. 9, the Commission indicated that upon completion, UAFCB shall serve a notice of availability of its report on the service list in R.12-01-005, or its successor.

Due to the error rates in UAFCB's samples, UAFCB cannot provide full assurance to the reasonableness of all the amounts that SCE reported in its EEGA reports.

In its comments on UAFCB's draft report, SCE indicated that it strongly disagreed with UAFCB's findings and stated that the majority of UAFCB's observations were factually incorrect, without merit and not supported. However, within its detailed response to each of UAFCB's observations, SCE admitted to many of UAFCB's observations. After receiving SCE's comments, UAFCB met with SCE to discuss its concerns both in person and by phone conference. SCE admitted that it was misguided by the size and number of exceptions and therefore, strongly contested all of UAFCB's observations. In the ensuing time between SCE's comments and the date of this memorandum, UAFCB encouraged SCE to provide any additional documentation in an effort to allow SCE every opportunity to clear UAFCB's exceptions. During this time period, SCE was able to clear \$226,218 of UAFCB's original observations.

A. Summary of Examination Observations and Recommendations

In the following section, UAFCB summarizes and groups its examination observations by type.⁶ UAFCB determined that SCE did not demonstrate compliance with Public Utility Code Sections 314 (a), 581, and 584, the Uniform System of Accounts, General Order 28, the Commission's directives on administrative costs, the terms of SCE's contracts, and SCE's own policies and procedures. In Appendix A, UAFCB describes its examination observations in detail.

Quarterly Reports Do Not Tie with SCE's Recorded Data: SCE corrected its annual reports for misclassifications and claimed that it is not required to correct its quarterly reports on the reporting website.⁷ The gross errors for the areas UAFCB reconciled were \$15.3 million and the net errors were \$2.7 million.⁸ The differences were primarily due to 2010 errors that SCE corrected in the 2011 quarterly reports. SCE included \$1.3 million of its local program administrative costs in its LGP category although it reported them separately under the LGP. UAFCB believes that this amount should have been reported in the SCE's portion. See Observation 1 at A-2 in Appendix A.

Recommendation 1: For any corrections SCE needs to make to future reports for errors made in a prior period, SCE should, at a minimum, adequately disclose the errors by showing the magnitude and nature of the correction, and the period in which the error occurred. Energy Division should assess the current quarterly reporting requirements and processes and address whether SCE is appropriately reporting Local Programs 1, 2 and 3 and 4, 5 and 6 costs and how corrections should be made when a utility discovers errors made in prior reporting periods. Within 90 days from the date of this report, SCE needs to provide UAFCB with supporting data and reports showing that an error in the amount of \$62,998 was found and corrected in SCE's 2010-2012 Monthly Energy Efficiency Program Report - April inception to date, and all subsequent reports.

⁶ Commission directives used to measure compliance included, but were not limited to, D.09-09-047, the ruling in R.01-08-028, dated February 21, 2006 and Energy Division's memo, dated October 22, 2009.

⁷ See Table 3 of SCE's annual report entitled "Southern California Edison Company's (U 338-E) 2012 Annual Report for 2011 Energy Efficiency Programs" and SCE's quarterly reports for each quarter of 2011, each entitled "2011 Energy Efficiency Fund Shift Report."

⁸ The total amount recorded for the year 2011 matched the total amount reported in SCE's 2011 annual report, but did not match the sum of all SCE's reported costs in its 2011 quarterly reports. For the net amount, UAFCB shows the overall variance in the total costs in the reports after UAFCB's reconciliation.

Misclassifications: SCE potentially misclassified almost \$24,793,188 of its reported costs in the areas UAFCB examined. Those misclassifications included, but were not limited to: a) SCE recording costs in a different program area than it should, b) using estimated allocation factors, and c) permitting its direct implementation contractors to allocate their total costs between direct implementation, administrative and marketing costs instead of directly charging costs from those areas. See Observations 3(A-7), 4(A-9), 7(A-12), 8(A-13), 9(A-15), and 10(A-17).

Recommendation 3: SCE needs to provide additional training to employees and any non-employees entering data in its accounting systems to ensure that they are able to differentiate direct implementation and marketing costs from administrative costs. SCE should improve the accuracy of its cost recording and reduce the amount of correcting entries that need to be made. Within 90 days from the date of this report, SCE needs to provide UAFCB with documentation demonstrating that it made the correcting entries and corrected its reporting.

Recommendation 4: SCE should verify the Distributive Cost Center (DCC) used in its SAP to ensure that it closely approximates its predetermined DCC since the predetermined DCC is supposed to remain constant over the cycle. Within 90 days from the date of this report, SCE should provide UAFCB with documentation showing that it corrected the names in SAP so they align with the DCC and explain the \$189,021 DCC discrepancy.

Recommendation 7: SCE and the other utilities need further guidance on their fixed price contracting processes. If the Commission decides to allow this type of contracting, wherein the vendors allocate their total costs to the direct implementation, marketing and administrative cost areas, the Commission may want to require that the utilities audit at least 20% of these contract costs annually to verify if the costs are accurately distributed between the three cost areas.

Recommendation 8 (b): In addition, SCE should provide additional training to employees or non-employees entering the data in its systems to ensure that they are able to differentiate direct implementation costs from administrative costs in order to reduce the amount of correcting entries made to correct misstatements of its direct implementation costs as administrative costs.

Recommendation 9 (a): The Energy Division should meet with the utilities to discuss their contracting practices and how these costs are provided. If the Energy Division and/or the Commission decide that the utilities' fixed price contracting with allocations is appropriate, the Commission should require the utilities to verify 20% of the costs charged by its contractors annually to ascertain if the fixed allocation percentage amounts are correct. The utilities should require contractors to bill for actual work performed in the three categories and not by a preset arbitrary percentage.

Recommendation 10 (a): SCE should verify that the DCC used in its SAP to ensure that it closely approximates its predetermined DCC since the predetermined DCC is supposed to remain constant over the cycle. Within 90 days from the date of this report, SCE should provide UAFCB with documentation showing that it corrected the names in SAP so that they align with the DCC and explain the \$1,785 discrepancy.

Inadequate Supporting Source Documentation: For \$4,447,179 of the expenditures UAFCB examined, SCE did not provide adequate supporting source documentation. See Observations 2 (A-6), 9(A-15) and 13(A-21).

Recommendation 2: SCE needs to ensure that its costs are clearly supported by adequate supporting source documentation, including, but not limited to proper authorization, and are recorded and reported accurately. In future examinations, UAFCB may disallow costs that are not properly supported.

Recommendation 9 (b): SCE needs to maintain adequate supporting source documentation as recommended above.

Recommendation 13: SCE should comply with its own policies and procedures and sound business practices by ensuring that written approval are maintained when its program managers approve any modifications to the original approved reservation. SCE should not earn incentives on at least \$76,226 of its MFEER.

Untimely Accrual: SCE did not accrue \$741,866 of its 2010 expenditures in 2010. See Observations 8(A-13) and 12(A-20).

Recommendation 8 (a): SCE needs to ensure that expenses are recognized in the year they are incurred.

Recommendation 12: SCE should record its program costs in a timely manner and consistently for comparative purposes from year to year. SCE should not be allowed to earn incentives on the \$733,603 of expenses that should have been accrued in 2010.

UAFCB recommends that the netting issue raised by SCE in its comments dated September 27, 2013 on accrual and inspections be addressed when it files its incentive advice letter. SCE presented the information as if it conducts inspection of every incentive payment and not on random selection of projects. This gives the UAFCB the opportunity to verify SCE's claims.

Unable to Verify Labor Sample of Charges: UAFCB requested supporting documentation for \$343,267 of SCE's labor charges. Rather than recording labor costs directly, SCE indicates that it uses a process to estimate its labor costs and then corrects those estimates to actual costs. SCE provided UAFCB with data and journal entries demonstrating how the correction is made. However, due to time constraints, UAFCB was not able to evaluate SCE's process. Since UAFCB did not evaluate SCE's process and did not have the time to review SCE's sampled actual labor costs for 2011, UAFCB will test SCE's 2012 labor costs during UAFCB's examination of 2012 EE programs. See Observations 5(A-10) and 10(A-17).

Recommendation 5: SCE should establish policies and procedures that allow UAFCB to effectively verify each amount listed as a labor cost. UAFCB should not have to pick a specific group or a test month as suggested by SCE to effectively verify actual labor costs. SCE should establish a way to address its employees' confidentiality while allowing UAFCB to verify its labor costs.

Recommendation 10 (b): As discussed in another observation above, SCE should set policies and procedures that will allow UAFCB to effectively verify every single amount listed as a labor cost.

Overstated OBF Committed Funds and Customer Overbillings: SCE did not return committed funds to the loan pool for OBF loans initiated in 2011 that did not materialize until 2013. In addition, it overbilled a customer in 2011 and did not correct this overbilling until 2013. In total, these errors amounted to \$471,147. See Observation 11(A-18).

Recommendation 11: SCE should promptly reverse loan amounts that are less than committed or for overcharges. In addition, SCE should reverse, within a reasonable timeframe, abandoned applications which were previously assigned loan commitments. Energy Division should establish a reasonable timeframe for determining when an application is considered abandoned.

Lax or Internal Controls Not Vigorously Enforced: Given the small sample tested by UAFCB and in view of the multiple kinds of errors UAFCB found during its examination, SCE clearly needs to improve its reporting and record keeping processes. SCE's controls are either too lax or SCE is not vigorously enforcing its internal controls. See observation 14(A-22)

Recommendation 14: Within 90 days from the date of this report, SCE should strengthen its internal controls for recording and reporting its EE to prevent future misreporting and misclassifications of SCE's EE, and provide UAFCB a copy of its revised internal controls. In addition, SCE should describe how it will monitor and vigorously enforce its controls to improve its recording and reporting. SCE made some substantial errors in recording and reporting its EE expenditures, as evidenced by UAFCB's observations and corrections SCE made to both its 2010 and 2011 recording and reporting. SCE asserts that its internal controls are working effectively. However, both preventative and detective controls are necessary. While a small percentage of errors can be tolerated, SCE should improve its controls to minimize recording and reporting errors and thereby eliminate the widespread errors occurring throughout the recording and reporting of SCE's EE activities. SCE should correct its 2011 and 2012 quarterly EEGA reports and inform the Chief of UAFCB of the corrections no later than 90 days from the date of this report.

B. Examination Process

Based on consultation with the Energy Division (ED) and UAFCB's prior experience examining SCE's EE programs, and the results of UAFCB's risk assessment, UAFCB limited its examination to the areas described above and evaluated compliance with accounting, recording, reporting of program expenses during 2011 and the associated procedures to safeguard those activities . Pertinent information about SCE's EE programs is found in Appendix B

UAFCB provided a copy of its analysis, observations, and recommendations to SCE for comment. UAFCB summarized SCE's comments including UAFCB's rebuttal to those comments in Appendix A. UAFCB made changes throughout the report to reflect comments received from SCE.

C. Conclusion

SCE should improve the accuracy of the recording and reporting of its EE programs. The Energy Division should improve directives on reporting and provide guidance to the utilities on their contracting processes.

A detailed summary of UAFCB's analysis and observations is attached in Appendix A.

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

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Appendix A Analysis and Findings

A.1 Introduction

The Utility Audit, Finance and Compliance Branch (UAFCB) discovered material errors when it sampled and tested Southern California Edison's (SCE) data associated with amounts SCE reported spent in 2011 for its energy efficiency program in the areas that UAFCB examined.¹ Due to the proportionality of the errors to the sample and some lack of documentation, as described in the following observations, UAFCB deems SCE's 2011 reports less than accurate and reliable.² In addition, UAFCB observed certain recordkeeping deficiencies and some other lack of compliance. UAFCB was unable to verify the labor charges requested in its sample. Consequently, UAFCB questions the correctness of the labor charged to the programs.

UAFCB's examination was limited in scope. UAFCB limited the areas it tested and for those areas it tested, it did not test 100% of the reported costs. UAFCB's examination only included an examination of the following 2011 EE portfolio cost categories:

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

UAFCB's examination only addresses observations that pertain to SCE's reporting and/or recording expenditure misstatements or inaccuracies. The examination excludes any management or regulatory compliance issues for program year 2011 that did not directly result in misstatements or inaccuracies in the program expenditures as reported by the utility. UAFCB will address those other management or regulatory compliance issues pertaining to 2011 in its subsequent report covering program years 2011-2012.

On September 10, 2013, UAFCB provided a copy of its draft observations and recommendations to SCE for comment. On September 12, 2013, SCE provided UAFCB with its comments. UAFCB summarized SCE's comments and UAFCB's rebuttal in the observation sections. After receiving SCE's comments, UAFCB met twice with SCE to discuss SCE's concerns. Due to the compressed timeframe of the examination, UAFCB allowed SCE to provide additional source documentation. By supplying UAFCB with the additional source documentation, SCE was able to clear \$226,218 of UAFCB's exceptions. UAFCB made changes throughout its report to reflect the comments and additional source documentation that UAFCB received from SCE.

A.2 Reconciliation of Reported to Recorded Costs

UAFCB conducted a reconciliation of the EE program areas that it reviewed. UAFCB found exceptions when comparing the administrative, direct implementation, OBF and MFEER

¹ UAFCB considers its observations material because of the (a) small size of UAFCB's sample, (b) that UAFCB could not test any of the labor costs sampled and (c) the frequency and multiple types of errors.

² SCE's 2011 reports can be found on the Energy Efficiency Groupware Application website (EEGA) at <http://eega.cpuc.ca.gov/>.

expenses that SCE reported to the Commission compared to the amount recorded in SCE's accounting records for 2011. Although Marketing & Outreach was not part of the scope of UAFCB's 2011 examination, during the reconciliation of the energy efficiency expenses by cost categories, UAFCB noted some discrepancies between SCE's recorded and reported amounts and reports them here.

Observation 1: SCE did not demonstrate compliance with Public Utility Code §§ 581 and 584³ and the Commission's reporting requirements.⁴ For the areas UAFCB reviewed, SCE improperly reported different amounts for its EE costs in its quarterly reports when compared to the amounts it recorded for 2011 and the amounts it reported in its annual report.⁵

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. The Commission's reporting requirements define allowable administrative costs and how they should be reported.

Condition: In the areas that UAFCB examined, SCE's costs as recorded and reported in its annual report do not match its costs extracted from its inception-to-date quarterly reports as shown in the following table.⁶

**Table A-1
Variances between Recorded and Reported
(Excluding OBF)**

Category	Recorded and Annual Rpt	Quarterly Report on EEGA	Difference
Administrative Costs			
IOU	\$17,340,698.88	\$17,125,906	\$(214,792.50)
LGP	3,000,035.52	4,293,783	1,293,747.56
TP	<u>6,784,704.00</u>	<u>7,016,200</u>	<u>231,495.95</u>
Total	<u>\$27,125,438.40</u>	<u>\$28,435,890</u>	<u>\$1,310,451.60</u>
Direct Implementation			
IOU	\$234,787,495.50	\$230,710,938	\$ 4,076,557
LGP	19,576,716.61	21,947,471	(2,370,754)
TP	<u>34,365,370.65</u>	<u>34,119,025</u>	<u>246,346</u>
Total	<u>\$288,729,582.76</u>	<u>\$286,777,434</u>	<u>\$ 1,952,149</u>
Marketing & Outreach Costs			
IOU	\$15,302,411.72	\$12,238,136	\$ 3,064,275.89
LGP	833,832.62	4,524,953	(3,691,120.82)
TP	<u>2,642,258.00</u>	<u>2,657,108</u>	<u>(14,849.70)</u>
Total	<u>\$18,778,502.34</u>	<u>\$19,420,197</u>	<u>\$ (641,694.63)</u>

³ All statutory references are to the Public Utilities Code unless stated otherwise.

⁴ ALJ Gottstein's Ruling in R.01-08-028, dated February 21, 2006, addressed and listed allowable costs and delegated authority to Energy Division to provide further clarification to the reporting requirements and list of costs. ED's memo, dated October 22, 2009, expanded cost definitions and defined how costs should be treated.

⁵ See Table 3 of SCE's annual report entitled "Southern California Edison Company's (U 338-E) 2012 Annual Report for 2011 Energy Efficiency Programs" and SCE's quarterly reports for each quarter of 2011, each entitled "2011 Energy Efficiency Fund Shift Report."

⁶ UAFCB subtracted 2010 amounts from the inception-to-date amounts in SCE's last quarterly 2011 report from the EEGA website.

In addition, during its fieldwork, UAFCB found the following discrepancies with what SCE reported for its OBF.

Table A-2
Variations between Recorded and Reported OBF

Total Cumulative as of Q1 2011	2010 Total expenses EEGA	2011 Q1 Expenses Extracted	Recorded and Annual Report	Variance
\$1,061,653.37	\$766,748.15	\$294,905.22	\$240,978.82	<u>\$53,926.40</u>

During the fieldwork, SCE made various representations about all of the variances that it corrected.

According to the data SCE provided to UAFCB after it provided its comments to UAFCB's draft report, SCE made various recording and reporting errors in 2010: \$1.3 million of net adjustments in its administrative cost area; \$2.0 million in its direct implementation cost area; and \$641,965 in its marketing and outreach cost area. With the exception of the OBF area, UAFCB found that SCE's reconciliations appear to demonstrate the reasons for the differences. However, UAFCB finds SCE's reconciliation and explanations for the OBF area unsatisfactory and was unable to verify SCE's assertions in this area.

During the examination, SCE represented that its total IOU Costs is determined by adding all statewide programs costs to Local Programs 1, 2, 3, and 6 costs and that Local Government Partnership (LGP) consisted of only Local Programs 4 and 5 costs. However, on EEGA, SCE reported all six Local Programs either under "Local and Statewide Partnership" or "Other" and "Partnership Programs." In addition, it changed how it reported these programs from the first two quarterly reports by including Local Programs 1, 2 and 3 and 4, 5 and 6 as subcategories under Local and Statewide Partnerships to showing Local Programs 1, 2, 3 and 6 under "Other" in quarters 3 and 4.

UAFCB finds the SCE's processes need to be improved so that their staffs make fewer errors when recording its data. Although SCE has processes to detect and correct errors, it is more expedient and less risky to prevent errors in the first place. SCE asserts that the EEGA website does not provide for being able to submit corrected quarterly reports. Ideally, when a utility finds errors in a subsequent period, it should be able to submit a corrected report for the period in which the error was made. If it isn't able to file a corrected report for the period in which the error was made, at a minimum, SCE should disclose the magnitude and nature of the correction, and the period in which the error occurred. In addition, SCE needs to report its Local Programs correctly.

Cause: SCE's internal controls appear inadequate and employees may not be trained properly in compiling data for the reports.

Effect: SCE materially misclassified its 2011 EE expenses in its quarterly EEGA reports.

SCE's Representation in the Field: SCE misclassified utility costs for Local Programs 1, 2, 3, and 6 in the amount of \$1.2 million as LGP administrative costs, \$2.4 million as

DI LGP amounts, and \$3.7 million as LGP marketing and outreach amounts. Instead, SCE should have reported these amounts as IOU costs in each of those areas. In addition, SCE found errors in 2010 which it corrected by adjusting the 2011 Inception-to-date reports to the Commission in calendar year 2011.

SCE's Comments: SCE made a reclassification based on a change to the classification for vendor fixed price contracts and did not change the overall annual expenditures reported for 2010 or 2011. SCE reported this reclassification in its 2010 annual report and incorporated the reclassification in subsequent inception-to-date quarterly reports. SCE states that it is not required to separately update its 2010 quarterly report to reflect a reclassification of administrative, marketing, and direct implementation costs. In addition, SCE asserts that it does not include Local Programs 1, 2, 3 and 6 as part of the LGP.

Rebuttal: With documentation it provided after it submitted its comments on UAFCB's draft report, SCE demonstrated to UAFCB that SCE made the TP correction correctly and its reconciliations appear to demonstrate the reasons for the differences between its recorded data and its quarterly EEGA reports. However, SCE adjustments for 2010 to the 2011 quarterly reports without adequate disclosure does not permit users of the reports to have an accurate picture of each year's true program costs. The reporting errors should be corrected or at least disclosed for each year so that accurate yearly totals for all program costs can be relied on. Correcting reports that contain errors would be the ideal solution and provide the most accurate information to users of the reports. While SCE attempts to separately report for the Local Programs 1, 2 and 3, and 4, 5 and 6 under LGP or "Other," its current reporting processes in this area can be misleading.

Recommendation: For any corrections SCE needs to make to future reports for errors made in a prior period, SCE should, at a minimum, adequately disclose the errors by showing the magnitude and nature of the correction, and the period in which the error occurred. Energy Division should assess the current quarterly reporting requirements and processes and address whether SCE is appropriately reporting Local Programs 1, 2 and 3 and 4, 5 and 6 costs and how corrections should be made when a utility discovers errors made in prior reporting periods. Within 90 days from the date of this report, SCE needs to provide UAFCB with supporting data and reports showing that an error in the amount of \$62,998 was found and corrected in SCE's 2010-2012 Monthly Energy Efficiency Program Report - April inception to date, and all subsequent reports.

A.3 Administrative Costs

UAFCB reviewed selected samples of transactions from SCE's administrative cost categories for substantive testing and noted the following: 1) SCE did not properly account for 19% or \$779,694 of the \$4.1 million sample of IOU administrative costs; 2) 3% or \$13,042 of the \$380,214 sample of LGP administrative costs; and 3) 54% or \$2.5 million of the \$4.8 million of the sample of TP administrative costs.⁷ Overall, out of the \$9.3 million sample of administrative costs that UAFCB reviewed, SCE did not properly account for 10% or \$921,775.

In the following table, UAFCB summarizes the total sample selected by administrative cost type.

⁷ During the examination, SCE provided substantiation showing that they had observed and corrected \$2.4 million of the \$2.5 million of errors.

**Table A-3
Sample Size**

Category	Total Recorded Data Provided ⁸	Total Sample	% of Total
IOU Admin Costs	\$20,487,100.16	\$4,131,165	20%
LGP Admin Costs	667,653.04	380,214	57%
TP Admin Costs	<u>5,970,685.20</u>	<u>4,802,509</u>	<u>80%</u>
	<u>\$27,125,438.40</u>	<u>\$9,313,888</u>	<u>34%</u>

In the following table, UAFCB shows its exceptions compared to the size of the sample.

**Table A-4
Total Exception per Sample**

Category	Total Sample	Total Exceptions	% of Sample	Error Corrected by SCE	% of Sample
IOU Admin Costs	\$4,131,165	\$779,694.01	19%		
LGP Admin Costs	380,214	13,042.04	3%		
TP Admin Costs	<u>4,802,509</u>	<u>129,039.22</u>	<u>3%</u>	<u>\$2,411,989.31</u>	<u>50%</u>
Total	<u>\$9,313,818</u>	<u>\$921,775.27</u>	<u>10%</u>		

Note: Exception amounts do not include exceptions found during the reconciliation. In addition, exceptions for the IOU administrative costs include \$336,015 of labor from UAFCB's sample that it was unable to verify for accuracy.

⁸ While the total, \$27,125,438 for the data provided by SCE for UAFCB's sampling, reconciled with the total amount SCE reported in its annual report and what it recorded for its EE administrative costs, the subtotals for IOU and LGP administrative cost types did not. SCE had organized the data it provided to UAFCB for sampling differently from the amounts it reported.

a) IOU Administrative Costs

Observation 2: SCE did not demonstrate compliance with §§ 581 and 584, General Order (GO) 28, the Uniform System of Accounts (USOA) and its own policies and procedures. Of the sample UAFCB tested, SCE did not provide adequate source documentation to support its temporary worker costs in its IOU Administrative Costs by 27% or by \$131,288.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. General Order 28 and the USOA require that the utilities preserve all records, memoranda, and papers supporting each and every entry so that this Commission may examine the same at its convenience. SCE's agreement with the vendors requires SCE representative's preapproval for mileage charges.

Condition: SCE did not require and/or maintain adequate documentation for some of the temporary worker costs UAFCB examined. On the contractor invoices, the cost associated with "meeting and support for all" did not provide sufficient detail to determine that the additional amount allocated to each worker was correct. The detailed information for "meeting and support for all" did not disclose whether each meeting covered all programs a person worked on. In some instances, the vendor's invoices give the impression that a person worked on more programs than he or she actually worked on. In addition, for mileage charges, there were no manager preapprovals noted. UAFCB summarizes its observation in the following table.

**Table A-5
Temporary Labor Overstated**

Description	Total Sample	Exception	% of Sample
Inadequate Documentation Temp/Supp		\$130,818.70	
Undocumented Mileage Approval		1,069.73	
	<u>\$495,138.89</u>	<u>\$131,288.43</u>	<u>27%</u>

Cause: Lax internal controls or internal controls that are not enforced can cause recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: SCE recorded and reported data to the Commission less than accurate and reliable because of the lack of supporting source documentation.

SCE's Representation in the Field: SCE originally asserted that the overstatement of its temporary worker costs as described above must be due to the fact that other costs were mistakenly added to the labor cost. Subsequently, SCE claimed that the additional costs were contractor costs allocated across all the programs and that although some programs were listed as two separate programs with two different names on the invoices they should be counted as one program for cost allocation purposes.

SCE's Comments: The time charged was appropriately allocated only to the programs the consultant supported. Invoicing documentation was consistent and met all conditions defined in the Purchase Order and SCE's Terms and Conditions. SCE asserts that its consultants are required to provide supporting documentation for hours incurred by person, by day, by task,

by hour. The invoices reviewed by UAFCB provided adequate supporting documentation to determine the time a person spent on each project. SCE indicated that mileage was verbally pre-approved by SCE, then validated and approved by SCE at time of invoice approval. SCE ensures that invoiced costs are clearly supported by adequate supporting documentation, including, but not limited to proper authorization, accounting, recording and accurate reporting.

Rebuttal: These contractor meeting costs should have been charged directly to the programs that each staff person worked on. While SCE claims that its P&P do not require written approval, in most other instances UAFCB reviewed, SCE interpreted the requirement for manager approval to mean written approval. Verbal approval is inadequate and not a sound business practice. Mileage charges should have been supported by preapproval documentation. SCE needs to ensure that its contractors provide sufficient detail on their invoices so that costs can be verified and traced to the specific program that was worked on. The vendor's invoices should not provide more than one name for a specific program. For charges that a utility does not maintain adequate documentation to support, the Commission could require that the utility not receive ratepayer funding or incentives.⁹

Recommendation: SCE needs to ensure that its costs are clearly supported by adequate supporting source documentation, including, but not limited to proper written authorization, and are recorded and reported accurately. In future examinations, UAFCB may disallow costs that are not properly supported.

Observation 3: SCE did not demonstrate compliance with §§ 581 and 584, and the Commission's guidelines on allowable administrative costs. Of the sample UAFCB tested, SCE improperly recorded and its quarterly and annual reports overstated its administrative costs by 7% or by \$123,370.16. In addition, for the transactions UAFCB reviewed, SCE also incorrectly recorded and reported \$45,820 of direct implementation and marketing costs as IOU administrative costs which it detected and corrected in its accounting system in 2011. SCE agreed to make corrections for the \$123,370.16.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. All costs must be properly accounted for and categorized in compliance with the Appendix to Administrative Law Judge (ALJ) Gottstein's Ruling on Reporting Requirements in Rulemaking (R.) 01-08-028, dated February 21, 2006 and Energy Division's letter, dated October 22, 2009, which expanded cost definitions and defined how costs should be treated..

Condition: In some of the sample items that UAFCB reviewed, based on documentation SCE provided during UAFCB's field work, SCE improperly recorded direct implementation and marketing costs as IOU Administrative Costs. SCE carried the error forward into its reports on EEGA. Based on documentation SCE provided when UAFCB was in the field, UAFCB originally found \$156,414 of direct implementation and

⁹ For example, see D.06-01-025, in which the Commission disallowed \$269,194 of plant for which the utility did not produce adequate source documentation for. In this instance, the utility produced an unsigned and undated General Work Order.

\$40,375 of marketing, for a total of \$196,789, that SCE recorded and reported incorrectly as IOU administrative costs.¹⁰ With its comments on UAFCB's draft report and subsequently to those comments, SCE provided sufficient documentation to demonstrate that it had correctly recorded \$27,598 of that amount and that SCE found and corrected \$45,820 that it had incorrectly recorded and reported.¹¹ In the following table, UAFCB summarizes its observations.

Table A-6
Overstated by DI and Marketing Costs

Cost Element	Description	Total Sample	Exception	% of Sample	Change in Observation	Total % of Sample
6161070	DI	\$ 116,276.4	\$ 40,461.56	35%	-	35%
6161225 (a)	DI	27,597.95	-	-	\$27,597.95	100%
6161145 (b)	DI	327,884.58	-	-	30,445.43	9%
6160510	DI	495,138.89	31,510	6%	-	6%
6150410	DI	558,445.66	26,398.6	5%	-	5%
Direct Implementation		1,525,343.48	98,370.16	6%	50,043.38	10%
6050030	Marketing	25,000.00	25,000.00	100%	-	100%
6161145 (b)	Marketing	327,884.58	-	-	15,375.00	5%
Total Marketing		352,884.58	25,000.00	7%	15,375.00	11%
Total		\$1,878,228.06	\$123,370.16	7%	\$73,418.38	11%

Notes Regarding Documentation SCE Provided After UAFCB's Draft Report:

(a) Amount SCE recorded and reported correctly.

(b) Amounts SCE recorded and reported incorrectly and reversed later.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: Misclassifications make reports and numbers less than accurate and reliable.

SCE's Representation in the Field: SCE did not realize that its total administrative costs included additional direct implementation and marketing costs. During the year 2011, SCE asserts that it caught several errors where direct implementation and marketing costs were recorded as administrative costs and corrected the errors.

SCE's Comments: Of the amounts above, SCE claims that \$27,597.95 in question was classified correctly as an administrative cost to procure services and materials for the center. SCE detected \$45,820.43 of classification errors in 2011 and corrected those exceptions. SCE will make corrections to the remaining \$123,370.16 of errors noted by UAFCB.

Rebuttal: SCE's employees who record and report the program costs need to be properly trained, conduct their work accurately, and their work needs to be reviewed for accuracy.

Recommendation: SCE needs to provide additional training to employees and any non-employees entering data in its accounting systems to ensure that they are able to

¹⁰ \$156,414 + \$04,375 = \$196,789.

¹¹ \$30,445.43 + \$15,375.00 = \$45,820.43.

differentiate direct implementation and marketing costs from administrative costs. SCE should improve the accuracy of its cost recording and reduce the amount of correcting entries that need to be made. Within 90 days from the date of this report, SCE needs to provide UAFCB with documentation demonstrating that it made the correcting entries and corrected its reporting.

Observation 4: SCE did not demonstrate compliance with §§ 581 and 584. Of the \$1.3 million sample UAFCB reviewed, SCE overstated these administrative costs by 15% or by \$189,021. SCE incorrectly allocated its energy efficiency administrative, general and overhead costs (A&G) between its programs by failing to use its pre-determined allocation percentage that it calculated at the beginning of the 2010-2012 cycle.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission.

Condition: SCE develops a pre-determined allocation factor at the beginning of the budget cycle for allocating its energy efficiency A&G over the entire period. SCE maintains that this pre-determined allocation factor is not subject to change during the entire cycle. SCE refers to this factor as the Distributive Cost Center (DCC).¹² Originally, based on data provided in the field and prior to UAFCB's draft report, SCE did not appear to use its DCC factors in SAP when allocating \$251,342 in costs from the sample that UAFCB reviewed.

Subsequent to providing its comments on UAFCB's draft report, SCE provided UAFCB with documentation showing that it correctly used SCE's predetermined DCC for \$62,322 in program costs that it had changed the names of but did not change the names in its SAP. However, SCE did not provide UAFCB with documentation to support the error UAFCB discovered regarding some allocations totaling \$189,021 or 15% of UAFCB's sample of \$1,250,178.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: Timely alignment of program names in the EEGA with the names in SAP would have saved the amount of time spent resolving this issue.

SCE's Representation in the Field: SCE claims that SAP cannot process less than a 0.1% allocation and therefore the SAP DCC percentage is slightly higher/lower than the original. SCE was aware that the percentage used to allocate costs between its programs was slightly different in its SAP system. SCE did not expect a big discrepancy between the percentage determined at the beginning of the cycle 2010-2012 to be used during the cycle and the percentage set in its SAP system.

¹² SCE defines DCC as a temporary cost object which allows EE G&A and overhead costs such as IMM and other allocated non-labor expenses to be collected on a monthly basis and distributed to other cost objects such as internal orders and final cost centers using a pre-determined percent allocation.

SCE's Comments: The DCC percentages that allocate energy efficiency A&G are predetermined in SAP. The 828% difference described in UAFCB's Draft Report is not accurate because UAFCB selected the incorrect percentage to test the DCC allocation. The auditor selected 0.32% for the C S V E L P allocation, when the auditor should have used 26.51% Local Government Strategic Planning Pilot Program's allocations. The DCC percentages in SCE's SAP system are accurate. However, SCE is aware there have been changes in the EEGA program names that have not been updated in SAP which could have led to the incorrect percentage being selected. While the names entered for the programs may not be identical in EEGA and SAP, the information for each program is identifiable, and SCE's SAP system is using the correct percentages for allocation. SCE agrees that the program names in SAP should be updated so the two systems are brought into alignment.

Rebuttal: The DCC percentages that allocate EE A&G do not appear to be predetermined by SAP or in SAP since the discrepancy between the original pre-determined percentages and the percentages in SAP is due to the fact that SAP cannot process some pre-determined percentages. SCE needs to ensure that it uses all of its predetermined DCC in its SAP. If it uses a different rate, then SCE should be able to justify any variance.

Recommendation: SCE should verify the DCC used in its SAP to ensure that it closely approximates its predetermined DCC since the predetermined DCC is supposed to remain constant over the cycle. Within 90 days from the date of this report, SCE should provide UAFCB with documentation showing that it corrected the names in SAP so they align with the DCC and explain the \$189,021 DCC discrepancy.

Observation 5: SCE did not demonstrate compliance with §§ 314(a), 581 and 584, GO 28 and the USOA. Of the \$336,015 sample that UAFCB reviewed, UAFCB was unable to verify that actual labor costs were accurate.

Criteria: Section 314(a) indicates "The commission, each commissioner, and each officer and person employed by the commission may, at any time, inspect the accounts, books, papers, and documents of any public utility." Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. GO 28 specifically states: "The manner in which these records, memoranda and papers shall be preserved must be such that this Commission may readily examine the same at its convenience." The USOA provides: "Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto."

Condition: SCE did not produce adequate source documentation to support the \$336,015 or 100% of the sampled labor costs. After SCE provided comments on UAFCB's draft report, SCE provided UAFCB with data and journal entries in the amount of \$314,114 showing how it made the correction to adjust labor standard costs to actual labor costs. However, since UAFCB did not have the time to review SCE's actual labor costs it sampled for 2011, UAFCB will test SCE's labor charges to the programs during its examination of 2012 program activities.

Cause: SCE does not directly use actual labor costs for recording and reporting its employees' labor costs. SCE asserts that it uses a process whereby it develops standard labor rates which it later adjusts with effective labor rates.

Effect: Without being able to substantiate any of SCE's labor costs, UAFCB will verify SCE's labor charges when it examines SCE's EE costs for 2012.

SCE's Representation in the Field: SCE did not expect UAFCB to pick its sample the way it did since SCE does not report its labor costs using the actual labor costs mostly for its employees' confidentiality. SCE suggested that UAFCB select a specific group (i.e. Program Operation, DSM Strategy, Residential, etc.) for a test month to effectively verify actual labor rates and residential labor calculations charged to programs.

SCE's Comments: In its comments when it met with UAFCB after SCE submitted its comments on UAFCB's draft report, SCE indicated it is willing to cooperate with UAFCB to avoid misunderstands surrounding this matter.

Rebuttal: UAFCB agrees to work with SCE on their differences in this matter.

Recommendation: SCE should establish policies and procedures that allow UAFCB to effectively verify each amount listed as a labor cost. UAFCB should not have to pick a specific group or a test month as suggested by SCE to effectively verify actual labor costs. SCE should establish a way to address its employees' confidentiality while allowing UAFCB to verify its labor costs.

Observation 6: SCE provided adequate documentation for \$39,405 of postage costs or 100% of the sample that UAFCB reviewed.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. The USOA and GO 28 require that the utilities preserve all records, memoranda, and papers supporting each and every entry so that this Commission may readily examine the same at its convenience.

Condition: Originally, SCE did not provide UAFCB with adequate supporting source documentation for the sample of postage costs it requested to review. However, after providing its comments on UAFCB's draft report, SCE provided UAFCB with adequate documentation to demonstrate that the postage costs were incurred for the EE programs.

SCE's Representation in the Field: SCE's prepaid postage costs as entered in its SAP's system meant that the amount was paid.

SCE's Comments: SCE claims that it provided UAFCB with adequate supporting documentation for the sample selected for postage costs.

Rebuttal: SCE did not provide adequate source documentation for this charge until after it provided UAFCB with its comments on UAFCB's draft report.

Recommendation: None.

b) Local Government Partnership Administrative Costs

Observation 7: SCE did not demonstrate compliance with §§ 581 and 584, the USOA and GO 28. SCE did not properly account for \$13,042 or 100% of the sample that UAFCB reviewed.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. The USOA and GO 28 require that the utilities preserve all records, memoranda, and papers supporting each and every entry so that this Commission may readily examine the same at its convenience.

Condition: Originally, based on documentation provided in the field and prior to UAFCB's draft report, SCE did not provide a contract to support \$28,916 in contractor invoices and did not provide documentation to support \$13,042 of contractor invoices. Subsequent to providing its comments on UAFCB's draft report, SCE provided the contract related to the former amount. However, the area to record the effective date in the contract was not filled in. SCE charged \$13,042 as administrative costs for a contractor but the invoices SCE provided to UAFCB as documentation could not be used to demonstrate support for the subcategories of charges.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors and/or create risk for SCE. SCE allows contractors to determine the subcategory amounts on the invoices billed to SCE based on the allowable cost categories using some predetermined allocation factors.

Effect: Doing business with a contract without an effective date detailed in the contract could put SCE at risk and is not a sound business practice. Inaccurate reporting of actual costs to three cost categories prescribed by the Commission and undermines its policy on allowable costs.

SCE's Representation in the Field: SCE was already doing business prior to having a written and fully executed agreement. With respect to the administrative costs discussed above, SCE stated that these administrative expenses reflected an estimate to satisfy the Commission's requirement that costs should be reported in three categories.

SCE's Comments: At no time did SCE record payments for transactions that took place prior to an executed contract. The agreement, dated September 23, 2011, referenced in the Draft Report is not the correct agreement for the \$28,916 of project costs. There were two executed agreements provided to UAFCB. The expense in question is appropriately charged to the agreement executed on April 5, 2010. SCE agrees that fully executed agreements should be in place prior to recording costs as an EE expense. SCE later admitted that it did not provide one of the agreements to UAFCB in the field.

SCE claims that the invoices reflect actual charges and cost estimates of the vendors. The supporting invoice also shows the vendor appropriately *allocated* its actual costs into the Allowable Cost Categories, as required by the contract and in compliance with the

Commission's reporting requirements. The purchase order is a fixed price contract for a nonresidential direct install program.

Rebuttal: SCE's policy may misclassify direct implementation, administrative and marketing costs. SCE allowing its contractors to use allocation factors to segregate actual costs into the allowable cost categories of direct implementation, administrative and marketing may circumvent the Commission's intention to have the costs reported separately.

Recommendation: SCE and the other utilities need further guidance on their fixed price contracting processes. If the Commission decides to allow this type of contracting, wherein the vendors allocate their total costs to the direct implementation, marketing and administrative cost areas, the Commission may want to require that the utilities audit at least 20% of these contract costs annually to verify if the costs are accurately distributed between the three cost areas.

c) Third Party Administrative Costs

Observation 8: SCE did not demonstrate compliance with §§ 581 and 584, the Commission's directives on administrative costs, and the USOA. SCE did not properly account for or report 39% or \$129,039 of the TP administrative costs samples that UAFCB reviewed. SCE included costs that should have been accrued in 2010 or were not administrative costs. In addition, SCE improperly recorded and then reversed entries for 50% or \$2.4 million of the sample UAFCB examined, when SCE determined that it had incorrectly recorded several of its TP direct implementation and marketing costs as administrative costs. SCE agrees that the \$8,263 should be accrued. In addition, SCE agrees that \$120,776 direct implementation costs were inappropriately recorded to administration, and will make the appropriate correcting entry.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. The USOA requires that utilities keep its accounts on the accrual basis, requiring the inclusion in its accounts of all known transactions of appreciable amounts and if bills haven't been received or rendered, the amounts shall be estimated. ALJ Gottstein's Ruling in R.01-08-028, dated February 21, 2006, provided a list of allowable administrative costs and also delegated authority to ED to provide guidance to EE utilities on administrative costs. As directed by D.09-09-047, ED issued a letter, dated October 22, 2009, providing further guidance to the utilities on administrative costs. In order to achieve accurate and appropriate reporting, EE expenses have to be classified appropriately as required by ED.

Condition: For the sample of TP administrative costs that UAFCB selected, SCE recorded some of its 2010 expenses in 2011 and did not accrue these expenses in 2010 as required under the accrual basis of accounting. Instead, it reported these expenses as 2011 administrative costs. Originally, based on documentation SCE provided UAFCB in the field and prior to its draft report, UAFCB found that SCE did not properly accrue \$58,018 of these costs. Subsequent to its comments on UAFCB's draft report, SCE provided documentation demonstrating that it made a manual accrual adjustment for \$49,755 of that amount, leaving \$8,263 for which it did not timely accrue.

In addition, of the sample UAFCB reviewed, SCE recorded \$120,776 of its direct implementation costs as administrative costs. With the \$8,263 SCE did not timely accrue, SCE misclassified its TP administrative costs in total in the amount of \$129,039.

During 2011, SCE also incorrectly recorded \$2.4 million of its TP direct implementation and marketing costs as administrative costs, representing 50% of UAFCB's sample of \$4.8 million. However, SCE discovered its mistake and reversed these errors before filing its reports. Therefore, UAFCB did not categorize this amount as an exception. However, UAFCB is concerned that the recording for this sample originally had a 50% error rate.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: Untimely accruals and misclassifications provide less than accurate data.

SCE's Representation in the Field: All the invoices associated with the 2010 expenses listed above in the amount of \$49,755 and \$8,263 were incurred during the month of December 2010 and not accrued until 2011. With respect to the \$120,776 in direct implementation costs, SCE did not realize that its total administrative costs included additional direct implementation costs. During the year 2011, SCE caught several errors where direct implementation costs were recorded as administrative costs and corrected the errors.

SCE's Comments: SCE did properly accrue \$49,755 of the exceptions noted in Draft Observation 8. These transactions were part of a year-end *manual* accrual process for all of the vendor's invoices that had not been accrued in the automated process. SCE agrees that the \$8,263 should also have been accrued. SCE also agrees that \$120,776 direct implementation costs were inappropriately recorded to administration, and will make the appropriate correcting entry. SCE will review its controls in place to monitor monthly accounting transactions, and to ensure charges are recorded correctly.

Rebuttal: In addition to the USOA's accrual requirement, SCE's own policies and procedures require outstanding purchase order invoices be accrued. Its policies and procedures require that the company assume that it received the material or services invoiced from those purchase orders. Even though SCE detected \$2.4 million of misclassification errors in UAFCB's sample, UAFCB found an additional \$120,776 that SCE did not to detect and correct. SCE needs to improve and enforce its controls to prevent misclassification errors and not rely solely on its error detection processes.

Recommendation: (a) SCE needs to ensure that expenses are recognized in the year they are incurred. In addition, (b) SCE should provide additional training to employees or non-employees entering the data in its systems to ensure that they are able to differentiate direct implementation costs from administrative costs in order to reduce the amount of correcting entries made to correct misstatements of its direct implementation costs as administrative costs.

A.4 Energy Efficiency Contracts

Observation 9: SCE did not demonstrate compliance with §§ 581 and 584, GO 28 and the USOA. Out of \$37.5 million of the direct implementation contract costs UAFCB selected, 76% or \$28.6 million were either inaccurate or were not adequately substantiated by supporting documents.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. The USOA and GO 28 require that the utilities preserve all records, memoranda, and papers supporting each and every entry so that this Commission may readily examine the same at its convenience.

Condition: UAFCB selected \$37.5 million in direct implementation contracts to review. SCE allowed contract terms to be set at a fixed price, with allocation factors for distributing total costs between direct implementation, administration and marketing predetermined. When the contractor bills for its actual costs, it used the allocation factors to distribute its costs among the three areas. Consequently \$24.5 million of these direct implementation contract costs were based on allocated amounts and may be misclassified.

SCE's policy to allow contractors to have a fixed-rate arrangement to split costs with a fixed percentage to direct implementation, a fixed percentage to administrative costs and a fixed percentage to marketing is arbitrary and may not reflect the actual costs of each cost element that the contractor incurred.

An example may be allocation factors of 85, 10 and 5 percent, respectively. While the total actual costs are the same, the direct implementation, administration and marketing segments are likely to be misclassified since the actual costs are not used to determine the factors. Using the predetermined allocation factors, the vendor could have allocated some of the actual costs to conduct marketing to direct implementation or administrative costs, or vice versa. In this situation, marketing when billed and ultimately reported by SCE would have been understated and misclassified as either administrative or direct implementation costs.

SCE indicated that they did not audit or verify the contractors' allocation of costs to these cost categories. SCE's policy may cause the misclassification of the direct implementation, administrative and marketing costs.

In addition, SCE did not maintain adequate supporting source documentation for \$4.2 million or 100% of the labor contracts UAFCB reviewed. The only documentation SCE provided to substantiate the charges tested was a timesheet signed by a manager with a code identifying a specific program to be charged. Some of SCE's EE vendors also work for other businesses within SCE.

Cause: Lax internal controls or internal controls that are not enforced can cause recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: SCE recorded and reported data to the Commission that may be misclassified and less than accurate. Allowing vendors to allocate or estimate actual charges for each cost type results in misclassified cost type amounts. Without adequate substantiation, UAFCB was unable to determine if the \$4.2 million in charges were for the EE program.

SCE's Representation in the Field: SCE asserts that contracts set at a fixed price allow the contractor to meet the Commission's requirements by estimating and dividing the total costs in the three costs categories: administrative, direct implementation and marketing costs. With respect to the labor costs approved by SCE's managers, SCE stated that its managers' signature means that the cost associated with a specific program was verified.

SCE's Comments: Contrary to UAFCB, the \$24.3 million of direct implementation recorded costs are actual costs, not estimated costs. SCE receives invoices from vendors for actual costs and not estimated costs. The invoices for these direct implementation costs provide detailed support for the vendors' actual costs and all costs were in compliance with the contracts. The supporting invoices show the vendors appropriately allocated their actual costs into the Allowable Cost Categories, as required by the contract and in compliance with Commission's reporting requirements. For CPUC reporting purposes, vendors were required to report their actual costs into the three cost categories: Administration; Direct Implementation; and Marketing. Submitted invoices were based on negotiated fixed price per unit/measure pricing as listed in the purchase order for work approved by SCE.

The remaining costs identified as exceptions were substantiated by adequate supporting documentation. The purchase order defines the invoicing requirements and SCE complied with the invoicing requirements. These requirements include an invoice supported by a timesheet noting the hours worked by employee, by day, by hour. Management approval is required, by pay period, for the approval of all timesheets, both internal SCE employees and external contingent workers. This approval confirms that the manager has reviewed the timesheet and the employee's hours have been reported correctly and are charged to the correct program accounting.

Rebuttal: The Commission doesn't require the vendors to arbitrarily split their costs between three categories on an estimated basis. Costs are supposed to be categorized correctly, based on actual services rendered. The Commission intended that the costs reported in the three cost areas would be accurate for evaluating targets and assessing actual costs for conducting marketing, administration and direct implementation. Any estimated costs should be reversed within a reasonable timeframe with actual substantiated costs. An SCE manager's approval without complete supporting documentation of the type of job performed is not adequate documentation. UAFCB needs to independently verify and confirm that a specific cost was assigned to the appropriate cost category. For charges that a utility does not maintain adequate documentation to support, the Commission could require that the utility not receive ratepayer funding or incentives.

Recommendation: (a) The Energy Division should meet with the utilities to discuss their contracting practices and how these costs are provided. If the Energy Division and/or the Commission decide that the utilities' fixed price contracting with allocations is appropriate, the Commission should require the utilities to verify 20% of the costs

charged by its contractors annually to ascertain if the fixed allocation percentage amounts are correct. The utilities should require contractors to bill for actual work performed in the three categories and not by a preset arbitrary percentage. (b) SCE needs to maintain adequate supporting documentation. SCE needs to ensure that its costs are clearly supported by adequate documentation, including, but not limited to proper authorization, and are recorded and reported accurately. In future examinations, UAFCB may disallow costs that are not properly supported.

A.5 On-Bill Financing (OBF)

Observation 10: SCE did not demonstrate compliance with §§ 314(a), 581 and 584, GO 28 and the USOA. Of \$38,682 in OBF that UAFCB reviewed, SCE did not properly account for and overstated its OBF by 6% or \$1,785. In addition, SCE did not provide adequate substantiation for \$7,252 or 100% of labor costs sampled.

Criteria: Section 314(a) indicates "The commission, each commissioner, and each officer and person employed by the commission may, at any time, inspect the accounts, books, papers, and documents of any public utility." Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. GO 28 specifically states: "The manner in which these records, memoranda and papers shall be preserved must be such that this Commission may readily examine the same at its convenience." The USOA provides: "Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto."

Condition: SCE did not use its predetermined DCC factors in SAP when allocating costs for the sample that UAFCB reviewed. Consequently, SCE overstated the cost allocation for the OBF direct implementation sample by 6 % or \$1,785. Therefore, these costs were misclassified as OBF. In addition, UAFCB could not verify the labor costs sampled because SCE did not provide documentation to substantiate the costs.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: SCE recorded and reported data to the Commission that could be less than accurate and reliable. Without being able to substantiate any of SCE's labor costs, UAFCB intends to review SCE's labor when UAFCB conducts its next examination on SCE's EE.

SCE's Representation in the Field: SCE was aware that the percentage used to allocate costs between its programs was slightly different in its SAP system. SCE did not expect a big discrepancy between the percentage determined at the beginning of the cycle 2010-2012 to be used during the cycle and the percentage set in its SAP system.

SCE's Comments: The DCC percentages that allocate energy efficiency A&G are predetermined in SAP and are accurate. However, SCE is aware there have been changes in the EEGA program names that have not been updated in SAP which could have led to the incorrect percentage being selected. SCE is swilling to cooperate with the UAFCB to avoid misunderstanding of how it processes its labor costs.

Rebuttal: The DCC percentages that allocate energy efficiency A&G do not appear to be predetermined in SAP since the discrepancy between the original pre-determined percentages and the percentages in SAP is due to the fact that SAP cannot process some pre-determined percentages. SCE needs to ensure that it uses all of its predetermined DCC in its SAP. If it uses a different rate, then SCE should be able to justify any variance. UAFCB is willing to work with SCE on the differences regarding SCE's labor practices.

Recommendation: (a) SCE should verify that the DCC used in its SAP to ensure that it closely approximates to its predetermined DCC since the predetermined DCC is supposed to remain constant over the cycle. Within 90 days from the date of this report, SCE should provide UAFCB with documentation showing that it corrected the names in SAP so that they align with the DCC and explain the \$1,785 discrepancy. (b) As discussed in another observation above, SCE should set policies and procedures that will allow UAFCB to effectively verify every single amount listed as a labor cost.

Observation 11: SCE did not demonstrate compliance with §§ 581 and 584. SCE did not properly account for its OBF funds and provided UAFCB data associated with the \$16 million OBF revolving loan pool that was not accurate.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission.

Condition: During the examination, SCE represented that its total OBF revolving loans in the amount of \$16 million consisted of \$3.9 million in total outstanding loans in 2011 and \$12.1 million in committed or reserved funds, as of December 31, 2011. SCE provided UAFCB with the information shown in the following table.

Table A-7
OBF Loan Composition per SCE

Description	Total Reported
Loans in 2011	\$ 4,304,677
Collected on Outstanding Loan	<u>(390,975)</u>
Total Outstanding Loans	3,913,702
Committed/Reserved Loans	<u>12,086,298</u>
Total	<u>\$16,000,000</u>

Of UAFCB's sample of \$10.4 million, or 65% of the total revolving loan funds of \$16 million, SCE misjudged the status of 5% or \$471,147. SCE overbilled a customer for \$9,084, whose loan was already fully paid. In addition, SCE did not update its records or release \$465,062 in funds from the committed loan group to the uncommitted loan funds when customers loans ended up being less than the committed amounts or customers

abandoned their applications. SCE did not reverse these amounts until 2013. In the following table, UAFCB shows the amounts it determined are misstated.

Table A-8
OBF Loan Sample and Exception

Description	Sampled as Reported	Actual per Examination	Exceptions	% of Sample
Total Loan in 2011	\$ 2,894,446.66	\$2,894,446.66	\$ 0.00	0%
Collected on Outstanding Loan	275,466.48	266,382.39	9,084.19	3%
Total Outstanding Loan	2,618,980.18	2,628,064.37	9,084.19	0%
Committed/Reserved Loan	<u>7,796,468.38</u>	<u>7,334,405.89</u>	<u>465,062.49</u>	<u>6%</u>
Total	<u>\$10,415,448.56</u>	<u>\$9,962,470.26</u>	<u>\$471,146.68</u>	<u>5%</u>

Customer applications indicate that the application and loan process must be completed in so many days. Once that timeframe has expired, SCE should look into the status of the loan and reverse the amounts if the application is not going to go forward. SCE should promptly reverse any overbillings.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: SCE recorded and reported data to the Commission that could be less than accurate and reliable. Some customers on the wait list could have received their loan funds sooner if SCE had promptly reversed the amounts discussed above. One customer in the sample UAFCB reviewed did not receive credit for SCE's overbilling until 2013.

SCE's Representation in the Field: SCE reversed the discussed discrepancies in 2013.

SCE's Comments: SCE did appropriately account for the \$16 million OBF revolving loan pool including the uncommitted funds. However, SCE does agree with the UFACB's discussion on the specific committed project funds referenced in the Draft Report. In 2011, funds typically remained committed until evidence demonstrated the customer project was no longer viable. In certain instances, as noted in the Draft Report, such evidence was not immediately apparent to SCE. SCE further agrees with the observation regarding overcharges. SCE has already corrected the over billing for \$9,084.

Rebuttal: Based on the documents UAFCB reviewed, all funds did not appear to remain committed in 2011 until evidence demonstrated the customer project was no longer viable. For example, an application that originated in October 21, 2010 was given until January 18, 2011 for the project to be approved by SCE. From this date forward, there was no further records or written communication associated with this customer for the remainder of year 2011. However, SCE claims it did not release these funds until 2013. SCE needs to promptly update its records to ensure that all OBF uncommitted funds are available for the wait list. This will avoid having, for example, a wait list for funds that are not in fact committed.

Recommendation: SCE should promptly reverse loan amounts that are less than committed or for overcharges. In addition, SCE should reverse, within a reasonable

timeframe, abandoned applications which were previously assigned loan commitments. Energy Division should establish a reasonable timeframe for determining when an application is considered abandoned.

A.6 Multi-Family Energy Efficiency Rebates (MFEER)

Observation 12: SCE did not demonstrate compliance with §§ 581 and 584, and the USOA. SCE did not accrue expenditures for MFEER in a timely manner, resulting in SCE overstating its MFEER expense in 2011 by 23% or by \$0.7 million of UAFCB's sample.

Criteria: Sections 581 and 584 require the utilities to provide complete and accurate data to the Commission. The USOA prescribes that "The utility is required to keep its accounts on the accrual basis. This requires the inclusion in its accounts of all known transactions of appreciable amount which affect the accounts. If bills covering such transactions have not been received or rendered, the amounts shall be estimated and appropriate adjustments made when the bills are received."¹³

Condition: During the month of December, 2010, SCE received incentive payment expense invoices for 23% or \$733,603 of UAFCB's total sample of \$3.3 million. However, SCE did not accrue these expenses in 2010. SCE should have accrued and recognized these expenses during the year 2010 instead of the year 2011.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: SCE recorded and reported data to the Commission that could be less than accurate and reliable.

SCE's Representation in the Field: According to SCE, MFEER invoice amounts subject to payment after inspection are not recorded before the inspection is complete.

SCE's Comments: SCE records program costs in a timely manner in accordance with SCE's accrual policy. SCE claimed it was unable to determine how UAFCB arrived at this observation and requests further information to provide complete comments.

Rebuttal: Subsequent to SCE's comments, UAFCB discussed its observation with SCE and afforded SCE the opportunity to provide any additional documentation. SCE needs to comply with FERC and properly accrue its MFEER invoices, regardless of when the inspections occur.

In its September 27, 2013 comments, SCE claims that it followed its policies not to accrue these expenditures until after inspections. SCE claims that UAFCB should take into account that it also did not accrue \$1.2 million expenditures at the end of 2011 that were pending inspections. Due to time constraints, UAFCB is unable to verify SCE's

¹³ See FERC USOA General Instructions 11.

assertions. UAFCB recommends that SCE include its proposal in the advice letter when it files for its incentives. If it does, UAFCB plans to verify its assertions.

Recommendation: SCE should record its program costs in a timely manner and consistently for comparative purposes from year to year. SCE should not be allowed to earn incentives on the \$733,603 of expenses that should have been accrued in 2010.

UAFCB recommends that the netting issue raised by SCE in its comments dated September 27, 2013 on accrual and inspections be addressed when it files its incentive advice letter. SCE presented the information as if it conducts inspection of every incentive payment and not on random selection of projects. This gives the UAFCB the opportunity to verify SCE's claims.

Observation 13: SCE did not demonstrate compliance with §§ 581 and 584, GO 28, the USOA and its Multifamily Energy Efficiency Rebate Program (MFEER) Policies and Procedures Program Years 2010-2012. SCE misclassified at least 5% or \$76,226 of the sample that UAFCB reviewed.

Criteria: Sections 581 and 584 require that the utility provide complete and accurate data to the Commission. GO 28 and the USOA require the utility to maintain adequate documentation. Section 105 Reservations, page 105-1 of SCE's MFEER Policies and Procedures, requires that the program manager may limit the quantity of products or total amount that each participant may request to be reserved at any one time and that at the discretion of the program manager, reservation request limits may be modified.

Condition: Of the almost \$1.5 million sample that UAFCB tested for compliance with SCE's reservation policies and procedures, SCE did not follow its policies and procedures for 11% or \$166,927 of the MFEER. According to the Reservation Forms that SCE approved and UAFCB reviewed, SCE chose to limit the quantity of products instead of total amount that each participant may request. Because SCE's program manager limited the quantities, a program manager's approval was necessary to modify those quantities. \$166,927 of the items paid was not approved in the original reservation and a program manager did not give written approval for the new reservation quantities. SCE even exceeded the approved quantity amount converted into dollars by \$76,226.

Cause: Lax internal controls or internal controls that are not enforced can lead to recording and reporting errors. Employees who are not properly trained and supervised can also contribute to recording and reporting errors.

Effect: SCE recorded and reported data to the Commission that could be less than accurate and reliable.

SCE's Representation in the Field: SCE's program manager responsible for approving any modifications to the quantity or amount listed in the original reservation stated that approval is always given. However, it is a verbal approval. In addition, since the quantity authorized is associated with a dollar amount per item, the quantity limit can also be converted in dollar amount making the quantity limit irrelevant as long as the

participant is not paid for an amount greater than the total dollar amount associated with the total quantity limit.

SCE's Comments: SCE points out that Program Manager approval was *verbally* provided when modifying those quantities. SCE claims that it complied with its policies and procedures when limiting the quantity of products (or total dollar amounts). SCE asserts that written approval is not required under the policies and procedures to demonstrate approval of the revised reservation quantities. However, SCE agrees that requiring written approval is a better practice.

Rebuttal: While SCE claims that its P&P do not require written approval, in most other instances UAFCB reviewed, SCE interpreted the requirement for manager approval to mean written approval. Verbal approval is inadequate and not a sound business practice. Even if UAFCB were to apply SCE's program manager's reasoning and disregard SCE's policies and procedures, SCE paid \$76,226 or 5% of the total sample tested above the total amount associated with the total quantity reserved. If SCE's reservation limits the quantity, it cannot later say that the quantity can be converted to a dollar amount without written approval and vice versa. Obtaining and maintaining adequate written approval helps to prevent errors and provides a verifiable trail that approval was given for any changes. SCE should fully comply with its policies and procedures and always require a program manager's *written* approval for any changes to the original reservation limitations.

Recommendation: SCE should comply with its own policies and procedures and sound business practices by ensuring that written approval are maintained when its program managers approve any modifications to the original approved reservation. SCE should not earn incentives on at least \$76,226 of its MFEER.

A.7 Internal Controls

Observation 14: As shown throughout this report, SCE did not demonstrate compliance with the Commission's EE reporting requirements, its own policies and procedures, the USOA, GO 28, §§ 581 and 584 and accounting best practices. As demonstrated in previous observations, SCE does not adequately control its data for EE reporting and record keeping.

Criteria: The Commission prescribes what administrative costs can be recovered and how they should be reported. The USOA and GO 28 require that the utilities preserve all records, memoranda and papers supporting each and every entry so that this Commission may readily examine the same at its convenience. The USOA also requires that the utilities use the accrual method of accounting. Section 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..." Section 584 requires utilities to provide reports to the Commission as specified by the Commission. Accounting best practices dictate the use of effective internal controls that are monitored and vigorously enforced.

Condition: SCE's quarterly EEGA reports are highly proportionally misclassified to the total sample tested for many different reasons. Given the small sample tested by the UAFCB during its examination and in view of the different kinds of reporting errors,

SCE clearly need to improve its reporting and record keeping processes. It needs to monitor and vigorously enforce its existing internal controls.

Internal controls are used to provide a company's management reasonable assurance about:

1. Effectiveness and efficiency of operations;
2. Reliability of financial reporting; and
3. Compliance with applicable laws and regulations.

Internal controls are put into place in these types of situations to prevent and identify accounting and reporting errors and the violation of laws and regulatory requirements.

The Committee of Sponsoring Organizations (COSO) is a nationally recognized group that provides thought leadership through the development of comprehensive frameworks and guidance on risk management, internal control and fraud deterrence.¹⁴ COSO indicates that internal controls consist of five interrelated components:

- **Control Environment**: Includes the integrity, ethical values and competence of the entity's people; and management's philosophy and operative style.
- **Risk Assessment**: The identification and analysis of relevant risks to the achievement of objectives and forms the basis of how the risks should be managed.
- **Control Activities**: Policies and procedures that help ensure management directives are carried out.
- **Information and Communication**: Pertinent information must be identified, captured and communicated, including, but not limited to, external parties such as regulators.
- **Monitoring**: Internal controls need to be monitored to assess the system's performance over time.

A first step in improving SCE's EE reporting processes should be for SCE to constantly monitor and vigorously enforce its internal controls for its EE reporting, including but not limited to, requiring audits of its own reporting processes and the reporting and processes of its contractors with respect to invoicing. When designing and implementing its new EE internal controls, SCE should consider all of the factors discussed above.

Cause: UAFCB and SCE found several errors that SCE made in recording its EE activities. Some of these were quite substantial, such as but limited to, UAFCB's sample wherein SCE originally misclassified over 50% of the sampled amount. SCE later found and corrected most or \$2.4 million of these errors, a demonstration that it clearly needs to improve its internal controls. Instead of admitting and agreeing to improve its internal controls, SCE continues to assert that its internal controls are not lax. SCE claims that

¹⁴ COSO was organized in 1985 to sponsor the National Commission of Fraudulent Financial Reporting, an independent private-sector initiative that studies the causal factors that can lead to fraudulent financial reporting. It also developed recommendations for public companies and their independent auditors, for the SEC and other regulators, and for educational institutions.

identifying errors, correcting them and timely reporting the adjustments demonstrates an effective control environment. UAFCB strongly disagrees. A key component of internal control is to prevent errors. Clearly SCE's internal controls are not effective to prevent many errors or not being vigorously enforced. The potential for material errors that are not detected and corrected will remain until SCE improves its internal controls and vigorously monitors and enforces them.

In addition, UAFCB found instances where management approval was required but SCE did not provide substantiation of the approval. SCE claims that its policies allow verbal approval. Clearly GO 28 and the USOA require that utilities preserve all records, memoranda, and papers supporting each and every entry. Allowing verbal approval does not meet this requirement. SCE has not vigorously monitored or enforced its internal controls with respect to its EE recording and reporting.

Effect: Without adequate internal controls that are vigorously monitored and enforced, SCE's recording and reporting errors are likely to continue.

SCE's Comments: SCE indicates that it has established proper internal controls over reporting and record keeping processes; specifically, internal policies and procedures exist that contain roles, responsibilities, and requirements to ensure effectiveness and efficiency of operations; reliability of reporting; and compliance with applicable laws and regulations. SCE asserts it regularly conducts internal reviews to determine the effectiveness of these internal controls. SCE claims that it provided UAFCB the control testing results and any improvement opportunities that were identified and implemented. In addition, SCE claims that its EEGA reports are not misstated.

Rebuttal: UAFCB does not dispute that SCE has established internal controls over its reporting and record keeping processes. However, as demonstrated throughout this report, SCE's controls are either not stringent enough or it isn't enforcing the ones it has. For example, SCE claims that its controls are sufficient and working well because it caught and reversed numerous errors on its own. As discussed earlier in this report, catching and correcting errors is not as efficient and is more risky than preventing the errors in the first place. Out of UAFCB's \$4.8 million TP sample, SCE caught and corrected \$2.4 million of errors, an error rate of 50%. During our examination, UAFCB discovered another \$244,146 that SCE did not to detect and correct.¹⁵ However, this is just one of many examples of where SCE's internal controls are inadequate or not working as designed.

Recommendation: Within 90 days from the date of this report, SCE should strengthen its internal controls for recording and reporting its EE to prevent future misreporting and misclassifications of SCE's EE, and provide UAFCB a copy of its revised internal controls. In addition, SCE should describe how it will monitor and vigorously enforce its controls to improve its recording and reporting. SCE made some substantial errors in recording and reporting its EE expenditures, as evidenced by UAFCB's observations and corrections SCE made to both its 2010 and 2011 recording and reporting. SCE asserts

¹⁵ \$244,146 = \$123,370 of direct implementation and marketing costs incorrectly recorded as IOU administrative costs + \$120,776 of direct implementation costs incorrectly recorded as TP administrative costs.

that its internal controls are working effectively. However, both preventative and detective controls are necessary. While a small percentage of errors can be tolerated, SCE should improve its controls to minimize recording and reporting errors and thereby eliminate the widespread errors occurring throughout the recording and reporting of SCE's EE activities. SCE should correct its 2011 and 2012 quarterly EEGA reports and inform the Chief of UAFCB of the corrections no later than 90 days from the date of this report.

Appendix B Program Compendium

B.1 Introduction

On September 24, 2009, the California Public Utilities Commission (Commission) issued Decision (D.) 09-09-047 which, among other things, authorized Southern California Edison (SCE) a total budget of approximately \$1.228 billion in ratepayer funds to administer and implement its Energy Efficiency (EE) programs for the years 2010 through 2012, including \$49 million dedicated to Evaluation, Measurement and Verification (EM&V). Since SCE estimated that it had \$35 million of unspent and uncommitted funds by the end of 2009, SCE subtracted the \$35 million from the \$1,228 billion in order to determine how much additional money needed to be recovered from customers during the cycle 2010-2012. SCE set rates over the three years period to recover \$1,193 billion (\$1,228 billion - \$35 million). In this decision, the Commission also set energy savings goals, established cost-effectiveness requirements, placed a cap of 10 percent on utility administrative costs, authorized types of programs, and set targets for certain programs.

B.2 EE Funding Components

SCE's total Commission authorized EE budget (net of EM&V of \$49 million) was \$ 1.179 billion for budget cycle 2010-2012. As of December 31, 2011, excluding EM&V expenditures, SCE spent \$606 million, or 51%, of its total authorized budget for the period 2010-2012. In the following table, UAFCB shows the amount carried forward, authorized budget, funds available for spending and actual expenditures for SCE during 2011 as reported on the Energy Efficiency Groupware Application (EEGA)'s website.

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

Description	Amount
Authorized Budget per D.09-09-047	\$1,178,880,003
Less: Actual 2010 EE Expenditures	<u>271,131,995</u>
Available for Spending in 2011	907,748,008
Less: Actual 2011 EE Expenditures	<u>334,633,524</u>
Amounts Carried Forward to 2012	<u>\$ 573,114,484</u>

SCE's Customer Service Business Unit (CSBU) is responsible for the operation of the energy efficiency programs, among other things. Under the CSBU, the Customer Programs & Services Division's (CP&S) primary function is to assure that energy efficiency programs are properly managed and in compliance with Commission's directives. Within the CP&S are the Customer Energy Efficiency and Solar Division (CEES), which manages the implementation and the day-to-day operation of SCE's energy efficiency programs. CEES groups include: 1) Program and Operations, 2) Regulatory, Controls and Solicitations, 3) Strategic Planning and Technical Services and 4) Measurement and Evaluations. As of December 31, 2011, CEES employed 180 fulltime employees, not including consultants and contract workers.

B.3 Administrative Costs- SCE's, TP, and LGP

Pursuant to D.09-09-47 OP 13, the Commission limited the utilities' administrative costs for managing the EE programs to 10% of the total EE budget for years 2010-2012. SCE's 2011 EE Budget was \$406.7 million and its total EE portfolio expenditure (net of EM&V) was \$334.6 million. SCE's total EE administrative expenditures (excluding EM&V) incurred in 2011 amounted to \$27.1 million and is shown by cost type in the following table.

Table B-2
SCE EE Expenditures by Cost Type

Category	Amount	% of Total Expenses
SCE Admin Costs	\$ 20,487,100	6.12%
Non-SCE (Excluding Gov't Partners) Admin Costs	5,970,685	1.78%
Government Partner Admin costs	<u>667,653</u>	0.2%
Total Administrative Costs	\$ <u>27,125,438</u>	<u>8.1%</u>
Total Portfolio Expenditure (Net of EM&V)	<u>\$334,633,524</u>	

SCE classifies EE administrative expenses into three cost categories: (1) program costs that are expenses related to EE program activities internally handled by SCE, (2) vendor costs that are non-IOU EE program activities from strategic partners, and (3) allocated costs that are indirect costs incurred by SCE's internal units that provide support services to the EE programs.

SCE uses two methods to allocate indirect costs to its EE programs- (1) the Distribution Cost Centers (DCC) method and the Internal Market Mechanism (IMM) method. The DCC method allocates Customer Service Business Unit (CSBU) costs incurred by EE programs which cannot be directly assigned to each program. DCC costs include financial support, regulatory support, internal audit, training, etc. The IMM involves the allocation of competitively procured services by internal providers and includes services such as telephone moves, telephone toll and long distance calls, pager services, device repairs.

In the following table, UAFCB shows a summary of SCE's 2011 EE administrative cost cap and target expenditures that demonstrates that SCE is on track to stay within the 10% cap imposed by the Commission.

Table B-3
Energy Efficiency Administrative Cost Cap and Expenditures For 2011

Expense Category	Amount (\$)	% to Total Budget Portfolio	% Cap	% Target
Non SCE (Excl. Gov't Partners) Admin Costs	\$ 5,970,685	1.47%		10%
Government Partner Admin Costs	667,653	0.16%		10%
SCE Admin	<u>20,487,100</u>	<u>5.04%</u>	10%	
Total Admin (Excluding EM&V)	\$ <u>27,125,438.00</u>	<u>6.67%</u>		
2011 Revised Operating EE Budget (Excl. EM&V)	<u>\$406,720,748.00</u>			

B.4 Energy Efficiency Contracts

The CPUC requires that 20% of the energy efficiency portfolio budget, including administration, marketing, and Evaluation, Measurement, and Verification (EMV) should be administered by contractors or consultants. As part of SCE's proposed 2010-2012 portfolio, SCE is required to identify those Third Party programs, which will count towards meeting or exceeding the 20% requirement. The Commission confirms as part of its compliance review and adoption of SCE's 2010-2012 that it met this requirement.

To track actual costs associated with these Third Party programs and other vendor related costs, SCE maintains four types of contracts. Each contract type is designed to track the different types of vendors including Third Party program providers.

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

The third contract type consists of programs that are related LGP programs. The focus of the LGP is to build capacity by implementing program activities within the local government area. The LGP is responsible for administering all aspects of the programs. The fourth contract type consists of contracts between SCE and "Other Contractors or Vendors". The vendor or contractor reaches out directly or through SCE to assist customer with EE projects to access rebate or incentive programs.

B.5 On Bill Financing

SCE's OBF program is a non-resource program offered to eligible non-residential customers to offset the cost of purchasing and installing qualified energy efficiency retrofit measures for approved project participating in energy efficiency programs such as the statewide commercial, industrial, and agricultural customized, express pending programs, or qualifying third party implemented programs. Through OBF, qualified non-residential customers receive a zero-interest, no fee unsecured financing.

Financing is available for up to 100% of the total actual installed costs including related labor charges. The minimum loan amount per service account is \$5,000. The maximum loan amount available per service account is \$100,000 for commercial customers and \$250,000 for governmental and institutional customer. However, government and institutional customers are eligible for loans of up to \$1 million and may designate one service account per facility to receive the \$1 million maximum loan amount.

In D.09-09-047, OP 40, the Commission set the commercial loans terms to up to five years or the expected useful life (EUL) of the bundle efficiency measures proposed, whichever is less. For institutional customers, a maximum loan term of 10 years or the EUL of the bundle efficiency measures proposed, whichever is less.

SCE's OBF budget for the 2010-2012 EE programs cycle is approximately \$24 million as set forth in D.09-09-047. The budget provides for operating expenses of \$8 million funded by the Public Goods Charge (PGC) and a revolving fund loan pool of \$16 million funded by non-PGC revenues pursuant to D.09-09-047 and approved in SCE's Advice Letters (AL) 2456-E and 2456-E-A.

AL 2456-E and AL 2456-E-A authorized SCE to set up an On-Bill Financing Balancing Account (OBFBA) for the 2010-2012 EE budget cycle to track OBF loan disbursement and repayment activities. A review of the OBFBA will be conducted during the examination of the 2012 Energy Efficiency Audit. As of December 31, 2011, SCE reported that its \$16 million revolving loan consisted of an outstanding

loan balance in the amount of \$3.9 million and the remaining \$12.1 balance was classified as committed loan as shown in the following table.

Table B-4
2011 OBF Loan Composition per SCE

Description	Total Reported
Total Loans in 2011	\$ 4,304,677
Collected on Outstanding Loans	<u>(390,975)</u>
Total Outstanding Loans	<u>3,913,702</u>
Committed/Reserved Loans	<u>12,086,298</u>
Total OBF Funds	<u>\$16,000,000</u>

In 2011 SCE spent \$1.5 million for the OBF program, of which 63% was charged to Direct Implementation. In D09-09-047, page 50, the Commission allows for non-resource programs such as OBF to treat as Direct Implementation those costs associated with activities that are a direct interface with the customer or program participant or recipient. In the following table, UAFCB shows the OBF loan funds by category.

Table B-5
2011 On-Bill Financing Program Expenditures

Expenditure Type	Labor	Non-Labor	Allocated Overheads	Total
Admin-IOU	\$ 15,491	\$296,335	\$226,342	\$ 538,168
Marketing/Outreach		602	0	602
Direct Implementation	<u>291,604</u>	<u>582,995</u>	<u>60,320</u>	<u>934,919</u>
Total Expenditures	<u>\$307,095</u>	<u>\$879,932</u>	<u>\$286,662</u>	<u>\$1,473,689</u>

B.6 Multi-Family Energy Efficiency Rebates

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

SCE MFEER's operating budget for 2011 was \$14.4 million. Since SCE's 2011 total MFEER expenditures were \$5.1 million, SCE carried the remaining \$9.3 million over to the year 2012. A detailed summary of SCE's 2011 MFEER expenses and list of rebates paid are shown in the following tables.

**Table B-6
2011 MFEER Program Expenditures**

Expenditure Type	Labor	Non-Labor	Rebates/ Incentives	Allocated Overheads	Total
Admin-IOU	\$ 21,989	\$ 11,179		\$ 505,946	\$ 538,168
Marketing/Outreach		52,580		18,533	71,113
Direct Implementation	<u>391,711</u>	<u>459,318</u>	<u>\$3,497,721</u>	<u>122,390</u>	<u>4,471,140</u>
Total Expenditures	\$ <u>307,095</u>	\$ <u>879,932</u>	\$ <u>3,497,721</u>	\$ <u>646,869</u>	\$ <u>5,081,364</u>

**Table B-7
Summary of 2011 MFEER Rebate Payments**

Measure	Incentive
ES Exterior Hardwired Fixtures	\$ 718,836.28
Electric Water Heater	780.00
ES Room Air Conditioner	2,050.00
Exit Sign LED	28,628.00
ES Interior Hardwired Fixtures	1,752,893.03
Occupancy Sensor	335,265.00
ES CFL Reflector Lamps	62,697.74
ES Refrigerator	22,500.00
T-8 Linear Fluorescent Fixtures	550,148.46
High Performance Dual-Pane Windows	<u>25,102.17</u>
Total 2011 MFEER Rebate	\$ <u>3,498,900.68</u>

According to SCE, the total rebates it paid in the amount of \$3.4 million include a credit of \$1,180 associated with a rebate for the year 2010. Therefore, the total rebates paid associated with the year 2011 in the amount of \$3.4 million represents 69% of the total 2011 MFEER's expenditures.