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August 13, 2018

Sean McCaughan
Chief Financial Officer
Oakville Hydro Electricity Distribution Inc.
861 Redwood Square
P.O. Box 1900
Oakville, ON, L6K 0C7

Dear Mr. McCaughan:

Re: Audit of processes related to global adjustment and RPP settlement

The Ontario Energy Board (OEB) issued an engagement letter to Oakville Hydro Electricity Distribution Inc. (Oakville Hydro) on February 27, 2018 advising that the OEB would be conducting an inspection of its processes and practices related to global adjustment and Regulated Price Plan (RPP) settlement with the IESO.

The main objective of this inspection was to determine whether Oakville Hydro has adequate systems and processes in place to ensure that:

- 1) accurate and complete RPP variances and embedded generation amounts are settled with the IESO and recorded in the appropriate variance accounts; and
- 2) global adjustment (GA) charges are properly allocated between RSVA-Power and RSVA-GA.

OEB staff has now completed the inspection, the results of which are included in the attached inspection report (Report). OEB staff expects Oakville Hydro's management to implement the applicable actions to address the findings outlined in this Report.

Please provide a management response to the Report by **August 27, 2018**.

OEB staff may conduct a follow-up inspection in order to ensure that the action plans in the Report have been implemented. Furthermore, OEB staff expects that Oakville Hydro will continue to apply the lessons learned from these findings going forward.

The findings in the Report represent the views of OEB staff and are not necessarily the views of the OEB as a whole. OEB staff provides no assurances that addressing the findings alone will resolve the issues identified in the Report.

We thank the staff of Oakville Hydro for the assistance and support provided to us during the inspection.

Yours truly,

A handwritten signature in black ink, appearing to read 'TS', is written over a horizontal dashed line.

Tony Stanco
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Cc. Rob Lister, President and CEO, Oakville Hydro Electricity Distribution Inc.
Maryanne Wilson, Director, Regulatory and Compliance, Oakville Hydro Electricity Distribution Inc.

ONTARIO ENERGY BOARD



Inspection Report

Oakville Hydro Electricity Distribution Inc.

**Inspection of Processes Related to RPP
Settlement and Global Adjustment**

August 2018

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1. SUMMARY

The OEB's Audit & Investigations staff (OEB staff) conducted an inspection of Oakville Hydro Electricity Distribution Inc.'s (Oakville Hydro) processes for the:

- 1) settlement of Regulated Price Plan (RPP) and embedded generation variances with the IESO; and
- 2) allocation of global adjustment (GA) charges between Accounts 1588 and 1589.¹

OEB staff found that, due to errors in calculating the settlement amounts for embedded generation customers with the IESO as well as incorrectly allocating GA charges, Oakville Hydro has materially misstated the balances reported for Accounts 1588 and 1589. Table 1 details the misstated balances, as at December 31, 2017:

Table 1: Accounts 1588 and 1589

	Balance reported in RRR 2.1.7 as of Dec 31, 2017	Misstatement due to miscalculation of embedded generation settlement	Misstatement due to misallocation of GA charges	Restated balance as of Dec 31, 2017
Account 1588	1,244,550	(967,335)	(1,240,162)	(962,947)
Account 1589	3,266,022		1,240,162	4,506,184

OEB staff noted that there has been no impact to customers for these years as these balances have not yet been approved for disposition. As a result, OEB staff expects Oakville Hydro to make the necessary adjustments to Accounts 1588 and 1589 as of 2017 to ensure accurate account balances are brought forward for disposition in its next rate application.

OEB staff also found the following during the inspection:

1. Oakville Hydro billed three customers based on RPP pricing in 2017, even though they were not eligible for RPP pricing. As a result, Oakville Hydro has settled incorrect RPP variances with the IESO in 2017.

¹ As per the OEB's Accounting Procedures Handbook, Accounts 1588 and 1589 are deferral and variance accounts to be used by distributors to record:

- The net difference between the energy amount billed to customers and the energy charge to a distributor using the monthly settlement invoice received from the IESO, host distributor, or embedded generator (Account 1588 – RSVA Power);
- The net difference between the global adjustment amount billed to non-Regulated Price Plan (non-RPP) customers and the global adjustment charge to a distributor for non-RPP customers using the monthly settlement invoice received from the IESO, host distributor or embedded generator (Account 1589 – RSVA GA).

2. Staff noted some instances of control weaknesses in the RPP settlement process with the IESO.

A complete description of the findings is detailed in **Appendix 1**.

2. REASON AND AUTHORITY FOR INSPECTION

On an annual basis, OEB staff prepares an Audit & Investigations Plan identifying inspections to be conducted for the fiscal year. OEB staff uses a risk-based approach to determine areas and entities for inspection. OEB staff identified Oakville Hydro for inspection based on a sector-wide review of global adjustment policies and processes.

This inspection was conducted under the authority of Part VII of the *Ontario Energy Board Act, 1998 (Act)* by OEB staff appointed as inspectors by the OEB's management committee under section 106 of the Act.

3. OBJECTIVE AND SCOPE

The main objective of this inspection was to determine whether Oakville Hydro has adequate systems and processes in place to ensure that:

- 1) accurate and complete RPP variances and embedded generation amounts were settled with the IESO and recorded appropriately in Account 1588; and
- 2) global adjustment charges were properly allocated between Accounts 1588 and 1589.

OEB staff limited the scope to the review of these specific processes and the impact of any errors to Accounts 1588 and 1589 in 2016 and 2017, and did not examine in detail all the amounts reported in Accounts 1588 and 1589.

4. METHODOLOGY

OEB staff gained an understanding of Oakville Hydro's procedures, systems, and controls with respect to the tracking, recording, calculating, and reporting of GA charges and settlement amounts with the IESO by inquiring with Oakville Hydro's management and performing walkthroughs of established procedures. OEB staff examined, on a test basis, evidence supporting Oakville Hydro's compliance with

guidelines and regulations, including the tracing of settlement records to underlying calculations and the source data of volumes and approved prices.

5. LICENSEE PROFILE

Oakville Hydro serves about 70,000 mostly residential and commercial electricity customers in the Town of Oakville.

Oakville Hydro was issued electricity distribution licence ED-2003-0135 on November 26, 2003 valid until November 25, 2023.

Oakville Hydro's last approved Cost of Service application was filed for 2014 rates (EB-2013-0159). Oakville Hydro's Accounts 1588 and 1589 were last disposed on a final basis as part of the IRM rate application finalizing 2017 rates (EB-2016-0097). On December 14, 2017, the OEB issued its Decision and Order approving Oakville Hydro's most recent IRM rate application to finalize 2018 rates (EB-2017-0067).

Appendix 1 – Detailed Findings

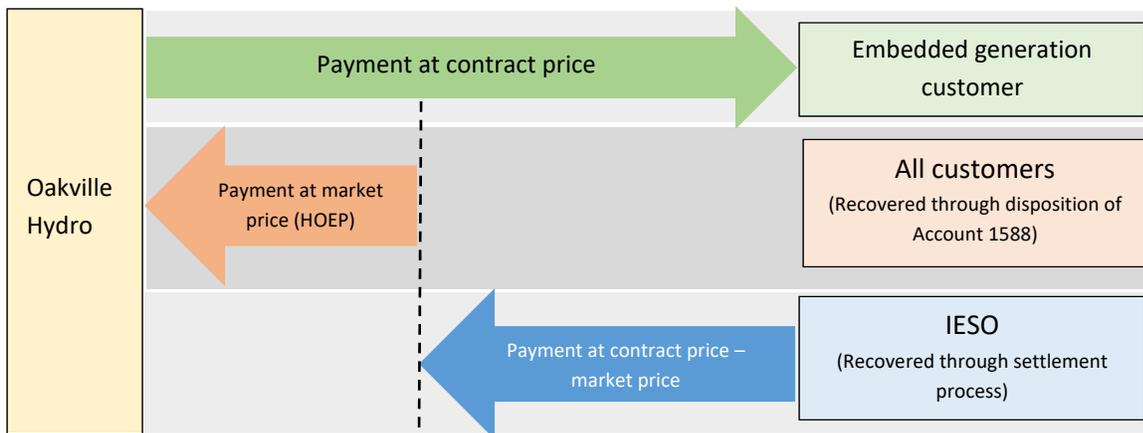
1 Finding 1 – Incorrect settlement of embedded generation amounts with the IESO

1.1 Basis of Finding

Oakville Hydro did not settle amounts for embedded generation customers with the IESO in accordance with OEB and IESO guidance. As a result, Oakville Hydro has overstated the amounts in variance Account 1588 (RSVA – Cost of Power) by \$484,939 in 2016 and \$482,396 in 2017.

Oakville Hydro pays its embedded generation customers for the power generated by these customers. These costs to Oakville Hydro are flow-through – i.e. the payments made by Oakville Hydro are fully recovered from the IESO and all of Oakville Hydro's customers. The OEB² and IESO³ guidance prescribe the mechanics for Oakville Hydro to recover these flow-through costs – namely, through the recording of these flow-through costs at the wholesale market price (i.e. HOEP) in variance Account 1588.

Fig. 1 – Correct allocation of embedded generation contract costs



During the inspection, Staff found that Oakville Hydro used not only HOEP in their calculation of the settlement with the IESO, but also erroneously added a component for global adjustment. As a result, Oakville Hydro has misallocated the recovery of embedded generation costs between its customers and the IESO. Cumulatively in 2016 and 2017:

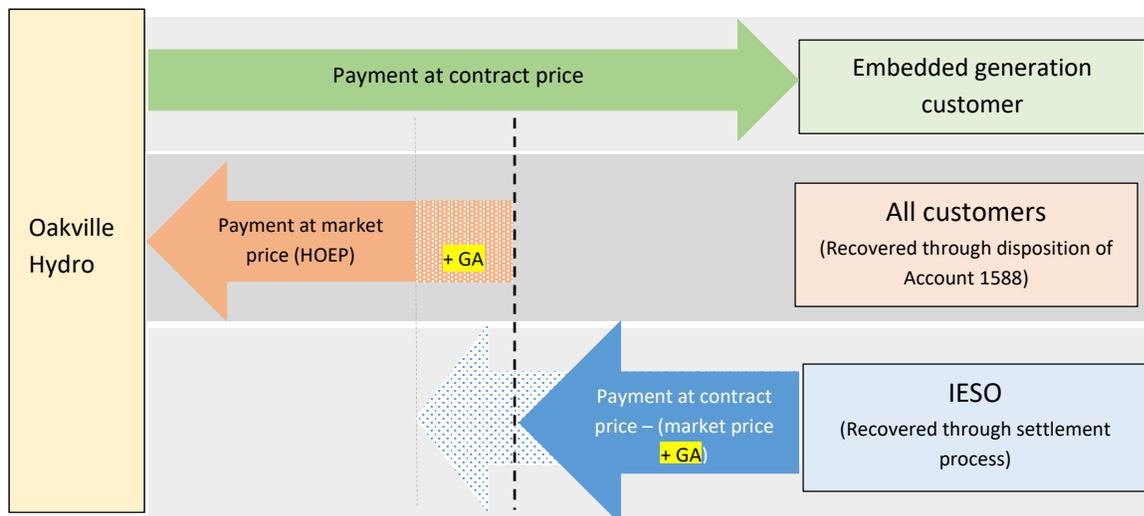
- the amount recovered from the IESO was **\$967,335 less** than it should have been; and
- the amount recorded in Account 1588 to be recovered from customers was **\$967,335 more** than it should have been.

² Accounting Procedures Handbook FAQ, July 2012.

³ Guidance on Online Data Submission, Dec 2017.

Appendix 1 – Detailed Findings

Fig. 2 – Incorrect allocation of embedded generation contract costs by including component for global adjustment in amount recorded in Account 1588 and to be recovered from Oakville Hydro’s customers



Since Oakville Hydro has yet to dispose of balances in Account 1588 in 2016 and 2017, customers have not yet been impacted by the error.

Oakville Hydro stated that its embedded generation settlement process had previously been updated as a result of an Ontario Ministry of Finance audit conducted in July 2010. However, OEB staff did not find evidence that Oakville Hydro’s erroneous updated process had been subsequently agreed to by Ministry of Finance audit staff.

OEB staff did note that during the course of this inspection, Oakville Hydro updated its processes to properly allocate embedded generation costs between the IESO and Account 1588, beginning in May 2018.

1.2 Required Action

Oakville Hydro should make the necessary adjustments for 2016 and 2017 to ensure accurate balances in Account 1588 prior to seeking approval for disposition in its next rate proceeding.

Oakville Hydro should also follow-up with the IESO to claim back the \$967,335 that was settled in error in 2016 and 2017.

Oakville Hydro should also ensure that its processes are in compliance with OEB and IESO guidance going forward.

Appendix 1 – Detailed Findings

2 Finding 2 – Incorrect allocation of global adjustment

2.1 Basis of Finding

Oakville Hydro did not allocate the true-up of global adjustment to Accounts 1588 and 1589. As a result, the GA charges recorded in Accounts 1588 and 1589 did not reflect true GA charges based on the IESO's final actual rates. Accounts 1588 and 1589 were misstated in 2016 and 2017 by an equal and offsetting amount of \$1,240,162.

The IESO charges Class B⁴ GA costs to Oakville Hydro as one lump sum for all its customers. However, the APH states that Account 1589 should include GA charges for non-RPP customers only. Therefore, Oakville Hydro is expected to have a process in place to allocate the lump sum Class B GA charges between RPP (Account 1588) and non-RPP (Account 1589) customers.

Oakville Hydro's process involves first recording the total Class B GA charges in Account 1589. Then, based on RPP consumption for the month, Oakville Hydro transfers the RPP portion of the Class B GA charges from Account 1589 to Account 1588. Oakville Hydro calculates the amount to be transferred based on a mix of GA rates – sometimes the 1st estimate, sometimes the 2nd estimate, sometimes a blend of both. Oakville Hydro uses an estimate because the GA actual rate is not yet available at the time of recording the entry.

When the GA actual rate is available, Oakville Hydro is expected to update its allocation of GA charges between Accounts 1588 and 1589 to reflect the final, actual charges from the IESO. However, Oakville Hydro did not do this. As a result, Account 1588 was overstated by \$1,240,162 and Account 1589 was understated by the same amount as of December 31, 2017.

Since Oakville Hydro has yet to dispose of balances in Accounts 1588 and 1589 in 2016 and 2017, customers have not yet been impacted by the error.

Staff noted that Oakville Hydro has since updated its processes to properly allocate the true-up of GA costs between Accounts 1588 and 1589 beginning in January 2018.

2.2 Required Action

Oakville Hydro should make the necessary adjustments to ensure accurate balances in Accounts 1588 and 1589 prior to seeking approval for disposition in its next rate proceeding. Oakville Hydro should also continue to incorporate the true-up from

⁴ Class B customers are billed GA based on consumption and a GA rate (1st estimate, 2nd estimate, actual). Class B GA charges on an IESO invoice to the distributor are shown as Charge Type 148.

Appendix 1 – Detailed Findings

estimate to actual into the split of GA costs between Accounts 1588 and 1589 going forward.

3 Finding 3 – Incorrect billing of ineligible RPP customers

3.1 Basis of Finding

Oakville Hydro billed three customers based on RPP pricing in 2017, even though they were not eligible for RPP pricing. As a result, Oakville Hydro has settled incorrect RPP variances with the IESO in 2017.

Oakville Hydro has a process in place to determine RPP eligibility of its customers. Annually, Oakville Hydro obtains a list of its general service customers with their average demand and annual consumption. If a customer's average demand is less than 50 kW or their annual consumption is less than 250,000 kWh, the customer is classified as a RPP customer.

In 2017, Oakville Hydro erroneously classified three customers with demand greater than 50 kW and annual consumption greater than 250,000 kWh as RPP customers and billed RPP prices. As a result, these customers' billed consumption was mistakenly included in the RPP variance settled with the IESO.

While the dollar impact is not material (\$8,000), Oakville Hydro did not settle accurate RPP variances with the IESO in 2017.

3.2 Required Action

Oakville Hydro should review its processes for determining RPP eligibility and ensure its customers are classified appropriately on an annual and ongoing basis. Oakville Hydro should immediately reclass any customers that have been classified incorrectly to ensure accurate RPP variances are settled with the IESO going forward.

4 Finding 4 – Incorrect calculation of i) unbilled consumption for RPP settlement, and ii) base period peak demand for Class A customers

4.1 Basis of Finding

Staff noted the following control weaknesses in the RPP settlement process with the IESO:

- 1) In calculating the accrual for unbilled kWh consumption to be included in the RPP variance settlement, Oakville Hydro included customers that did not actually have

Appendix 1 – Detailed Findings

unbilled consumption since their last bill date. For example, the unbilled accrual for November 2017 included an accrual of 546 days for one customer's "unbilled consumption". As a result, the unbilled kWh accruals have been overstated. Although the amounts are not material, Oakville Hydro should have a process in place to ensure that the accruals are accurate.

- 2) In calculating the base period peak demand for Class A⁵ customers, Oakville Hydro inadvertently used the same demand for the 2015 and 2016 base periods. While the change from one period to the next is not material, Oakville Hydro should have controls in place to ensure that the peak demand figures being submitted to the IESO are accurate.

4.2 Required Action

The control weaknesses impact the accuracy of the DVA balances (and underlying revenue and expense accounts) that are reported to the OEB, as well as settlement amounts with the IESO.

Staff encourages Oakville Hydro to continue making efforts to improve on its internal controls and strengthen its reviews to ensure the accuracy of its DVA balances and the integrity of the RPP variance settlement processes. Oakville Hydro should consider implementing measures such as:

- 1) Reasonability checks on system-generated information, such as number of days since a customer was last billed.
- 2) Additional management review procedures prior to submission of RPP settlement variances to the IESO.

⁵ Class A customers are customers who participate in the Industrial Conservative Initiative (ICI), and pay global adjustment based on their percentage contribution to the top five hours of energy use in Ontario over a 12-month base period (May 1 to April 30).