Ontario Energy Board

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Commission de l'énergie de l'Ontario

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Ontario

BY EMAIL

December 18, 2013

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: E.L.K. Energy Inc. - EB-2013-0123 - Audit of Group 1 and Group 2 Deferral and Variance Accounts - Board Decision and Order (EB-2011-0099)

The Ontario Energy Board (the "Board") authorized an audit of E.L.K. Energy Inc.'s ("E.L.K.") Group1 and Group 2 deferral and variance accounts[1] ("DVA") as per the Board Decision and Order EB-2011-0099. This audit was conducted by the Board's Regulatory Audit and Accounting group ("Regulatory Audit"). This audit was conducted by the Board's Regulatory Audit and Accounting group ("Regulatory Audit"), and the final audit report ("Audit Report") was issued on December 5, 2013.

On October 31, 2013, Regulatory Audit filed a letter with the Board and stated that pursuant to the Board's direction, Regulatory Audit intends to file the full audit report on the record in the E.L.K.'s 2014 IRM rate proceeding EB-2013-0123.

In the Procedural Order 1 ("PO 1") dated December 13, 2013, the Board stated,

> Prior to the filing of the Application, and as authorized by the Board in proceeding EB-2011-0099, the Board's Regulatory Audit and Accounting group ("Regulatory

1 Please refer to the July 31, 2009 *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR)* [EB-2008-0046] for classification and descriptions of Group 1 and Group 2 accounts.

> Audit") conducted an audit of E.L.K. Energy. On October 31, 2013, Regulatory Audit filed a letter with the Board Secretary summarizing the findings of the audit and expressing thanks to E.L.K. Energy for its assistance and support during the audit. The letter also stated that Regulatory Audit intends to file the full audit report (the "Audit Report") on the record in this proceeding. The Board intends to accept the filing of the Audit Report on the public record of this proceeding, pursuant to section 111(1)(a) of the *Ontario Energy Board Act, 1998,* as it is required in connection with the Board's administration of the Act. Pursuant to section 110(3) of the Act, the Board will provide E.L.K. Energy with an opportunity to make representations with respect to the intended introduction of the Audit Report. The Board will respond to any representations as may be required.

Pursuant to PO 1 for proceeding EB-2013-0123, E.L.K filed a letter with the Board on December 18, 2013, stating that:

> As stated in the Procedural Order, a regulatory audit was conducted on our accounting records, authorized by the Board in proceeding EB-2011-0099. The final Audit Report was received by E.L.K Energy Inc. (E.L.K.) on December 5, 2013.
>
> E.L.K. acknowledges the findings and observations made by Regulator Audit staff and will take the appropriate steps to address the issues.
>
> E.L.K. understands that the Audit Report will be filed as part of proceeding EB-2013-0123, and as such will be on the public record.

As per the Board's PO 1 in proceeding EB-2013-0169, Regulatory Audit is filing the Audit Report dated December 5, 2013 on the record.

Yours truly,

D. Babai

Daria Babaie, *P. Eng., CMA*
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cc : Michael Audet, CEO – E.L.K
Mark Danelon, Manager, Finance and Regulatory Affairs – E.L.K

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Ontario

December 5, 2013

Michael Audet, CEO
E.L.K. Energy Inc.
172 Forest Ave.
Essex, ON N8M 3E4

Dear Mr. Audet:

Re: Audit of Group 1 and Group 2 Deferral and Variance Accounts - Board Decision and Order (EB-2011-0099)

The Ontario Energy Board (the "Board") authorized an audit of E.L.K. Energy Inc.'s ("E.L.K.") Group1 and Group 2 deferral and variance accounts[1] ("DVA") as per the Board Decision and Order EB-2011-0274. This audit was conducted by the Board's Regulatory Audit and Accounting group ("Regulatory Audit").

Regulatory Audit issued an engagement letter on June 19, 2013 regarding an audit of E.L.K.'s DVA balances as of December 31, 2011. The objective of this audit was to examine E.L.K.'s DVA balances as at December 31, 2011 for material accuracy and determine whether accounting policies and procedures for these accounts were properly and consistently applied and reported to the Board in accordance with Accounting Procedures Handbook ("APH"), Reporting and Record-keeping Requirements ("RRR"), and related guidelines. Regulatory Audit examined entries in the Group 1 and Group 2 DVA account balances since the last time these account balances were disposed.

A final report based on Regulatory Audit's work (the "Report") has now been completed. The Report outlines the audit objective, scope, criteria, procedures used, findings and observations, basis of findings and observations, areas of non-conformity requiring action, areas of concerns, management responses, and management action plans for E.L.K.

Regulatory Audit notes that E.L.K stated in its management responses that June 30, 2014 is the effective date for implementation of its action plans for bringing its regulatory books of accounts in accordance with the APH. However, Regulatory Audit expects that effective immediately, ELK will apply the APH for calculating all its DVAs and will make all necessary

[1] Please refer to the July 31, 2009 *Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR)* [EB-2008-0046] for classification and descriptions of Group 1 and Group 2 accounts.

adjustments to its 2012 and 2013 balances in its regulatory books of accounts unless it requires time for any system changes or process improvement. Regulatory Audit also expects that ELK will correct its RRR 2.1.7 filings for 2012 and file with the Board RRR 2.1.7 for 2013 in accordance with the APH.

To ensure that the audit findings related to DVAs audited as outlined in the Report are properly and consistently addressed and the required action plans are implemented by E.L.K., Regulatory Audit will be conducting a follow-up audit in the 2014. As part of 2014 follow-up audit, Regulatory Audit will examine E.L.K.'s 2012 and 2013 balances to ensure their accuracy and conformity with the APH.

The findings in the Report represent the views of Regulatory Audit and are not necessarily the views of the Board as a whole. Regulatory Audit provides no assurances that addressing the areas of non-conformity requiring actions alone will resolve the issues identified in the audit.

On October 31, 2013, Regulatory Audit filed a letter with the Board Secretary under E.L.K.'s 2014 IRM proceeding EB-2013-0123, summarizing the findings of the audit. The letter also stated that Regulatory Audit intends to file the full audit report on the record in this proceeding.

We thank the staff of E.L.K. for the assistance and support provided to us during this review.

Yours truly,

D. Babaie

Daria Babaie, *P. Eng., CMA*
Manager, Regulatory Audit & Accounting
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cc : Ron McDermott, Chair
Mark Danelon, Manager, Finance and Regulatory Affairs

ONTARIO ENERGY BOARD

AUDIT REPORT

Audit of Group 1 and Group 2 Deferral and Variance Accounts

E.L.K. Energy Inc.

Regulatory Audit and Accounting

December 2013

Audit of Group 1 and Group 2 Deferral and Variance Accounts
E.L.K. Energy Inc.
December 2013

Executive Summary

This audit ("Audit") of E.L.K. Energy Inc.'s ("E.L.K.") was undertaken by the Regulatory Audit and Accounting department ("Regulatory Audit") of the Ontario Energy Board (the "Board") pursuant to the Board's Decision in E.L.K.'s 2012 Cost of Service proceeding EB-2011-0099.

In that proceeding, the parties entered into a Settlement Agreement which was accepted by the Board in its entirety. The parties agreed to the following:

> For the purpose of settlement, the Parties have agreed to the disposition of 50% of all Group 1 and Group 2 account balances as set out in Board Staff IR #39 (d) over the 12 month period commencing on the effective date of the Rate Order arising out of this proceeding. The Parties note that Account 1562 is being addressed separately in this Settlement Agreement for the reasons discussed below. The Parties have agreed that the amounts remaining for disposition will be determined through a suitable audit process. In this regard, the Parties respectfully request that the Board direct the Regulatory Accounting and Audit branch of the Board to conduct an audit of E.L.K's Group 1 and Group 2 account balances at a time that is mutually acceptable to E.L.K and the Board. The Parties have agreed that the results of the audit would be addressed by E.L.K. in its 2014 IRM rate adjustment application, the intention being that the Board would determine the final outstanding amounts to be authorized for disposition commencing May 1, 2014.
>
> With respect to the disposition of balance in Account 1562 (Deferred Payment in Lieu of Taxes), E.L.K. had originally calculated this balance as $40,047 recoverable from customers. In discussions with Board Staff, it appears that the balance may actually be an amount of $751,938 payable to customers. The Parties have agreed for the purpose of settlement to the payment to customers of 50% of the $751,938 over a 36 month period commencing on the effective date of the rate order arising out of this proceeding. The Parties respectfully request that E.L.K. be allowed the proper time to review and analyze all activity in this account and subsequently to undergo a regulatory audit or other detailed review of this account by the Board if the Board determines such an audit or detailed review is required. The Parties have agreed that the results of this review by E.L.K. or the Board, or a regulatory audit by the Board, would be addressed by E.L.K. in its 2014 IRM rate adjustment application, the intention being that the Board would then determine the final outstanding amounts to be authorized for disposition, commencing May 1, 2014 and the appropriate disposition period would then be addressed.

The Audit focussed on the account balances in E.L.K.'s Group 1 and Group 2 deferral and variance accounts ("DVA") as of December 31, 2011.

Regulatory Audit has completed the Audit and concluded that the balances in E.L.K.'s DVAs as of December 31, 2011 were not accurately recorded in E.L.K.'s general ledger ("GL"), and not accurately reflected in the Board's Reporting and Record Keeping Requirements ("RRR") 2.1.7 (Annual Trial Balance Filing) for 2011. In addition, Regulatory Audit has noted that E.L.K. has not followed some of the accounting procedures as prescribed in Accounting Procedures Handbook ("APH") and its related guidance in recording the transactions in the DVAs.

The audit findings and observation of this Audit are found in Sections 8, 9, and 10 of this audit report ("Audit Report"). Regulatory Audit noted that as a result of the Audit, E.L.K has made adjustments to its Group 1 and Group 2 balances as of December 31, 2011 for a total credit amount of approximately ($168,000). Regulatory Audit notes that the revised total balance of ($751,938) in Account 1562 as at April 30, 2012 is consistent with the balance approved on an interim basis in the EB-2011-0099 proceeding.

Regulatory Audit notes that E.L.K stated in its management responses that June 30, 2014 is the effective date for implementation of its action plans for bringing its regulatory books of accounts in accordance with the APH. However, Regulatory Audit expects that effective immediately, ELK will apply the APH for calculating all its DVAs and will make all necessary adjustments to its 2012 and 2013 balances in its regulatory books of accounts unless it requires time for any system changes or process improvement. Regulatory Audit also expects that ELK will correct its RRR 2.1.7 filings for 2012 and file with the Board RRR 2.1.7 for 2013 in accordance with the APH.

Regulatory Audit notes that E.L.K. filed its 2014 IRM rate application EB-2013-0123 on October 25, 2013. Regulatory Audit expects that the E.L.K's IRM rate application reflects all adjustments that were made by E.L.K in its regulatory books of accounts as a result of this Audit.

Regulatory Audit filed a letter with the Board on October 31, 2013 stating that it completed the Audit and that it has an intention to file the full Audit Report in E.L.K.'s 2014 IRM rate proceeding.

Findings Summary

Findings Impacting Group 1 DVA balances

1. In 2011 E.L.K. inappropriately realized a gain of approximately $125,000, representing the difference between energy sales and cost of power. As a result, the 2011 RSVA account balances were overstated (i.e. included an excess debit balance recoverable from the customers) by $125,000.

2. The journal entries removing the dispositions of DVAs in 2011 IRM proceedings were incorrectly made for the interest component of the dispositions, as E.L.K.'s journal entry for Account 1595 included approximately $9,000 in excess of the amount approved by the Board. This would have an impact of collections from the customers in excess of the Board approved amount.

Findings Impacting Group 2 DVA balances

1. E.L.K. did not record variances in Account 1518 and Account 1548 as required by the APH.

2. E.L.K. inappropriately used Account 2405 - Other Regulatory Liabilities/ Credits. It used this account for recording amounts unrelated to ratemaking actions of the Board.

3. The total credit balance of ($751,938) in Account 1562 – Deferred Payments in Lieu of Taxes as at April 30, 2012 is consistent with the balance approved on an interim basis in the EB-2011-0099 proceeding.[1] However, E.L.K. did not accurately report the balance for Account 1562 as at December 31, 2011 in its RRR 2.1.7 filing.

Findings Related to DVAs' Accounting Procedures

1. E.L.K. does not use the proper revenue accounts for recording billings related to Global Adjustment ("GA"). E.L.K informed Regulatory Audit that it does not apply the regulatory accounting treatment that is outlined in the APH to the GA.

2. E.L.K. does not calculate and record monthly variances in its deferral and variance accounts. This practice is not in accordance with the APH.

3. No carrying charges are recorded by E.L.K. on the DVA balances. This practice is not in accordance with the APH.

4. Balances for the Low Voltage billings are incorrectly reported to the Board. This was one of the main reasons for the reported numbers of E.L.K. showing a profit or loss on the commodity and other flow-through costs.

[1] Page 41 E.L.K Settlement Agreement stated that "With respect to the disposition of balance in Account 1562 (Deferred Payment in Lieu of Taxes), E.L.K. had originally calculated this balance as $40,047 recoverable from customers. In discussions with Board Staff, it appears that the balance may actually be an amount of $751,938 payable to customers. The Parties have agreed for the purpose of settlement to the payment to customers of 50% of the $751,938 over a 36 month period commencing on the effective date of the rate order arising out of this proceeding."

5. The LV unbilled recording entry was missed in 2011. Although, the amount was not material, this is not in accordance with the APH.

6. E.L.K. did not reduce the higher of the revenues and costs for the purpose of calculating the LV variance as required by the APH. Instead, it increased the lower of the revenues and costs (in this case, increased the costs to the level of the revenues in 2011).

7. It is E.L.K.'s practice to not remove the dispositions ordered by the Board until the year-end. This practice is contrary to the Board policy.

Observation Summary

1. There appears to be a control weakness with regards to the implementation of E.L.K.'s review controls in its regulatory accounting function.

1. Background

E.L.K. is wholly owned by The Corporation of the Town of Essex. It serves more than 11,000 customers in the Towns of Essex, Lakeshore and Kingsville.

E.L.K.'s most recent approved base revenue requirement was approximately $3.7 million in its 2012 Cost of Service proceeding EB-2011-0099.

2. Authority for review

To the extent that this Audit required E.L.K. to provide documents, records or information, Regulatory Audit acted under its inspection powers under Part VII of the *Ontario Energy Board Act, 1998*.

During the IRM plan term, the Board decided that the revised Group 1 Account balances would be reviewed and that a preset disposition threshold of $0.001/kWh (debit or credit) would trigger their disposition. The Board has decided that at the time of rebasing all account balances should be reviewed and disposed of unless otherwise justified by the distributor or as required by a specific Board decision or guidance.[2]

To assist the Board in discharging its responsibilities related to the DVAs, pursuant to the Board Decision and Order EB-2011-0099 Regulatory Audit initiated an Audit of E.L.K.'s account balances in Group 1 and Group 2 DVAs as of December 31, 2011, to mitigate the risk associated with the incorrect disposition of these account balances.

3. Reason for Audit

Board's audit function is a regulatory instrument of the Board to ensure that the regulated licensed entities conform to the APH and the Board's issued regulatory accounting guidelines and policies.

The Board requires electric utilities to report certain information to the Board at specific intervals. The Board relies on this information for industry monitoring, replying to stakeholders' requests, assisting in the review of applications and many other purposes. The DVA balance information is important to the Board, as it assists the Board in ensuring that accurate amounts are cleared through rates to customers. It is important that distributors file information that is complete, accurate and on time.

[2] July 31, 2009 Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR) (EB-2008-0046), Executive Summary

4. Objectives

The objectives of this Audit are to determine whether the DVA account balances as at December 31, 2011 that were approved for disposition in E.L.K.'s 2012 rate proceeding on an interim basis are reasonable; and to determine whether regulatory accounting policies and procedures of these accounts were properly and consistently applied in accordance with the APH, RRR, and Board Orders.

5. Scope

This Audit covered the testing for the accumulation of the balances in E.L.K.'s Group 1 DVAs from January 1, 2010[3] to December 31, 2011. The Audit of E.L.K.'s Group 2 balances included audit testing in these accounts since the last time these account balances were disposed.

The Table below provides the details of E.L.K.'s DVAs as of December 31, 2011 and Board approved interim disposition:

USoA	Account Description	Dec. 31, 2011 Balance Requested for Disposition	Interim Approval of 50% Balance for Disposition
Group 1			
1550	LV Variance Account	(38,329)	(19,165)
1580	RSVA - Wholesale Market Service Charge	(531,905)	(265,953)
1584	RSVA – Retail Transmission Network Charge	(73,138)	(36,569)
1586	RSVA – Retail Transmission Connection Charge	(155,983)	(77,992)
1588	RSVA – Power (excluding Global Adjustment)	(3,257,593)	(1,628,797)
1588	RSVA – Power – Sub-Account Global Adjustment	3,506,704	1,753,352
1595	Disposition and Recovery/ Refund of Regulatory Balances	(102,206)	(51,103)
	Sub-Totals:	**(652,450)**	**(326,225)**
Group 2			
1508	Other Regulatory Assets	129,702	64,851
1525	Misc. Deferred Debits	3,276	1,638
1562	Deferred Payment in Lieu of Taxes (50% over 3 years)	(751,938)	(375,969)
1592	Input Tax Credit	(567)	(284)
1521	Special Purpose Charge	21,085	10,543
	Sub-Totals:	**(598,442)**	**(299,221)**
	Totals:	**(1,250,892)**	**(625,446)**

[3] 2009 balances were last disposed in the 2011 IRM proceeding EB-2010-0126

6. Criteria

The Audit relied on the following documents to establish the criteria to perform the audit testing:

1) APH effective January 1, 2012 and APH effective July 1, 2007
2) Various APH FAQs
3) Various Board Letters on the APH
4) Board Decision and Order EB-2010-0126
5) Board Decision and Order EB-2011-0099
6) Board Decision and Order EB-2008-0381Account 1562 Deferred PILs Combined Proceeding
7) Report of the Board on Electricity Distributors" Deferral and Variance Account Review Initiative (EDDVAR) EB-2008-0046
8) Board's RRR guidelines

7. Procedures Used

Regulatory Audit used procedures that consisted primarily of enquiry, observation, analytical procedures, and discussion related to information and materials provided by E.L.K.'s management or available to the Board from filings made under the Board's Electricity RRR filings for electricity distributors.

8.
Findings Impacting Group 1 DVA balances

8.1.1 Finding 1

E.L.K. inappropriately realized a gain of approximately $125,000 for the difference between energy sales and cost of power in 2011. As a result, the 2011 RSVA account balances were overstated (i.e. included an excess debit balance recoverable from the customers) by $125,000. E.L.K.'s initial RRR 2.1.7 information filing with the Board for the year ended December 31, 2011 showed that E.L.K. had made a loss of approximately $1.5 million on commodity. E.L.K.'s 2011 Audited Financial Statements ("AFS") showed that it had made a loss of approximately $440,000 on commodity.

8.1.2 Basis for Finding

Regulatory Audit notes that for the year ended December 31, 2011 E.L.K. showed a loss of approximately $440,000 on its AFS on commodity, and an initial loss of approximately $1.5 million on its RRR 2.1.7 filings for 2011 with the Board, as a result of incorrect application of RSVA accounting to its energy sales and cost of power.

Regulatory Audit used the information filed by E.L.K in its RRR 2.1.7 filing for 2011 to group the accounts related to commodity sales and costs. A $1.5 million loss on the commodity was derived by Regulatory Audit through mapping of commodity revenues and expenses during the Audit process based on information that E.L.K had filed with Board.

E.L.K. had corrected and re-stated its 2010 AFS subsequent to it becoming aware that the 2010 retail settlement variance component of regulatory assets was overstated as a result of an error in the calculation.

Upon further examination of E.L.K.'s 2011 RSVA account balances and further discussion with the E.L.K. and its auditors, Regulatory Audit has determined that information in E.L.K.'s 2011 RRR 2.1.7 filing was inaccurate. E.L.K. had inappropriately realized a gain of approximately $125,000 and not a loss of $440,000 for the difference between energy sales and cost of power in its 2011 AFS. As a result, E.L.K.'s 2011 net income was over-stated by approximately $125,000 and subsequently its RSVA account balances were overstated by the same amount (i.e. included $125,000 excess amount recoverable from the customers).

APH Article 490, Chapter 4 of the RSC indicates that all electricity distributors shall settle non-competitive electricity service costs based on rates approved by the Board. Since there will be differences between the amount ultimately owed (i.e. based on the settlement invoice) to the IESO (or host distributor) by a distributor and the amount billed to customers and retailers (i.e. using Board approved rates and calculated under Sections 4, 5, and 6 of the RSC), Retail Settlement Variance Accounts shall be used by all distributors to record such differences. As a result, the energy sales and cost of power after the recording of RSVA should be the same.

E.L.K. was asked to make a total audit adjustment of $125,000 to the 2011 RSVA account balances and revise the RRR information for 2011 with the Board. Regulatory Audit notes that E.L.K. has made the necessary adjustments to the 2011 RSVA account balances, and has filed the revised 2011 RRR information with the Board. The correct account balances are expected to be included in the E.L.K.'s 2014 IRM application for disposition in its 2014 IRM proceeding.

Regulatory Audit notes that although the improper gain of $125,000 may not be material with respect to quantum of E.L.K's cost of power for 2011[4] and not material to the audited E.L.K. financial statements, given E.L.K's small size and regulatory materiality threshold of $50,000, E.L.K.'s gain of $125,000 is material, and may result in some material implications for regulatory reporting.

Regulatory Audit notes that any gain or loss recorded in the distributor's AFS as a result of improper RSVA accounting, depending on materiality, may result in either an over- or under-stated net income. Furthermore, this may result in incorrect balances of

[4] E.L.K.'s cost of power for 2011 per its AFS was $20,088,089

regulatory assets and liabilities reported in the distributor's balanced sheet section of the AFS. Not applying the proper regulatory accounting treatment to RSVA accounts could be problematic given the fact that the Board relies on the distributor's AFS for disposition of the account balances in a rate setting proceeding.[5] As a result of improper RSVA accounting, inappropriate amounts could be recovered from or returned to customers when account balances are disposed in a rate proceeding.

Furthermore, an over- or under-stated net income may lead to an inaccurate calculation for the actual regulatory return on equity ("ROE") performance. When an entity performs outside a 3% earnings dead band from its approved regulatory ROE, the Board may initiate a regulatory review.[6] The review is conducted based on the utility's actual performance in any given fiscal year. E.L.K. reports its actual ROE as a part of the Reporting and Record Keeping Requirements 2.1.5.6 filing with the Board. The distributor's actual regulatory ROE performance may need to be adjusted if the correct data is not used in its calculation. These adjustments either would increase or decrease the ROE, depending on the nature of the adjustment.

In addition, Regulatory Audit notes that Board uses the information from the AFS for a variety of other regulatory purposes including preparation and publication of annual Statistical Yearbook for Electricity Distributors and monitoring of financial viability of the sector.

Regulatory Audit notes that E.L.K. has made the necessary adjustments to correct the 2011 RSVA account balances and has filed the revised 2011 RRR 2.1.7 information with the Board.

Regulatory Audit notes that the information in E.L.K.'s 2012 RRR 2.1.7 filing with the Board showed that E.L.K. had a loss of approximately $615,000 and the RRR 2.1.6 for the 2012 AFS showed that E.L.K. had a gain of approximately $180,000 attributable to the differences between energy commodity sales and cost of power. As part of 2014 follow-up audit, Regulatory Audit will examine E.L.K.'s 2012 balances to ensure their accuracy and conformity with the APH.

8.1.3 Area of Non-Conformity Requiring Action

E.L.K. should investigate the errors made in its 2012 RSVA account balances by removing any possible gain or losses for the difference between energy sales and cost of power and make necessary adjustments to 2012 RSVA account balances.

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[5] Section 2.12 (Exhibit 9 Deferral and Variance Accounts) of the Filing Requirements For Electricity Distribution Rate Applications Last Revised on July 17, 2013 states that "Explanation if the account balances in the continuity schedule differ from the account balances in the trial balance reported through the Electricity Reporting and Record-keeping Requirements and the Audited Financial Statements".

[6] Per Report of the Board on 3rd Generation Incentive Regulatory for Ontario's Electricity Distributors

Moving forward, E.L.K. should ensure that the gain or loss on commodity shown in the audited financial statements is neither over- or under-stated due to difference between energy sales and costs of power and there is zero gain or loss on the commodity component.

Moving forward, E.L.K. should establish appropriate internal controls to ensure the net income shown in the audited financial statements is neither over- or under-stated due to difference between energy sales and costs of power and there is zero gain or loss for the energy commodity.

8.1.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

8.1.5 Management Action Plan

E.L.K. Energy Inc has made the necessary entries to correct the RSVA account balances and has filed the revised 2011 RRR 2.1.7. E.L.K. Energy Inc will investigate the potential errors in its 2012 RSVA account balances and remove any gain or loss from the difference between energy sales and cost of power and make any adjustments to the appropriate RSVA accounts if required by June 30, 2014. E.L.K. Energy Inc will work towards strengthening internal controls through internal reviews and re-developing accounting templates to ensure that the gain or loss on commodities is neither over or understated due to the difference between energy sales and cost of power and is a zero gain or loss for the energy commodity.

8.2.1 Finding 2

The journal entries removing the dispositions of DVAs in 2011 IRM proceedings were incorrectly made for the interest component of the dispositions, as E.L.K.'s journal entry for Account 1595 included approximately $9,000 in excess of the amount approved by the Board. This would have an impact of collections from the customers in excess of the Board approved amount.

8.2.2 Basis for Finding

The Board Decision and Order EB-2010-0126, in part, stated the following:

> The combined total of Group 1 account balances is a debit of $1,548,504 (debit balances are amounts recoverable from customers).
>
> E.L.K. Energy included interest on these account balances using the Board's prescribed interest rates to April 30, 2011. E.L.K. Energy's account balances as

at December 31, 2009, plus projected carrying charges to April 30, 2011, are shown below ($"s).

Table 2 – Deferral and Variance Account Balances

Account Description	Account Number	Principal Amounts A	Interest Amounts B	Total Claim C=A+B
LV Variance Account	1550	0	0	0
RSVA – Wholesale Market Service Charge	1580	217,602	2,206	219,808
RSVA-Retail Transmission Network Charge	1584	(677,170)	(6,867)	(684,037)
RSVA-Retail Transmission Connection Charge	1586	394,682	4,002	398,684
RSVA – Power (Excluding Global Adjustment	1588	78,460	796	79,256
RSVA–Power (Global Adjustment Sub-account)	1588	1,788,799	18,138	1,806,937
Recovery of Regulatory Asset Balances	1590	(269,412)	(2,732)	(272,144)
		1,532,961	**15,543**	**1,548,504**

The Board Decision and Order in EB-2010-0126 also stated:

> I approve the proposed balances for Group 1 accounts as presented by E.L.K. Energy. The December 31, 2009 balances and projected interest up to April 30, 2011 are considered final. For accounting purposes, the respective balance in each of the Group1 accounts shall be transferred to the applicable sub-accounts in account 1595 established by the Board pursuant to the December 23, 2010 Frequently Asked Questions document accompanying the Accounting Procedures Handbook for disposition of balances in 2010, as soon as possible but no later than June 30, 2011 so that the RRR data reported in the second quarter of 2011 reflect these adjustments.

The December 2010 FAQ #6, in part states the following:

> **"**Sub-account Carrying Charges Approved for Disposition in 2010**"** should be used to record the carrying charge of approved accounts. **No additional carrying charges will be applied or added to these carrying charge balances.** [Emphasis added]

Based on the above criteria, the additional interest amount (in addition to the approved amount of $15,543) of approximately $9,000 debited to Account 1595 was not in accordance with the Board Decision (EB-2010-0126) and the APH.

E.L.K. should have recorded only the approved interest component of the dispositions in Account 1595. Regulatory Audit notes that E.L.K. has since made the necessary audit adjustments, and has corrected it 2.1.7 reporting with the Board.

8.2.3 Area of Non-Conformity Requiring Action

E.L.K. should follow the APH with respect to regulatory accounting treatment of Account 1595.

8.2.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

8.2.5 Management Action Plan

E.L.K. Energy Inc will follow the APH with respect to regulatory accounting treatment of account 1595. No additional carrying charges will be applied or added to the carrying charges approved for disposition. The implementation date is effective June 30, 2014.

Findings Impacting Group 2 DVA balances

8.3.1 Finding 3

E.L.K. did not record variances in Account 1518 and Account 1548. This practice is not in conformity with the APH.

8.3.2 Basis for Finding

With respect to Account 1518, APH Article 220 states:

> **1518 RCVA Retail**
>
> A. This account shall be used monthly to record the net of:
>
> i) revenues derived, including accruals, from the following services:
>
> a) Establishing Service Agreements;
> b) Distributor-Consolidated Billing; and
> c) Retailer-Consolidated Billing.
>
> AND
>
> ii) the costs of entering into Service Agreements, and related contract administration, monitoring, and other expenses necessary to maintain the contract, as well as **the incremental costs incurred to provide the services** in (b) and (c) above, as applicable, and the avoided costs credit arising from Retailer-Consolidated Billing, including accruals. [Emphasis added]

With respect to Account 1548, APH Article 220 states:

> **1548 RCVASTR**
>
> A. This account shall be used monthly to record the net of:
>
> i) revenues derived, including accruals, from the Service Transaction Request services and charged by the distributor, as prescribed, in the form of a:
>
> a) Request fee;

b) Processing fee;
c) Information Request fee;
d) Default fee; and
e) Other Associated Costs fee;

AND

ii) **the incremental cost of** labour, internal information system maintenance costs, and delivery costs related to the provision of the services associated with the above items. [Emphasis added]

No amounts were requested for disposition by E.L.K. in its 2012 Cost of Service application EB-2011-0099 with respect to Accounts 1518 and 1548. During the course of that proceeding, Board staff asked an interrogatory[7] to determine how the two RCVA variance accounts were accounted for. E.L.K.'s response indicated that it considered the revenues from the RCVA Retail and RCVA STR to be immaterial, and therefore these variances were not tracked.

During the course of this Audit, Regulatory Audit obtained more detailed information[8] and found that the total revenues in 2011 for both accounts related to these variances were approximately $20,000 for 2011 and approximately $24,000 for 2010. Regulatory Audit requested the incremental costs related to retailer transactions and retailer STR. According to E.L.K., the costs could not be separated out, and for the purpose of this Audit, E.L.K. estimated the costs in order to calculate and record the RCVA variances.

Based on the actual revenues and estimated costs, E.L.K. calculated a cumulative balance of a credit of approximately $34,000 in Account 1518 as of December 31, 2011. E.L.K. also calculated a cumulative balance of zero as of December 31, 2011 for Account 1548, using the same methodology.

Regulatory Audit notes that E.L.K. has since made entries to record the balances in the regulatory Account 1518 and Account 1548 as per the APH. Regulatory Audit notes that E.L.K. has made the necessary credit adjustment of $34,000 to Account 1518. The RRR 2.1.7 reporting for 2011 for Account 1518 has also been adjusted for the error as described above. E.L.K. has re-filed the revised RRR 2.1.7 with the Board.

8.3.3 Area of Non-Conformity Requiring Action

Going forward, E.L.K. should maintain sufficient records to identify the amounts related to retailer costs. The RRR reporting should reflect the retailer related variances properly.

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[7] Board staff IR #32 and response received from ELK per page 234 of the IRR.
[8] Email received from ELK on August 20, 2013.

8.3.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

8.3.5 Management Action Plan

E.L.K. Energy Inc. will record variances in accounts 1518 and 1548. The implementation date is effective June 30, 2014.

8.4.1 Finding 4

E.L.K. was using Account 2405 - Other Regulatory Liabilities/ Credits incorrectly.

8.4.2 Basis for Finding

The RRR 2.1.7 filing for 2011 showed that E.L.K. had approximately $1.5 million credit in account 2405 – Other Regulatory Liabilities/Credits. In response to Regulatory Audit's question about the use of this account, E.L.K. indicated[9] that it uses this account for Deferred Taxes Payable.

The description of Account 2405, per APH Article 220 is as follows:

> This account shall include the amounts of regulatory liabilities, not included in other accounts, imposed on the utility by the **ratemaking actions of the Board**. [Emphasis added]

Deferred taxes do not result from the ratemaking actions of the Board, and therefore, do not belong in this account.

In 2009, the Canadian Institute of Chartered Accountants (CICA) Handbook, Section 3465, Income Taxes, was amended such that rate-regulated companies were required to recognize future income tax liabilities and assets. However, if the utility chooses to recognize certain future income tax amounts as regulatory assets or liabilities for audited financial statement purposes, these amounts are not necessarily considered to be approved by the Board and recognized as deferral or variance account balances for regulatory purposes.

The October 2009 FAQ #16 stated the following regarding a utility's choice to report taxes on a future income taxes basis using the liability method for audited financial statement purposes. The FAQ also provided guidance on the permitted accounts to be used in the Uniform System of Accounts ("USoA") for recording certain future income tax amounts:

[9] Email from ELK dated August 7, 2013

The Accounting Procedures Handbook (APH) specifies that a utility can choose to report taxes on a future income taxes basis (even when the taxes payable method was in effect for rate-regulated entities) and that such treatment has no bearing on what the utility chooses to apply for in distribution rates. Article 440 at page 2, states: "…the method of accounting for future income taxes will not affect the manner in which just and reasonable rates are approved by the Board and the accounts provided in the Uniform System of Accounts (USoA) are provided only for the convenience of the electric utility."

The USoA provides accounts for the electric utility to recognize future income taxes in accordance with CICA Handbook Section 3465—Income Taxes, as follows:

• 2296, Future Income Taxes – Current;
• 2350, Future Income Taxes – Non-Current; and
• 6115, Provision for Future Income Taxes.

The Board does not prescribe financial reporting requirements for financial statement purposes. Consequently, the reporting of income taxes in financial statements, whether based on the taxes payable or the future income taxes method, is for the distributor to decide in accordance with CICA Handbook requirements.

E.L.K. should not have recorded future income tax amounts under Account 2405 - Other Regulatory Liabilities/Credits without Board approval. As a result of this Audit, E.L.K. has removed these amounts under Account 2405.

Regulatory Audit notes that E.L.K. has re-filed the revised RRR 2.1.7 with the Board.

8.4.3 Area of Non-Conformity Requiring Action

Going forward, E.L.K. should follow APH to ensure that the regulatory accounts are used appropriately. E.L.K. should not use regulatory accounts for the purpose of non-rate regulated activities.

8.4.4 Management Response:

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

8.4.5 Management Action Plan:

E.L.K. Energy Inc has removed these amounts under account 2405 through an accounting entry and re-filed the revised RRR 2.1.7. E.L.K. Energy Inc will not record future income tax amounts under 2405 – Other Regulatory Liability/Credits and will create a new account 2350-02 Other Regulatory Liabilities Re : 2350-04. The OEB accounts 2296 and 2350 will be used for recording future tax balance sheet amounts. This information will be shared with KPMG who prepares E.L.K.'s tax entries. The implementation date is effective June 30, 2014.

8.5.1 Finding 5

Regulatory Audit notes that the total balance of ($751,938) in Account 1562 – Deferred Payments in Lieu of Taxes as at April 30, 2012 is consistent with the balance approved on an interim basis in the EB-2011-0099 proceeding.[10] However, E.L.K. did not accurately report the balance for Account 1562 as at December 31, 2011 in its RRR 2.1.7 filing.

8.5.2 Basis for Finding

E.L.K. had originally filed a debit balance of $1,975,889 in Account 1562 in its RRR 2.1.7 as at December 31, 2011. $527,889 of the $1,975,889 balance represented regulatory Deferred PILs. The remaining debit balance of $1,448,000 in Account 1562 represented future income taxes as incurred for financial reporting purposes. No carrying charges were recorded in E.L.K.'s general ledger on the former balance in Account 1562.

A sub-component of the $1,975,889 Account 1562 balance originally filed in the RRR represents regulatory Deferred PILs. This sub-component was a $527,889 debit balance. The $527,889 debit balance was not accurately stated as it did not reflect Board guidance with respect to Account 1562, including Board letters, instructions, and SIMPIL models. Furthermore, the Account 1562 balance that E.L.K. had proposed in its pre-filed evidence in EB-2011-0099 was a debit balance of $155,453[11] as at December 31, 2011. This amount of $155,453 did not tie to the general ledger balance or RRR 2.1.7 balance as at December 31, 2011.

Former balance in Account 1562:

$527,889	regulatory Deferred PILs
$1,448,000	future income taxes

[10] Page 41 E.L.K Settlement Agreement stated that "With respect to the disposition of balance in Account 1562 (Deferred Payment in Lieu of Taxes), E.L.K. had originally calculated this balance as $40,047 recoverable from customers. In discussions with Board Staff, it appears that the balance may actually be an amount of $751,938 payable to customers. The Parties have agreed for the purpose of settlement to the payment to customers of 50% of the $751,938 over a 36 month period commencing on the effective date of the rate order arising out of this proceeding."
[11] EB-2011-0099 Exhibit 9, Tab 2, Schedule 2, page 8

$1,975,889 Account 1562 balance as originally filed in RRR 2.1.7 as at December 31, 2011

The definition of Account 1562 as per Article 220 of the APH does not include future income taxes. As future income taxes are not attributable to Account 1562, they do not belong in this account.

The future income tax balance originally reported in Account 1562 should be reclassified to a different Uniform System of Account number. The regulatory Deferred PILs balance in Account 1562 should change to a principal credit balance of ($597,189) as at December 31, 2011 and a carrying charge balance of ($154,749) as at April 30, 2012 to reflect Board guidance with respect to Account 1562, including Board letters, instructions, and SIMPIL models. Regulatory Audit notes that the revised total balance of ($751,938) in Account 1562 as at April 30, 2012 is consistent with the balance approved on an interim basis in the EB-2011-0099 proceeding.

Revised balance in Account 1562:

($597,189)	regulatory Deferred PILs principal balance as at December 31, 2011
($154,749)	regulatory Deferred PILs carrying charges to April 30, 2012
($751,938)	revised Account 1562 balance as at April 30, 2012

Regulatory Audit notes that E.L.K. did not file the SIMPIL models on the EB-2011-0099 record to reflect the ($751,938) Account 1562 balance that was accepted by the Board in its Settlement Agreement. The SIMPIL models that reconcile to the proposed Account 1562 credit balance of ($751,938) as at April 30, 2012 need to be filed on the record. These models are as follows:

1. PILs Summary
2. SIMPIL 2001
3. SIMPIL 2002
4. SIMPIL 2003
5. SIMPIL 2004
6. SIMPIL 2005

Regulatory Audit also notes that:

- E.L.K. paid approximately $1.93 million in tax, as per the Ontario Ministry of Finance Tax Assessments for the 2001 to 2005 taxation years;
- E.L.K. billed approximately $1.70 million to customers from May 1, 2002 to April 30, 2006, as per the Account 1562 “Interest” worksheet in the PILs Summary model;
- E.L.K. paid an amount of approximately $0.23 million to the Ministry of Finance beyond its exposure of the $1.70 million amount billed to customers; and

- E.L.K. had approximately $1.68 million of a PILs provision in rates from May 1, 2002 to April 30, 2006, as per the Account 1562 "Interest" worksheet in the PILs Summary model.

E.L.K. should not have recorded future income tax amounts under Account 1562 – Deferred Payments in Lieu of Taxes. Regulatory Audit notes that E.L.K. removed these future income tax amounts from Account 1562 in its RRR 2.1.7 as at the 2011 year end.

Regulatory Audit notes that E.L.K. has updated its balance in Account 1562 in its general ledger to reflect the amount accepted by the Board in its Settlement Agreement in the EB-2011-0099 proceeding and re-filed the revised RRR 2.1.7 with the Board.

E.L.K. has filed the SIMPIL models on the record as a part of its 2014 IRM application to reflect the ($751,938) balance accepted by the Board in its Settlement Agreement.

8.5.3 Area of Non-Conformity Requiring Action

Going forward, E.L.K. should not record future income tax amounts under Account 1562 – Deferred Payments in Lieu of Taxes.

Going forward, E.L.K. should accrue carrying charges on the revised principal balance in Account 1562 up to the date which the balance in Account 1562 is cleared.

8.5.4 Management Response:

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

8.5.5 Management Action Plan:

E.L.K. Energy Inc will not record future income tax amounts under 1562 – deferred payments in lieu of taxes accounting and has created account 2350-04 deferred payments in lieu – accounting to record. E.L.K. Energy Inc will share this information with KPMG as they complete the tax entries for E.L.K. Energy Inc. E.L.K. has removed the future income tax amounts from account 1562 in its RRR 2.1.7 as at December 31, 2011 year-end and refiled a revised 2.1.7. E.L.K. has also filed the SIMPIL models on record as of October 29, 2013. E.L.K. will also notify KPMG to accrue carrying charges on the revised principal balance in account 1562 up to the date which the balance in account 1562 is cleared as KPMG completes the tax entries. The implementation date is effective June 30, 2014.

9 Findings related to DVAs' Accounting Procedures

9.1.1 Finding 1

E.L.K. does not use the proper revenue accounts to record billings related to GA. E.L.K does not apply the required regulatory accounting treatment to the GA as outlined in the APH.

9.1.2 Basis for Finding

In response to Regulatory Audit's information request received on July 12, 2013, E.L.K. stated that over the year, both, revenues and expenses related to GA, i.e. all IESO GA costs as well as GA revenues collected from customers regarding this account, are recorded in account 4705-08. At year-end, a re-classification is done that moves all of the revenues collected with respect to the GA to the Revenue Adjustment Account 4050.

The above treatment is not consistent with the APH. Article 220 of the APH, in part, states the following:

> **1588 RSVA Power, Sub-account Global Adjustment**
>
> A. This account shall be used to record the net difference between:
>
> i) the global adjustment amount billed to non-Regulated Price Plan consumers,
>
> AND
>
> ii) the global adjustment charge (i.e., charge types 146, 142 and others as applicable) to a distributor for non-Regulated Price Plan consumers using the settlement invoice received from the Independent Electricity System Operator ("IESO"), host distributor or embedded generator.
>
> B. The related accounts used to record the global adjustment billed to customers (e.g., accounts 4006 to 4055) and to record the global adjustment charges/credits to the distributor (e.g. 4705 and 4710) shall be sub-divided to show the global adjustment amounts including adjustments recorded in each of these accounts.

Furthermore, Regulatory Audit noted that E.L.K. missed recording approximately $1 million in credit variances in its accounts in 2010. As a result, E.L.K. had to restate its

2010 audited financial statements. E.L.K.'s unconventional regulatory accounting practice was the primary reason for this restatement.

9.1.3 Area of Non-Conformity Requiring Action

E.L.K. should have used the proper revenue and cost accounts for recording billings and costs related to GA.

Going forward, E.L.K. should bring its accounting practice related to GA in line with the APH and use the proper revenue and cost accounts for recording billings and costs related to GA.

9.1.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

9.1.5 Management Action Plan

E.L.K. Energy Inc will bring its accounting practise related to Global Adjustment in line with the APH and create a separate GA expense account so revenue and expenses related to GA are separated. The implementation date is effective June 30, 2014.

9.2.1 Finding 2

E.L.K. does not calculate and record monthly variances in its deferral and variance accounts. This practice is not in accordance with the APH.

9.2.2 Basis for Finding

According to information received from E.L.K.[12], no monthly variances or subsequent reversing entries are recorded by E.L.K. All variances for the year are recorded at the year-end as a permanent entry.

[12] Response from E.L.K. to Information request 2.2 received on July 9, 2013

The APH requires utilities to calculate and record monthly variance entries in their accounts based on the differences between the costs and the billings.

According to the APH Article 490,

> **Non-competitive Electricity Charges**
>
> Chapter 4 of the RSC indicates that all electricity distributors shall settle non-competitive electricity service costs based on rates approved by the Board. Since there will be differences between the amount ultimately owed (i.e. based on the settlement invoice) to the IESO (or host distributor) by a distributor and the amount billed to customers and retailers (i.e. using Board approved rates and calculated under section 4, 5 and 6 of the RSC), Retail Settlement Variance Accounts shall be used by all distributors to record such differences.
>
> In this section, the RSVA refers to a set of accounts that will separately capture information relating to the following:
>
> a) Wholesale Market Service Charges (RSVA$_{WMS}$)
> b) Non-recurring Wholesale Market Service Charges (RSVA$_{One\text{-}time}$)
> c) Retail Transmission Network Service Charges (RSVA$_{NW}$)
> d) Retail Transmission Connection Service Charges (RSVA$_{CN}$)
>
> **Mechanics**
>
> The RSVA listed above are used to record the net difference between the amount paid in the month (i.e. using the settlement invoice) to the IESO (or host distributor) by a distributor and the amount billed to customers and retailers in the month based on Board-approved rates. To accomplish this, distributors will need to compare related revenue and expense streams and record the difference in the appropriate RSVA by way of **a monthly journal entry**. It will be necessary to perform this comparison and resulting journal entry on a monthly basis since the net monthly opening balance will attract “Carrying Charges” as mentioned below. This approach is generally referred to as the “billed” method and the basis of the accounting procedures for the RSVAs on the original issuance of this Article. [Emphasis added]
>
> Alternatively, however, a distributor may elect to use the accrual method. Under this method **accruals are recorded monthly** for unbilled revenue and for unbilled charges to a distributor using the settlement invoice received from the IESO, host distributor or embedded generator. **The difference between the respective revenues and expenses after recording the accruals are recorded into the various RSVA accounts**. Where the accrual method is used, monthly carrying charges are calculated on these balances (i.e., not on a billed/cash basis). This approach also facilitates consistency in the case of

distributors whose normal accounting practices includes accrual for monthly IESO charges and unbilled revenues. [Emphasis added]

Note: The new APH effective January 1, 2012 allows the accrual method only.

9.2.3 Area of Non-Conformity Requiring Action

E.L.K. should have calculated and recorded monthly variances in its deferral and variance accounts.

Going forward, E.L.K. should ensure that the amounts recorded in the DVAs are in accordance with the APH.

9.2.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

9.2.5 Management Action Plan

E.L.K. Energy Inc will calculate and create revised accounting spreadsheets to calculate monthly variances in its deferral and variance accounts. The implementation date is effective June 30, 2014.

9.3.1 Finding 3

No carrying charges are recorded by E.L.K. on the DVA balances. This practice is not in accordance with the APH.

9.3.2 Basis for Finding

According to information received from E.L.K. on July 9, 2013, E.L.K. did not record carrying charges over the period in the audit scope. E.L.K. indicated that it calculated the carrying charges, but due to immateriality of the amounts, did not record the amounts in its GL accounts for the period from 2010 to 2012.

According to the APH Article 490, monthly carrying charges should be calculated and recorded in the variance accounts. The APH states that:

> **Carrying Charges**
>
> The carrying charge amounts shall be calculated and recorded in a separate subaccount using simple interest applied to the monthly opening balances in the RSVA. For the period up to April 30, 2006, the distributor shall use an interest rate equal to the applicable deemed debt rate set out in Chapter 3 of the 2000 Electricity Distribution Rate Handbook, Table 3-1. Effective May 1, 2006, the rate of interest shall be the rate prescribed by the Board for the respective quarterly period.
>
> This rate shall be applied to any balance in the account, either positive or negative, less any accumulated interest in the account.

9.3.3 Area of Non-Conformity Requiring Action

E.L.K. should have recorded carrying charges on the DVA balances in accordance with the APH.

Going forward, E.L.K. should ensure that the amounts recorded in the DVAs are in accordance with the APH.

9.3.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

9.3.5 Management Action Plan

E.L.K. will calculate carrying charges on DVA balances in accordance with the APH. The implementation date is effective June 30, 2014.

9.4.1 Finding 4

Balances for the Low Voltage ("LV") billings are incorrectly reported to the Board. This was one of the reasons why E.L.K. showed a profit or loss on the commodity in the numbers reported to the Board under the RRR and in its AFS.

9.4.2 Basis for Finding

Balances for the LV billings were incorrectly reported to the Board under RRR 2.1.7, as well as on E.L.K.'s annual AFS for years 2011 and 2012. While LV costs were reported, no corresponding revenues were reported under account 4075 in 2.1.7. According to E.L.K., LV revenues were reported in RRR 2.1.7 filings under Account 4220 – Other Electric Revenues. This assertion was vouched by Regulatory Audit. E.L.K. also stated that it uses Account 4321 to record billings for LV in its GL, and provided GL Transactions Listing from its system[13] as the back-up documentation to show that it did, indeed, record the billings in its GL Account 4321. However, neither Account 4321, nor Account 4220 is the correct account for recording LV billings. For the purpose of reporting to the Board, the correct account number for LV billings is Account 4075, per the APH.

9.4.3 Area of Non-Conformity Requiring Action

E.L.K. should not have reported incorrect balances for the LV billings.

Going forward, E.L.K. should follow the APH to ensure that the DVA balances are reported to the Board under the proper accounts.

9.4.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

9.4.5 Management Action Plan

E.L.K. Energy Inc will create a new account 4075- Billed LV to record revenue for LV and not record the revenue in 4220- other electric revenues or in 4321. The implementation date is effective June 30, 2014.

9.5.1 Finding 5

The LV unbilled recording entry was missed in 2011. This is not in accordance with the APH.

[13] Per response to the Information Request 2.8 received July 9, 2013.

9.5.2 Basis for Finding

In response to Regulatory Audit's information request, received July 9, 2013, E.L.K. stated that although it missed the unbilled entry for LV revenues, the account balance contains 12 months of data (i.e. the January number relates to the previous year's unbilled), and that the difference from year to year is immaterial.

According to APH Article 330:

> This Article discusses the appropriate accounting treatment of unbilled revenue based on CICA Handbook Section 1000—Financial Statement Concepts and CICA Handbook Section 3400—Revenue. Since unbilled revenue meets the revenue recognition requirements specified in the CICA Handbook, **unbilled revenue should be accrued at year-end using the accounts provided in the USoA.** [Emphasis added]

And, according to the APH Article 220:

4075 Billed – LV

> This account shall be used by an embedded distributor to record amounts billed to its customers for transmission or low voltage charges. Depending on an embedded distributor's normal monthly accounting practices this account may include accruals for monthly unbilled estimates. The embedded distributor must ensure a proper matching of the billed amounts recorded in Account 4075 to those charges recorded in Account 4750.

9.5.3 Area of Non-Conformity Requiring Action

E.L.K. should have recorded the LV unbilled recording entries in its books in accordance with the APH.

Going forward, E.L.K. should ensure that the amounts recorded in the DVAs are in accordance with the APH.

9.5.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

9.5.5 Management Action Plan

E.L.K. will review in greater detail that the correct 12 months are recorded in the correct year. This was a human error during the 2011 year-end process and is not a recurring issue.

9.6.1 Finding 6

In 2011, E.L.K. did not reduce the higher of the revenues and costs for the purpose of calculating LV variance. Instead, it increased the lower of the revenues and costs (in this case, increased the costs to the level of the revenues in 2011).

9.6.2 Basis for Finding

While there was no impact on the account balance, the relevant revenue and expense accounts may not be accurately reflected in RRR 2.1.7.

It is important that cost of power expense is accurately stated for regulatory purposes as it forms part of the working capital allowance included in E.L.K.'s revenue requirement.

Article 490 of the APH states:

Entry 3: Calculating the RSVA balance

> A comparison of the revenue/ "Billed" accounts to the expense/ "Charges" accounts will result in a journal entry which will **reduce the higher of the revenue or expense account** with an offsetting entry to the related RSVA accounts [emphasis added]

9.6.3 Area of Non-Conformity Requiring Action

E.L.K. should have reduced the higher of the revenues and costs for the purpose of calculating LV variance in accordance with APH.

Going forward, E.L.K. should follow the APH to ensure that the DVA balances generated are in line with the Board guidance.

9.6.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

9.6.5 Management Action Plan

E.L.K. will review in greater detail. Going forward E.L.K. will continue to follow the APH to ensure the DVA balances are in line with Board Guidance. This entry was a human error where the wrong account was debited/credited.

9.7.1 Finding 7

As a general practice, E.L.K. does not remove from the deferral and variance accounts, the dispositions that are ordered by Board Decisions and Orders until the year-end. This regulatory accounting practice is contrary to the Board policy.

9.7.2 Basis for Finding

The entries for dispositions ordered by the Board were not made during the year. E.L.K. entered the dispositions into its GL in conjunction with the annual variance entries into the deferral and variance accounts[14]. During the audit, Regulatory Audit noted that E.L.K. did not remove the dispositions on a timely basis from its DVA accounts as ordered by Board Decisions and Orders EB-2009-0197, EB-2010-0126, and EB-2011-0099.

E.L.K.'s practice to remove the dispositions at year-end is not consistent with the Board guidance provided under APH. Regulatory Audit found that it was also contrary to the Board Decision and Order in E.L.K.'s rate proceeding EB-2010-0126.

The Board Decision and Order EB-2010-0126 stated:

> For accounting purposes, the respective balance in each of the Group 1 accounts shall be transferred to the applicable sub-accounts in account 1595 established by the Board pursuant to December 23, 2010 Frequently Asked Questions document accompanying the Accounting Procedures Handbook for disposition of balances in 2010, as soon as possible but no later than June 30, 2011 so that the RRR data reported in the second quarter of 2011 reflect these adjustments.

9.7.3 Area of Non-Conformity Requiring Action

[14] Email from E.L.K. dated August 19, 2013

E.L.K. should have recorded the disposition entries as ordered by the Board soon after the Board Decision, in accordance with the APH. The entries should have been made in time for the next quarterly filing RRR 2.1.1 with the Board, following the Board Decision.

Going forward, E.L.K. should move the dispositions following the Board Decision and Order, and in time for the next quarterly RRR reporting to the Board.

9.7.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps outlined below to address the issue.

9.7.5 Management Action Plan

On a go forward basis, E.L.K. Energy Inc. will remove the dispositions as ordered through the Board Decision and Order on a timely basis and in time for the next quarterly RRR report to the Board.

10. Observations

10.1.1 Observation 1

There appears to be a control weakness with regards to the implementation of E.L.K's review controls in its regulatory accounting function.

10.1.2 Basis for Observation

There appears to be a control weakness with regards to the implementation of timely review controls. During the course of the Audit, multiple instances of the control weakness were observed including:

1. E.L.K.'s audited financial statements for 2011 and 2012 and its 2.1.7 filings showed that the commodity related revenues and expenses were not equal, and that E.L.K. showed a profit or loss on the commodity.
2. Incomplete year-end unbilled entries where the unbilled entry for the LV revenues was missed.

3. The account balance in account 1562 requested for disposition in E.L.K's 2012 rate proceeding was originally a debit of approximately $155,000[15], materially different from the amount that was eventually calculated based on Board guidelines. This amount is approximately $750,000 credit.

10.1.3 Area of Concern

E.L.K. is encouraged to review and strengthen its internal control regarding its regulatory accounting activities and implement timely review controls with respect to its regulatory books.

10.1.4 Management Response

E.L.K. Energy Inc acknowledges the comments made by Regulatory Audit staff and will take the appropriate steps to address the issue.

[15] EB-2011-0099 Exhibit 9, Tab 2, Schedule 2, page 8