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January 9, 2015

**John Pickernell**  
Manager (Acting)  
Applications Administration  
Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street, 27th Floor  
Toronto ON M4P 1E4

Dear Mr. Pickernell:

**Re: Toronto Hydro Electric System Limited – EB- 2014-0116, Audit of Deferral and Variance Accounts**

I am writing to the Board regarding the results of the follow-up audit that the audit team of the Audit and Performance Assessment Department (the "Audit") of the Ontario Energy Board (the "Board") conducted on Toronto Hydro Electric System Limited ("THESL")'s Group 1 and Group 2 Deferral and Variance accounts ("DVAs"), as a part of Audit's 2014-2015 auditing activities.

The audit report (the "Report") for the initial audit was conducted as a part of Audit's 2013-2014 auditing activities, and was issued to THESL on March 31, 2014. The Report outlined seven audit findings and THESL's action plans to address the findings.

By letter dated May 20, 2014, Audit advised THESL of Audit's plan to conduct a follow-up audit to examine the implementation of THESL's proposed action plans with respect to the audit findings. Audit completed the follow-up audit except for one finding in the Report, as outlined below:

**8.1.1 Finding 1**

THESL does not use the amount billed to the customers to record the revenues reflected in the RSVA variances. Instead, it calculates the revenues reflected in the RSVA variances based on the amount of purchased power. As a result, the variances recorded in RSVAs may be

misstated since the amount of purchased power may not equal to billed power due to the differences between approved loss factors and actual loss factors.

Regarding other audit findings as outlined in the Report, Audit found no issues related to the implementation of THESL's management action plans related to the findings, except for Finding 8.1.1.

The management action plans for Finding 8.1.1 in the Report stated that:

As noted by Audit staff, THESL has agreed, as part of its 2014 IRM Settlement agreement which was accepted by the Board, to evaluate options to measure or estimate actual line losses and the impacts on Account 1588 balances in accordance with the Accounting Procedures Handbook. THESL believes that the data that is starting to becoming available as a result of the smart meter program will allow for a more accurate and timely reflection of total system sales on the same period basis as its information on power purchases, so that actual losses may be calculated with a greater degree of accuracy, and a robust method of reflecting billed revenue as per the APH will be utilized to record variances to the RSVA accounts in the future.

Notwithstanding the above, THESL agrees to explore options, based on research on other utilities' methodologies (including Hydro One and Enersource, etc) to develop a methodology in the interim period which will allow for a proxy estimate to record balances in Account 1588 for the period 2009 to 2013. THESL will propose a methodology and estimate to OEB Audit staff within the next 1-3 months, and record any estimated balances for disposal at its next Rate Filing. THESL will also evaluate the results of this methodology as the basis for any potential adjustments to Accounts 1580, 1584 and 1586. THESL agrees to evaluate options to measure or estimate actual line losses and the impacts on Account 1588 balances in accordance with the Accounting Procedures Handbook.

As noted above in THESL's management action plans, THESL acknowledged this issue in the Phase 2 settlement agreement under THESL's rate proceeding EB-2012-0064 dated December 18, 2013:

THESL agrees to evaluate options to measure or estimate actual line losses and the impacts on Account 1588 balances in accordance with the Accounting Procedures Handbook. THESL will file the results in its application for 2015 rates.

In its 2015 Customer IR rate application EB-2014-0116 dated November 24, 2014, THESL disclosed the audit conducted by Audit and voluntarily filed the Report issued by Audit as part of THESL's application. THESL disclosed to the Board the outstanding finding and stated that:

Toronto Hydro is progressing on this evaluation, and will file the information as an update to this application.

Audit has been monitoring the status of THESL's implementation of its action plan for Finding 8.1.1 and has held several discussions with THESL's staff regarding THESL's work on this matter. However, Audit will be unable to complete its follow-up audit with respect to this finding until THESL provides the audit evidence for the adjustments resulted for the Group 1 Account 1588 RSVA Power and other Group 1 RSVAs<sup>1</sup> in mid 2015. THESL is still in the process of implementing its quantification methodology of balances for these accounts and validating the results. Audit understands that the delay in implementation of THESL's action plan is due to several unexpected factors beyond THESL's control including analyzing and modeling significantly high volume of billing data since 2009, e.g., 200 million annual transactions for THESL's 700,000 customers, complexities as a result of THESL's legacy billing system, unfamiliarity of some of THESL's current staff with its legacy billing system and staff changes and the review of the internal audit staff. It is expected that THESL will continue closely working with Audit during 2015 towards successful implementation of the management action plans with respect to Finding 8.1.1.

Audit notes that an accurate determination of THESL's account balances for the Group 1 Account 1588 RSVA Power and other Group 1 RSVAs according to the Accounting Procedures Handbook (APH) is a key consideration for the Board's clearance of these accounts and setting just and reasonable rates for the THESL's customers. Therefore, Audit respectfully recommends that the Board consider deferring clearance of these accounts until a time at or before THESL's next rate proceeding when the Board sets the THESL's 2016 distribution rates. This deferral will allow Audit to properly complete its audit of these account balances and file the results with the Board for final disposition of these accounts.

Yours truly,



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cc: JS Couillard, Executive Vice President and Chief Financial Officer

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<sup>1</sup> These accounts are 1580 – RSVA WMS, 1584 – RSVA Network, 1586 – RSVA Connection, and 1589 RSVA Global Adjustment.