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March 27, 2012

Mr. Douglas Bradbury
Director, Regulatory Affairs
Algoma Power Inc.
1130 Bertie Street
PO Box 1218
Fort Erie, Ontario
L2A 5Y2

Dear Mr. Bradbury:

Re: Audit Review of Deferral and Variance Accounts

By letter dated July 11, 2011, the Regulatory Audit and Accounting group ("Regulatory Audit") of the Ontario Energy Board (the "Board") notified Algoma Power Inc. ("Algoma Power") that Regulatory Audit would review Algoma Power's Deferral and Variance Accounts ("DVAs"). 2009.

The letter dated July 11, 2011 also stated that Regulatory Audit would conduct the audit review in two phases, Phase I and Phase II.

- Phase I audit review covered Group 1¹ deferral and variance account balances as at December 31, 2010, which was completed before Algoma Power filed its 2012 IRM application with the Board in December 2011.
- Phase II audit review covered Group 2¹ deferral and variance account balances as at December 31, 2010. Upon issuance of this letter, Phase II audit review is now complete.

A final report based for Group 1 and Group 2 DVAs on Regulatory Audit's review (the "Report") has now been completed. The Report outlines the review's objective, scope, criteria, procedures used, findings, basis of finding, areas of non-conformity requiring action, management responses, and management action plans for Algoma Power.

To ensure that the audit findings related to DVAs as outlined in the Report are properly and consistently addressed and the required action plans are implemented by Algoma Power, Regulatory Audit will be conducting a follow-up audit review in 2012-2013.

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.

The findings and observations 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 review.

The findings of the audit review will be reported to the Board and may also ultimately be used as evidence in a future Algoma Power proceeding before the Board.

We thank the staff of Algoma Power for the assistance and support provided to us during this review.

Yours truly,

A handwritten signature in black ink, appearing to read 'D. Babaie', with a stylized flourish at the end.

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Cc : William Daley, President, CEO & Chairman of the Board
Glen King, Vice President & CFO
Tim Lavoie, General Manager
Judith Parker, Director of Finance

**Audit Review Report on Deferral and Variance Accounts
Algoma Power Inc.
March 2012**

Executive Summary

The Ontario Energy Board (the “Board”) authorized an audit review of Algoma Power Inc.’s (“Algoma Power”) deferral and variance accounts (each a “DVA”). This review (“Audit Review”) was conducted by the Board’s Regulatory Audit and Accounting (“Regulatory Audit”) during 2011 and 2012 and the resulting audit review report (“Audit Review Report”) is hereby being issued, as described below.

The Audit Review focused on the review of Group 1 and 2 DVA balances.

This Audit Review was planned to be conducted in two phases:

- Phase I audit review covers Group 1 DVA balances as at December 31, 2010.
- Phase II audit review covers Group 2 DVA balances as at December 31, 2010 from the last time that the Group 2 DVA balances were disposed.

Algoma Power’s Group 1 and Group 2 accounts balances (except 1588 Sub-account Global Adjustment) as at December 31, 2009 were disposed in the Cost of Service (“CoS”) rate application EB-2009-0278. As a result, Regulatory Audit focused on the transactions incurred in 2010 in its Audit Review.

Regulatory Audit has concluded that some of the DVA balances as of December 31, 2010 were not accurately reflected in the Board’s Reporting and Record Keeping Requirements (“RRR”) 2.1.7, Annual Trial Balance Filing. In addition, Regulatory Audit notes that Algoma Power has not followed the accounting procedures as stated in Accounting Procedures Handbook (“APH”) and its related guidance in recording the transactions in certain of its DVAs. The reasons for the incorrect reporting are discussed below.

The audit findings of this Audit Review are found in two parts: Part A of the Audit Review Report is related to Group 1 DVAs¹ and Part B of the Audit Review Report is related to the observations noted during the Audit Review. Algoma Power made the necessary adjustments to the Group 1 DVA balances as at December 31, 2010 during its 2012 Incentive Regulation Mechanism (IRM) rate application EB 2011-0152 that it filed in December 2011².

¹ Please refer to the July 31, 2009 Report of the Board on Electricity Distributors’ Deferral and Variance Account Review Initiative (EDDVAR) (EB 2008-046) for classification and descriptions of Group 1 and Group 2 accounts.

² On December 7, 2011, Algoma Power sent a Letter of Disclosure to the Board regarding the findings which have impact on the Group 1 DVA balances requested for disposition in Algoma Power’s rate application under EB 2011-0152.

In February 2012, Algoma Power filed with the Board a Motion to Review and Vary the Board's Decision ("Motion") issued for its 2012 IRM rate proceeding EB-2011-0152 because of a significant error made in IESO form 1598 resulting in incorrect balances of Account 1588 RSVA Power and Account 1588 RSVA Sub-account Global Adjustment as at December 31, 2010. Subsequently, Algoma Power filed with the Board the revised balances for these two Group 1 accounts. Regulatory Audit had filed a letter dated February 15, 2012 to the Board noting that it reviewed Algoma Power's revised balances in Account 1588 RSVA Power and Account 1588 RSVA Sub-account Global Adjustment and that its review found no issues from Regulatory Audit's perspective that would materially impact the updated 2010 balances for these two accounts. In the Decision on Motion issued on March 5, 2012, the Board approved the revised balances for Account 1588 RSVA Power and Account 1588 RSVA Sub-account Global Adjustment. Algoma Power has not yet re-filed RRR 2.1.7 for the updated Group 1 DVA balances.

There are no audit findings noted in this Audit Review that will materially impact the Group 2 DVA balances as at December 31, 2010.

Findings Summary

The findings of this Audit Review indicate that Algoma Power has a number of areas of non-conformity with the APH, Board's Reporting and Record Keeping Requirements ("RRR"), and other Board guidance with respect to its Group 1 and Group 2 DVAs. The areas of the non-conformity with Board regulatory accounting guidance involves not accurately recording and reporting some of the DVA balances and associated carrying charges as well as not following APH and related guidance issued by the Board in recording the transactions related to certain DVAs.

After Regulatory Audit's Phase I audit review, Algoma Power made the necessary adjustments in the Group 1 DVA balances and incorporated these changes in its 2012 IRM rate application EB-2011-0152 and subsequently updated the Group 1 balances in the Motion. Algoma Power is expected to re-file the updated Group 1 balances in the 2010 RRR filings with the Board. Algoma Power also needs to ensure that the regulatory accounting policies and procedures for Group 1 and Group 2 DVAs are properly and consistently applied in accordance with the APH, RRR, and other Board guidance.

1. Background

Algoma Power is a licensed host electricity distributor which distributes electricity in the service areas of Northern Ontario and north and east of the City of Sault Ste. Marie.

Algoma Power Inc. is a wholly owned subsidiary of FortisOntario Inc. which is the Ontario based subsidiary of Fortis Inc. Algoma Power Inc. has approximately 11,600 customers.

Regulatory Audit has concluded that some of the DVA balances as of December 31, 2010 were not accurately reflected in the Board's RRR 2.1.7. In addition, Regulatory Audit notes that Algoma Power has not followed the accounting procedures as stated in the APH and its related guidance in recording the transactions in certain of its DVAs.

Algoma Power made the necessary adjustments in the Group 1 DVA balances and incorporated these changes into its 2012 IRM rate application EB-2011-0152 and subsequently updated the Group 1 balances in the Motion. Algoma Power is expected to re-file the updated Group 1 balances in the 2010 RRR filings with the Board. Algoma Power also needs to ensure that the regulatory accounting policies and procedures for Group 1 and Group 2 DVAs are properly and consistently applied in accordance with the APH, RRR, and other Board guidance. A follow-up review will be scheduled after Algoma Power addresses the findings and observations that are detailed in this Audit Review Report.

2. Authority for review

To the extent that this Audit Review required Algoma Power 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 2 Accounts will be reviewed using the Board's current process as outlined in *Guidelines for Review of Electricity Deferral and Variance Accounts, September 28, 2005*. Under this process, the Board will issue an order for all distributors on completion of its annual review of the Accounts. The order will reflect the Board's determination as to whether the Account balances reviewed ought to be disposed of, and if so, the balance(s) that will be disposed of and how they will be reflected in rates.³

The Board stated that at the time of rebasing, all account balances should be disposed of unless otherwise justified by the distributor or as required by a specific Board decision or guideline. The Board also articulated that if the net balances of all Account

³ July 31, 2009 Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR) (EB-2008-0046), page 12

balances when unitized are lower than \$0.0001/kWh or \$0.0001/kW, then the disposition should not occur.⁴

To assist the Board in discharging its responsibilities related to DVAs, Regulatory Audit initiated a review of Algoma Power's DVAs balances in order to mitigate the risk associated with the incorrect disposition of these account balances.

3. Reason for Audit Review

The Board's audit review 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.

4. Objectives

The objective of this Audit Review is to review the Group 1 and Group 2 DVA balances as at December 31, 2010 for Algoma Power to determine whether regulatory accounting policies and procedures of these accounts are properly and consistently applied in accordance with the APH, RRR, and other Board guidance.

5. Scope

This Audit Review was undertaken to determine if Algoma Power is in conformity with requirements of the APH, RRR, and other Board guidelines for the DVAs.

This Audit Review covered the 1500 and 2400 series of account numbers in the Uniform System of Accounts, and related revenue and expense accounts. Account 1562, Account 1563, and Account 1592 were not reviewed as part of the Group 2 DVA Audit Review because a separate process was established as part of the Deferred PILs Board proceeding (EB-2008-0381), which may impact the final balances in these

⁴ July 31, 2009 Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR) (EB-2008-0046), page 13

accounts. Account 1555 and Account 1556 were not included in the Audit Review, as Algoma Power is expected to file a stand alone rate application with the Board in 2012 for the disposition of smart meter account balances. Account 1565 and Account 1566 were not reviewed as the period of spending on CDM activities has ended and the balances in these accounts are immaterial. Account 1521 was also not reviewed in the Audit Review as it was requested by Algoma Power to be cleared with the Group 1 deferral and variance accounts balances in the 2012 IRM proceeding and was disposed in the proceeding.

The period of review for Group 1 and Group 2 DVAs and related revenue and expense accounts is 2010.

This Audit Review was conducted in two phases:

- Phase I Audit Review covers Group 1 DVA balances as at December 31, 2010 – findings related to Group 1 DVAs are stated in this Audit Review Report
- Phase II Audit Review covers Group 2 DVA balances as at December 31, 2010 – findings related to Group 2 DVAs are stated in this Audit Review Report

6. Criteria

This Audit Review relied on the following documents to establish the criteria:

1. APH
2. APH FAQs December 2003
3. Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR) (EB-2008-0046)
4. Electricity RRR 2.1.7
5. Board Decision EB 2009-0278 and EB 2010-0400
6. Board Decision and Order EB-2011-0152
7. Board Decision on Motion to Review and Vary EB-2011-0152

7. Procedures Used

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

Part A: Findings related to Group 1 DVAs

8. Findings Impacting Group 1 DVA Balances

8.1.1 Finding 1 – Over-accrual of the Commodity Cost in Account 1588 RSVA Power

The accrual methodology used by Algoma Power to record the commodity costs in Account 4705 appears to be not reasonable. As a result, the commodity costs recorded in Account 4705 Power Purchased as at 2010 year end may be overstated by an amount of approximately \$81,000 and Account 1588 RSVA Power may also be overstated by the same amount.

8.1.2 Basis of Finding

Page 10 of APH Article 490 states:

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 in bold)

As per review of Algoma Power's GL for Account 1588 RSVA Power, Regulatory Audit noted that Algoma Power uses the accrual method in accounting for the variances in Account 1588 RSVA Power. However, Regulatory Audit noted that the accrual methodology used by Algoma Power to record the commodity costs appears to be not reasonable since it accrues the spot and fixed price energy difference in addition to the actual commodity costs based on the fixed prices. Regulatory Audit compared the accrued commodity costs to the actual commodity costs on IESO invoices for the months of May and December of 2010 and noted the over-accrual of the commodity costs for both months by 30% and 40%, respectively. The net impact of the over-accrual on the commodity costs is approximately \$81,000⁵. As a result, Account 1588 RSVA Power as at December 31, 2010 (debit balance) is overstated by an amount of approximately \$81,000.

⁵ \$81K is quantified by Algoma Power in its email dated November 16, 2011 and reviewed by Regulatory Auditor

Regulatory Audit noted that Algoma Power included an adjustment in Account 1588 RSVA Power balance before it filed its 2012 IRM rate application. Algoma Power accrued the commodity costs based on the IESO settlement invoices received in January 2012⁶.

8.1.3 Area of Non Conformity Requiring Action

Algoma Power's accrual methodology of the commodity costs appears to be not reasonable. As a result, Account 4705 Power Purchased and Account 1588 RSVA Power are overstated by an amount of approximately \$81,000 as at 2010 year end.

The updated balance for Account 1588 RSVA Power should be reflected in the RRR 2.1.7.

Moving forward, Algoma Power should continue its 2012 accrual methodology for the commodity costs based on the settlement invoices received from IESO, or adopt some other methodology to accurately forecast the costs.

8.1.4 Management Response

Management agrees to the above audit finding.

8.1.5 Management Action Plan

Starting December 2011, management has begun to use 'shadow invoices' as provided by Utilismart as a basis for accruing cost of power at month-end. Recently, Algoma Power retained Utilismart as its retail settlements service provider. The shadow invoice is created based on data available as at the 1st or 2nd day after month-end, and is intended to represent an accurate estimate of what the IESO invoice will be. Management will also resubmit the 2010 RRR 2.1.7 using the adjusted balances per OEB audit, and this will be done in conjunction with the submission of the 2011 RRR 2.1.7 filing.

⁶ As per review of the journal entry and IESO invoice sent by Algoma Power in the email dated February 17, 2012

8.2.1 Finding 2 – Incorrect fixed rates used on IESO Form 1598 of May 2010

Algoma Power did not use the RPP prices related to its RPP settlement submission on its IESO form 1598 of May 2010. As a result, Account 1588 may be overstated due to the wrong RPP prices which were used.

8.2.2 Basis of Finding

As per inquiry of Algoma Power, Regulatory Audit noted that Algoma Power settles the RPP claims with the IESO with a one month lag through IESO former form 1598. For example, Algoma Power's April IESO form 1598 settles the RPP volumes and rates of March 2010 and Algoma Power's May IESO form 1598 settles the RPP volumes and rates of April 2010.

As per review of Algoma Power's May 2010 IESO form 1598, Regulatory Audit noted that the RPP prices used by Algoma Power were for May 2010 even though they were settling for April 2010. The RPP prices used by Algoma Power were higher than the RPP prices that should have been used on the form 1598 of May 2010. As a result, Account 4705 Power Purchased was overstated by approximately \$75,000 and Account 1588 RSVA Power was overstated by approximately \$75,000.⁷

Regulatory Audit noted that Algoma Power included an adjustment in Account 1588 RSVA Power balance before it filed its 2012 IRM rate application.

8.2.3 Area of Non Conformity Requiring Action

Algoma Power did not use the correct RPP prices on its RPP settlement submission through the form 1598 of May 2010. As a result, Account 4705 Purchased Power and Account 1588 RSVA Power are overstated.

Algoma Power should reflect the updated balances for Account 4705 Purchased Power and Account 1588 RSVA Power in the 2010 RRR 2.1.7 when it re-files it with the Board.

Moving forward, Algoma Power should ensure the correct RPP prices are reflected in the IESO former form 1598 in order to reflect the accurate settlement amounts in the Account 1588 RSVA Power.

⁷ \$75K is quantified by API in its email dated November 16, 2011 and reviewed by Regulatory Audit

8.2.4 Management Response

Management agrees to the above audit finding.

8.2.5 Management Action Plan

Management has completed the true-up process for 2009 and 2010 during the OEB audit process, and as a result of this true-up process, the RPP tiered prices were correctly applied and calculated. Going forward, the true-up process will be completed on a more regular basis (i.e. annualized) to ensure that all former Form 1598 submissions and true-ups have been correctly stated on a timely basis. Management will also resubmit the 2010 RRR 2.1.7 using the adjusted balances per OEB audit, and this will be done in conjunction with the submission of the 2011 RRR 2.1.7 filing.

8.3.1 Finding 3 – Form 1598 True up process

Algoma Power did not follow its established process to perform regular true ups for 1598 forms 1598 RPP settlement with the IESO. Due to employee turn over, the true up of 2009 IESO 1598 forms was not performed in accordance with the process. Algoma Power had not performed the 2010 true up by the time it submitted the 2010 Group 1 balances with the Board. As a result, the account balances for Account 1588 RSVA Power and 1588 Sub-account Global Adjustment might not be accurate as of December 31, 2010.

8.3.2 Basis of Finding

Algoma Power stated⁸ that a true up process was in place and had been completed previously. As per review of the IESO 1598 forms, Regulatory Audit noted that the 2008 true up adjustment amount of \$300.83 was included in the January 2010 IESO form 1598. Algoma Power also confirmed⁹ that the 2009 true up was overlooked due to employee turn over. Algoma Power stated that the 2009 true up and 2010 true up would be completed by the end of 2011.

Regulatory Audit noted that the lack of consistently in conducting the true up process of the RPP settlement with the IESO may impact the balances of Account 1588 RSVA Power and 1588 Sub-account Global Adjustment. As a result, Account 1588 RSVA Power and 1588 Sub-account Global Adjustment may not be accurately stated in the RRR filings.

⁸ As per API's response to Outstanding items questionnaire dated October 18, 2011

⁹ As per API's email to Regulatory Audit dated November 9, 2011

Algoma Power filed its 2012 IRM rate application with the Board on September 15, 2011. On December 7, 2011, as a result of the audit review of the DVA balances, Algoma Power filed a letter with the Board disclosing the audit finding by Regulatory Audit. In its letter, Algoma Power explained the impact of the audit finding on its application and filed updates to the Group 1 DVA balances. The updated Group 1 DVA balances were included¹⁰ in Algoma Power's 2012 rate application EB-2011-0152. In the Decision EB-2011-0152 issued on January 20, 2012, the Group 1 DVA balances as at December 31, 2010 except Account 1588 RSVA Sub-account Global Adjustment were approved by the Board for disposition on a final basis.

On February 1, 2012, Algoma Power informed Regulatory Audit that Algoma Power discovered an error related to the IESO form 1598 for the period of January 1, 2012 to December 31, 2010, which is used to include adjustments as part of the settlement of monthly IESO invoices. Algoma Power indicated that the error in form 1598 was a result of the energy sales to retail customers being erroneously included as RPP sales instead of non-RPP sales.

On February 2, 2012 Algoma Power filed a letter to the Board for a Motion to Review and Vary the Board's Decision ("Motion"). Algoma Power explained that the error pertains to the balances for the year ended December 31, 2010 for Account 1588 RSVA Power and 1588 RSVA Power Sub-account Global Adjustment. In the letter, Algoma Power re-iterated what it had explained to Regulatory Audit and stated that the error was related to a significant error in the IESO form 1598 which was presented in the audit.

Algoma Power filed its adjustments with IESO on February 7, 2012 and IESO has accepted Algoma Power's adjustments after Regulatory Audit worked with Algoma Power staff to examine the reasons for the difference between the balances disposed in Algoma's EB-2011-0152 rate application and the updated balances resulting from the Motion.

On February 15, 2012, Algoma Power filed with the Board its revised balances and revised Draft Rate Order. Regulatory Audit examined the supporting documentation and evidence related to the revised balances and did not note any issues. Regulatory Audit noted that Algoma Power quantified the impact of 2009 and 2010 true ups on Account 1588 RSVA Power and Account 1588 RSVA Sub-account Global Adjustment, submitted the adjustments to the IESO in February 2012 and made necessary adjustments to the account balances as at December 31, 2010 in its GL¹¹. On February 21, 2012, Regulatory Audit informed the Board of this matter. In the Decision on Motion issued on March 5, 2012, the Board approved the revised balances for Account 1588

¹⁰ Decision EB-2011-0152, Page 12, Note 5 states that "During the course of the proceeding Algoma updated its Group 1 D/V account balances, including the Global Adjustment sub-account, in light of the findings of a regulatory audit of the Group 1 Accounts. The amounts noted in this Decision are the updated amounts."

¹¹ As per review of the supporting spreadsheets, journal entry, IESO form 1598 submitted to IESO in February 2012 sent by Algoma Power in the email dated February 17, 2012

RSVA Power and Account 1588 RSVA Sub-account Global Adjustment. Algoma Power has not yet re-filed 2010 RRR 2.1.7 for the updated Group 1 DVA balances.

8.3.3 Area of Non Conformity Requiring Action

Algoma Power did not consistently perform the true ups of its RPP claims with the IESO after 2008.

Algoma Power should re-file the 2010 RRR 2.1.7 balances for Account 1588 RSVA Power and Account 1588 RSVA Sub-account Global Adjustment.

Moving forward, Algoma Power should enhance its IESO true ups process and consistently conduct its established true ups process.

8.3.4 Management Response

Management agrees to the above audit finding.

8.3.5 Management Action Plan

Going forward, the true-up process will be completed on a more regular basis (i.e. annualized) to ensure that all former Form 1598 submissions and true-ups have been correctly stated on a timely basis. Management will also resubmit the 2010 RRR 2.1.7 using the adjusted balances per OEB audit, and this will be done in conjunction with the submission of the 2011 RRR 2.1.7 filing.

8.4.1 Finding 4 – RRR 2.1.7 of 2010 was not correctly reported

Algoma Power's reported balance of Account 1588 RSVA Power as of December 31, 2010 did not reflect the actual GL balance as at December 31, 2010. The reported balance included the rural rate actual costs on the IESO invoice by mistake and did not include the micro-fit expense incurred by Algoma Power. As a result, the balance reported in RRR 2.1.7 may not be accurate.

8.4.2 Basis of Finding

As per review of the reconciliation of the Algoma Power's GLs, RRR and AFS, Regulatory Audit noted that Algoma Power's GL agreed to its 2010 AFS. However, there were differences between RRR 2.1.7 and the GL balance as of December 31, 2010 for Account 1588 RSVA Power, as shown in Table 1 below:

Table 1

	Account 1588 Power (\$)	Account 1588 Sub- account GA (\$)	Account 1588 including GA (\$)
As per GL:			
GL balance as of December 31, 2010	3,127,173	-668,009	2,459,164
Less: 2009 balance disposed in EB-2009-0278 and recorded in 2011	3,125,187	-66,872 (Note 1)	3,058,315
Net balance after the transfer of the disposition – (A)	1,986	-601,137	
As per RRR:			
RRR 2.1.7 – (B)	30,726	-601,137	-570,411
DIFF – (A – B)	28,740	0	

Note 1: Refer to Finding 8.5.1

As per an inquiry from Algoma Power¹², the difference of \$28,740 between RRR 2.1.7 and GL was due to the inclusion of rural rate settlement charges on IESO invoices of \$49,037 and the exclusion of the micro-fit costs of \$20,297 in the RRR 2.1.7 balance of Account 1588 RSVA Power. However, the rural rate settlement charges on IESO invoices should be included in Account 1580 RSVA wms because it was identified as one of the charges to be recorded in Account 4708 Charges wms, and hence reflected in Account 1580 RSVA wms. The micro-fit costs should be included in the cost of power and reflected in Account 1588 RSVA Power because it relates to the commodity amounts that have been paid to customers who are generating electricity into the system.

Regulatory Audit noted that Algoma Power did record the relevant costs correctly in its GL for these two costs. However, the reported balance of Account 1588 RSVA Power was incorrect.

¹² As per email dated Nov 3, 2011

8.4.3 Area of Non Conformity Requiring Action

Algoma Power should re-file the 2010 RRR 2.1.7 which should exclude the rural rate settlement charges and include the micro-fit costs into Account 1588 RSVA Power.

Moving forward, Algoma Power should ensure that RRR 2.1.7 balance agrees to the GL balance.

8.4.4 Management Response

Management agrees to the above audit finding.

8.4.5 Management Action Plan

Management will resubmit the 2010 RRR 2.1.7 using the adjusted balances per OEB audit, and this will be done in conjunction with the submission of the 2011 RRR 2.1.7 filing.

8.5.1 Finding 5 – Account 1588 RSVA Sub-account Global Adjustment

Algoma Power did not have the Board's approval for disposition of 2009 credit balance of Account 1588 RSVA Sub-account Global Adjustment after parties reached a settlement agreement in the rate proceeding EB-2009-0278. Nonetheless, Algoma Power transferred the account balance in Account 1595 and started refunding to customers in December 2010¹³. Since the Account 1588 RSVA Sub-account Global Adjustment has its own rate rider (Non-RPP customers), the mistake made by Algoma Power may cause the cross-subsidization between different rate groups.

8.5.2 Basis of Finding

In the settlement agreement EB-2009-0278 dated September 17 2010 item No 9a, the Group 1 DVA balances as of December 31, 2009 were proposed to the Board for disposition. Parties had agreed to dispose all Group 1 DVA balances except the balance for Account 1588 RSVA Sub-account Global Adjustment.

¹³ The DVA rate rider will be ended May 31, 2013

As per review of the reconciliation of RRR 2.1.7, AFS and GL for Account 1588 RSVA Sub-account Global Adjustment, Regulatory Audit noted that the 2009 credit balance of \$66,872 was transferred to Account 1595. Algoma Power explained¹⁴ that the transfer for the global adjustment to Account 1595 was overlooked when the rate calculations were made for final DVA rate rider. As a result, the 2009 Account 1588 RSVA Sub-account Global Adjustment balance was included with the remainder of the disposed Group 1 DVAs and allocated on kWh. Because Account 1588 RSVA Sub-account Global Adjustment disposes over Non-RPP customers only, the mistake made by Algoma Power might cause cross-subsidization between different rate groups.

On December 7, 2011 Algoma Power filed a letter disclosing this finding to the parties within its 2012 IRM rate application EB-2011-0152. Algoma Power proposed that the existing rate rider run its full term, that is to May 31, 2013, and that, when Algoma has the billing capacity for the separate disposition of the Global Adjustment sub-account, the balance for this account could be reconciled and settled at the Board's direction in a future proceeding.

In the Decision for Algoma Power's 2012 IRM rate application EB-2011-0152 issued in January 2012, the Board stated that

The Board disagrees with the treatment proposed by the Algoma, which would have the effect of propagating the error until May 31, 2013. The Board finds that, as of the effective date of this Decision and Order, the 2011 rate rider calculation should be corrected to remove the credit balance \$66,872, which is the amount for the Global Adjustment sub-account erroneously included in the rate rider calculation. The calculation of the corrected rate rider will be based on the same particulars set out in the EB-2009-0278 decision, i.e. the same charge determinants and term (to May 31, 2013). Algoma is directed to adjust the credit balance in the Global Adjustment sub-account, increasing the credit balance by \$66,872. The corrected balance of the Global Adjustment sub-account is subject to the findings set out by the Board above.¹⁵

In the Decision on Motion issued in March 2012, the Board re-iterated that

The 1588 Global Adjustment sub-account balance to be disposed in a future proceeding is a debit of \$353,951 as of December 31, 2010. The Board reminds Algoma that the Decision remains unchanged with regard to the requirement that Algoma file an application for the disposition of the 1588 Global Adjustment sub-account by June 1, 2012 with the attendant proviso as found in the Decision.¹⁶

¹⁴ API's response to outstanding items dated October 18, 2011, Q22

¹⁵ Algoma Power 2012 IRM rate application EB-2011-0152 Decision and Order, Page 14

¹⁶ Algoma Power 2012 IRM rate application EB-2011-0152 Decision on Motion, Page 4

8.5.3 Area of Non Conformity Requiring Action

Algoma Power should not have disposed the 2009 credit balance of \$66,872 in Account 1588 RSVA Sub-account Global Adjustment without the Board's approval.

As directed by the Board Decision EB-2011-0152, Algoma Power should make the adjustments in Account 1588 RSVA Sub-account Global Adjustment, remove the balance from 2011 DVA rate rider, and file an application with the Board for Account 1588 RSVA Sub-account Global Adjustment by June 1, 2012.

8.5.4 Management Response

Management agrees to the above audit finding.

8.5.5 Management Action Plan

Management has booked a journal entry in January 2012 to move the (\$66,872) out of the 1595 Recovery account and into the 1588 Power – sub Global Adjustment account.

9. Findings related to Accounting Procedures Group 1 DVAs

9.1.1 Finding 1 – Algoma Power Not Reduce the Higher of Revenues and Expenses

Algoma Power did not reduce the higher of revenues and expenses consistently in recording RSVA variances. The variances were always recorded into an expense account regardless of the debit and credit position in the variance account.

There was no net impact on the RSVA balances as a result of this finding. However, the related revenue and expense account balances may be misstated if the higher of revenues and expenses was not reduced. In addition, it is important that certain costs be stated accurately, e.g. cost of power expense should be accurately stated for regulatory purposes as it forms part of the working capital allowance included in Algoma Power's revenue requirement.

9.1.2 Basis of Finding

As described in APH Article 490, there are two methods for calculating the RSVA balances: Alternative A and Alternative B. When the utility is using Alternative A, a comparison of the revenue accounts to the expense 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. When the utility is using Alternative B, the related revenue and expense accounts are closed out at month end directly to each respective RSVA for that month.

Regulatory Audit noted that Algoma Power uses an expense account in recording the RSVA variances consistently by not comparing the higher of revenues and expenses, e.g. Algoma Power debited an expense account (i.e. increase the expense) in recording the variances for Account 1588 RSVA Power and Account 1588 RSVA Sub-account Global Adjustment when the accumulative revenues are higher than accumulative expenses. This practice was confirmed by Algoma Power in its email¹⁷ to Regulatory Audit.

9.1.3 Area of Non Conformity Requiring Action

Algoma Power did not reduce the higher of revenues and expenses in recording the RSVA variances.

Algoma Power should reduce the higher of revenues and expenses in recording the cumulative RSVA variances into respective RSVA account as specified in the APH Article 490. Moving forward, Algoma Power should follow the APH in recording the variances and reflect the relevant revenue and expense USoAs in the RRR 2.1.7 and other filings with the Board.

9.1.4 Management Response

Management agrees to the above audit finding.

9.1.5 Management Action Plan

Although management agrees with the above audit findings, management intends to continue to use the current approach of recording monthly variances to the expense accounts, rather than reducing the higher of revenues or expenses. Management believes by continuing with the current approach, a more appropriate analysis of the changes in revenues over prior periods can be made, as the revenues currently being recorded are a true reflection of the actual customer billings. If management was to adopt an alternative designated with the APH Article 490, it would become very difficult to analyze the changes in revenues or expenses over prior periods. There would be some consistency issues in that in some periods it would be the revenues that would have had the variance recorded, while in other periods it would have been the expenses.

¹⁷ As per API's email to Regulatory Audit dated Oct 31, 2011

Management would also like to point out that the current approach does not result in any net margin differences and does not create any misstatements in the regulatory asset/liability accounts. Additionally, in the cost of service application, the cost of power is provided, so the method of accounting for variances does not affect the outcome of the rate application. Finally, because trending within the cost of service rate application is based on kWhs and not dollars, the method of accounting for the variances that Algoma Power has chosen does not affect the outcome of trending.

9.2.1 Finding 2 – Using One Expense Account for Account 1584 and Account 1586

Algoma Power does not use separate accounts for recording the expenses for Account 1584 and Account 1586. The 2010 RRR 2.1.7 report for expense Accounts 4714 and expense Account 4716 balances may be misstated.

9.2.2 Basis of Finding

Article 490 of the APH, pages 17, 18, and 19 states:

The following expense accounts will be used to record service charges incurred by the distributor for services received from the IESO (or host distributor):

- Account 4714, Charges - NW. This account is to be used by distributors deemed by the Board to be transmission customers to record the amounts charged by the Independent Electricity System Operator (based on the settlement invoice) for retail transmission network services.
- Account 4716, Charges - CN. This account is to be used by distributors deemed by the Board to be transmission customers to record the amount charged by the Independent Electricity System Operator (based on the settlement invoice) for retail transmission connection service.

Regulatory Audit noted that in the review of the months May and December of the 2010 journal entries to record the variances that Algoma Power used its internal expense account (401-0440-982-1299 which is mapped to both Accounts 4714/1584 and 4716/1586) to record the net revenues for Accounts 1584 and 1586. The table below shows Algoma Power's internal mapping of its accounts with the USoA accounts.

Algoma Power Internal Expense Code for Both Accounts 1584 & 1586	Algoma Power's Mapping	Nature of Transaction Recorded
401-0440-982-1299	4714/1584	Expense
401-0440-982-1299	4716/1586	Expense

Algoma Power confirmed that the RSVA variances regardless of debit or credit position are always posted to the same GL expense account (401-0440-982-1299).¹⁸

Regarding the 2010 RRR 2.1.7 filing to the Board, Algoma Power stated that Algoma Power reported all of the balances recorded in GL account 401-0440-982-1299 for Account 4714 and reported \$829,630 balance for Account 4716.

Algoma Power estimated that the accurate balance that should have been reported in the 2010 RRR 2.1.7 filing should be \$113,785 lower in USoA Account 4714 and \$113,785 higher in USoA Account 4716 based on Audit Review. The original filing amounts were \$1,195,795 for USoA Account 4714 and \$829,630 for USoA Account 4716. Therefore, it is expected that Algoma Power will file an account balance of \$1,082,010 for Account 4714 and a balance of \$943,415 for Account 4716.¹⁹

9.2.3 Area of Non Conformity Requiring Action

Algoma Power did not use separate sub accounts for recording the expenses for Account 1584 and Account 1586.

Algoma Power should re-file the 2010 RRR 2.1.7 balances for the USoA Account 4714 and Account 4716.

Moving forward, Algoma Power should use separate sub accounts for recording the expenses in Account 4714/1584 and in Account 4716/1586 as per APH.

9.2.4 Management Response

Management agrees to the above finding.

¹⁸ Response to email October 31, 2011.

¹⁹ E-mail from Algoma Power dated March 27, 2012

9.2.5 Management Action Plan

Management will resubmit the 2010 RRR 2.1.7 using the adjusted balances per OEB audit, and this will be done in conjunction with the submission of the 2011 RRR 2.1.7 filing.

Management understands that there is a need for two separate cost accounts for OEB 1584 and OEB 1586, and the importance of ensuring that the balances are correctly classified amongst these two accounts. Since the changeover to Algoma Power's new accounting system as at Jan 1, 2012, the monthly variances for OEB 1584 and OEB 1586 are now being correctly allocated.

9.3.1 Finding 3 – OPG Rebate Not Recorded in Correct USoA Account

Algoma Power recorded the OPG rebate in Account 1110, Other Accounts Receivable rather than in Account 2315, Accumulated Provision for Rate Refund, as specified in APH FAQs. Although the charge amount is not material, Algoma Power should follow the correct accounting procedure in recording the charges.

9.3.2 Basis of Finding

APH FAQ #10 December 2003 states that Account 2315, Accumulated Provision for Rate Refund should be used in recording OPG Market Power Mitigation Agreement Rebate.

Regulatory Audit noted that Algoma Power recorded the OPG rebate on its November 2010 IESO invoice under Account 1110, Other Accounts Receivable rather than Account 2315, Accumulated Provisions for Rate Refund. Although the amounts may not be material, the amounts recorded in the Account 1110 and Account 2315 may not be accurately reflected in the RRR 2.1.7.

9.3.3 Area of Non Conformity Requiring Action

Algoma Power did not record the OPG Rebate on IESO invoices in the correct USoA as per APH FAQs.

Moving forward, Algoma Power should record the OPG Rebate in the Account 2315, Accumulated Provision for Rate Refund rather than in Account 1110, Other Accounts Receivable.

9.3.4 Management Response

Management agrees to the above audit finding.

9.3.5 Management Action Plan

Going forward, management will ensure that the OPG rebates on IESO invoices will be recorded in an account that maps back to OEB 2315 rather than OEB 1110.

9.4.1 Finding 4 – Carrying Charges

Algoma Power did not record the carrying charges for the RSVA accounts on a monthly basis. As a result, the balances for these accounts may not be accurately reflected in RRR 2.1.7.

9.4.2 Basis of Finding

APH Article 490 states:

Entry 4: Calculating carrying charges

In the next month, the opening balance of the RSVA for the month consistent with method used to determine the balance in the account (billed or accrual) will be used for purposes of calculating carrying charges **for the month**.

Entries 1 to 4 above will be repeated for **each month** in the fiscal period until the last month in the period. (Emphasis added in bold)

For all RSVAs, Article 220 of the APH states:

C. Carrying charge amounts shall be calculated using simple interest applied to the **monthly opening** debit or credit balances in the account (exclusive of accumulated interest) and recorded in a **separate sub-account** of this account. (Emphasis added in bold)

In its review of the 2010 GL and the RSVA Continuity Schedules, Regulatory Audit noted that Algoma Power did not record monthly carrying charges. The following accounting practices were also noted in the review:

- a) For the RSVAs, Algoma Power recorded a one-time six month carrying charges in 2010 at the end of the year.²⁰ When recording the one-time carrying charges

²⁰ Response to Request for Information July 19, 2011 Q2.1 (Continuity Schedule)

for the RSVA accounts, Algoma Power did not record the interest expenses separately in Account 6035, Other Interest Expense and interest income in Account 4405, Interest and Dividend Income. Rather, Algoma Power used Account 4405 to record both interest expense and interest income.

- b) Sub accounts for carrying charges were not used.

9.4.3 Area of Non Conformity Requiring Action

Algoma Power did not follow the APH in regards to recording the carrying charges for the RSVA accounts.

Moving forward, Algoma Power should follow the APH and record the carrying charges on a monthly basis. To address the other accounting practices, Algoma Power should set up the appropriate sub-accounts for recording the carrying charges. Algoma Power should calculate the carrying charges based on the monthly opening balance of the RSVA account. Algoma Power should use Account 6035 to record the interest expense and Account 4405 to record the interest income of the RSVA.

9.4.4 Management Response

Management agrees to the above audit finding.

9.4.5 Management Action Plan

With respect to the appropriate use of OEB accounts for carrying charges overall, since the changeover to ALGOMA POWER's new accounting system as at Jan 1, 2012, management has been using separate accounts to track carrying charges, and has been calculating carrying charges on a monthly basis as per APH Article 490. Interest income is correctly being recorded in an account that maps back to OEB 4405 and interest expenses are correctly being recorded in an account that maps back to OEB 6035.

Part B: Observations related to Group 1 and Group 2 DVAs

10.1.1 Observation 1 – No Internal Accounting Policies

Algoma Power stated that it has not developed internal accounting policies and procedures to provide guidance to its staff in regards to accounting treatment of the DVAs.

10.1.2 Basis for Observation

Based on its response from the interview with Regulatory Audit, Algoma Power stated that it follows the direction provided in APH; however, Algoma Power does not have any specific internal procedures to provide guidance to its staff for regulatory accounting treatment of the DVAs²¹.

10.1.3 Area of Concern

Algoma Power should develop internal accounting procedures to provide guidance to its staff in respect to accounting treatment of DVAs.

10.1.4 Management Response

Please refer to comments provided in 10.2.4 below.

10.1.5 Management Action Plan

Please refer to comments provided in 10.2.5 below.

10.2.1 Observation 2 – Lack of Internal Review

It appears that Algoma Power has not established a well documented internal review process for some of its DVAs. This observation is supported by a number of changes in Algoma Power's true up adjustment numbers for Account 1588 RSVA Power and Account 1588 RSVA Sub-account Global Adjustment.

10.2.2 Basis for Observation

During the review of Algoma Power's settlement form 1598 with the IESO, Regulatory Audit noted that there is a lack of second check on the 1598 settlement form with the IESO. For example, the RPP rates used on the 1598 form were not right for a number

²¹ Algoma Power's response to Interview Questions dated July 19, 2011, Q#1.

of months; although the errors were corrected by Algoma Power subsequently in most of the months except May 2010 (refer to Finding 8.2.1).

During the review of Algoma Power's Account 1588 RSVA Sub-account Global Adjustment, Algoma Power explained that the transfer for the global adjustment to Account 1595 was overlooked when the rate calculations were made for final DVA rate rider. As a result, the 2009 Account 1588 RSVA Sub-account Global Adjustment balance was included with the remainder of the disposed Group 1 DVAs and allocated on kWh. Algoma Power could have avoided this issue by establishing internal review and control process to accurately calculate the DVA rate riders as per the Board Decision and Order (refer to Finding 8.5.1).

During the review of Algoma Power's true up adjustments (refer to Finding 8.3.1), Regulatory Audit noted that Algoma Power changed the figures a number of times due to some manual input errors in the true up spreadsheets. As a result of the changes, Algoma Power had to file a motion to review for the updated balances for its Account 1588 RSVA Power and 1588 sub-account Global Adjustment.

10.2.3 Area of Concern

Regulatory Audit is concerned with the extent of Algoma Power's internal review process. Without the established process of internal review, there is an increased risk of making errors and mistakes by Algoma Power's staff which could result in incorrect account balances. Algoma Power is encouraged to establish and implement an internal review policy to enhance its internal controls.

10.2.4 Management Response

Management thanks the Regulatory Audit Group for their recommendations and observations.

10.2.5 Management Action Plan

Algoma Power Inc. ("API") had operated as a division of Great Lakes Power Limited ("GLPL") prior to June 2009. In June 2009, the distribution division was split from GLPL into a separate legal entity. FortisOntario acquired 100% of the shares of that legal entity in October 2009. During this period of change in corporate structure and ownership there have been numerous changes in the finance staffing complement at API likely leading to some of the issues outlined in this report.

An early decision in the API acquisition was the moving of the accounting function to FortisOntario's corporate offices in Fort Erie and the conversion of the accounting

system to SAP. As of January 1, 2012, API's accounting is based out of Fort Erie. Going forward, API will benefit larger from a larger staff complement in Fort Erie, including individuals with specific responsibility for the regulatory accounts. API will also benefit from the internal controls, including reviews, established in Fort Erie.

Management will consider the need to implement specific accounting procedures and policies documentation for regulatory deferral and variance accounts. Management will review the internal controls relating to the deferral and variance accounts.

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