

ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

2019 ELECTRICITY DISTRIBUTION RATES

Lakefront Utilities Inc.

EB-2018-0049

December 5, 2018

Introduction

Lakefront Utilities Inc. (Lakefront Utilities) filed an incentive rate-setting mechanism (IRM) application with the Ontario Energy Board (OEB) on August 13, 2018 under section 78 of the *Ontario Energy Board Act, 1998*. Through the application, Lakefront Utilities seeks approval for changes to the rates that it charges for electricity distribution, effective January 1, 2019.

The purpose of this document is to provide the OEB with the submissions of OEB staff based on its review of the evidence submitted by Lakefront Utilities, and in light of a preliminary issue having already been determined by the OEB¹.

Lakefront Utilities is in its final year of transition towards a fully fixed monthly distribution charge. Lakefront Utilities has demonstrated that no rate mitigation is required. Consistent with the Chapter 3 Filing Requirements, Lakefront Utilities has also applied the Price Cap IR adjustment factor to adjust the monthly service charge and volumetric distribution rate during the incentive rate-setting years. OEB staff has no concern with Lakefront Utilities' proposals.

Lakefront Utilities has requested an update to its Retail Transmission Service Rates to recover the wholesale transmission rates charged by its host distributor, Hydro One. If the OEB approves an update to the 2018 Hydro One RTSR's prior to the Decision and Order for Lakefront Utilities' 2019 rates, OEB staff will update Lakefront Utilities' rate generator model accordingly.

OEB staff's submission relates to the following issue:

- Deferral and Variance Account Disposition

Deferral and Variance Account Disposition

Lakefront Utilities submitted a completed Deferral and Variance Account (DVA) Continuity Schedule included in the 2019 IRM Rate Generator Model at Tab 3 for its Group 1 DVAs. Lakefront Utilities' total Group 1 DVA balances amounted to a debit of \$2,002,764. The balance of Account 1589 – RSVA Global Adjustment (GA) is a credit of

¹ Through Procedural Order No.1, the OEB indicated that prior to proceeding to hear Lakefront Utilities' IRM application, the OEB would first allow for written submissions in order to make a determination on the following preliminary question: "Should the OEB consider Lakefront Utilities' request for standby charges in an IRM application?" Lakefront Utilities had requested approval for standby charges for specific classes of customers that install load displacement generation and require Lakefront Utilities to provide reserve capacity to back up their facilities when the load displacement generation is not available. On November 20, 2018, the OEB issued its Decision on the Preliminary Question and Procedural Order No. 2 and, as set out therein, determined that the request to establish standby charges is out of scope for an IRM application.

\$117,460. The balance of Account 1588 – RSVA Power is a debit \$1,640,990. The remaining DVAs excluding Accounts 1588 and 1589 amount to a debit of \$479,234. These balances also include interest calculated to December 31, 2018.

Based on the threshold test calculation, the Group 1 DVA balances equate to a debit of \$0.0085 per kWh which exceeds the pre-set disposition threshold of \$0.001 per kWh. However, in its application, Lakefront Utilities has indicated that due to a credit of \$2,099,600 that it had received from the IESO in March 2018 (relating to its 2017 commodity pass through account balances), which offsets its total December 31, 2017 Group 1 DVA balances, it is not proposing to dispose of its Group 1 DVA balances as part of the current proceeding. With the IESO credit factored in, Lakefront Utilities states in its application that the total for the group 1 DVA balances would be a credit of \$96,836, which would put the DVA balances below the pre-set OEB disposition threshold of \$0.001 per kWh. The IESO credit is explained in further detail later in this submission.

OEB staff agrees with Lakefront that no disposition should be ordered in this proceeding but for different reasons than not passing the threshold test. OEB staff has significant concerns with the adjustments (both audit and non-audit) that Lakefront Utilities has made to its December 31, 2017 commodity pass-through variance account balances. OEB staff proposes that Lakefront Utilities provide explanations to a number of questions that OEB staff has laid out in this submission, as part of Lakefront Utilities' next rate application and that the OEB direct the utility to undertake another audit of the commodity pass-through variance accounts.

Third Party Audit Report

In addition to the information provided in its application, Lakefront Utilities filed a third-party audit report of its balances in Account 1588 and 1589 dated August 23, 2018. The audit report was ordered by the OEB in its Decision and Rate Order² for Lakefront Utilities' 2018 IRM application which stated the following:

The OEB accepts Lakeland Utilities' withdrawal of its proposal to dispose of the December 31, 2016 balances in the Group 1 deferral and variance accounts. It is critical that balances are accurate before they are disposed. The OEB requires Lakefront Utilities to have a third-party audit of the December 31, 2017 balances in Accounts 1588 and 1589, and of the settlement process Lakefront Utilities uses for these accounts. Lakefront Utilities shall file the audit report in its next rate application.

² EB-2017-0057 Decision and Order, December 14, 2018

The audit report was filed as part of the current application. An outcome of the third-party audit was that adjustments were made by Lakefront Utilities to its two commodity pass-through accounts 1588 RSVA Power and 1589 RSVA GA for 2016 and 2017 in relation to the allocation of Charge Type (CT) 148 for the cost of power, as shown in the table below.

Lakefront Utilities Inc.
Schedule of variance accounts 1588 and 1589
For the Period 1-1-2016 to 12-31-2017

Account #	Account Description	Prior Balance As at December 31st, 2017	2016 Adjustments (Note 2)	2017 Adjustments (Note 2)	Closing Balance As at December 31st, 2017
02-100-1588-0000	RSVA Power Principal	\$638,965.68	(\$1,390,292.67)	\$2,373,485.16	\$1,622,158.17
02-100-1588-1000	RSVA Power Interest	\$8,334.87	(\$7,752.77)	(\$12,409.07)	(\$11,826.97)
02-100-1589-0000	RSVA Global Adjustment Principal	\$865,622.90	\$1,390,292.67	(\$2,373,485.16)	(\$117,569.59)
02-100-1589-1000	RSVA Global Adjustment Interest	(\$20,291.98)	\$7,752.77	\$12,409.07	(\$130.14)

Note 1 Basis of Accounting - Significant Accounting Policies

The Schedule of variance accounts 1588 and 1589 of Lakefront Utilities Inc. have been prepared in accordance with Modified International Financial Reporting Standards ("MIFRS")

The Company is licensed and regulated by the Ontario Energy Board (OEB) under the authority of the Ontario Energy Board Act, 1988 Per the Ontario Energy Board Accounting Procedures Handbook (APH) For Electricity Distributors Issued December 2011:

"The accounting procedures and requirements set out in this APH apply to a distributor that prepares its financial accounting records and reporting on the basis of CICA Handbook Part I – International Financial Reporting Standards.
The Board generally requires regulatory filing and reporting under IFRS, as modified for regulatory purposes by the Board (modified IFRS or MIFRS)."

Note 2 Adjustments

Management identified issues with the split of charge type 148 for the cost of power from the IESO and corrected the balances prior to the audit.

Lakefront Utilities' Discovery of Class A Settlement Error

In addition, as part of its application, Lakefront Utilities has also proposed to adjust its audited December 31, 2017 balances in its commodity pass-through accounts 1588 RSVA Power and 1589 RSVA GA due to issues it had identified in its RPP settlement processes with the IESO relating to Class A customer kWh volumes. In particular, Lakefront Utilities explained in response to OEB staff interrogatory #6d that it had adopted Class A customers for the first time during 2017 (starting July 2017) and was therefore not aware of the requirement to report its Class A kWh to the IESO.

As a result of Lakefront Utilities' failure to report its Class A kWh for the 2017 consumption months of July, August, September, and December 2017 (December was due to technical difficulty with the IESO portal), Lakefront Utilities was overcharged by the IESO for its Class B Global Adjustment. Lakefront Utilities explained that the net result was that it was due back a credit of \$2,099,600 from the IESO that it would like to return to ratepayers as part of the current proceeding by applying it against the December 31, 2017 Group 1 DVA balances. Lakefront Utilities indicated that it was credited for the corrections in March 2018 (on the February 2018 invoice) after it filed

corrections with the IESO, as per Table 1³ below. Sum of Global Adjustment – RPP and Global Adjustment – non-RPP (\$1,393,924) + (\$705,675.57) = (\$2,099,600).

Table 1: Lakefront Utilities – IESO Billing Adjustment February 2018

Account	Description	Actual February Invoice	February Invoice without Credit	Difference
4705	Power Purchased	\$395,293.61	\$395,293.61	\$0.00
4707	Class A Global Adjustment	\$356,932.39	\$356,932.39	\$0.00
4705	Global Adjustment - RPP	(\$557,299.36)	\$836,625.08	(\$1,393,924.44)
4707	Global Adjustment - Non-RPP	(\$282,133.33)	\$423,542.24	(\$705,675.57)
4705	Ontario Fair Hydro Plan	(\$277,552.06)	(\$277,552.06)	\$0.00
1110	Global Adjustment Modifier	(\$44,255.44)	(\$44,255.44)	\$0.00
4705	FIT/MicroFIT	(\$72,965.76)	(\$72,965.76)	\$0.00
2290	HST	(\$49,529.77)	(\$49,529.77)	\$0.00
4708	Wholesale Market Services	\$94,138.04	\$91,244.14	\$2,893.90
4708	CBDR Class B	(\$2,828.83)	\$6,078.58	(\$8,907.41)
4708	CBDR Class A	\$1,722.95	\$1,722.95	\$0.00
4751	Smart Meter Entity Charge	\$7,947.77	\$7,947.77	\$0.00
1250	OESP Credit	(\$33,500.23)	(\$33,500.23)	\$0.00
1110	Ontario Rebate	(\$130,741.10)	(\$130,741.10)	\$0.00
Total IESO Bill		(\$594,771.12)	\$1,510,842.40	(\$2,105,613.52)

It is unclear to OEB staff as to why the third-party audit of Lakefront Utilities' December 31, 2017 balances of Accounts 1588 and 1589 would not have identified the adjustment that Lakefront Utilities is proposing in order to correct the Class A settlement error. Specifically, it appears that Lakefront Utilities was aware of its errors in 2017 as evidenced by the fact that they began to properly report their Class A consumption to the IESO in October and November 2017. Therefore, OEB staff questions why Lakefront Utilities would not have disclosed the errors to the auditors prior to, or during the audit, since the actual audit work didn't take place until 2018. Furthermore, it is also not clear how or why the auditor's audit procedures did not identify and review the subsequent credit received from the IESO in March 2018 in respect to these 2017 Class A consumption reporting errors⁴. Furthermore, it is not clear that the third-party audit that was performed on the commodity pass-through accounts included an audit of the

³ Lakefront Utilities response to Staff IR #6 b)

⁴ The audit report was dated August 23, 2018 and Lakefront Utilities corrected the error with the IESO in March 2018, and therefore auditors should have been aware of the errors and adjusted for them accordingly.

settlement process that Lakefront Utilities uses for these accounts, which was also ordered by the OEB in the utility's 2018 IRM application.

Exclusion of Settlement Error from Audit Report

Lakefront Utilities indicated that it had identified this adjustment on their own accord, after the third-party audit, and further noted as part of its response to OEB staff interrogatory #6, that its auditors "have been informed" of the adjustment after the release of the audit report. Lakefront Utilities also indicated that its auditor does not intend to restate their third-party audit report on Lakefront Utilities' December 31, 2017 balances of Accounts 1588 and 1589 and instead will correct this error during the Lakefront Utilities 2018 annual financial statement audit.

The OEB relies on audited DVA balances in order to support the accuracy of the disposition amounts. However, the third-party audited December 31, 2017 balances of Accounts 1588 and 1589 are materially different compared to what Lakefront Utilities is bringing forward in its current application. OEB staff notes that an annual financial statement audit is performed at a much higher materiality level and would therefore not provide the same level of assurance and rigour over the balances of Accounts 1588 and 1589 than what was intended when the OEB had ordered a specifically focused third-party audit of the Lakefront Utilities' 2017 commodity pass-through accounts.

OEB staff is concerned with the accuracy of the adjustment that the applicant has proposed to the Group 1 DVA balances in the current application as it has not been audited and therefore its accuracy has not been confirmed. Furthermore, the fact that this adjustment was identified and corrected after the third-party audit was performed on the balances raises further questions and concerns as to whether any other adjustments may be required to the 2016 and 2017 commodity pass-through accounts, 1588 RSVA Power and 1589 RSVA GA; other adjustments that may not have been identified during the course of the audit as well.

Impact of Audit Adjustments and Non-Audit Adjustment (Class A Settlement Error) on the IESO Settlements Performed during 2016 and 2017

The external audit of Accounts 1588 and 1589 yielded some audit adjustments that Lakefront Utilities recorded within the December 31, 2017 account balances. In addition, as noted above, Lakefront Utilities identified a further adjustment to its commodity pass-through accounts of \$2,099,600. However, what isn't clear to OEB staff is whether the impact of these adjustments on Lakefront Utilities' 2016 and 2017 IESO settlements have been properly reflected within its December 31, 2017 commodity pass-through account balances.

The initial monthly settlements that Lakefront Utilities would have performed with the IESO during 2016 and 2017 would have included the settlement of the variance pertaining to the RPP portion of the CT 148 GA cost paid to the IESO. This would necessitate an amount to be paid to, or recovered from the IESO.

For example, in relation to the audit adjustments, if the initial amount charged to account 1588 relating to the CT 148 GA cost paid was overstated by \$1,390,292, then it would be expected that the credit to account 1588 for 2016 would be returned to the IESO. Conversely, if the initial amount charged to Account 1588 relating to the CT 148 GA cost paid was understated by \$2,373,485, then it would be expected that the debit to account 1588 for 2017 would be recovered from the IESO. A similar analysis can also be deduced related to the impact from the non-audit adjustment of \$2,099,600.

OEB Staff Submission

Lakefront Utilities Discovery of Class A Settlement Error

As noted in the above, it is unclear to OEB staff as to why the external auditors were not aware of the Class A settlement error and why Lakefront Utilities would not have notified the auditor about the error, before the conclusion of the audit, when the utility appears to have been aware of it prior to the end of 2017 (and the audit took place in 2018). OEB staff submits that Lakefront Utilities should address this and provide further clarity on the matter as part of its next rate application. In particular, OEB staff recommends that Lakefront Utilities addresses the following:

- Why it did not notify their auditors of the error sooner when it appears they were aware of it prior to the commencement of the audit.
- Why its auditors would not have reviewed the IESO credit received by Lakefront Utilities in March 2018 as part of the audit procedures performed (this may be addressed through discussions with the external auditor).
- Was an audit of the settlement process that Lakefront Utilities uses for Accounts 1588 and 1589 included as part of the audit procedures performed. If not, please explain why.
- Why the auditor does not intend to restate the Audit Report in light of the material error that was identified by Lakefront Utilities but not reflected in the December 31, 2017 balances of Accounts 1588 and 1589, as presented in the Audit Report. Lakefront Utilities should include an explanation by the external auditor that clarifies why correcting the error in its upcoming financial statement audit of Lakefront Utilities instead of restating the Audit Report (on the audit of Accounts 1588 and 1589) is appropriate when each of these audits are independent of each other and serve different purposes and a different set of users of the

financial information. Furthermore, it is presumed that each of the audits would be performed at different materiality levels and therefore a financial statement audit would not provide the same level of assurance over the balances in Accounts 1588 and 1589 compared to the audit that was ordered by the OEB.

Impact of Audit Adjustments and Non-Audit Adjustment on IESO Settlements

As noted above, it is unclear to OEB staff as to what impact both the audit and non-audit adjustments would have on Lakefront Utilities' settlements performed with the IESO and whether any resulting settlement true-ups have been reflected within the December 31, 2017 balances in the commodity pass-through accounts. As such, OEB staff submits that Lakefront Utilities provide further clarity on this matter as part of its next rate application. In particular, the Lakefront Utilities' address:

- How its IESO settlements for 2016 and 2017 were impacted by both the audit and non-audit adjustments to their commodity pass-through accounts.
- If there was no impact to the IESO settlements, an explanation as to why that is the case.
- If the IESO settlements were impacted, information as to what Lakefront Utilities did to adjust their settlements, the resulting settlement true-ups that were recorded, the period they were recorded in, and the dollar value associated with those true-ups.

Group 1 DVA Disposition

OEB staff submits that the OEB should require Lakefront Utilities to arrange to have an auditor undertake another third-party audit of Lakefront Utilities' December 31, 2018 balances of its commodity pass-through accounts 1588 RSVA Power and 1589 RSVA GA. In addition to Lakefront Utilities' answers to the OEB staff questions laid out in this submission, the next rate application should contain the results of the subsequent audit. The auditor should confirm that the transactions booked to account 1588 RSVA Power have been appropriately dealt with, regarding any RPP settlement transactions that would result from the 2016 and 2017 audit adjustments as well as the adjustment related to Lakefront Utilities' discovery of the Class A settlement error. The result of the audit should be reported as part of its next rate application.

Conclusion

OEB staff submits that the December 31, 2017 Group 1 DVA balances should not be disposed and that the OEB direct Lakefront Utilities to undertake another third party audit of Accounts 1588 and 1589 in order to address the concerns noted in this submission.

OEB staff further submits that the OEB can require that this audit be performed by an external audit firm or the OEB's Audit and Investigations unit.

All of which is respectfully submitted.