

REPORT on the PROCESS OF THE
EVALUATION AND AUDIT COMMITTEE (“EAC”)
OF ENBRIDGE GAS DISTRIBUTION (“EGD”)
FOR THE 2007 YEAR

To: All Members of the EGD DSM Consultative

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This is a brief report on the activities of the EAC relating to the 2007 Enbridge DSM Audit. EGD has also prepared a report detailing the changes in the TRC, SSM, LRAM and DSMVA figures as a result of the audit process, and the recommendations that arose from the process. This report will focus on the conduct of the process, and the views of the EAC members on areas in which change should be considered.

The Role of the Auditor

The process this year largely adopted the assumptions last year about what the auditor would do, and how the auditor and the EAC would interact.

As the process evolved, four issues emerged that are worth commenting on:

1. ***Independence of the Auditor.*** We were lucky in this case to have an auditor who, relatively quickly, understood that the process this year is different than has previously been the case, and the key difference is the need for the auditor to exercise more independent judgment. Future EACs should be more vigilant (which we probably were not) in ensuring that the RFP and initial explanatory documents relating to the audit role emphasize this more clearly.
2. ***Formal Audit Opinion.*** The old style of audit was essentially a review of the evaluation report, an often qualitative commentary on the methods and results, and resolutions on many of the ‘numbers’ issues. However, it has been common that not all of those issues were resolved by auditors. Then the audit committee and the company would negotiate numbers or other solutions for issues not resolved by the auditor. The new style of audit is supposed to be based on the financial audit paradigm. This year we asked the auditor to give a formal opinion on the numbers, which we drafted using the opinion on financial statements as a starting point. A copy of that wording is attached. However, because we proposed this late in the process, the company and the auditor legitimately said that it may be difficult to do it this year. The 2008 EAC should follow up on this, and ensure that this is included in the RFP right at the outset, so the auditor is aware of what will be expected by way of final opinion.

Of course it is clear that in the foreseeable future the EAC members may still have to negotiate some issues that arise during the audit process. In the past, this was

done in a subsequent phase that ended up with agreed TRC, SSM, LRAM and DSMVA numbers. Under the new model, this would not be in a subsequent phase. Rather, these discussions would happen with the auditor in the room, providing his or her own perspective, and the end result would be part of the opinion the auditor provides.

3. ***Auditing vs Evaluating.*** There is some confusion that arises from time to time about the status of evaluation studies and whether these need to be reviewed by the auditor. Specifically the studies done on custom projects are regarded by some as being more like an audit than like evaluation work, and those with this view feel they do not need to be audited. This issue should be discussed by the Consultative to clarify the role and requirements for these studies.

4. ***Access to Information.*** Generally speaking, the auditor had access to most information that he wanted to see, but from time to time the Company resisted providing information where it felt that the auditor was going beyond his mandate. This was more of a problem for the EAC than for the auditor, and we believe that, once the role of the auditor is more clearly defined, the flow of information will be less controversial.

5. ***Communications with Company and with EAC.*** The ongoing communications between the Company and the auditor became a bit of a problem for EAC members when it appeared that it might compromise the auditors' independence. In one particular incident, a revised copy of the auditors' report was sent to the Company, but the Company revised it further before sending it to the intervenor representatives. The revisions were apparently made by the Company, and the audit principal, who was away, did not see them. The intervenor representatives were not told that the Company had made further revisions. This was ultimately resolved, and it appears to have been a mixup rather than something deliberately done, but it highlights the need to ensure that communications protocols are clear from the outset. Of particular importance, the auditor should ensure that all communications they send to the Company also go to the EAC members.

Role of the EAC

Just as we are still understanding the new role of the auditor, there is also an equally radical shift in the role of the EAC. Some of the issues that arose in that context are the following:

1. ***Intervenor Development of Common Understandings.*** The more compressed schedule now in place, coupled with the different skillsets of the intervenor reps, means that the intervenor reps should make a point of meeting early in the process and reaching common understandings as to what they expect from the process. Discussion of schedule, information flow, deliverables, division of responsibilities, and other such matters would make the intervenor involvement more effective, not only as representatives of the stakeholders, but also for the Company and the auditor. Once the process starts, it happens at a pretty fast pace, and it quickly becomes too late to ruminate on what we think should be happening next.

2. ***Forest and Trees Problem.*** From the utility's point of view, what they need from the EAC is a sign-off on several dozen individual items – numbers, judgements, principles, etc. – over the course of the process. Tactically, the smart thing for them to do is eat away at that list, step by step, getting things off the table whenever they can by focusing on individual issues rather than the overall goals of the process. This creates a problem for the EAC, since issues are thus reviewed without context, and it is easy to make mistakes. The intervenor representatives should develop, at the beginning of the process, their own list of issues to be addressed, and the context in which each has to be considered. Indeed, it might even be better if the Company and the intervenors do this together, although that may be more difficult.

3. ***Access to Information.*** For this 2007 process, getting information from the Company in a timely manner was a constant battle. Whether the Company was being resistant, or whether there were legitimate issues, is something that can be debated in another context. What is clear is that lack of information ultimately prevented timely filing of the Company's audit. From this year's experience, the intervenor representatives conclude that they should identify as early as possible information they want to see, and they should be less patient about getting that information if it is not forthcoming quickly and easily.

There were two specific issues that had to be addressed in this context. First, the Company wanted many categories of information treated as confidential, and wanted to impose their own confidentiality regime, different from that of the OEB. This was ultimately resolved, but a common understanding as to confidentiality going forward should probably be developed. Second, the Company felt that many things that the auditor saw were not appropriately disclosed to the EAC because its role is narrower than that of the auditor. We were able to convince the Company to provide that material, but it took a while.

4. ***Late Evaluation Studies.*** Three major evaluation reports had been commissioned in the summer of 2007 to examine 2007 savings and free ridership values. While the deliverable dates for the studies were in December, none of them were available at the beginning of the audit process in April. While drafts of 2 of the studies arrived later in April, the third arrived only in June with less than 2 weeks remaining in the original audit process timetable. This interfered with the auditors job, who should have reviewed the studies (in the end, 2 of them were reviewed in draft form and the third was not audited) and the process of reviewing and providing comments on the studies was in competition with more immediate audit tasks among both intervenor and EGD members of the EAC.

In our view, evaluation studies in process for a given fiscal year should be completed by the end of the first quarter of the calendar year, and before the auditing process begins.

5. ***Advisory vs. Supervisory Status.*** Throughout this process, there was a fundamental disagreement between the Company and the intervenor representatives as to

whether the EAC are basically advisors to the Company, or whether the EAC has an independent role to supervise the work of the auditors. The Generic Decision has statements consistent with both paradigms, and we found that there were many practical implications of choosing one or the other. We believe that, in keeping with the model of the financial auditor, the EAC should take a directly supervisory role in the audit process, so that the stakeholders and the Board can have confidence in the outcome.

6. ***Schedule.*** EGD took the view that the June 30th RRR deadline was a hard deadline, and the responsibility to meet it was theirs. They pressed the process forward very hard, and planned to file something (including what they believed would be a valid audit report) without the EAC completing its work or addressing all of the issues that had been raised. This creates three issues. One, it will be important in the future to have a common understanding regarding who finalizes and files the audit report. Two, the combination of delays in getting information, plus the hard deadline, led to a crunch in which it was difficult to do a good job. This was ultimately resolved by filing later, but in the future it will be important for the intervenor representatives to manage their participation so that the June 30th deadline can be met without such a crunch. Three, the Company assumed that the process would have two phases, the first in which the audit was done and filed, and the second in which the parties negotiated a final settlement of the numbers. This doesn't really work in the new environment, and all steps should be completed prior to filing.

7. ***Negotiations.*** In the past, the final numbers have sometimes been the result of a kind of mini-ADR within the EAC, since auditors have not resolved all issues. Under the new audit paradigm, we have expressed the view that the audit should be more complete, and the parties should be able over time to increase their reliance on the opinion of the auditor and reduce their reliance on negotiations. We think that is what the Board wants, and what is best for the parties. The Company is willing to move in that direction, but is hesitant. Of course, this approach means that the independence of the auditor, and the audit supervisory process, both become more important. It also means, that, when the EAC has to address issues, the auditor will have to be included (as opposed to having a subsequent phase, as in the past). On the other hand, if we continue to adopt that approach, as we did this year, the result should be more reliable numbers over time.

8. ***Communications with Auditor.*** The intervenor representatives typically do not have direct and private contact with the auditor, but the Company does. This auditor tried to ensure that as many communications as possible went to the whole EAC, but it would have been useful for the intervenor representatives to have one or more private meetings with the auditor. This is often done in financial audits, where the Audit Committee meets with the auditors with management excluded, to ensure that any necessary disclosures can be made. This should be considered in this context as well.

Conclusions

The Company has produced a memorandum summarizing the work of the EAC, and we concur with its conclusions. We are also satisfied that the Audit Report produces

numbers for TRC, SSM, LRAM and DSMVA that are reliable enough to use for clearance this year. A number of improvements in calculations, assumptions and methods have been identified by the auditors and by the Company, and in this memo we have identified improvements in the process that should also be considered.

Subject to those comments, we recommend that the Consultative members accept the numbers coming out of the Audit Report for the purposes of clearing 2007 deferral and variance accounts relating to DSM.