



TECHNIQUES FOR AUDITING REVENUES AND EXPENSES

BURDEN OF PROOF

- ➔ In U.S. , the utility generally has the burden of proof to show that what it is proposing or requesting is reasonable.
 - Utilities seem to forget this, and if we don't remind them, regulators will spend their time assuming the utility is right unless we disprove it. **DON'T FALL INTO THE TRAP!**

OPERATING REVENUES

- ⇒ Sales volumes should be examined for conditions that are not representative of the period.
- ⇒ Look for growth trends
 - Customer growth or shrinkage
 - Look at per customer usage
- ⇒ Look for oddities or a break in any indicated trends
- ⇒ Make sure that any recent rate changes have been annualized
- ⇒ Make sure revenues from special contracts are included
- ⇒ Spot check a few customer bills to make sure that the authorized rates are being charged.

OTHER REVENUES

⇒ Miscellaneous Revenues

- Review history
- Is a normal amount reflected?
- Have revenues (and costs) associated with unregulated revenues been removed?

⇒ Unbilled Revenues

- Unbilled revenue adjustments match the test year's revenues with expenses applicable to the same test period.
- Need to make sure that there is 12 months of revenue with expenses applicable to the same test period
- Need to examine the records for accruals and reversals

OTHER REVENUES

⇒ Unregulated Revenues

- Determine if utility has unregulated sales
- How are regulated/unregulated revenues separated?
- Make sure there is a matching of unregulated revenues and expenses

⇒ Uncollectible Revenues (Bad Debt)

- Is the balance consistent with the utility's write-off policy?
- Is the percentage of uncollectibles consistent with that from recent history? Or, is there an unusually large amount that is not reflective of normal periods?

OTHER REVENUES

➔ Universal Service Funding

- Is any being received (if there is such a program)?
- How is it being reflected in the rate computation?
 - If a revenue subsidy, is it included in operating revenues?
 - If zero cost capital, has plant paid for with these funds been removed from the plant which is to earn a return?

SALARIES AND BENEFITS

- ➔ Obtain an understanding of how compensation plan works
 - Automatic annual increases?
 - Are increases based on merit or cost of living?
 - Has plan changed from prior years?
 - Is there an incentive compensation plan?
 - What benefits are provided?
- ➔ How does the utility itself determine that its plan is reasonable?
 - Salary surveys?
 - Per customer comparison to other companies?

SALARIES AND BENEFITS

- ➔ Reconcile with payroll records or payroll tax records.
- ➔ Verify increases to union contracts or Board of Directors minutes or other source.
- ➔ Compare employee counts to payroll records.

SALARIES AND BENEFITS

⇒ Overtime

- Compare the percentage of overtime to recent history to determine if a pattern exists
- Consider smoothing by using a 3 to 5 year average if inconsistent pattern year to year
- Is it obvious that it would be cheaper to add additional employees than pay too much overtime?

⇒ Capitalization versus Expense Ratio

- Compare the percentage to recent history to determine if pattern exists
- Consider smoothing by using a 3 to 5 year average if consistent pattern year to year

SALARIES AND BENEFITS

➔ Incentive Compensation

- How is it awarded? What goals are established as part of the incentive program?
- Does meeting the goals benefit ratepayers or shareholders?
- Is the plan discriminatory? (officers versus others)

SALARIES AND BENEFITS

➔ Pension Expense

- Review pension plans
- Review actuarial reports
- Reconcile test year employee counts with pension plan actuarial study employee counts
- Over/underfunding of plan may need to be addressed

OPERATING EXPENSES

- ⇒ Perform Variance Analyses of Expenses for 3 to 5 year period (if data is available)
 - Use to identify areas to examine more closely
- ⇒ Perform Variance Analyses of Expenses for each month of the test year (if data can be obtained)
 - Use to identify areas to examine more closely

REPAIR AND MAINTENANCE

- ➔ Review schedule of major maintenance projects
 - Consistent with the past?
 - Catch up from the past?
- ➔ Should any of these costs be capitalized rather than expensed?

INSURANCE COSTS

- ⇒ Review insurance policies and plans
- ⇒ Changes in coverage?
- ⇒ Changes in deductibles?
- ⇒ Does policy cover more than just regulated operations? If yes, how are costs allocated?
- ⇒ If company is self-insured, review history of payouts to determine appropriate reserve levels

SECURITY COSTS

- ➔ Likely to be increasing with global situation
- ➔ Costs should be measured for reasonableness
(may require some best judgment along with available third party information)
- ➔ How do increases compare with what is happening to the rest of the industry?

MORE OPERATING EXPENSES

⇒ Advertising

- When companies were monopolies, regulators generally disallowed advertising expenses since they were seen as self-promotional rather than as necessary to retain revenues. Things are changing with competition.
- Informational and safety advertising costs are considered legitimate for ratemaking computations

⇒ Dues and Donations

- Is the expense related to the provision of service?
- Identify lobbying expenses and disallow them.

MORE OPERATING EXPENSES

⇒ Outside or Contract Service Expenses

- Identify types of costs
- Are costs related to the regulated operations?
- Is there an unusual level of activity that should be normalized to reflect more on-going levels?
- Explore the need and reasonableness of expenditures

MORE OPERATING EXPENSES

➔ Regulatory or Rate Case Expense

- Is the level included in the request recurring and normal? Is there a need to normalize some portion of the test year expense?
- Are the costs prudent?
- Are there start-up costs that need to be amortized?

MORE OPERATING EXPENSES

⇒ Property Taxes

- Review for non-utility property
- Match to changes in plant
- Look for changes in tax rate

DEPRECIATION

- ⇒ Obtain or prepare a schedule looking at beginning and ending plant balances cost of removal rates, estimated lives, and plant retirements.
- ⇒ Verify Commission approved depreciation rates
- ⇒ Look for consistency between depreciation expense, accumulated depreciation, and plant in service

CONCLUDING THE AUDIT

⇒ Audit Recap

- What items are still to be provided?
- Has company agreed to any changes or corrections?
- What items are on the auditor/analyst's to-do list for back in the office?

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