TECHNIQUES FOR AUDITING
REVENUES AND EXPENSES
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!
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 suing a 3 to 5 year average if consistent pattern year to year
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?
CONTACT INFORMATION

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