Decision 03-02-006 February 13, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 1999. (U 39 M)	Application 97-12-020 (Filed December 12, 1997)
Investigation into the Reasonableness of Expenses Related to the Out-Of-Service Status of Pacific Gas and Electric Company's El Dorado Hydroelectric Project and the Need to Reduce Electric Rates Related To This Non-Functioning Electric Generating Facility.	Investigation 97-11-026 (Filed November 19, 1997)
Application of Pacific Gas and Electric Company for Authority, Among Other Things, to Decrease its Rates and Charges for Electric and Gas Service, and Increase Rates and Charges for Pipeline Expansion Service.	Application 94-12-005 (Filed December 9, 1994)
Order Instituting Investigation Into Rates, Charges, and Practices of Pacific Gas and Electric Company.	Investigation 95-02-015 (Filed February 22, 1995)

OPINION ON BUSINESS AND ACCOUNTING SYSTEM VERIFICATION AUDIT

1. Summary

In connection with Pacific Gas and Electric Company's (PG&E) test year 1999 general rate case (GRC), the Commission reviews an audit by the Office of Ratepayer Advocates (ORA) of PG&E's Systems Applications and Products in Data Processing business and accounting system (SAP System). Pursuant to an agreement reached by PG&E and ORA following issuance of ORA's audit report, $2 million is removed from PG&E's distribution rate base and $1.5 million is removed from the expense-related distribution revenue requirement to correct the effects of overstated Materials and Supplies (M&S) inventory balances in 1997. Pursuant to an earlier Commission order establishing the effective date of the revenue requirements authorized in this GRC, the adopted adjustments are made effective as of January 1, 1999.

2. Background

Decision (D.) 00-02-046, issued in February 2000, resolved most of the issues in PG&E's test year 1999 GRC while leaving certain issues open for further consideration. One category of such remaining issues pertains to PG&E's business and accounting system. Ordering Paragraph 13 of D.00-02-046 provides the following:

> Upon completion of the SAP AG (SAP) business system verification audit, ORA shall file a report setting forth its findings, conclusions, substantive recommendations, and any procedural recommendations for formal Commission consideration thereof. Comments may be filed 15 days after the filing of ORA's report. The [Administrative Law Judge (ALJ)] will make a determination of whether and how to proceed formally thereafter.

Ordering Paragraph 21 of D.00-02-046 provides that these consolidated proceedings shall remain open pending disposition of, among other things, "issues pertaining to the ORA verification audit of PG&E's SAP business system."

ORA's examination of the SAP System primarily covered the years 1998 and 1999, although certain transactions were traced to 1996, the year that the SAP system became operational. The examination included a review of the system's Financial, Control (CO), FERC (Federal Energy Regulatory Commission), and Materials Management modules. On June 6, 2000, ORA filed its audit report (SAP Report) in response to Ordering Paragraph 13, concluding as follows:

> In conclusion, ORA is of the opinion that PG&E's SAP Business and Accounting System fairly presents its internal bookkeeping, as well as the components of its recorded FERC accounts. However, because of the intimate details associated with the use and performance of the system, ORA emphasizes the need for continuous technical support, in all future proceedings. (SAP Report, p. 6-5.)

As a result of its examination of the SAP System, ORA made the following recommendations (SAP Report, p. 1-3):

A. That PG&E provide complete documentation in the way of supporting invoices and explanations for expenses included in its accounts, as reflected in the FERC and CO modules.

B. That PG&E continue to provide continuous technical support for ORA in its use of the SAP business and accounting system.

C. That PG&E be directed to restate its M&S inventory balances for 1996 through 1998, so as to properly reflect vendor discounts afforded.

D. That PG&E be directed to adjust its recorded 1997 ratebase, as a result of the overstated inventory balance, in the amount of $10.5 million.

E. That PG&E keep ORA informed of any new modules or upgrades that it may create pertinent to SAP.

F. That PG&E be subject to critical review of expenditures incurred for any modifications or upgrades to SAP.

G. That PG&E provide, during future onsite reviews, not only similar access to SAP as provided during this review, but readily available technical staff to assist in the access to appropriate SAP data.

PG&E filed comments on the SAP Report on June 21, 2000. No other comments were filed. PG&E found the report to be a fair and balanced assessment of the SAP System, and it agreed with ORA's basic conclusions regarding the validity of the SAP System and the need for PG&E to provide continued technical support to Commission auditors. Apart from certain minor technical clarifications, PG&E took issue only with ORA's conclusion that PG&E's M&S inventory balances are overstated, and ORA's recommendations for a restatement of the M&S balances and a rate base adjustment of $10.5 million. PG&E took the position that ORA's reasoning on the issue was flawed, although it could not say that ORA's assertions regarding M&S inventory balances were totally without merit. PG&E recommended that a joint PG&E/ORA investigation of this issue be conducted, and that PG&E and ORA jointly report their conclusions to the ALJ. PG&E recommended that any adopted rate base adjustment be made effective from the date of the order adopting such adjustment.[1]

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[1] On August 1, 2000, the ALJ circulated a draft decision that would have made the electric revenue requirements associated with M&S inventory balances subject to reduction, and related gas rates subject to refund, effective as of the date of adoption of

Footnote continued on next page

In a ruling issued on July 11, 2000, the ALJ directed PG&E and ORA to pursue a joint investigation of PG&E's M&S inventory balances and any other issues related to ORA's recommendations in the SAP Report for a rate base reduction. By letter dated August 22, 2000, submitted on behalf of PG&E and ORA, PG&E announced that it had met with ORA several times and that they had completed their investigation of the M&S inventory balances.[2] The letter summarizes their investigation results and areas of agreement as follows:

1. The problem ORA identified in its report was a result of incorrect goods receipt postings that occurred in 1997. Incorrect goods receipt postings typically occur when a duplicate goods receipt is posted for the same material or service or when a goods receipt overstates the goods or services actually received. This results in a temporary difference between the amount accrued on the books versus the actual cash payment. The temporary difference is eventually corrected, but often not within the same year.

2. Historically, prior to the implementation of SAP, incorrect goods receipt postings primarily affected M&S inventory balances. In its past GRCs, PG&E made adjustments to its M&S inventory balances to account for this temporary timing difference. With the implementation of SAP, however, this timing difference also affected expense and capital to a greater extent than in the past.

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that decision. ORA filed comments proposing that the effective date be January 1, 1999. PG&E filed a reply in opposition to ORA's proposal. The draft decision was subsequently withdrawn from Commission consideration.

[2] A copy of the August 22 letter is attached to an ALJ ruling issued September 27, 2000.

3. The 1997 imbalance identified by ORA was accounted for in four areas on PG&E's books: M&S inventory, expenses, capital, and clearing.

4. The M&S portion of the imbalance ($2.7 million) was already removed from rate base in PG&E's showing in the 1999 test year GRC as an "unbilled liability." Thus, no further action is needed for this portion of the imbalance.

5. The expense portion of the imbalance ($4.1 million) was booked in 1997. PG&E and ORA agree that, to the extent that 1997 recorded data was relied upon as the basis for 1999 GRC distribution expense estimates and the imbalances were present in that 1997 recorded data, the resulting GRC-adopted electric and gas revenue requirements should be reduced. However, only the distribution portion of the imbalance should affect the GRC revenue requirement. The portion of the imbalance that is charged to other Unbundled Cost Categories (UCCs), such as Gas Transmission, Electric Transmission, Or Electric Generation, does not affect the GRC revenue requirement. Further, because the Commission did not adopt PG&E's estimates in many instances, there is uncertainty regarding the amount of the imbalance that was ultimately included in the GRC-adopted expenses. Thus, PG&E and ORA have reached a compromise and agree that only fifty percent of the distribution portion of the expense-related imbalance ($1.1 million) should be removed from the revenue requirement.

6. The capital portion of the imbalance was included in rate base. PG&E and ORA agree that rate base should be adjusted to remove the capital portion of the imbalance. However, only the distribution portion of the imbalance should affect the GRC revenue requirement. The distribution capital portion of the imbalance is $1.6 million.

7. The portion of the imbalance that is shown as clearing in 1997 is allocated to expense and capital using the 1997 ratio of expense to capital. Thus, PG&E and ORA agree that the portion of clearing that flowed to distribution capital ($0.4 million) should be removed from rate base and fifty percent of the portion of clearing that flowed to expense ($0.3 million) should be removed from the electric and gas revenue requirement.

8. The total distribution capital amount that should be removed from rate base is $2 million. The total distribution expense amount that should be removed from the revenue requirement is $1.5 million.

9. PG&E has agreed to make process improvement to minimize the magnitude of these temporary timing differences on PG&E's financial books in any given period.

The August 22, 2000 letter noted that PG&E and ORA disagreed on whether the agreed upon ratemaking adjustments should be made effective retroactively to January 1, 1999.

On September 27, 2000, the ALJ issued a ruling providing parties opportunity to comment on the recommendations set forth in the August 22 letter, including the issue of whether the proposed revenue requirement adjustments should be made effective January 1, 1999 as proposed by ORA. PG&E and ORA filed comments. PG&E filed a reply to ORA's comments.

3. Discussion

3.1 Uncontested Issues

The principal substantive issue before us is whether the ratemaking adjustments that PG&E and ORA have agreed upon should be made effective January 1, 1999 as proposed by ORA. Before resolving this issue we briefly review the uncontested recommendations of ORA regarding accessibility of the

SAP System, PG&E's responses to those recommendations, and the proposed ratemaking adjustments.

With respect to ORA's recommendation that PG&E provide complete documentation for expenses included in its accounts, PG&E agrees that all invoices and supporting documentation for accounting entries in PG&E's financial books must be available for inspection by the Commission staff. PG&E's goal is to have such documentation optically archived and available through the SAP System. For the time being, PG&E states that it must rely on hard copy or electronic support other than optical archiving. We note that PG&E agrees that it should provide technical support for Commission staff in using the SAP System during regulatory audits, that it should keep ORA informed of any new modules or other system upgrades, and that it should provide continued access to SAP as was provided during the current review along with readily available technical staff to assist in the access to appropriate SAP data. We also note PG&E's agreement that it is subject to "critical review" of expenditures incurred for any modifications or upgrades to the SAP system.

We commend PG&E and ORA for their collaborative efforts in addressing and resolving the issues that were raised in connection with the SAP System verification audit. We note with approval that PG&E appears to recognize the need to make its business and accounting system accessible to the Commission staff, including ORA, in a meaningful way. We expect PG&E's continued cooperation in this regard. This includes the timely provision of supporting documentation for all accounting entries and the provision of necessary technical support and assistance in the use of the system.

We will adopt PG&E's and ORA's uncontested joint recommendations to remove $2 million from PG&E's distribution rate base and to remove $1.5 million from the expense-related distribution revenue requirement, which recommendations are more fully described in the background section of this opinion. We are satisfied that the recommendations reflect the informed judgments of both PG&E and ORA regarding the effects of the overstated M&S inventory balances in 1997. Among other things, the compromise recommendation on expenses fairly and appropriately resolves the uncertainty regarding the amount of the imbalance that was included in the expenses previously approved.

3.2 Effective Date of Adjustments

PG&E contends that ORA's proposal to make the agreed-upon rate base and expense adjustments effective January 1, 1999 violates established principles regarding retroactive ratemaking, and should therefore be denied. ORA takes the position that the interim relief balancing accounts that were created in this proceeding by D.98-12-078 were specifically designed to address the prohibition on retroactive ratemaking, and should be utilized here. D.98-12-078 provides in part that:

> The authorization provides PG&E with an opportunity to later recover the authorized test year 1999 revenue requirements that the Commission will adopt in its final decision in this proceeding, now scheduled for issuance in late March of 1999. It also protects the interests of PG&E's customers by ensuring that they are responsible for providing no more in revenues than the amount ultimately authorized by the Commission. (D.98-12-078, p. 1.)
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> Ordering Paragraph 1 of D.98-12-078 states the following:
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> Contingent upon [PG&E's] continued waiver of any future argument that the prohibition against retroactive ratemaking precludes any revenue requirement adjustments, including decreases, necessary to reflect the final decision in this GRC as if

> it had been adopted on January 1, 1999, PG&E may file the advice letters and tariffs further described in Ordering Paragraphs 2 and 3.

PG&E takes the position that the balancing accounts established pursuant to D.98-12-078 are inapplicable here because D.00-02-046 is a final decision. PG&E finds no indication in D.00-02-046 that the revenue requirement adopted for 1999 in that decision was not final.

It is true that to the extent that the relief granted in D.98-12-078 is not operative, ORA's proposal to make the revenue requirement adjustments effective January 1, 1999 would constitute impermissible retroactive ratemaking. However, PG&E is ignoring the clear intent of D.00-02-046, and is elevating form over substance in claiming that the balancing account mechanism established pursuant to D.98-12-078 is inapplicable here because D.00-02-046 did not clearly order that the adopted revenue requirements are subject to further adjustment upon completion of the ORA SAP System verification audit. Contrary to PG&E's assertion, D.00-02-046 was not a "final decision in this GRC," as that term is used in Ordering Paragraph 1 of D.98-12-078, as to issues pertaining to the ORA verification audit of PG&E's SAP business system. Therefore, as to those issues, the relief granted in D.98-12-078 remains operative. Our reasoning is as follows.

We first observe that by operation of Ordering Paragraphs 1 and 2 of D.98-12-078, and by virtue of PG&E's advice letter filings to implement D.98-12-078, PG&E waived any argument that the prohibition against retroactive ratemaking precludes any revenue requirement adjustments, including decreases, necessary to reflect the final decision in this GRC. As noted earlier, Ordering Paragraph 13 of D.00-02-046 provided for the SAP System verification audit, and Ordering Paragraph 21 explicitly stated that the GRC proceeding remains open to consider, among other things, "issues pertaining to the ORA verification audit of PG&E's SAP business system." To understand the Commission's intent in D.00-02-046 with respect to the SAP issues, it is useful to review the portion of the GRC decision that pertains to the SAP System and the verification audit:

> PG&E's new SAP business system has been in use since May 1996. In order to meet regulatory reporting requirements, PG&E, with assistance from SAP, designed a "FERC translation module" that allows the corporate financial information kept in the new business system to be presented in FERC account format. At the outset of this GRC proceeding, ORA determined that it needed to have read-only, on-line access to the SAP system in order to follow the audit trail of booked costs and transactions. ORA was not able to gain such access on a timely basis. For example, PG&E did not provide ORA with access to the "controlling" or "CO" module of the system. As a consequence, ORA was not able to complete its audit of the FERC translation module. ORA requests that we require PG&E to conduct further testing of the FERC derivation process in SAP. ORA also recommends that we exercise caution when using 1996 and 1997 recorded numbers submitted by PG&E in its 1999 GRC. (D.00-02-046, p. 452.)
>
> PG&E fully agrees that ORA and the Commission must have confidence that the FERC translation module is accurately translating financial information contained in the new business system to FERC accounts. PG&E and ORA report that they have commenced discussions on the structure, content and timing of a verification effort. PG&E sees the purpose of such an audit as ensuring that data recorded in the new business system are accurately translated into the FERC accounts. PG&E has committed to keeping the Commission and the parties apprised of the status of negotiations with ORA as well as any agreement that may be reached. (*Id.*, pp. 452-53.)

In its discussion of the SAP audit, the Commission stated its intent that ORA's audit be completed, and it explicitly left open the possibility that further formal proceedings on SAP-related issues were possible. (*Id.*, p. 453.) In view of the fact that ORA did not have timely access to the SAP System at the outset of this GRC and therefore could not follow the audit trail of booked costs and transactions, the fact that ORA was not able to complete its audit of the FERC module on a timely basis as a consequence of PG&E's failure to make the system fully accessible at the outset of the proceeding, ORA's request for an order directing further testing, and ORA's admonition to exercise caution when using 1996 and 1997 recorded numbers submitted by PG&E in its 1999 GRC; and in view of PG&E's stated understanding that the purpose of the verification audit was to ensure that data recorded in the new business system are accurately translated into the FERC accounts, it was clearly reasonable and appropriate for the Commission to leave open for further consideration "issues pertaining to the ORA verification audit of PG&E's SAP business system."

Having left open such issues for further consideration, it is not reasonable to conclude, as PG&E does, that the Commission intended to make the revenue requirements associated with those issues final. A fair reading of the GRC decision, including the above quoted language as well as Ordering Paragraphs 13 and 21, reveals that there was clear and effective notice to PG&E that further adjustments to the adopted revenue requirements were possible.

There can be no argument that ORA's initial audit recommendation to remove $10.5 million from recorded 1997 rate base, and the subsequent agreed-upon ratemaking adjustments of $2.0 million in rate base and $1.5 million in expenses are "issues pertaining to the ORA verification audit of PG&E's SAP business system." As to those issues, the interim relief crafted in D.98-12-078 was not extinguished with the issuance of D.00-02-046. Accordingly, ORA's proposal to make the adjustment effective January 1, 1999 is not barred by the prohibition against retroactive ratemaking.

4. Draft Decision

The ALJ's draft decision was issued pursuant to Public Utilities Code Section 311(g). Pursuant to Rule 77.7(b) of the Rules of Practice and Procedure, parties were permitted to review and comment on the draft decision. No comments were filed. We have made minor modifications to the draft decision to clarify that the prohibition against retroactive ratemaking does not bar this order.

5. Assignment of Proceeding

This matter is assigned to Commissioner Wood and ALJ Wetzell.

Findings of Fact

1. PG&E agrees that all invoices and supporting documentation for accounting entries in PG&E's financial books must be available for inspection by the Commission staff.

2. PG&E agrees that it should provide technical support for Commission staff in using the SAP System during regulatory audits, that it should keep ORA informed of any new modules or other SAP System upgrades, that it should provide continued access to SAP as was provided during the current review along with readily available technical staff to assist in the access to appropriate SAP data, and that it is subject to critical review of expenditures incurred for any modifications or upgrades to the SAP system.

3. PG&E's and ORA's joint recommendations to remove $2.0 million from PG&E's distribution rate base and to remove $1.5 million from the expense-related distribution revenue requirement reflect the informed judgments of

PG&E and ORA regarding the effects of the overstated M&S inventory balances in 1997, and are therefore reasonable.

4. PG&E waived any argument that the prohibition against retroactive ratemaking precludes any revenue requirement adjustments, including decreases, necessary to reflect the final decision in this GRC.

5. ORA's initial audit recommendation to remove $10.5 million from recorded 1997 rate base and the agreed upon adjustments of $2.0 million in rate base and $1.5 million in expenses are "issues pertaining to the ORA verification audit of PG&E's SAP business system."

6. Pursuant to Ordering Paragraph 21 of D.00-02-046, the agreed-upon rate base and expense adjustments are unresolved issues in PG&E's test year 1999 GRC.

Conclusions of Law

1. PG&E should make its business and accounting system accessible to the Commission staff, including ORA, in a meaningful way, for all data for which the Commission has a right of access.

2. With respect to issues pertaining to the ORA verification audit of PG&E's SAP business system, D.00-02-046 was not a "final decision in this GRC" as that term is used in Ordering Paragraph 1 of D.98-12-078.

3. The rate base and expense adjustments adopted by this order should be made effective January 1, 1999 in accordance with D.98-12-078 and D.00-02-046.

4. This proceeding should remain open to resolve pending issues in these consolidated dockets.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company's (PG&E) authorized revenue requirements shall be adjusted to reflect the agreement between PG&E and the Office of Ratepayer Advocates to remove $2.0 million from rate base and to remove $1.5 million from expense-related revenue requirement as set forth in more detail in the August 22, 2000 letter from PG&E to the Administrative Law Judge. Said adjustments shall be made effective January 1, 1999 in accordance with Decision (D.) 98-12-078.

2. The final results of operations analysis to be performed pursuant to the Commission's order in D.01-10-031, at p. 45, shall reflect and incorporate the adjustments ordered in Ordering Paragraph 1.

3. These proceedings shall remain open.

This order is effective today.

Dated February 13, 2003, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners