



ENERGY EFFICIENCY PROGRAM PERFORMANCE AUDIT

Southern California Edison Company (SCE)

For the Program Year Ended December 31, 2018

Utility Audits, Risk and Compliance Division
Utility Audits Branch
August 11, 2020



PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

August 11, 2020

Ms. Katie Sloan
Director of Customer Programs & Services
Southern California Edison
1515 Walnut Grove Avenue
Rosemead, CA 91770

Dear Ms. Sloan:

Final Report Transmittal Letter—Audit of Southern California Edison’s Energy Efficiency program for the period of January 1, 2018 through December 31, 2018

The Utility Audits Branch of the California Public Utilities Commission has completed its audit of Southern California Edison’s (SCE) Codes & Standards and Non-Resource program expenditures reported for the Energy Efficiency program for the period of January 1, 2018 through December 31, 2018 or Program Year 2018. The final audit report is enclosed.

SCE’s response to the draft report finding is incorporated into this final report. SCE agreed with the audit finding. We will post the final audit report on our website at <https://www.cpuc.ca.gov/utilityaudits/>.

A Corrective Action Plan (CAP) addressing the finding and recommendation was included in SCE’s response to the draft audit report.

We appreciate SCE’s assistance and cooperation during the engagement, and its willingness to implement corrective actions. If you have any questions regarding this report, please contact Masha Vorobyova, Assistant Director, at Masha.Vorobyova@cpuc.ca.gov, or Edwin Esternon, Senior Management Auditor, at Edwin.Esternon@cpuc.ca.gov.

Sincerely,

Angie Williams

Angie Williams, Director
Utility Audits, Risk and Compliance Division

cc: Elizabeth Leano, Senior Regulatory Audits Manager, SCE
Patrick Nandy, Regulatory Audits Manager, SCE
Saul Gomez, Deputy Executive Director, Office of the Commission, CPUC

Ms. Katie Sloan
Director of Customer Programs & Services
Southern California Edison
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Jennifer Kalafut, Program Manager, Energy Division, CPUC
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Jeff Walter, Public Utilities Regulatory Analyst III, Utility Audits Branch, CPUC

MEMBERS OF THE TEAM

Angie Williams, Director

Masha Vorobyova, Assistant Director

Edwin Esternon, Lead

Jeff Walter, Staff

A digital copy of this report can be found at:

<http://www.cpuc.ca.gov/utilityaudits/>

You can contact our office at:

**California Public Utilities Commission
Utility Audits, Risk and Compliance Division
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EXECUTIVE SUMMARY

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a performance audit of the Energy Efficiency Program Codes & Standards (C&S) and Non-Resource (NR) program expenditures, reported by Southern California Edison (SCE) for the audit period of January 1, 2018 through December 31, 2018 or Program Year (PY) 2018.

Our audit objective was to determine whether SCE's C&S and NR program expenditures were reported accurately, incurred for allowable purposes, supported by appropriate source documents, and in compliance with applicable CPUC directives, orders, rules, regulations, and SCE's policies and procedures.

Based on the procedures performed, sample tested, and evidence gathered, we found an instance of noncompliance with requirements for PY 2018. This instance is quantified in Summary Schedules of Audit Results and described in Finding and Recommendation section of this audit report. The audit finding is as follows:

Finding: Overstated Non-Resource Program Expenditures totaling \$12,405.

SCE reported \$28,502,101 in C&S and NR program expenditures and \$1,085,761 in corresponding ESPI management fees for PY 2018. Our audit found that \$28,489,696 in program expenditures are allowable and \$12,405 are unallowable. The unallowable program expenditures do not affect ESPI management fees for the year, as SCE exceeded its ESPI award cap set for PY 2018. Therefore, the entire amount of ESPI award cap totaling \$1,085,761 is allowable.

We issued a draft audit report on July 23, 2020. SCE's Director of Customer Programs & Services responded by letter dated August 4, 2020, agreeing with the audit results. SCE's response is included in this final report as an attachment in Appendix A—Utility's Response to Draft Audit Report.

AUDIT REPORT

Background

Energy Efficiency Program

Energy Efficiency (EE) programs are established to help California be more energy efficient and significantly reduce California's greenhouse gas emissions. The primary purpose of the EE programs is to develop programs and measures to meet energy savings goals and transform technology markets within California. The programs span a variety of sectors encompassing residential homes and commercial buildings, large and small appliances, lighting and heating, ventilation, air conditioning, industrial manufacturers, and agriculture. The CPUC authorizes set budgets to the EE programs annually, which are funded by a small portion of electricity and gas rates included in ratepayer bills. EE programs utilize a variety of tools to meet energy savings goals, such as financial incentives and rebates, research and development for EE technologies, financing mechanisms, codes and standards development, education and public outreach, and marketing.

The EE program is principally administered and implemented by the four major Investor-Owned Utilities (IOUs) in California. The four major IOUs in California are Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company (SCG).¹

Energy Savings and Performance Incentive

The CPUC adopted the Efficiency Savings and Performance Incentive (ESPI) mechanism to promote achievement of EE goals while protecting ratepayers through various cost containment mechanisms. In D.13-09-023, Ordering Paragraph (OP) 15 and 16, the CPUC authorized an incentive award to be paid to the IOUs as a management fee equal to 12 percent of authorized C&S program expenditures and 3 percent of authorized NR program expenditures, respectively.

Codes & Standards Programs

C&S programs facilitate the IOUs efforts in working with local, state, and federal authorities to develop and substantiate new building codes and appliance standards that, once adopted and enacted, result in more energy efficient buildings and appliances in California and the rest of the country. C&S programs also support compliance improvements through development and delivery of education, training, and tools. The C&S programs facilitate energy savings by:

- Influencing standards and code-setting bodies to strengthen energy efficiency regulations
- Improving compliance with existing C&S
- Assisting local governments to develop ordinances that exceed statewide minimum requirements
- Coordinating with the other programs and entities to support the state's ambitious policy goals

Non-Resource Programs

NR programs do not directly procure energy resources that can be counted but rather facilitate meeting energy savings goals through marketing, outreach, education, and training. IOUs incorporate a selection of these NR programs into their portfolios, such as statewide marketing and outreach programs, information and education programs, workforce education and training, and emerging technologies

¹ San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SCG) are affiliated subsidiaries of SEMPRA Energy.

programs that support CPUC's short-term and long-term energy savings goals. NR programs consists primarily of labor and contracting-related expenditures.

Audit Authority

The UAB conducted this audit under the general authority outlined in the Public Utilities (PU) Code Sections 314.5, 314.6, 581, 582, and 584. Furthermore, pursuant to D.13-09-023, OP 17, the CPUC directed the UAB to verify the C&S and NR program expenditures for the purposes of awarding the IOUs the ESPI management awards.

Objective and Scope

Our audit objective was to determine whether SCE's C&S and NR program expenditures were reported accurately, incurred for allowable purposes, supported by appropriate source documents, and in compliance with applicable CPUC directives, orders, rules, regulations, and SCE's policies and procedures.

The scope of our audit covered the EE C&S and NR program expenditures reported by SCE for the audit period of January 1, 2018 through December 31, 2018 or PY 2018.

Methodology

In planning our audit, we gained an understanding of the EE program and respective sub-programs and SCE operations and identified relevant criteria, by reviewing the EE Policy Manual, relevant PU Code sections, rules, regulations, CPUC decisions, resolutions, advice letters, and interviewing SCE personnel.

We conducted a risk assessment, including evaluating whether SCE's key internal controls relevant to our audit objective were properly designed, implemented, and operating effectively. Our assessment included conducting interviews, observing processes, or performing walkthroughs, and testing transactions. Deficiencies in internal control that were identified during our audit and determined to be significant within the context of our audit objective are included in this report.

Additionally, we assessed the reliability of the data extracted from the SCE's accounting system. Our assessment included examining extracted reports, tracing data between differing report formats to verify completeness, and tracing report data to source documents. We determined the data to be sufficiently reliable to address the audit objective.

Based on the results of our planning, we developed specific methods for gathering evidence to obtain reasonable assurance to address the audit objective. To achieve our audit objective, we:

- Reviewed SCE's accounting system, accounting policies, processes and procedures for recording, tracking, and monitoring EE program costs.
- Assessed whether SCE's policies, procedures, and practices comply with the EE program requirements.
- Reviewed SCE's 2018 EE Annual Report filed with the Commission to determine accuracy of reported EE program data and information and ensure compliance with applicable rules and program requirements.

- Reconciled the expenditure transactions recorded in the SCE's system to the balances reported in EE Stats in SCE's 2018 EE Expenditure Claim Report for completeness.
- Assessed significance by performing analysis of expenditure data and evaluating program requirements.
- Reviewed results of prior audits and verified whether corrective actions were implemented.
- Obtained an understanding of SCE's key internal controls relevant to the EE program, such as classifying and recording, monitoring, approving, and reporting the EE program expenditures, and assessed the design, implementation, and operating effectiveness of selected controls that are significant to the audit objective by:
 - Interviewing key personnel and completing internal control questionnaire;
 - Reviewing SCE's policies and procedures, and assessing their implementation pertaining to accounting, recording, and reporting of EE expenditure data;
 - Performing walkthroughs of selected transactions; and
 - Tracing selected transactions to source documents.
- Conducted a risk assessment to determine the nature, timing, and extent of substantive testing.
- Performed transaction testing by judgmentally selecting a non-statistical sample of significant transactions for the following categories:
 - Direct Implementation – We tested \$6,848,692 of \$26,377,155.
 - Marketing – We tested \$37,853 of \$442,722.
 - Administrative – We tested \$84,455 of \$1,682,224.

For the selected samples, errors found, if any, were not projected to the intended total population.

- For the selected samples, traced expenditures recorded in the SCE's accounting records to supporting documentation and determined whether costs were accurate, relevant to the EE program, supported by appropriate source documents, and incurred in compliance with applicable CPUC directives, orders, rules, regulations, and SCE's policies and procedures by:
 - Reviewing and evaluating supporting documentation such as purchase orders, detailed invoices, contracts, receiving reports, timesheets and additional documentation as needed;
 - Reviewing and evaluating relevant contracts to determine if contract terms and provisions adequately supported the objective and purpose of the EE program; and
 - Reviewing SCE's accrual entries and verifying the cutoff of expenditure transactions to determine if proper expenditure amounts were recorded and reported in the proper accounting period.

- Recomputed revised ESPI management fee amounts for the C&S and NR programs based on audited expenditure amounts.

We did not audit SCE's financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that SCE reported, incurred, and supported its EE program expenditures in accordance with the applicable criteria. We considered SCE's internal controls only to the extent necessary to plan the audit and achieve our audit objective.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Conclusion

Based on the procedures performed, sample tested, and evidence gathered, we found an instance of noncompliance with the requirements outlined above for PY 2018. This instance is quantified in Summary Schedules of Audit Results and described in Finding and Recommendation section of this audit report.

SCE reported \$28,502,101 in C&S and NR program expenditures and \$1,085,761 in corresponding ESPI management fees for PY 2018. Our audit found that \$28,489,696 in program expenditures are allowable and \$12,405 are unallowable. The unallowable program expenditures do not affect ESPI management fees for the year, as SCE exceeded its ESPI award cap set for PY 2018. Therefore, the entire amount of ESPI award cap totaling \$1,085,761 is allowable.

Follow-up on Prior Audit Findings

Our prior Energy Efficiency audit report for PY 2017, covering the period of January 1, 2017 through December 31, 2017, issued on August 5, 2019, disclosed audit findings. SCE implemented corrective actions to address the prior audit findings. However, based on the work performed in the current audit and as noted in the Finding and Recommendation section of this audit report, SCE should implement stronger oversight procedures to ensure compliance with its internal accrual policy.

Views of Responsible Officials

We issued a draft audit report on July 23, 2020. SCE's Director of Customer Programs & Services responded by letter dated August 4, 2020, agreeing with the audit results. SCE's response is included in this final report as an attachment in Appendix A—Utility's Response to Draft Audit Report.

Restricted Use

This audit report is intended solely for the information and use of SCE and the CPUC; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this audit report, which is a matter of public record and is available on the CPUC website at www.cpuc.ca.gov/utilityaudits/.

Angie Williams

Angie Williams, Director
Utility Audits, Risk and Compliance Division

FINDING AND RECOMMENDATION

Finding: Overstated NR Program Expenditures

Condition: SCE overstated NR program expenditures reported for PY 2018 totaling \$12,405 because it recorded expenditures belonging to PY 2017 in PY 2018.

An overstatement of EE program expenditures has been a repeated finding in prior audits, including, but not limited to, PY's 2013, 2014, 2015, 2016, and 2017.

Criteria: PU Code Sections 581, 582, and 584 require that the utility provide timely, complete, and accurate data to the CPUC. The EE Policy Manual (R.09-11-014), Version 5, dated July 2013, provides policy rules for the administration, oversight, and evaluation of the EE program. In addition, SCE's internal policies and procedures state compliance with GAAP, which requires appropriate timing of expenditures through the usage of accrual basis of accounting.

D.13-09-023, OP 15 and 16 indicate that the ESPI incentive award shall be calculated as management fee equal to 12 percent of authorized C&S program expenditures and 3 percent of authorized NR program expenditures, not to exceed authorized expenditures and exclusive of administrative costs.

Cause: SCE improperly recorded and accrued \$12,405 in expenses to PY 2018 due to inadequate oversight procedures ensuring adherence to its internal accrual policy.

Effect: Overstating costs to EE program expenditure can lead to an overpayment of incentive awards to SCE. It is critical to ensure that EE program costs are accurately recorded and reported since these programs are funded by ratepayers. Furthermore, an overstatement of expenditures can inflate authorized budget amounts in future years, as prior year costs influence prospective budgeted amounts. This practice can result in over-collections of ratepayer funds that support the EE programs.

Failure to record expenditures in the proper period resulted in an overstatement of EE program costs reported to the CPUC. The overstated costs can subsequently lead to overstated ESPI award amounts. However, the unallowable program expenditures do not affect ESPI management fees for PY 2018, because SCE exceeded its ESPI award cap set for the year, as noted in Advice Letter 4070-E. Therefore, no adjustment to the ESPI award amount totaling \$1,085,761 will be made, as detailed in Table 2, Summary Schedules of Audit Results section of this report.

Recommendation:

SCE should exclude overstated NR program expenditures totaling \$12,405 for PY 2018 from reported costs. Furthermore, SCE should implement stronger oversight procedures to ensure compliance with its internal accrual policy and to ensure its staff are properly trained and well-versed in its internal protocols for the accrual process.

SUMMARY SCHEDULES OF AUDIT RESULTS

Table 1 - Schedule of Energy Efficiency PY 2018 Expenditures

Cost Category	Reported	Allowable	Audit Adjustment¹
Codes & Standards	\$7,060,003	\$ 7,060,003	\$ -
Non-Resource	<u>21,442,098</u>	<u>21,429,693</u>	<u>(12,405)</u>
Total	<u><u>\$28,502,101</u></u>	<u><u>\$28,489,696</u></u>	<u><u>\$ (12,405)</u></u>

¹ Overstated amount came from NR Marketing cost category.

Table 2 - Codes & Standards & Non-Resource ESPI Management Fee Calculation

Basis	Reported	Audited	ESPI Cap Amounts³	Audit Adjustment
C&S ESPI Base ²	\$6,556,772	\$ 6,556,772		\$ -
Earnings Rate	<u>12%</u>	<u>12%</u>		
C&S Award	<u>\$ 786,813</u>	<u>\$ 786,813</u>	<u>\$ 634,559</u>	<u>\$ -</u>
NR ESPI Base ²	\$20,263,105	\$20,250,700		\$ (12,405)
Earnings Rate	<u>3%</u>	<u>3%</u>		
NR Award	<u>\$ 607,893</u>	<u>\$ 607,521</u>	<u>\$ 451,202</u>	<u>\$ -</u>
Total Award	<u><u>\$ 1,394,706</u></u>	<u><u>\$ 1,394,334</u></u>	<u><u>\$ 1,085,761</u></u>	<u><u>\$ -</u></u>

² C&S and NR ESPI Base Amounts exclude Administrative Costs.

³ ESPI Award caps are per Advice Letter 4070-E.

APPENDIX A—UTILITY’S RESPONSE TO DRAFT AUDIT REPORT



Katie Sloan
Director, Customer Service
Customer Programs & Services

August 4, 2020

Angie Williams – Director
Utility Audits, Risk and Compliance Division
California Public Utilities Commission
180 Promenade Circle, Suite 115
Sacramento, CA 95834

Transmitted via e-mail to: Masha.Vorobyova@cpuc.ca.gov

Dear Ms. Williams:

Southern California Edison Company (SCE) appreciates the opportunity to review and provide comments on the draft *Energy Efficiency Audit Report on Southern California Edison Company’s (SCE’s) Energy Efficiency Program For the Period January 1, 2018 through December 31, 2018* (Draft Report), issued on July 23, 2020 by the California Public Utilities Commission’s Utility Audits Branch (UAB).

SCE’s comments to the Draft Report are attached to this letter and provide additional clarification and information related to the finding in the Draft Report and SCE’s Corrective Actions. SCE appreciates UAB’s audit review of the Energy Efficiency Program, as SCE is committed to continuous improvement and uses the feedback received from these audits to implement such improvements. SCE would also like to express its appreciation to the UAB for the professional and courteous fashion in which the audit engagement was conducted.

If you have questions about SCE’s comments or would like to set up a meeting to discuss the information provided, please contact Patrick Nandy at 626-302-2049 or Patrick.Nandy@sce.com.

Thank you,

Signature:  Date: August 4, 2020

Katie Sloan
Director, Customer Service
Customer Programs & Services

Attachment

- cc: Masha Vorobyova, Assistant Director, Utility Audits Branch, CPUC
- Edwin Esternon, Senior Management Auditor, Utility Audits Branch, CPUC
- Jeffrey Walter, Public Utilities Regulatory Analyst III, Utility Audits Branch, CPUC
- Elizabeth Leano, Senior Manager, Regulatory Affairs & Compliance, SCE
- Patrick Nandy, Advisor, Regulatory Affairs & Compliance, SCE

P.O Box 800
2244 Walnut Grove Ave.
Rosemead, CA 91770

SCE's Comments to the Draft Report in UAB's Audit of SCE's Energy Efficiency Programs for the Year Ended December 31, 2018

Following are SCE's comments to the Draft Report prepared by the Utility Audit Branch (UAB) based on its audit of SCE's 2018 Energy Efficiency (EE) Programs.

1. Overstated NR (Non-Resource) Program Expenditures

Draft Finding: *SCE overstated NR program expenditures reported for PY 2018 totaling \$12,405 because it recorded expenditures belonging to PY 2017 in PY 2018.*

An overstatement of EE program expenditures has been a repeated finding in prior audits, including, but not limited to, PY's 2013, 2014, 2015, 2016, and 2017.

Draft Recommendation: *SCE should exclude overstated NR program expenditures totaling \$12,405 for PY 2018 from reported costs. Furthermore, SCE should implement stronger oversight procedures to ensure compliance with its internal accrual policy and to ensure its staff are properly trained and well-versed in its internal protocols for the accrual process.*

SCE Comments

SCE acknowledges that the costs identified by the UAB were recorded in the incorrect Program Year and will exclude such costs from PY 2018 reported costs. SCE also acknowledges that the issue of accruals has been raised in prior audits and agrees with the importance of EE costs being accurately recorded and reported. It is SCE's goal to have all expenditures correctly recorded in the appropriate accounting period and we continue striving to meet that objective. SCE is unsatisfied with any missed accruals and will continue to emphasize to all program personnel the importance of capturing and recording costs in the correct accounting period as part of SCE's ongoing communications and training for accruals.

Corrective Actions

As recommended by UAB, in recent years SCE has implemented stronger oversight procedures to ensure compliance with our internal accrual policy and to ensure staff are properly trained and well-versed in internal protocols for the accrual process.

As the UAB will recall, in response to recommendations from the UAB's 2011-2012 Audit of SCE's EE Programs, SCE developed a Revised Internal Controls Plan (Plan) using the COSO (Committee of Sponsoring Organizations of the Treadway Commission) model for its EE programs. As part of the Plan, SCE improved its year-end accrual procedures and accrual training just prior to year-end 2014. The UAB acknowledged and commended such strengthening of SCE's accrual policy and procedures as part of the 2015 Draft Report's Observation 35.

More recently, in early 2018 SCE established an accruals team within the Customer Programs & Services (CP&S) Economic Analysis & Reporting (EAR) Group and increased focus on quarterly accruals in addition to year-end, in an effort to further enhance accrual oversight and performance. Among other things, the accruals team delivers numerous sessions of live year-end accrual training; holds multiple quarterly and year-end office hours to assist employees with accrual questions; and distributes several periodic email communications to employees that include timing and deadline reminders as well as links to accrual templates, job aids, and training information. SCE believes these actions have resulted in improved accrual performance and compliance with internal protocols.