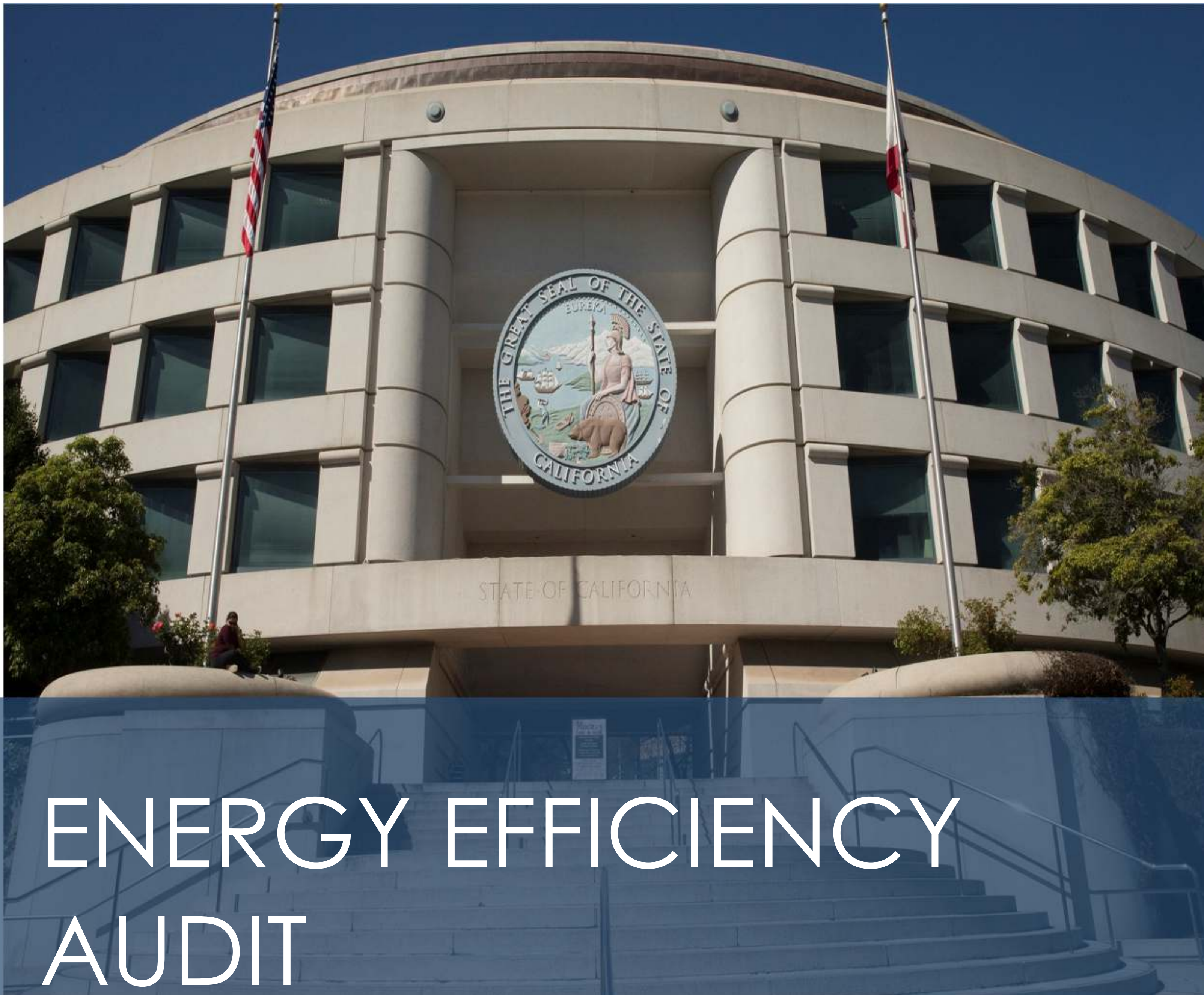


ENERGY EFFICIENCY AUDIT

SAN DIEGO GAS & ELECTRIC COMPANY
PROGRAM YEAR 2016

A digital copy of this report can be found at:

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

Table of Contents

Executive Summary

The California Public Utilities Commission (Commission) was established by Constitutional Amendment as the Railroad Commission in 1911. The Legislature passed the Public Utilities Act, expanding the Commission's regulatory authority to include natural gas, electric, telephone, and water companies as well as railroads and marine transportation companies in 1912. One of the Commission's duties is to oversee billions of dollars expended on the energy efficiency (EE) program funded by California ratepayers. These EE programs are predominantly administered by the four major Investor-Owned Utilities (IOUs) in California. They 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] The primary purpose of the EE program is to develop programs and measures to meet energy savings goals and transform technology markets in California.

Pursuant to California Public Utilities Code (PUC) Sections 381 *et seq.*, and 454.5[2], the Commission is responsible to oversee EE program, which is principally administered and implemented by the four major IOUs in California and funded by California ratepayers. The Commission has statutory authority to inspect and audit the books and records of the IOUs to ensure that ratepayers' money is well spent, specifically, pursuant to Sections 314.5, and 314.6. Other relevant criteria can be found in Decision (D.) 13-09-023, Ordering Paragraph (OP) 17, Energy Efficiency Policy Manual (Version 5 dated July 2013), and other applicable PUC codes, directives, rulings, etc. For the audit on SDG&E's EE program for program year (PY) 2016, we reviewed the expenditures of the EE programs and selected subprograms administered and implemented by SDG&E in accordance with Generally Accepted Government Auditing Standards (GAGAS) as required in Section 314.6(b).

The scope of this audit covered the period January 1, 2016 to December 31, 2016 or PY 2016. The purpose of this audit was to ensure that SDG&E was in compliance with EE program rules and regulations and to determine whether its reported EE expenditures and commitments were accurate, allowable and verifiable. For the audit on SDG&E's EE program, expenditures of the EE program and subprograms administered and implemented by SDG&E for the period under audit were reviewed. The specific SDG&E EE program and subprogram areas audited are included in the scope section of this report. Based on the audit, the following findings were identified:

- Finding #1: Lack of Compliance with Accrual Policy and Procedures Respecting its EE Program Costs for PY 2016
- Finding #2: Overstatement of the Efficiency Savings and Performance Incentive (ESPI) Award Amount for PY 2016
- Finding #3: Failure to Follow GAAP While Closing its Accounting Records
- Finding #4: Lack of Reconciliation of Amounts Committed/Unspent Funds

[1] San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SCG) are affiliated subsidiaries of SEMPRA Energy.
[2] All statutory citations are the California Public Utilities Code, unless otherwise noted.

- Finding #5: SDG&E Needs to Strengthen its Oversight over its Contractors
- Finding #6: Lack of Adequate Monitoring and Oversight over its Accounting Policies and Procedures
- Finding #7: SDG&E Procured Third-Party Contractors with High Rebate Processing Service Costs

Audit Report

BACKGROUND

Pursuant to California Public Utilities Code (PUC) Sections 381 et seq., and 454.5, the Commission is responsible to oversee the energy efficiency (EE) program which is principally administered and implemented by the four major Investor-Owned Utilities (IOUs) in California and funded by California ratepayers. We conducted this audit of San Diego Gas and Electric Company's (SDG&E's) 2016 EE program pursuant to Section 314.5 and Decision (D.) 13-09-023, Ordering Paragraph (OP) 17.

The major IOUs 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). To meet California's aggressive electricity and natural gas energy efficiency goals, the Commission authorized billions to the EE program, which is funded by electric and gas rates included in ratepayer bills.[3] The IOUs have greatly increased its costs and budgets through rate increases for administering and implementing the EE program over the time. Prior to 2016, the Commission authorized the IOUs budgets for the EE program based on a three-year program cycle. In Rulemaking (R.) 13-11-005, the Commission contemplated moving away from authorizing the EE budgets on a triennial basis and towards authorizing the EE budgets on an annual "rolling" portfolio basis. However, the Commission recognized that the adoption that the adoption of authorizing EE budgets on a "rolling" portfolio basis would not be completed on time for the 2015 funding levels. As a result, in D.14-10-046, the Commission approved the 2015 EE funding levels and authorized the IOUs to use 2015 annual spending levels until the year 2025 or when the Commission issued a superseding decision on funding levels. Subsequently, on October 22, 2015, the Commission issued D.15-10-028 which, among other things, authorized the IOUs 2016 EE funding levels at 2015 annual spending levels.

The EE program spans a variety of sectors encompassing residential homes and commercial buildings, large and small appliances, lighting and heating, ventilation and air conditioning (HVAC), industrial manufacturers, and agriculture. Within those sectors, the EE program utilizes 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, marketing and others. The Commission also adopted the Efficiency Savings Performance Incentive (ESPI) mechanism with the intent "to motivate the utilities to prioritize EE goals, while protecting ratepayers through necessary cost containment mechanisms." [4] In D.13-09-023, OP 15 and 16, the Commission authorized an incentive award to be paid to the IOUs as a management fee equal to 12% of authorized Codes and Standards (C&S) program expenditures and 3% of authorized non-resource

[3] Section 381 established a Public Goods Charge (PGC) that consumers pay on electricity consumption for cost-effective energy efficiency, renewable technologies, and public interest research. Section 900 established a natural gas surcharge to fund cost-effective energy efficiency and other public purpose programs.

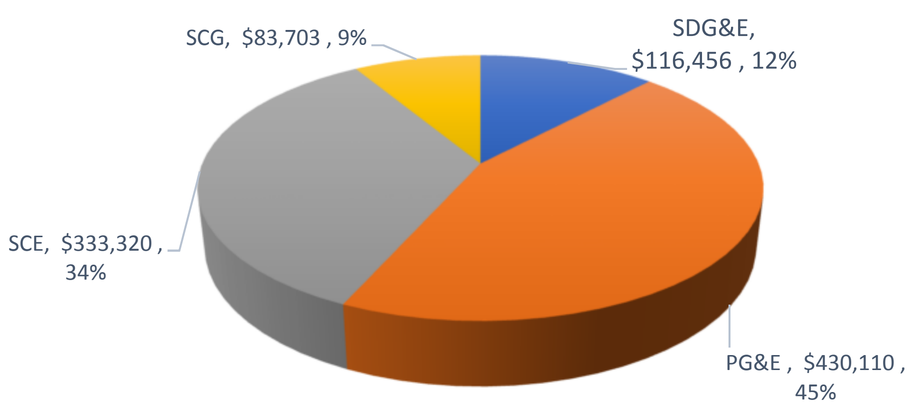
[4] D.13-09-023, page 2

(NR) program expenditures, not to exceed authorized expenditures and exclusive of administrative costs.[5]

Sempra Energy is a San Diego-based Fortune 500 (NYSE: SRE) energy services holding company whose subsidiaries provide electricity, natural gas and value-added products and services. Sempra Energy owns two regulated California public utility companies: San Diego Gas and Electric (SDG&E) and Southern California Gas Company (SoCalGas or SCG). SDG&E is one of the four major IOUs who are authorized to receive funding from ratepayers to administer the EE programs.

For program year (PY) 2016, the Commission issued Decision D.15-10-028, which, among other things, authorized SDG&E a total budget amount of $116.5 million, which represents approximately 12% of the total $963.6 million EE program budget for all four IOUs for PY 2016. SDG&E's PY 2016 authorized budget also included $4.6 million for Evaluation, Measurement and Verification (EM&V) which is outside the scope of this examination. A chart reflecting SDG&E's portion of the total $963.6 million EE program budget authorized for PY 2016 is shown in the Figure 1 below.

Figure 1
2016 Energy Efficiency Budget
(in $000)



SDG&E collects its funding for the EE program from its customers through a Public Purpose Program (PPP) rate authorized by the Commission.

SCOPE

Our audit objective was to ensure that SDG&E was in compliance with EE program rules and regulations and to determine whether the EE expenditures claimed by SDG&E were for allowable purposes and supported by appropriate documentation, such as invoices, contracts and relevant records, and were recorded appropriately in PY 2016.

[5] The C&S and Non-Resource programs support energy savings but do not provide direct energy savings.

In this audit, we examined the expenditures of the following EE programs and subprograms:

1. Codes and Standards (C&S)
2. Non-Resource (NR)
3. Residential Energy Advisor (REA)
4. Commercial Energy Advisor (CEA)
5. Plug Load and Appliances (PLA)
6. Third-Party (TP)

In addition to examining the expenditures of the above selected EE programs and subprograms, we also reviewed the EE commitments that SDG&E reported to the Commission and reviewed the monthly EE reports submitted by SDG&E to the Commission's California Energy Efficiency Statistics (EEStats) website[6]. A follow-up review was also performed on its PY 2015 EE audit [7] recommendations to determine whether SDG&E has implemented the appropriate corrective actions.

METHODOLOGY

To address the audit objectives and assist the Commission in its oversight over the EE programs, the procedures performed include, but not limited to, the following:

- Obtained an understanding of the EE program by reviewing relevant laws, rules, regulations, PUC codes, decisions, resolutions and advice letters.
- Obtained and reviewed SDG&E's accounting system, accounting policies, processes and procedures for recording, tracking, and monitoring EE program costs.
- Assessed whether the SDG&E's policies, procedures, and practices comply with the EE program requirements.
- Performed analysis of expenditure data to identify any anomalies or significant variances.
- From the SDG&E's accounting data, judgmentally selected expenditure transactions for review and testing.
- Requested and reviewed supporting documentation such as purchase orders, detailed invoices, contracts, receiving reports, timesheets and additional documentation as needed for the expenditure transactions selected for testing.
- Reviewed relevant contracts to determine if contract terms and provisions supported the EE program.
- Reviewed the SDG&E's accrual entries and verified the cutoff of expenditure transactions to determine if proper expenditure amounts were recorded and reported in the proper accounting period.
- Traced expenditures recorded in SDG&E's accounting records to supporting documentation and determined whether costs were reasonable, allowable, verifiable, and relevant to the EE program.

[6] This California Energy Efficiency Statistics (EEStats) website is a repository of utility-submitted reports to the Commission and contains up-to-date savings, budgets, expenditures, and cost effectiveness results for each IOUs EE programs.
[7] UAFCB report entitled "Financial, Management, Regulatory, and Compliance Examination Report on San Diego Gas and Electric Company's (SDG&E's) Energy Efficiency (EE) Program for the Period January 1, 2015 through December 31, 2015", dated July 31, 2017.

- Reviewed SDG&E's accrual entries and verified the cutoff of expenditure transactions to determine if proper expenditure amounts were recorded and reported in the proper accounting period.
- Reviewed the SDG&E commitments reported in EEStats and performed reconciliation of these reported amounts to SDG&E's records to determine whether these commitments were sufficiently justified and properly reported to the Commission.

FINDINGS AND RECOMMENDATIONS

FINDING 1: Lack of Compliance with Accrual Policy and Procedures Respecting its EE Program Costs for PY 2016

Condition:
SDG&E incorrectly recorded $731,135 [8] in PY 2016 expenditures belonging to PYs 2015 and 2017, resulting in an overstatement of PY 2016 expenditures reported to the Commission.

Based on its review and testing, SDG&E improperly recorded and accrued $731,135 in expenditures to PY 2016 due to the inconsistent application of its own internal accrual policy and procedures. A detailed breakdown of expenditure amounts overstated by SDG&E by program area is provided in the **Appendix B, Table 1**.

Criteria:
Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. Section 793 requires that accounts, records, and memoranda prescribed by the Commission for a corporation subject to the regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. 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.

The SDG&E's Customer Program – Program Advisor Handbook (Handbook) 2016, Version 6.2, dated December 2016, provides, among other things, accounting policies and procedures for the administration and implementation of its EE program. Specifically, in Section 8.4, it states that "In accordance with GAAP, an accrual is to ensure that all valid significant and larger incurred expenditures/credits are accurate and that all liabilities are recorded in the company's financial statements. Expenses incurred and not yet invoiced prior to the end of each month should be accrued."

Cause:
SDG&E reported and recorded expenditures incurred in PYs 2015 and 2017 to PY 2016 due to the followings:

1. SDG&E kept its accounting records open until the end of February 2017 in order to include expenditures from January and February 2017 to PY 2016.

[8] This exception amount only pertains to the selected EE programs included in the scope section of this audit report.

2. SDG&E creates and uses unique internal order numbers[9] in its accounting system for each EE funding cycle. UAFCB found, in many instances, SDG&E recorded EE expenditures to incorrect internal order numbers in PY 2016.

3. SDG&E's accounting policy only requires quarter-end expenditures to be accrued when "significant and large expenditures/credits consist of significant items greater than $100,000 for a non-quarter-end month, single items greater than $10,000 for a quarter-end month." [10]

4. SDG&E doesn't consistently apply its own internal accounting policy and procedures. In many instances, it was found that SDG&E failed to properly accrue EE costs greater than $10,000 as stipulated in its internal accounting policy. Instead, SDG&E relied on its vendors to submit accrual amounts at the end of an accounting period.

Effect:
Failure to record expenditures in the proper period and program year resulted in an overstatement of program costs reported to the Commission by $731,135. It is critical to ensure that EE costs are accurately recorded and reported because these programs are funded by ratepayers. When SDG&E reports incorrect costs, it can have negative impacts on ratepayers' funds. An overstatement of expenditures leads to an overpayment in incentive awards to SDG&E. Furthermore, an overstatement in expenditures may lead to higher than anticipated authorized budget in future years since SDG&E develops its future year EE budgets on prior year costs. This practice can result in over-collections in ratepayer funds that support the EE program.

Recommendation:
SDG&E should adhere to accrual basis of accounting when recording and reporting its EE program expenditures. SDG&E should reduce its PY 2016 EE program costs by a total amount of $731,135 based on the exception amounts identified in the audit for the EE program and subprogram areas listed in the scope section of this report.

Furthermore, SDG&E should implement the following:

1. Properly close its accounting period in accordance with GAAP.

2. Provide training to staff to ensure proper recording of EE expenditures to appropriate internal order in its accounting system.

3. Evaluate and revise its accrual policy from $10,000 to a lower thresholds amount, and make it more applicable and practical to its EE programs, and be consistent with financial reporting to the Commission, and ensure accurate recording and reporting of ratepayers' funds.

4. Develop a systematic process or policy to ensure correct reporting of EE costs by actively identifying accrual amounts, instead of relying on contractors to submit these numbers.

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[9] An internal order in the SAP accounting system is used to accumulate costs for a specific project or task for a specific time period.
[10] SDG&E, Customer Programs, Program Advisor's Handbook, Version 6.2, dated December 2016, page 130.

It is our responsibility to bring this finding to the Commission and SDG&E's attention since an overstatement of EE program expenditures caused by accrual basis of accounting has been a repeated finding in prior UAFCB audits including, but not limited to, PY's 2013, 2014 and 2015.

On the positive note, SDG&E has continued its effort to improve its processes by providing training to its staff on the accrual basis of accounting. However, accrual basis of accounting still remains an area of significant concern and in need of improvement.

FINDING 2: Overstatement of the Efficiency Savings and Performance Incentive (ESPI) Award Amount for PY 2016

Condition:
In D.13-09-023, the Commission authorized the IOUs a new Efficiency Savings and Performance Incentive (ESPI) awards mechanism to promote achievement of EE goals. The ESPI mechanism offers each IOU incentive awards in four performance categories:

1. **Energy Efficiency Resource Savings:** A performance award for ex-ante locked down and ex-post verified net lifecycle resource programs (energy efficiency programs that are intended to achieve and report quantified energy savings) energy savings measured in MW, GWh, and MMTh.
2. **Ex-Ante Review (EAR) Process Performance:** A performance award for IOUs ex-ante review conformance.
3. **Codes and Standards (C&S):** A management fee award for the IOUs advocacy of codes and standards.
4. **Non-Resource Programs:** A management fee award for implementing non-resource programs (an energy efficiency program that has no directly attributed energy saving but the programs support the energy efficiency portfolio through activities such as marketing or improved access to training and education.)

In D.13-09-023, Ordering Paragraph (OP) 15 and 16, the Commission authorized an incentive award to be paid to the IOUs as a management fee equal to 12% of authorized Codes and Standards (C&S) program expenditures and 3% of authorized non-resource (NR) program expenditures, not to exceed authorized expenditures and exclusive of administrative costs.[11] The decision also ordered verification of the C&S and NR program expenditures for the purposes of awarding the management fees.[12]

Based on its review and testing of the C&S and NR program expenditures, SDG&E overstated its ESPI award amount for PY 2016. Based upon its recalculation, it was determined that the revised ESPI base amount for calculating C&S and NR program management fee incentive award amounts should be adjusted to $432,756 and $6,508,826, respectively. Consequently, SDG&E's incentive award amount should be adjusted to $51,931 and $195,265 for the C&S and NR program, respectively. A detailed recalculation of SDG&E's revised ESPI award amounts for C&S and NR for PY 2016 is provided in the tables below.

11 The C&S and Non-Resource programs support energy savings but do not provide direct energy savings.
12 D.13-09-023, OP 17

C&S ESPI Recalculation	
Reported C&S ESPI Base	$ 517,572
UAFCB's Audit Exception	(84,816)
Revised C&S ESPI Base	432,756
C&S Earnings Rate	12%
Revised ESPI Award	**$ 51,931**

NR ESPI Recalculation	
Reported NR ESPI Base	$6,878,695
UAFCB's Audit Exception	(369,869)
Revised NR ESPI Base	6,508,826
NR Earnings Rate	3%
Revised ESPI Award	**$ 195,265**

Criteria:
Commission D.13-09-023 authorizes an incentive to be paid to each IOU as a management fee equal to 12% of authorized C&S program expenditures and 3% of authorized NR program expenditures, not to exceed authorized expenditures in each program year, and excluding administrative expenditures.

Cause:
When SDG&E overstated its PY 2016 EE program costs in Finding #1, it also overstated its incentive awards for its C&S and NR programs.

Effect:
SDG&E overstated their C&S and NR program incentive awards filed in AL 3109-E/2606-G. The proper incentive award amounts should be $51,931 and $195,265 for the C&S and NR programs, respectively.

Furthermore, it is critical to ensure that the savings claimed are accurate. Overstatements of incentive awards claimed by the IOUs can have negative consequences to ratepayers.

Recommendation:
Since SDG&E filed AL 3109-E/2606-G to claim its C&S and NR program incentive awards for PY 2016, the Commission's Energy Division (ED) should adjust SDG&E's management fee incentive awards to $51,931 and $195,265 for the C&S and NR programs, respectively, when SDG&E's 2016 ex-post ESPI true-up AL is processed.

FINDING 3: Failure to Follow GAAP While Closing its Accounting Records

Condition:
SDG&E overstated its PY 2016 EE expenditures since it elected to open the accounting period until February 2017. This accounting practice only applies to its EE program and further explained that

"For other programs that require reporting of only current-year activities, such as SDG&E's Energy Saving Assistance (ESA) program, SDG&E uses manual adjustments to report only the current-year activity (net of accruals) in its annual report. This manual approach, which does not record adjustments in SAP, is not the most efficient mechanism for tracking annual expenses for EE."

Using SDG&E's accounting information including cost elements, internal orders or programs, and cost centers, payroll costs were identified as being incurred by SDG&E's employees in January and February 2017. Payroll costs belonging to 2017 of $360,027 were posted to the PY 2016 costs.

Criteria:
Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporations subject to the regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. 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.

Cause:
SDG&E explained that it maintained the open year for 2016 EE program costs through February 2017 to allow for a program cycle cut-off which reduced the need for carry-over funds to the 2017 program cycle.

In addition, they asserted that "In order to provide the most accurate financials and tie to the realized measure savings, it is standard practice is to ensure that expenses associated with the program year are reported by the May 1st annual report. SDG&E elected to report the program year 2016 activities through February 2017 for measures installed in fiscal year 2016. This process allowed SDG&E to report over $7 million in invoices or accrual adjustments that were recorded by December 31, 2016, providing a more accurate annual report for 2016 as filed on May 1, 2017."

Effect:
When SDG&E maintained the open year for 2016 program costs through February 2017, the practice is a departure from GAAP. It was found, in several instances, that SDG&E made journal entries to correct proper periods in its accounting records. Specifically, this accounting practice allowed SDG&E to charge over $360,027 in staff labor charges for processing year-end activities incurred in January and February 2017 to PY 2016.

Recommendation:
SDG&E should close its accounting records in accordance with GAAP to ensure the proper recording and reporting of EE expenditures funded by ratepayers. SDGE should reduce its expenditures by $360,000 for PY 2016.

The Commission requires that expenditures and activities related to EE programs should be properly accounted for in proper funding period. Therefore, SDG&E should close its accounting period at the end of each program year, or calendar year for all EE programs, unless otherwise authorized by the Commission.

FINDING 4: Lack of Reconciliation of Amounts Committed/Unspent Funds

Condition:
In the D.12-11-015, the Commission defines "committed funds as those that are associated with individual customer projects and/or are contained within contracts signed during a previous program cycle and associated with specific activities under the contract. All activities carried out under a contract and/or customer obligation during a specific program cycle need not be completed and funds need not be spent during that particular program cycle so long as there is an expectation that the activities will be completed."

The Commission's goal is to ensure that there are no stop/start periods associated with continuing activities and programs for purely administrative or contractual reasons. The Commission also refers to the Policy Manual guidance that discusses long-term projects with long lead times and allows for certain authorization to be requested via advice letter if more than 20% of the budget for the current program cycle must remain encumbered for activities that will take place in the following program cycle.

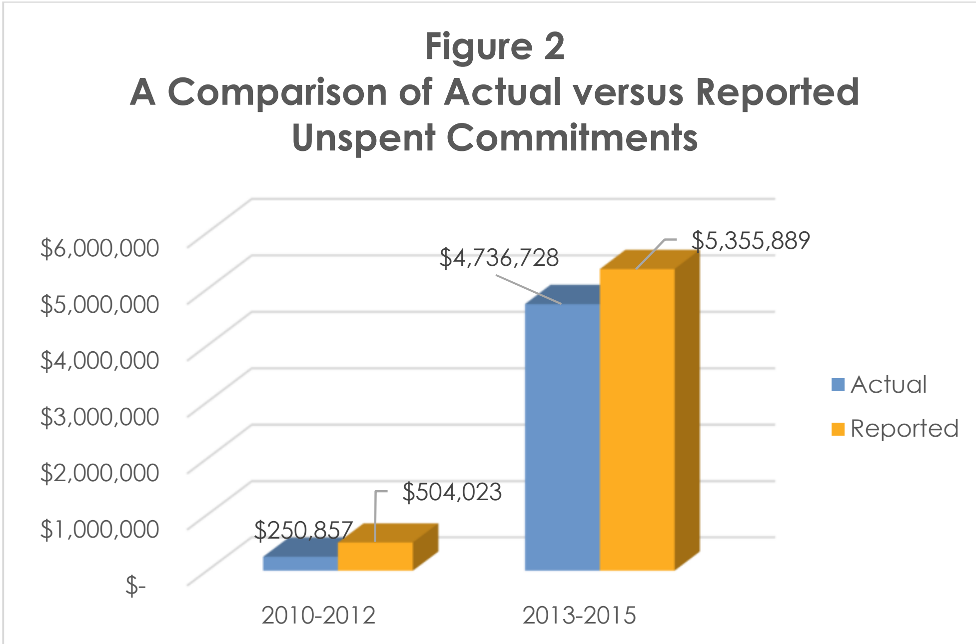
SDG&E's commitments were reviewed and the following deficiencies were noted:

1. SDG&E elected not to include adjustments and cancellations of its commitments in the monthly EEStats reports.

SDG&E didn't account for adjustments and/or cancellations to the committed amounts in its monthly reports in EEStats. As a result, SDG&E's Committed Fund Balance amounts reported to the Commission was overstated by a total of $253,166 and $619,162 for program cycles 2010-2012 and 2013-2015, respectively.

SDG&E submitted monthly reports to the Commission and provided commitment information by program cycle in Tables E-3 and G-3, pursuant to D.01-11-066. In addition, SDG&E asserts that the "Commitment amounts included in the E2-G2 tables of the CPUC monthly report already take into consideration any adjustments and cancelations. It is only the EEStats report that does not include a field to report adjustments or cancelations." SDG&E further explained that "The E&G tables per CPUC monthly report are reported for a period of 12 months of the calendar year; our EEStats report includes activity that is related to 2016 cycle that is still reported in January and February 2017 creating a discrepancy in between the two reports due to timing and adjustments."

Figure 2 presents a comparison of the actual unspent committed fund balances in the SDGE's records versus those in the reports on the EEStats website.



2. SDG&E was unable to provide a reconciliation of the commitments to the amortization amount filed in the Advice Letter.

In its annual review of PPP revenue requirements, SDG&E considers any unspent funds including commitments that have been canceled, along with Balancing Account over or under collections based on sales as well as forecasted spending for the remainder of the current cycle and upcoming program cycle. If SDG&E had unspent/uncommitted funds that were collected in the Balancing Account, they would have been included in the amortization amount in the advice letter. When a reconciliation was requested detailing cancellations and adjustments of its commitments, SDG&E was unable to provide a reconciliation. It cited that the amortization amounts filed in the Advice Letter for gas and electric were the result of assessing the number of funds that were going to be needed for the cycle based on expenditures forecast, unspent funds, and committed funds.

We were unable to determine if SDG&E included cancellations and adjustments of commitments in the advice letter as well as how the unspent commitment amounts were refunded back to ratepayers.

3. SDG&E's records consisted of unspent commitments from 2010.

SDG&E records consist of outstanding (unspent) commitments without any activities from 2010. These unspent funds should be returned to ratepayers because it doesn't meet the "expectation that the activities will be completed". When asked for an explanation, SDG&E responded that it would clear the two commitments, but no detail was provided. It is unclear when and how SDG&E refunded these unspent commitments to ratepayers.

Criteria:
Pursuant to D.12-11-015, the Commission defines "committed funds as those that are associated with individual customer projects and/or are contained within contracts signed during a previous program

cycle and associated with specific activities under the contract. All activities carried out under a contract and/or customer obligation during a specific program cycle need not be completed and funds need not be spent during that particular program cycle so long as there is an expectation that the activities will be completed."

Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. Section 793 requires that accounts, records, and memoranda prescribed by the Commission for a corporation subject to the regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. 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.

Commission D.01-11-066, OP 10, requires that monthly reports be submitted to the Commission's Administrative Law Judge (ALJ) Division and ED to help facilitate the monitoring and oversight of the energy efficiency funds collected and expended in SDG&E's service territory. These reports should include commitment information by program cycle.

The SDG&E's Handbook, section 12.3.6, requires staff to "ensure the Commitments Report is current because this report is used by the Financial group to report expected program energy savings and fund encumbered. It is likely that whatever is in this report is what the CPUC auditors will base their audit questions (i.e. what is committed, why, how much)."

The Handbook, section 10.8, states that SDG&E is required to report the progress of its programs and "The commitments report reflects where the program is progressing with its past commitments. The commitments report also reflects cancelations and adjustments. If an adjustment or cancelation occurs, associated with a project or service, this is reflected in the commitments report."

Additionally, Section 10.8 of the Handbook states that "When discrepancies are found in the reporting, follow-up with the assigned Policy Advisor and/or Supervisor to remedy the problem."

Cause:
SDG&E's elected not to include adjustments and cancelations in the commitment amounts reported to the Commission in PY 2016. In addition, SDG&E was unable to provide a reconciliation of reported commitment amounts.

Effect:
The committed fund balances were not reported correctly in the EEStats reports submitted to the Commission. Failure to include any adjustments and/or cancellations resulted in an overstatement of $253,166 and $619,162 for program cycles 2010-2012 and 2013-2015, respectively.

It is unclear how SDG&E included cancellations and adjustments of commitments in the advice letter as well as how the unspent commitments refunded back to ratepayers because SDG&E could not provide reconciliations for these adjustments.

In addition, we cannot determine when and how SDG&E refunded these unspent commitments from 2010 to ratepayers because SDG&E didn't provide its detailed plan. Furthermore, SDG&E could not provide documentation to support how it refunds its ratepayers these unspent committed funds.

Recommendation:
SDG&E should report its commitment amounts correctly in the monthly reports filed with the Commission. When SDG&E identifies errors, SDG&E should adhere to its internal policy and remedy the problem by revising and submitting correct information to the Commission.

FINDING 5: SDG&E Needs to Strengthen its Oversight over its Contractors

Condition:
SDG&E is mandated by the Commission to have 20% of the EE portfolio administered by contractors or consultants, who are awarded a predetermined budget to pursue set measures and, in most cases, specific customer segments within which to work. In addition, SDG&E enters into agreements with outside contractors to carry out EE programs when SDG&E is unable to meet specialized needs for the programs. For example, SDG&E contracts its audit reviews to an outside engineering company to allow the review to be more independent. SDG&E may also use contract employees for specific periods of time for other needs. In particular, EE third-party programs are implemented through third-party contractors.

SDG&E has a contract management framework in place, but it needs to strengthen controls and improve oversight in the following areas to reduce contract risks:

1. Contract languages state that SDG&E should periodically audit the contractors, but SDG&E didn't perform audits on the vendors. Instead, SDG&E relies on system reports submitted by vendors for the adequacy of invoices.
2. During the audit, SDG&E was asked to provide a number of its contracts containing the total contract values for the 2016 EE programs. SDG&E was unable to provide the requested information. It was noted that SDG&E has the same contracts for both its businesses and EE programs.
3. SDG&E could not provide supporting documentation as required in the contract language. For example, SDG&E did not ensure that training materials were updated and failed to maintain copies of attendee certificates and attendee surveys for trainings conducted by vendors.
4. SDG&E did not adhere to contract terms and negotiated a contract price without contract amendments.
5. In several instances, the entire vendor invoice was paid without proper retention amounts as stipulated in the contract provisions.
6. Our review and testing disclosed several transactions in which vendor invoices were overpaid, not timely paid in accordance with contract terms and conditions and paid without evidence to

support the deliverables completed and/or services performed in accordance with the signed agreement.

Criteria:
Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. Section 793 requires that accounts, records, and memoranda prescribed by the Commission for corporations subject to the regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States.

SDG&E's Handbook, Section 6.9.2, regarding contract activities requires that "Deviation from the Agreement terms should not occur. If a deviation is needed, an Agreement Amendment should be requested. Examples of deviations include: modification to the fee schedule, out of scope tasks or activities, time extension, etc. "

Cause:
SDG&E didn't appropriately manage and monitor third party vendor contracts in accordance with the provisions of the signed agreements. SDG&E didn't have separate contracts for EE programs. Instead, it has the same contracts for both its corporation and EE programs.

Effect:
SDG&E was not able to identify the EE contracts and its contract values. As a result, SDG&E may not be able to keep track of its EE program budgets. It could result in payments that are not properly supported and authorized according to program and contract requirements. Signed contracts are legally binding agreements and failure to uphold contractual obligations can result in legal consequences, potentially void the contracts, and result in higher financial, credit, operational, legal and operational risk to SDG&E and the EE program funded by ratepayers.

Without customer feedback surveys, SDG&E is unable to access contractors' services and value provided to the EE program and determined if ratepayers' funds are utilized appropriately.

Negotiation of contract terms without contract amendments imposes a risk of non-compliance and incorrect payments because the contract terms were not communicated, updated, and verified in SDG&E's accounting system. It could also impose a liability risk to SDG&E and the EE program funded by ratepayers.

Recommendation:
The following recommendations address several deficiencies in SDG&E's contracting practices:

1. SDG&E should strengthen its contract management oversights and adhere to its policies to ensure that provisions of signed vendor agreements are effectively monitored and adequately enforced. SDG&E should update its contracting manual, conduct a supervisory review of contracts, and require regular training for contract staff.

2. SDG&E should establish a depository to maintain and manage its contracts in a way that it should be able to provide how much funding is left for each EE contract as well as its specific expiration dates for each EE contract.

3. SDG&E should implement customer feedback surveys to gain feedback on contractors' services and value provided to the program. SDG&E should develop and implement a customer feedback survey for its training programs and evaluate its training programs in an effort to better assess performance. SDG&E should evaluate and implement appropriate contractor performance monitoring tools such as customer feedback surveys. Once surveys are obtained, SDG&E should discuss the feedback with each contractor to determine whether the training provided any values to the EE program as intended. SDG&E should negotiate with vendors and implement best practices regarding EE outreach and training programs.

4. SDG&E should not enter in to a side agreement with contractors or change the contract terms and payments without contract amendments.

FINDING 6: Lack of Adequate Monitoring and Oversight over its Accounting Policies and Procedures

Condition:
Several deficiencies were uncovered in SDG&E's accounting practices that could impact the EE program including increased risks that EE costs are not appropriately accounted for nor reported correctly, and errors and mistakes are not detected or corrected.

1. SDG&E's accounting records included numerous correcting journal entries to its expenditures in PY 2016. The data was sorted, and it was estimated to be more than10% of EE costs stemmed from corrections for various reasons including, but not limited to, corrected journal entries for:
    - Internal order
    - Cost category
    - Cost element
    - Incorrect amounts
    - EE cost was recorded in both companies: SDGE and SCG, in one instance.

   Figure 3 below depicts the percentage of correcting journal entries made by SDG&E in comparison to its total EE costs recorded for PY 2016.

2. SDG&E opened its accounting period to record expenditures from January and February 2017 to PY 2016. This accounting policy has created numerous corrections to SDG&E's accounting records caused by confusion of selecting proper accounting period for EE expenditures. SDG&E, in several instances, made journal entries to correct proper periods in its accounting records. In addition, it was estimated that SDG&E included $360,027 of its employee payroll costs related to 2017 to PY 2016 costs as indicated in Finding #3.

3. SDG&E uses internal orders[13] to track the program years in its accounting system. For every new funding cycle, SDG&E assigns new internal order numbers to track EE costs. During the audit, numerous adjusting journal entries in SDG&E's accounting records were caused by confusion of selecting a correct internal order in a proper accounting period for EE

[13] An internal order in SAP accounting system is used to accumulate cost for a specific project or task for a specific time period.

expenditures. SDG&E, in several instances, made journal entries to correct internal orders in its accounting records.

4. SDG&E used manual reclassifications of its overhead costs when reporting EE program costs to the Commission. SDG&E did not have a documented review process for the manual cost reclassifications of overhead costs, as they were completed on a case-by-case basis. These manual processes caused reports filed in EEStats to contain errors.

5. SDG&E did not provide sufficient information on how it accounts for sales taxes charged to EE program expenditures. During the audit, it was noted that SDG&E manually wrote the sales tax amount on Work Orders Invoices created by its Copy Center, or on vendor invoices who didn't charge sales taxes. In response to our inquiries, SDG&E explained that it was required to pay sales tax on material received. SDG&E provided accounting documents for these sales tax transactions. However, these documents were not sufficient to determine how SDG&E accounted for these sales tax amounts charged to EE invoices.

Criteria:
Sections 581, 582, and 584 require that the utility provide timely, complete and accurate data to the Commission. Section 793 requires that accounts, records, and memoranda prescribed by the Commission for a corporation subject to the regulatory authority shall not be inconsistent with the systems and forms established for corporations by or under the United States. 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.

SDG&E's Handbook states that "Invoices that offer discounts for early payment receive Priority processing. Payment defaults are set to pay no earlier than 45 days from the date of the invoice – *Net 45;* unless otherwise stated in the terms of the Purchase Order."

Cause:
SDG&E's accounting practice caused a significant number of correcting journal entries due to errors and adjustments, reclassification of cost categories, and adjustments of EE costs for PY 2016.

Effect:
Failure to record accurate expenditures in the proper period and program year resulted in an overstatement of program costs reported to the Commission in PY 2016.

Recommendation:
SDG&E must strengthen its internal controls and consider to revising its accounting policies in the following areas:

1. Minimize errors and mistakes by providing proper training to staff.
2. Properly close its accounting period and implement the same practice as to another area such as the Energy Assistance Program. (Refer to Finding #3.)
3. Communicate timely to staff when new internal orders are assigned to a new funding cycle to ensure proper recording, provide adequate training with business practices and procedures to responsible staff and program areas.

4. SDG&E asserted that it changed its process of classifications from being cost center based, which required a certain level of manual classifications based on system restrictions, to an internal order-based method in 2017. The internal order (IO) method assigns a unique IO for each cost category (Admin, Marketing, DI). This eliminates the need for manual adjustments, with defaults to Administrative cost categories. This process will be reviewed in the audit on PY 2017.
5. SDG&E should be able to provide documentation to display complete accounting entries for transactions with sales taxes.

FINDING 7: SDGE Procured Third-Party Contractors with High Rebate Processing Service Costs

Condition:
Our review identified instances in which SDG&E entered into contracts with third-party contractors for processing customer rebates and vouchers. Selected invoices were reviewed which included two distinct sections: the Direct Implementation (DI) –Incentive, and the DI – Non-Incentive. The incentive amount was for reimbursement of incentive rebates or installations, while the non-incentive amount was for third-party contractor service fees for processing EE rebates, project management, training and program communication. It was noted that the service fee or non-incentive fee amounts were approximately 96% to 103% of the rebate amounts.

Criteria: Sections 454.55 and 454.56 require the Commission, in consultation with the California Energy Commission (CEC), to identify all potentially achievable cost-effective electricity and natural gas efficiency savings and "establish efficiency targets"184 for electrical or gas corporations to achieve.

Section 381 mandate that the Commission "allocates funds spent on programs that enhance system reliability and provide in-state benefits including: (1) cost-effective EE and conservation activities.

D.09-09-047 states that "By law, each utility's portfolio of programs for the funding cycle must be cost-effective." Section 276.5(b) mandates the Commission to administer ratepayers' fund so that any charge imposed to support the goals of service reasonably equals the value of the benefits created (§276.5b). The Commission also requires that proposed expenditures are reasonable and do not include unnecessary costs.

Cause:
SDG&E did not make an effort to find the most cost-effective process for the EE program.

Effect:
It will cost ratepayers more processing fees to process rebates. The goal of the program is to save energy in an efficient way. If the cost exceeds the benefits, it defeats the purpose of the program.

Recommendation:
SDG&E needs to negotiate with third-party vendors for more reasonable processing service rates and retain vendors who would provide the best value with lower costs for ratepayers.

CONCLUSION

In conducting our audit, we obtained a reasonable understanding of SDG&E's internal controls, which were considered relevant and significant within the context of our audit objectives. Deficiencies in internal control that were identified during the audit and determined to be significant are included in this report.

SDG&E's management is responsible for the development of its policies and procedures to ensure that expenditures and commitments of its EE programs were reported accurately and timely. The Commission is responsible to ensure the ratepayers' monies funding energy efficiency programs in California explicitly support the EE goals and strategies and protect ratepayers' funds against fraud and abuse.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to afford a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our limited audit objectives.

The report is intended solely for the information and use of the Commission and SDG&E and is not intended to be and should not be used by anyone other than these specified parties.

Barbara Owens

Barbara Owens, CIA, CISA, CGAP, CRMA
Director, Enterprise Risk and Utility Audits

Kevin Nakamura, Supervisor
KieuChinh Tran, Auditor, CPA, CFE

Appendices

APPENDIX A
Applicable Rules and Regulations

Rule/Regulation Types	Reference	Description
Public Utility Code	Section 314	Guidance providing the Commission the authority to conduct financial and performance audits consistent with Generally Accepted Government Auditing Standards (GAGAS), and to follow-up on findings and recommendations
	Section 381	Guidance mandating that the Commission to allocate funds spent on EE programs that enhance system reliability and provide in-state benefits including cost-effective EE and conservation activities.
	Section 581	Guidance providing the Commission the authority to require a utility to file complete and correct reports in prescribed form and detail
	Section 582	Guidance providing the Commission the authority to require a utility to timely provide applicable records
	Section 584	Guidance providing the Commission the authority to require a utility to furnish reports to the commission
	Section 783	Guidance on the system of accounts and the forms of accounts, records, and memoranda prescribed by the Commission.
Decisions & Rulemaking	D.09-09-047	Adopting Efficiency Savings and Performance Incentive Mechanism
	D.12-11-015	Approving 2013-2014 EE Programs and Budgets
	D.15-10-028	Establishing a "Rolling Portfolio" process for regularly reviewing and revising EE goals for 2016 and beyond
	D.14-10-046	Establishing EE Savings Goals and Approving 2015 EE Programs and Budgets (Concludes Phase I of R.13-11-005)
	R. 13-11-005	Establishing a proceeding in which to fund the current energy efficiency portfolios through 2015, implement energy efficiency "rolling portfolios", and address various related policy
Advice Letters	AL No. 3109-E/2606-G	Request of SDG&E for its 2015 and 2016 EE Saving Incentive

APPENDIX B

Table 1
Proposed Audit Adjustments for the Selected EE Programs
PY 2016

2016 Seledted EE Programs	Proposed Adjustments
Codes and Standards (C&S)	(84,816)
Non-Resource (NR)	(369,869)
Residential Energy Advisor (REA)	(21,483)
Commercial Energy Advisor (CEA)	(8,742)
	(111,175)
Third Party (TP)	(135,050)
Total	**(731,135)**

SDG&E's Responses

SDGE
A Sempra Energy utility

Brittney L. Lee
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San Diego Gas & Electric Company
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July 24, 2018

Ms. Barbara Owens
Director, Enterprise Risk and Utility Audits
Utility, Audit, Finance and Compliance Branch
California Public Utilities Commission
455 Golden Gate Avenue, 7/F
San Francisco, CA

Re: San Diego Gas & Electric Company's (SDG&E's) Comments on Draft Energy Efficiency Audit Report of SDG&E's Energy Efficiency (EE) Program Year 2016

Dear Ms. Owens:

San Diego Gas & Electric Company (SDG&E) appreciates the opportunity to comment on the Draft Energy Efficiency Audit Report of its 2016 Program Year (PY). SDG&E institutes several management and process controls to effectively manage its EE portfolio on behalf of its ratepayers. The Draft Report acknowledges this:

> "In our opinion, except for the non-compliance items noted in the Findings and Recommendation section, SDG&E has complied, in all material respects, with the recording and reporting requirements for the EE costs for the audit period of January 1, 2016 to December 31, 2016. UAFCB's opinion is limited to the EE programs and subprogram areas that it reviewed in this audit."[1]

SDG&E's PY 2016 Total Portfolio expenditures are $144,800,694. Utility, Audit Finance and Compliance Branch (UAFCB) examined a significant sample - 24% - of these expenditures ($34,638,025). UAFCB reported findings, as discussed in the Draft Report, on only 2.9% of the sampled expenditures ($1,004,414).[2] This represents only 0.7% of SDG&E's total portfolio expenditures.

SDG&E has reviewed the UAFCB's draft *Energy Efficiency Audit Report* (Draft Report), received on July 10, 2018, and provides its responses below.

SDG&E's Responses to Findings:

Finding 1: Lack of Compliance with Accrual Policy and Procedures Respecting its EE Program Costs for PY 2016

Response to Recommendations:

The Draft Report states "SDG&E incorrectly recorded $1,015,571 in PY 2016 expenditures belonging to PYs 2015 and 2017, resulting in an overstatement of PY 2016 expenditures reported to the Commission."[3] SDG&E provides the following responses to a selected set of transaction findings that constitute a part of the total $1,015,571 at issue:

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[1] *Energy Efficiency Audit Report (Draft Report)*, July 10, 2018, p. 19.
[2] Based on a discussion with SDG&E on July 19, 2018, the UAFCB auditor agreed that there were entry errors in the UAFCB supporting documents used to tally the totals in the Draft Report.
[3] *Id.*, p. 6.

Program	UAFCB Proposed Adjustments	Correction to UAFCB (without SDG&E requested adjustments)	SDG&E Requested Adjustments	SDG&E Rational
Codes and Standards (C&S)	(103,582)	(103,582)	18,766	DR 2 Sample 8--Submitted contract to support transaction
None-Resource (NR)	(635,539)	(624,382)	254,513	DR 2 Sample 53 and 54--Resubmitting documentation to support transactions

SDG&E submitted additional back-up documentation to support SDG&E's assertion that certain expenditures should be reinstated for the purpose of calculating the ESPI earnings basis.[4] The updated information supports removing these transactions from the UAFCB proposed total reductions of $1,015,718, resulting in a new total of $1,004,414. The impact to the 2016 ESPI is discussed in the response to Finding 2 in the next section.

It is important to note that UAFCB does not dispute the validity of any of the $1,015,718 in payments and only has concern regarding the timing of SDG&E's recording to the program.

The following are SDG&E's responses to the Draft Report's specific recommendations related to Finding 1:

1. *Properly close its accounting period in accordance with GAAP.*

Response: Please refer to response to Finding #3 below.

2. *Provide training to staff to ensure proper recording of EE expenditures to appropriate internal order in its accounting system.*

Response: PY 2016 was a new program year under the Rolling Portfolio cycle, and as such new internal orders were established to track program costs. SDG&E will continue to improve its processes and staff training.

3. *Evaluate and revise its accrual policy from $10,000 to a lower thresholds amount, and make it more applicable and practical to its EE programs, and be consistent with financial reporting to the Commission, and ensure accurate recording and reporting of ratepayers' funds.*

Response: SDG&E follows corporate guidelines for processing accruals, which include a minimum threshold of $10,000 at the end of each quarter and each year. These guidelines have been found by Deloitte & Touche LLP to be materially acceptable for corporate financial reporting purposes.

4. *Develop a systematic process or policy to ensure correct reporting of EE costs by actively identifying accrual amounts, instead of relying on contractors to submit these numbers.*

[4] SDG&E submitted additional back-up documentation to UAFCB auditors on July 23, 2018.

Response: SDG&E will continue to improve its processes, and provide additional staff and contractor training.

FINDING 2: Overstatement of Efficiency Savings and Performance Incentive (ESPI) Award

Response to Recommendation:

SDG&E provided additional information to UAFCB to support the transactions identified in Finding 1 above. The additional information relating to Finding 1 supports updating UAFCB's recommendation to reduce the earnings basis for the ESPI by a lesser amount. The table below shows SDG&E's proposed correction to Table 1 of the Draft Report.[5]

Table 1 C&S ESPI Recalculation

C&S	UAFCB Audit Report	Corrected UAFCB Audit Report	SDG&E Response
Reported NR ESPI Basis	517,572	517,572	517,572
UAFCB's Audit Exception	(103,582)	(103,582)	(34,808)
Revised NR ESPI Basis	413,990	413,990	482,765
NR Earnings Rate	12%	12%	12%
Revised ESPI Award	49,679	49,679	51,381

Table 1 NR ESPI Recalculation

C&S	UAFCB Audit Report	Corrected UAFCB Audit Report	SDG&E Response
Reported NR ESPI Base	6,578,695	6,578,695	6,578,695
UAFCB's Audit Exception	(435,139)	(624,382)	(69,309)
Revised NR ESPI Base	6,143,556	6,254,313	6,509,386
NR Earnings Rate	3%	3%	3%
Revised ESPI Award	187,395	190,609	195,256

Finding 3: Failure to Follow GAAP While Closing its Accounting Records

Response to Recommendation:

SDG&E's accounting practices for Energy Efficiency programs generally follow GAAP and Commission rules and practices. There is a slight disconnect with GAAP, to the extent that the Commission requires all program results (e.g., installed savings, commitments, and expenditures) associated with the program year to be reported in the Annual Report that is due every May 1 of the following year. For example, for PY 2016, all costs associated with the implementation of PY 2016 should be reported in the 2016 Annual Report. To comply with this, there continues to be expenses associated with paying customer rebates/incentives and closing out projects and program business associated with the 2016 program year, in the following year (2017). These costs are then reported as part of the PY 2016 expenses, even if the costs were recorded in 2017. This practice is recognized and allowed by the Energy Division, and has been a regular practice since the 1990s. More recently, Resolution E-4898 stated, "we directed the IOUs to only include savings for measures installed in the same year for which they are claiming incentives.[10"6, 7]

Should the CPUC now require strict adherence to GAAP for the EE Annual report, this should be discussed as part of R.13-11-005 Phase III Accounting and Funding issues.[8] Furthermore, such a change

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[5] Draft Report, p. 5.
[6] Resolution E-4897, p. 15.
[7] Footnote 10 states, "The annual installation date based claims requirement was introduced in D.04-09-060 (at 33 and Findings of Facts 14), clarified and reiterated in D.05-04-051 (at 55, Findings of Fact 36-42, Conclusion of Law 3, Ordering Paragraph 17), D.05-09-043 (at 84) and again in Resolution G-3510 (at 13) and Resolution 4807 (OP.10)."
[8] *Assigned Commissioner and Administrative Law Judge's Ruling and Amended Scoping memorandum (Regarding Remainder of Phase III)*, April 26, 2018, p. 10.

should be prospective and not retroactive, as SDG&E should not be penalized simply for following established past precedent

Finding 4: Lack of Reconciliation of Amounts Committed/Unspent Funds

Response to Recommendation:

SDG&E does report adjustments or cancelations of committed funds, as required in its Energy Efficiency report pursuant to Decision 05-11-066, Ordering Paragraph 10, Tables E-3 (electric) and G-3 (natural gas). SDG&E considers such adjustments in its annual review of the revenue requirement, along with several other factors such as forecasted expenditures and collections. Should there be errors in its reports, SDG&E revises and resubmits the impacted report(s).

Finding 5: SDG&E needs to strengthen oversight over its Contractors

Response to Recommendations:

1. *SDG&E should strengthen its contract management oversights and adhere to its policies to ensure that provisions of signed vendor agreements are effectively monitored and adequately enforced. SDG&E should update its contracting manual, conduct a supervisory review of contracts, and require regular training for contract staff.*

Response: SDG&E Customer Programs will conduct training sessions in 2018 to improve program advisor contract and vendor management. Additionally, Customer Programs continues to work closely with its Supply Management to ensure that best practices are understood and relayed to program staff and contractors.

2. *SDG&E should establish a depository to maintain and manage its contracts in a way that it should be able to provide how much funding is left for each EE contract as well as its specific expiration dates for each EE contract.*

Response: SDG&E contracts are maintained by Supply Management's Enterprise Contract Management (ECM) System. The ECM System provides contract managers with reminders for contract expiration and funding level notices. Customer Programs will reinforce monitoring of contract expiration dates and funding levels as part of its improvement for contract and vendor management described in response to Finding #5, Recommendation 1, above.

3. *SDG&E should implement customer feedback surveys, to gain feedback on contractors' services and value provided by the program. SDG&E should develop and implement a customer feedback survey for its training programs and evaluate its training programs in an effort to better assess performance. SDG&E should evaluate and implement appropriate contractor performance monitoring tools such as customer feedback surveys. Once surveys are obtained, SDG&E should discuss the feedback with each contractor and determine if the programs delivered values as intended. SDG&E should negotiate with vendors and implement best practices in the areas of training.*

Response: SDG&E appreciates this recommendation. However, moving forward with the increased reliance on third party program implementers to deliver program results, such as energy savings, SDG&E will be monitoring contract performance through contribution to program metrics and KPIs developed specifically for each program. After such monitoring, SDG&E will consider whether the use of customer feedback surveys would be appropriate to improve contractor performance.

4. *SDG&E should not enter a side agreement with contractors or change the contract terms and payments without contract amendments.*

Response: Customer Programs follows Supply Management best practices. As a business standard policy, no changes to contract terms, payment terms, or payment structures may be made without a signed and executed contract amendment. Customer Programs will reinforce this requirement as part of its improvement for contract and vendor management described in response to Finding #5, Recommendation 1, above.

Finding 6: Lack of Adequate Monitoring and Oversight over Accounting Policies and Procedures

Response to Recommendations:

1. *Minimize errors and mistakes by providing proper training to staff.*

Response: SDG&E will continue to improve its processes and staff training.

2. *Properly close its accounting period and implement the same practice as to another area such as the Energy Assistance Program. Refer to Finding #3.*

Response: Please refer to Finding #3 for SDG&E's response.

3. *Communicate timely to staff when new internal orders are assigned to a new funding cycle to ensure proper recording, provide adequate training with business practices and procedures to responsible staff and program areas.*

Response: Please refer to Finding #6, Recommendation 1 for SDG&E's response.

4. *Evaluate and revise the accrual policy from $10,000 to a lower thresholds amount, and make it more applicable and practical to its EE programs, and be consistent with financial reporting to the Commission, and ensure accurate recording and reporting of ratepayers' funds as well as develop a systematic process or policy to identify accrual amounts, instead of relying on contractors to submit accrual amounts.*

Response: Please refer to Finding #1, Recommendation 3 for SDG&E's response.

5. *SDG&E asserted that it changed its process of classifications from being cost center based, which required a certain level of manual classifications based on system restrictions, to an internal order based method in 2017. The internal order (IO) method assigns a unique IO for each cost category (Admin, Marketing, DI). This diminishes the need for manual adjustments, with defaults to Administrative cost categories. This process will be reviewed this process in the audit for PY 2017.*

Response: For Program Year 2016, SDG&E utilized Cost Centers to determine and report Administration, Marketing, and Direct Implementation classifications. As part of its continuous improvement, SDG&E shifted to managing its cost categories reporting by converting to Internal Orders rather than Cost Centers. This change should improve tracking of program expenditures by cost categories. SDG&E looks forward to UAFCB's review of its new tracking methodology for its PY 2017 expenditures.

6. *SDG&E should be able to provide accounting entries showing how it accounted for sales taxes.*

Response: SDG&E will provide upon request accounting entries for sales tax in future audits and ensure that the UAFCB auditor understands SDG&E's sales tax procedures.

7. *SDG&E should be able to provide accounting entries showing how discounts were credited to purchases related to EE program.*

Response: SDG&E did provide accounting information details (e.g., screen shots of its SAP entry) to demonstrate that the discounts at issue were credited to the relevant EE program. In response to DR21, Question 1, SDG&E explained that vendor discounts are credited back to the internal order where the original expense was recorded. In the future, SDG&E will work closely with the UAFCB auditors to ensure complete understanding of SDG&E's accounting processes.

Finding 7: SDG&E procured Third-Party Contractors with High Rebate Processing Service Costs

Response to *Recommendation:*

SDG&E continues to monitor programs and contractors for cost-effective delivery of services, rebates, and incentives. As an example, for the appliance recycle program, SDG&E determined early in 2016 that the work to recycle the appliances (particularly refrigerators) and payments to the contractor had become too expensive, and the costs exceeded incentives paid to customers. As a result of a cost-effectiveness analysis, SDG&E decided to close the program. SDG&E consistently uses standard program management and best practices to determine a program's cost effectiveness and overall effectiveness.

Sincerely,

Brittney Lee
Regulatory Case Manager

Table 2 Correction:

SDG&E provided additional information to the UAFCB auditor to support the transactions.

Table 2				
UAFCB's Proposed Audit Adjustments for the Selected EE Programs				
PY 2016				
2016 Selected EE Programs	Proposed Adjustments	Updated Proposed Adjustments (per error)	SDG&E Requested Adjustments	Rational
Codes and Standards (C&S)	$(103,582)	$(103,582)	$18,766	DR 2 Sample 8-- Submitted contract to support transaction
None-Resource (NR)	(635,539)	(624,382)	254,513	DR 2 Sample 53 and 54—Resubmitting documentation to support transactions
Residential Energy Advisor (REA)	(21,483)	(21,483)		
Commercial Energy Advisor (CEA)	(8,742)	(8,742)		
Plug Load and Appliances(PLA)	(111,175)	(111,175)		
Third Party (TP)	(135,050)	(135,050)		
Totals	$(1,015,571)	$(1,004,414)	$273,279	

SDG&E Corrections to Appendix B:

Table 1 Correction:

The individual line items in Table 1 did not add up to the totals reflected in the table. SDG&E added an "Other" to show the totals reviewed by the auditors.

Table 1
Summary of EE Samples Selected for Testing
PY 2016

2016 Selected EE Programs	Total 2016 EE Program Expenditures	Total Value of Selected Samples	Percentage	Rational
Codes and Standards (C&S)	$597,895	$206,419	35%	
None-Resource (NR)	8,120,067	2,114,851	26%	
Residential Energy Advisor (REA)	375,673	105,127	38%	
Commercial Energy Advisor (CEA)	745,015	214,927	29%	
Plug Load and Appliances(PLA)	4,862,436	2,189,308	45%	
Third Pary (TP)	21,544,018	4,675,814	22%	
Other	108,655,590	25,131,584	23%	Added this category since the Draft Report total did not add up.
Totals	$144,800,694	$34,638,025	24%	

Evaluation of Responses

SDG&E's responses to the draft report have been reviewed and incorporated into the final report. In evaluating SDG&E's response, we provide the following comments:

FINDING 1: Lack of Compliance with Accrual Policy and Procedures Respecting to its EE Program Costs for 2016

We appreciate SDG&E's openness to use our report to improve its processes and provide staff training to staff in order to enhance its accuracy for recording and reporting EE program costs.

In regards to item #3, SDG&E asserted that Deloitte &Touch LLP (Deloitte) have found the $10,000 threshold is acceptable for corporation reporting purposes. Although Deloitte accepts this practice, it is not necessary a "one-size fits all" threshold. It is important to evaluate the principal nature of corporate transactions and that of the EE program and modify the accrual threshold for the EE costs to ensure the program accuracy and meet regulatory requirements. We strongly encourage SDG&E to carefully consider our recommendation because this high accrual amount may not be suitable to the EE program and may have partially contributed to the 10% corrections in its accounting records as discussed on page 16 of this report. This high number of errors and corrections directly leads to a higher risk of an overstatement of EE costs, unreliable reports, as well as higher budget requests in future years.

We disagree with SDG&E's comment that "It is important to note that UAFCB does not dispute the validity of any of the $1,015,718 in payments and only has a concern regarding the timing of SDG&E's recording to the program." During the audit, we found that not all payments were valid. Besides the timing issue, EE costs are disallowed for a variety of reasons including, but not limited to, double counting of costs, unallowable EE program costs, and payments for corporate sponsorships that are unrelated to the EE program.

We provided SDG&E ample opportunities to provide supporting documentation with our follow-up questions during the audit. We stressed the importance of providing sufficient and specific documentation to save time for both parties. In these instances, SDG&E's submissions were inadequate and unverifiable. After receiving the draft report, SDG&E submitted additional documentation to support these EE costs. This delay leads to these audit exceptions and impacts our audit timeline and progress. After reviewing additional documents submitted by SDG&E, we have decided to make a one-time exception as a courtesy by reducing $273,279 in the final audit report. In the future, SDG&E should ensure to provide adequate documentation during the audit. It is not our practice to accept additional documentation after the draft report is issued.

FINDING 2: Overstatement of the Efficiency Savings and Performance Incentive (ESPI) Award Amount for PY 2016

With additional documentation provided after the draft report was issued, we make an adjustment to the ESPI amount in this final report.

FINDING 3: Failure to Follow GAAP While Closing its Accounting Records

SDG&E stated that "SDG&E accounting practices for Energy Efficiency programs generally follow GAAP and Commission rules and practices. For PY 2016, all costs associated with the implementation of PY 2016 should be reported in the 2016 Annual Report. To comply with this, there continues to be expenses associated with paying customer rebates/incentives and closing out projects and program business associated with the 2016 program year, in the following year (2017). These costs are then reported as part of the PY 2016 expenses, even the costs were recorded in 2017."

We strongly disagree with SDG&E's interpretation of the Commission's requirements for its flexibility and discretion to open its accounting book. SDG&E has used the accrual basis of accounting, which allows SDG&E to estimate and report all 2016 costs in its 2016 Annual Report. The SDG&E's Customer Program – Program Advisor Handbook (Handbook) 2016, Version 6.2, dated December 2016, in Section 8.4, states that "In accordance with GAAP, an accrual is to ensure that all valid significant and larger incurred expenditures/credits are accurate and that all liabilities are recorded in the company's financial statements. Expenses incurred and not yet invoiced prior to the end of each month should be accrued." In fact, SDG&E accounting records revealed that it continuously accrued and re-accrued EE costs on a monthly basis. Therefore, SDG&E doesn't have a need to keep open its accounting period in order to comply with the Commission directives. SDG&E should close its accounting period at the end of each program year, or calendar year for the EE programs. As we discuss on page 10 of this report, this open book accounting practice only applies to SDG&E's EE program, but not for other programs that require reporting of only current-year activities, such as SDG&E's Energy Saving Assistance (ESA) program. SDG&E uses manual adjustments to report only the current-year activity (net of accruals) in its ESA annual report. For the EE program, the Commission contemplated moving away from authorizing the EE budgets on a triennial basis and towards authorizing the EE budgets on an annual "rolling" portfolio basis[14]. With this change, SDG&E is only required to record current year activities to its EE programs, as it has been for its ESA program. SDG&E should apply the same accounting policy to the EE program. In conclusion, SDG&E should not keep open its accounting book to record 2017 costs to the PY 2016.

SDG&E quoted Resolution E-4898, page 15, that "we (the Commission) directed the IOUs only include savings for measures installed in the same year for which they are claiming incentives."

We find that SDG&E's interpretation of Resolution E-4898 is erroneous because the above direction was applied to claiming savings and incentives, which are not expenditures. The Commission made it clear in Resolution E-4807, p.47, that "Commission staff expects the IOUs, after the close of a calendar year, to close its books on savings for that year expeditiously and accurately just as is expected for fiscal and expenditure accounting processes. The expenditure accounting process and the savings accounting process are separate issues and the accounting of the two is separate. Program costs related to a specific project are paid and those costs reported over time in most instances and are not held to project closeout. ***Payments to implementers and partial incentive payments to customers are paid and those costs reported over time in the year they occur***." Furthermore, Resolution E-4897 Order # 5 stated that "Pacific Gas and Electric Company, Southern California Edison Company, San

[14] Rulemaking (R.) 13-11-005.

Diego Gas & Electric Company, and Southern California Gas Company shall only make claims on funds spent in the respective program year. ***Claims must exclude all funds reported as spent in previous years*** and all committed expenditures for activities in future years." Based on the Commission directives, we find that SDG&E's position on this particular issue to be unjustified. We continue to emphasize the importance of closing its accounting records properly and reporting only EE costs in the year they incur.

SDG&E also asserted that "This practice (open accounting book) is recognized and allowed by Energy Division and has been a regular practice since the 1990s." We do not audit the Energy Division and cannot make a comment on this statement. We are puzzled for a public company like SDG&E to make such statement because the practice of keeping open its accounting book is not only an uncommon practice, but also a departure from GAAP, which could lead to an adverse opinion in an audit of its financial statements.

This open accounting book practice may have partially contributed to the 10% corrections on page 16 of this report. This happened when staff was confused in selecting proper accounting period to record EE expenditures. During the audit, SDG&E agreed, in many instances, that it had inadvertently recorded costs from PY 2015 and PY 2017 to PY 2016 as we discussed in Finding 1, page 5 of the report. Therefore, we continue to address the importance of closing its accounting records in accordance with GAAP, of striving for fewer errors and corrections, and reporting reliable EE costs reported in its Annual Report to the Commission. We withstand our proposal to remove $360,027 of its employee payroll costs recorded in 2017 from the PY 2016 costs. In addition, SDG&E should work with the Energy Division to determine the effect of this $360,027 on its ESPI incentive award.

FINDING 4: Lack of Reconciliation of Amounts Committed/Unspent Funds

SDG&E stated that it does report adjustments and cancellations of committed funds, as required in its Energy Efficient report pursuant to Decision 01-11-066, Ordering Paragraph 10, Table E-3 (electric), and G-3 (natural gas).

We find that SDG&E's statement contradicts with its responses provided during the audit. SDG&E had acknowledged that cancellations and adjustments were not included in the monthly EEStats reports. We discuss our concerns related to committed funds reported to the Commission on pages 10 and 11 of our report. In response to our inquiries, SDG&E asserted that it is unable to provide reconciliations of its commitments. We continue to address our concerns of the accuracy of committed funds reported to the Commission as well as how and when these unspent committed funds would be refunded to the ratepayer.

FINDING 6: Lack of Adequate Monitoring and Oversight over Accounting Policies and Procedures

For items #2 and #4, refer to our responses to Findings 3, and 1, respectively.

For item #5, SDG&E stated changes in its processes have been in place. Therefore, we look forward to working with SDG&E in the review of PY 2017.

For item #6, we find that SDG&E's comment "to ensure the UAFCB auditor understand SDG&E's sales tax procedures" is inappropriate, and misleading. The issue at heart is not that our auditor doesn't understand its procedures, but the accounting documentation provided during the audit is unsatisfactory. As discussed on page 17 of our report, we expressed our concerns related to sales taxes written by hand on EE invoices. We requested SDG&E to provide its accounting entries showing how sales tax transactions were accounted for. In this particular issue, SDG&E provided two separate screen prints for debits and credits, which is unusual. SDG&E cut the screen print from its accounting system and provided only one debit side denoting the invoice amount plus the sales taxes. We don't have questions regarding this debit entry. For the credit side, SDG&E provided a different screen print from its SAP accounting system. However, this amount didn't match with the sales taxes recorded on the first print screen. At the exit meeting, we explained our position and provided SDG&E an additional opportunity to submit the complete, not partial accounting entries. We have made our efforts to verify if SDG&E appropriately accounted for these hand-written sales taxes collected from EE transactions as a liability in its accounting records and submit these sales taxes to the California Department of Tax and Fee Administration (CDTFA)[15] as required by tax law. Despite our efforts, SDG&E has not been able to provide the complete double accounting entries with debits and credits on the same screen print. We are puzzled with SDG&E's responses that "SDG&E WILL provide upon request accounting entries for sales tax in future audits", but is not able to provide accounting entries for this year audit. We strongly disagree with SDG&E's comments "to ensure that the UAFCB auditor understand SDG&E's sales tax procedures." We fully understand sales tax regulations and its procedures. It is SDG&E who is unable to show how it accounts for these sales tax transactions. We are unable to determine how SDG&E recorded its sales taxes collected from EE related transactions.

For item #7, we explained our position at the exit meeting and provided SDG&E an additional opportunity to provide an explanation or submit complete accounting entries but received no additional reply. We have made our efforts to verify if SDG&E appropriately credited purchase discounts to EE expenditures. SDG&E submitted documentation but didn't provide an adequate explanation or reconciliation of various discounted figures. In this particular issues, SDG&E recorded a net payment with a purchase discount for a total amount on the invoice in its SAP financial accounting system. Then, SDG&E broke down the total cost and recorded them to different EE programs with its unique internal numbers in the SAP cost system. Several days later, it manually inputs the break-down discounts to associated costs. It is very difficult to track these transactions when total invoices, associated discounts were recorded in different amounts, on different dates and in separate SAP accounting modules. SDG&E's comments "SDG&E will work closely with the UAFCB auditor to ensure complete understanding of SDG&E's accounting processes." This statement is inaccurate. We do not have questions of SDG&E's accounting processes, but the accounting entries. During the audit, we frequently sent follow-ups for unclear responses and addressed the importance of providing a satisfactory explanation and reconciled figures, if necessary, to avoid additional requests, consequently such findings. After we reviewed SDG&E's accounting records, the item is removed from the final report. However, we remind SDG&E that it is its responsibilities to provide a clear explanation and adequate supporting documents in the future.

[15] As known previously as the California State Board of Equalization (BOE).