

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's)
Review of Fuel Adjustment Clause) Case No. 10-479-EL-UNC
Guidelines.)

ENTRY

The Commission finds:

- (1) Pursuant to Sections 4928.142(D)(1)-(2) and 4928.143(B)(2)(a), Revised Code, an electric utility may recover, among other things, the costs of fuel and purchased power. However, the costs must be prudently incurred before the Commission can authorize recovery through a fuel adjustment clause (FAC). In order to properly ensure that the costs of fuel and purchased power were prudently incurred, the Commission may conduct an audit or direct that an audit be performed.
- (2) To assist in the review of these fuel costs, we believe that it would be helpful to establish guidelines to provide uniform standards and specifications for the FAC audits. While the Commission believes it is important to establish these guidelines, we note that these guidelines should only serve as a guide for the auditor and Staff, and should not be used to the exclusion of the auditor's initiative, imagination, or thoroughness when reviewing a company's FAC.
- (3) To this end, Staff has proposed FAC guidelines. To assist in its review of Staff's proposed guidelines, the Commission is seeking comments from interested persons on Staff's proposed guidelines, which will be posted on the following website upon the issuance of this entry:

www.puco.ohio.gov/puco/rules

To minimize the expense of this proceeding, the Commission will serve a paper copy of only this entry. All interested persons are directed to download the proposed rules from the above website, or to contact the Commission's Docketing Division at (614) 466-4095, Monday through Friday between the hours of 7:30 a.m. and 5:30 p.m., if a paper copy of the proposed rules is required.

- (4) All comments should be filed in this docket by July 14, 2010, and reply comments should be filed by July 28, 2010.

Pursuant to the Commission's May 7, 2008, entry in Case No. 06-900-AU-WVR, comments and replies may be filed electronically. Further information is available at <http://dis.puc.state.oh.us/> by clicking on "Electronic Filing Information & Links."

All comments filed may be viewed at:

<http://dis.puc.state.oh.us/CaseRecord.aspx?CaseNo=10-479>

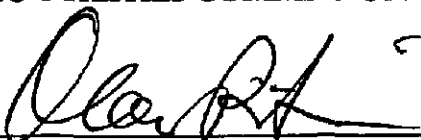
Any person filing comments may request paper copies of the other comments by filing a notice of such request in this docket. All other commentors shall then serve a copy of the comments upon the requesting party via email or hard copy to the address provided.

It is therefore,

ORDERED, That all interested persons file comments and reply comments with the Commission regarding Staff's proposed guidelines by July 14, 2010 and July 28, 2010, respectively. It is, further,

ORDERED, That a copy of this entry, without any attachments, be served upon all electric utilities in the State of Ohio, the Office of the Ohio Consumers' Counsel, and all interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO



Alan R. Schriber, Chairman


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Entered in the Journal

JUN 23 2010Renee J. Jenkins
Secretary

Fuel Adjustment Clause Guidelines

I. Introduction

Ohio electric utilities are required to provide consumers a standard service offer of electric service. The electric utility can provide this service through either a market rate offer (MRO) or an electric security plan (ESP). An MRO or ESP may recover, among other things, the costs of fuel and purchased power, provided that the costs are prudently incurred.¹ The Public Utilities Commission of Ohio must ensure that the costs were prudently incurred before the Commission can approve recovery of costs under a fuel adjustment clause (FAC). In order to properly investigate the costs incurred, the Commission may conduct or direct that an audit be performed. The guidelines set out below are intended to provide guidance throughout the audit process. However, appropriate discretion on the part of the auditor will be essential in order to conduct an audit in conformance with specific requirements set forth by different standard service offerings.

II. Audit Standards

A. Management/Performance Audit

(1) Purpose

The purpose of the Management/Performance Audit Standards for the Fuel Adjustment Clause is to provide uniform standards and specifications as guidelines for conducting a FAC management/performance audit. The FAC management/performance audit program is only a guide and should not be used to the exclusion of the auditor's initiative, imagination, and thoroughness.

(2) Objectives

Unless otherwise ordered by the Commission, the objectives of the FAC management/performance audit program are as follows:

- (a) Ascertain the fuel procurement and emission allowance management policies and practices followed by the company and determine whether such procedures are practical and reasonable.
- (b) Ascertain the procedures utilized by the company to assure that lowest reasonable prices at the time of purchase are paid for fuel and purchased power, emission allowances and environmental reagents.
- (c) Determine whether the policies followed by the company assure fuel supplies at reasonable prices.

¹ Sections 4928.142(D)(1) and (2); 4928.143(B)(2)(a), Revised Code.

- (d) Evaluate the economic efficiency of the fuel procurement and utilization practice.
 - (e) Identify specific areas for improvement of organizational and management practices to ensure fuel operations of the company at the lowest reasonable overall cost.
- (3) Audit standards

The FAC management/performance audit provided by these guidelines shall be conducted in accordance with the "Government Auditing Standards, July 2007 Revision" and any subsequent updates to those standards.

- (4) Scope of the FAC management/performance audit
- (a) The FAC management/performance audit shall consist of a management/performance audit and a follow-up performance audit. The auditor shall conduct the audit for the time period established by the Commission.

The auditor shall conduct a detailed management/performance audit with respect to at least one area of the company's fuel cost and renewable energy practices. Practices to be considered for the performance audit assessment shall include, but not be limited to, the following:

- (i) Procedures employed to assure the quality of delivered fuel as contracted.
 - (ii) Procedures employed to assure that lowest reasonable overall prices are paid for fuel purchased in the spot market.
 - (iii) Policies followed to assure a fuel supply at reasonable prices.
 - (iv) Policies followed to assure the most economical purchases of power.
 - (v) Practices employed to effectively negotiate long-term contracts.
- (b) Follow-up performance audit

The auditor shall conduct a follow-up performance audit to determine whether the recommendations developed in previous management/

performance audits and those determined to be reasonable in a FAC hearing have been effectively implemented by the company.

(5) Minimum review requirements

At minimum, the auditor shall review the following:

- (a) Fuel procurement policies and practices.
- (b) The company's long-term fuel supply contracts and amendments to the contracts.
- (c) Arrangements with fuel suppliers owned or controlled, in whole or in part, by the company.
- (d) Environmental compliance with Title IV of the Clean Air Act Amendments of 1990.
- (e) The system dispatcher's policies for power purchases, interchanges, and sales for resale.

(6) Audit procedures for fuel procurement

The procedures that the auditor shall follow in analyzing the company's fuel procurement practices and policies include, but are not limited to, the following:

- (a) A review the company's fuel procurement policies, procedures, and practices.
- (b) Assess the company's organizational ability to procure fuel and provide reliable electric service at the lowest reasonable overall cost.
- (c) Analyze the fuel purchasing department's formal procedures for purchasing fuel, contract negotiation, and fuel contract administration as follows:
 - (i) Determine whether the terms of each fuel supply contract contain a price escalation provision.
 - (ii) Review any contract amendments that contain a price escalation provision and review correspondence on the amendment negotiations.
 - (iii) Evaluate the delivery performance of the fuel supplier for each long-term fuel supply contract.

- (iv) Determine whether the company must buy spot coal at a higher price than that contained in a long-term fuel supply contract if the fuel supplier does not fulfill its obligations.
 - (v) If the company jointly owns a generating plant, determine which company has responsibility for fuel procurement and how the fuel procurement policies are determined between the owners.
- (d) Review management of the company to evaluate the following:
- (i) Whether management has set limits for long-term or short-term fuel supply contracts in terms of years or price.
 - (ii) Determine if the company has a policy that limits the types of transactions it would use to secure long-term fuel supply contracts.
 - (iii) If the company secures long-term fuel supply contracts by purchasing coal lands, turn-key operations, purchasing a coal company, or some other means.
 - (iv) Establish whether restrictions are placed upon the amount of capital which the company considers appropriate to put upfront for operations listed in Section (iii) above.
 - (v) If legal issues relative to the purchase of such operations listed above in Section (iii), have been explored.
 - (vi) Verify whether turn-key operations have been explored and if so, on what basis the company proceeded.
 - (vii) Evaluate whether limits result from cash flow problems, capital availability problems, or other such factors.
 - (viii) If policies have changed over time due to economic conditions.
 - (ix) Verify that economic efficiency was the determinative criteria for purchasing fuel supplies.
 - (x) Identify whether there are any restraints on operational efficiency imposed by environmental regulation, legislation, or operating requirement.
- (e) Review with the fuel purchasing agent for the company:

- (i) What the agent believes to be the company's primary criteria for coal purchasing.
- (ii) What the agent considers to be the most important factors in dealing with coal companies.
- (iii) How the agent begins negotiations for a long-term fuel supply contract.
- (iv) What areas of responsibility the agent has and what responsibilities are supervised.
- (v) How the agent assures that the established criteria are met.
- (vi) What checks are run and how the performance and overall compliance with applicable lawful standards, such as OSHA and water quality standards, of coal companies with which the company deals are evaluated.
- (vii) How the agent assures that the coal company is giving the best price and that the company is dealing with the coal company in an appropriate business posture.
- (viii) Whether the agent often deals with the same fuel supply sources.
- (ix) How the agent obtains current information on coal and the coal industry.
- (x) What ongoing educational programs have been established.

(7) Audit procedures for station visitation

The objective of the station visitation is to review the company's coal processing procedure from the receipt of the coal to the disposition of fly ash. When conducting the station visitation, the auditor shall follow the procedures set forth below:

- (a) Obtain a description of the company's coal receiving procedures and controls for shortages, overages, or other discrepancies, and do the following:
 - (i) Determine how the coal is weighed as received.
 - (ii) Determine how freight bills and car number discrepancies are handled.

- (iii) Determine how damaged cars are checked and who initiates claims for shortages.
 - (iv) Review the month end cutoff procedure.
 - (v) Note any situations where the company does not follow the described procedure.
- (b) Obtain a description of the company's coal sampling procedures, and do the following:
 - (i) Determine the frequency of coal sampling.
 - (ii) Determine how the coal samples are identified.
 - (iii) Determine what control is exercised over forwarding coal samples to the laboratory.
 - (iv) Determine how a representative coal sample is selected for each fuel supplier.
 - (v) Obtain copies of receiving data for one-month during the FAC audit period to compare with purchasing and accounting records.
- (c) Obtain a description of the company's laboratory procedures for testing coal samples, and do the following:
 - (i) Determine how coal samples are received and identified.
 - (ii) Identify any problems encountered in following the testing procedures.
 - (iii) Determine whether the testing methods are acceptable.
 - (iv) Determine how unusual results are handled.
 - (v) Obtain copies of laboratory sampling reports for one-month during the FAC audit period to compare with purchasing and accounting records.
 - (vi) Determine how the company assures that all samples are received and actually tested.
- (d) Obtain a description of the company's procedure for handling coal from the stockpile to the firebox or boiler, and do the following:

- (i) Examine the scale calibrating logs for conformity with the described procedure.
 - (ii) Determine what procedure is followed when coal scales are inoperable.
 - (iii) Review the month-end cutoff procedure.
 - (iv) Obtain copies of consumption data for one-month during the FAC audit period to compare with accounting and generation records.
- (e) Obtain a description of the company's procedure for taking physical inventories of coal and fuel oil, and do the following:
 - (i) Determine the frequency of the physical inventories.
 - (ii) Determine how density tests are performed and whether the samples are accurate.
 - (iii) Determine how cutoff data are established, who controls the data, and how often cutoffs are established.
 - (iv) Review the working papers on physical inventories and trace an adjustment to the general books, including fuel stock and consumption records.
 - (v) Review how the company treats physical inventory adjustments in the fuel component calculation and examine related reporting.
 - (vi) Determine whether the company complies with the commission's approved procedures from physical inventory adjustments.
- (f) Discuss with the station manager all procedure descriptions.
- (g) Determine levels of review applicable to the operating statistics.
- (h) Examine station reports and note any reviews, comments, or investigations.
- (i) Obtain copies of the station reports sent to the company's general office for incorporation into company statistics and trace the reports to the statistics.

- (8) Audit procedures for environmental compliance with Title IV of the Clean Air Act Amendments of 1990.

The auditor shall review matters involving the implementation of the company's environmental compliance plan, including, but not limited to, the following:

- (a) Review the policies for receiving emissions data from jointly-owned plants.
- (b) Review the manner in which Continuous Emissions Monitoring (CEM) results are communicated to those areas responsible for making decisions regarding allowance transactions.
- (c) Review the company's policies and procedures as they relate to the following items:
 - (i) Utilizing emission allowances to maximize its use of Ohio coal, consistent with least-cost principles.
 - (ii) Monitoring the emission allowance market.
 - (iii) Forecasting of emission allowance values.
 - (iv) Sales and purchases of allowances.
 - (v) Incorporating emission allowances into dispatching and fuel procurement decisions.
- (d) Identify any environmental standards or regulations that significantly affect the economic efficiency of the company's fuel utilization.
- (e) Review all allowance transactions in which the company participated during the audit period, as well as foregone transactions.
- (f) Such other matters as the Commission may direct to be investigated or reviewed.

- (9) Audit procedures for purchased power and sales for resale policy evaluation.

The procedures which the auditor shall follow in reviewing the company's power purchases and sales for resale policies include, but are not limited to, the following:

- (a) Obtain a description of the policies followed by the system dispatcher in purchasing power and making sales for resale, and determine the following:

- (i) Whether economic power, including economic energy, is purchased in the most advantageous periods.
 - (ii) How emergency energy is purchased.
 - (iii) The basis on which emergency energy sales are priced.
 - (iv) Whether the company supplies a proper share of stabilizing power to its interconnected systems.
 - (b) Review the company's procedures for assuring that economic efficiency is the determinative criteria for power purchases, sales for resale, and fuel utilization.
 - (c) Evaluate the company's endeavors to purchase power or generate energy at a fuel cost significantly less than higher priced power under a contract or interconnection agreement.
- (10) Audit report

The auditor shall prepare a management/performance audit report to be filed with the Commission that includes, at a minimum, all of the following:

- (a) Description of the scope and objectives utilized in conducting the FAC audit.
- (b) Description of the methodology utilized in conducting the FAC audit.
- (c) An objective presentation of the findings, facts, and conclusions in a clear and concise manner.
- (d) Include only the findings, facts, and conclusions that are adequately supported in the audit report or in the auditor's working papers (which may include supporting schedules or cross referencing of issues).
- (e) A primary emphasis upon improvement rather than criticism of the past practices.
- (f) An identification and explanation of any issues, areas, or questions that need further examination.
- (g) Specific recommendations and, when possible, an estimate of the savings to be realized by implementing the recommendations.
- (h) An identification of areas that are well-managed and a notification of any improvements.

- (i) An evaluation of management decisions in light of the conditions, circumstances, and available information at the time the decisions were made.

(B) Financial Audit

(1) Purpose

The purpose of the Financial Audit Standards for the FAC is to provide uniform standards and specifications as guidelines for conducting a FAC financial audit. The FAC financial audit is only a guide and should not be used to the exclusion of the auditor's initiative, imagination, and thoroughness.

(2) Objectives

Unless otherwise ordered by the Commission, the objectives of the FAC financial audit program are as follows:

- (a) Determine that the company has procedures in place and that are being followed regarding the following activities:
 - (i) Processing of fuel receipt and consumption transactions.
 - (ii) Processing of energy purchase and sale transactions.
 - (iii) Processing of emission allowance purchases, swaps, and sales.
 - (iv) Accurately calculating the FAC rate, including compliance with the Commission's financial audit guidelines.
- (b) Verify the arithmetic accuracy of fuel component and other allowable amounts passed through the FAC rate to the company's customers.
- (c) Verify the arithmetic accuracy of the company's calculation of the FAC rate.
- (d) Verify the proper FAC rates are applied to customer's bills.
- (e) Review the procedures and control for assembly and reporting of information in the FAC forms.
- (f) Determine whether the company is following procedures for processing fuel data and whether the procedures are reasonable.
- (g) Determine whether the fuel delivered to the company meets quality and quantity specifications.

- (h) Determine whether the company correctly reported payments made for acquisition and delivery costs of fuel.
- (i) Calculate the difference between actual net revenues and actual net fuel costs.

(3) Audit standards

The FAC financial audit provided by these guidelines shall be conducted in accordance with generally accepted auditing standards established by the American Institute of Certified Public Accountants.

(4) Scope of the FAC financial audit

The auditor shall conduct a financial audit for the audit period established by the Commission. In addition to the objectives stated above, the auditor shall determine, at minimum, the following:

- (a) The difference, if any, between the total billed charges and those that should have been billed for the period excluding the effect of any commission findings from the current management/performance or financial audits.
- (b) Whether the recommendations developed in previous financial audits have been effectively implemented by the company.

(5) Minimum review requirements

The auditor's review shall include, but not be limited to, a review of the following procedures:

- (a) Fuel procurement not under long-term contracts.
- (b) Accounting for fuel receipts, testing, and payments.
- (c) Weighing, testing, and reporting coal burned.
- (d) Amortizing nuclear fuel costs corresponding to nuclear generated energy.
- (e) Recording purchases and interchanges.
- (f) Accounting treatment of emission allowances.
- (g) Calculating the FAC rate, including an evaluation of the company's compliance with the Commission's audit guidelines, and their application to customer bills.

(6) Audit procedures for fuel procurement

The procedures that the auditor shall follow in reviewing the company's fuel procurement practices and policies include, but are not limited to, the following:

- (a) Review the company's fuel procurement procedures manual and written instructions for purchasing fuel and determine whether the procedures are being followed.
 - (b) Obtain the company's fuel supply contracts and review specifications for the following:
 - (ii) Total and periodic amount of fuel to be supplied.
 - (iii) Pricing provisions, including extent to which the contract is a cost plus profit contract, if its duration exceeds one year.
 - (iv) Contract audit provisions.
 - (c) Review the quality specifications in each coal contract and determine whether the company's payments reflect adjustments for calorific value when the weighted average calorific value of fuel received differs from that stated in the contract.
 - (d) Review the company's procedures for verifying price escalations and contract amendments.
 - (e) Determine whether the price escalation provisions were correctly computed.
 - (f) Review the results of any fuel contract audits.
 - (g) If the company jointly owns a generating plant, determine whether fuel accountability transfers among companies are properly recorded.
 - (h) Determine that any deferred fuel amounts comply with commission ordered treatment.
- (7) Audit procedures for activities in the emission allowance market

The procedures which the auditor shall follow in reviewing the electric utility's activities in the emission allowance market are:

- (a) Determine the appropriateness of the company's allocation of emission allowances among companies within its system.
- (b) Determine whether modifications to the allowance inventory were correctly computed.

- (c) Determine the appropriateness of emission allowance distribution for the operating utility of jointly-owned units.
- (d) Such other matters as the Commission or its Staff may direct be investigated or reviewed.

(8) Audit procedures for processing coal orders

The procedures which the auditor shall follow in reviewing the processing of coal orders by the company include, but are not limited to, the following:

- (a) Obtain a brief description of the company's procedure for processing fuel purchase orders.
- (b) Obtain purchase orders for one month's fuel procurement during the FAC audit period and complete the following:
 - (i) Relate and reconcile the purchase orders to fuel requirements.
 - (ii) Examine any changes to the purchase order and obtain explanations for unusual changes.
 - (iii) Compare the purchase orders to approved purchased requisitions.
- (c) Obtain cash vouchers for one month during the FAC audit period and complete the following:
 - (i) Compare the invoice to the purchase order.
 - (ii) Trace the invoice quantities to the received reports.
 - (iii) Trace the invoices to the fuel ledger.
 - (iv) Trace adjustments for British thermal units from the laboratory to the adjustment's application to payment invoices.
- (d) For several days during the FAC audit period, obtain daily reports on the error conditions from matching invoices and receiving reports, note the errors' disposition, and review any unusual items.
- (e) Obtain freight cash vouchers from two to five days of coal receipts during the FAC audit period, compare the freight cash vouchers to the coal received reports and the fuel ledger, and note any differences.

- (f) Obtain two cash vouchers each for barging the coal unloading during the FAC audit period, compare the tonnage to the unloading reports, and trace the terms and rates of the cash vouchers to the contract's purchase order, and to the fuel ledger.
- (g) Obtain a description of the company's procedures for preparing monthly fuel analysis reports.
- (h) Test such procedures by tracing adjustments from the fuel analysis reports to the payment invoices.
- (i) Review all pending or approved retroactive escalations.
- (j) Obtain purchase orders for two additional months during the FAC audit period and explain any unusual changes from the month reviewed under paragraphs (B)(8)(b) of these guidelines.
- (k) Correlate coal orders with contracts to validate consistency.
- (l) Summarize all discrepancies and suggestions resulting from the FAC audit and discuss them with officials of the company.

(9) Audit procedures for purchased power

The procedures which the auditor shall follow in reviewing the company's power purchases are:

- (a) Obtain a description of the procedures followed by the system dispatcher in purchasing power and determine:
 - (i) Whether economic power, including economy energy, is properly reported based on the company's interconnection agreement.
 - (ii) The basis for purchasing emergency power.
 - (b) Review the procedures for reporting purchase power transactions to ensure they include sufficient information to complete the FAC forms.
 - (c) Verify purchased power transactions to related invoice, paid cash voucher, or cash receipts.
- (10) Audit procedures for reviewing the FAC rate.

The procedures which the auditor shall follow in reviewing the FAC rate charged by the company include, but are not limited to, the following:

- (a) Obtain for the FAC audit period copies of all monthly, semiannual, and annual reports filed with the Commission.
- (b) Obtain copies of the company's working papers for computing the FAC rates charged during the FAC audit period, verify the accuracy of the calculations, and trace the costs shown on the working papers to their sources.
- (c) Compare the FAC rate calculations in the working papers with the reports filed with the Commission.
- (d) Determine whether the company's calculations of the FAC rates comply with these guidelines.
- (e) Determine whether the company's estimated data in calculating the FAC rates are reasonable.
- (f) Determine the method for calculating the average cost of fuel consumed.
- (g) Identify the first billing cycle in the next current period to which a new FAC rate will be applied.

(11) Audit report

The auditor shall prepare a financial audit report to be filed:

- (a) State the scope and objectives of the FAC audit.
- (b) State the standards utilized in conducting the FAC audit.
- (c) Objectively present findings, facts, and conclusions in a clear and concise manner.
- (d) Include only the findings, facts, and conclusions that are adequately supported in the audit report or in the auditor's working papers (which may include supporting schedules or cross referencing of issues).
- (e) State specific recommendations, if any, and, when possible, an estimate of the savings to be realized by implementing the recommendations.
- (f) Place primary emphasis upon improvement rather than criticism of the past.
- (g) An identification and explanation of any issues, areas, or questions that need further examination.