

**BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Review of the Delivery	)	
Capital Recovery Rider Contained in the	)	
Tariffs of Ohio Edison Company, Cleveland	)	Case No. 15-1739-EL-RDR
Electric Illuminating Company, and the	)	
Toledo Edison Company.	)	

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**COMMENTS  
BY  
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL**

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**I. INTRODUCTION**

For nearly seven years FirstEnergy has been collecting money from consumers and earning a return on certain distribution plant through its Delivery Capital Rider (“DCR”).<sup>1</sup> However, OCC’s review of the financial audit that was conducted of this rider has turned up some concerns regarding FirstEnergy’s accounting practices. Additionally, the independent auditor identified issues with the Utility’s project management. On behalf of FirstEnergy’s 1.9 million customers, the Office of the Ohio Consumers’ Counsel (“OCC”) attempts to ensure that costs charged to those customers under the DCR Rider are reasonable and that customers do not pay for significant cost overruns.

**II. COMMENTS**

**A. The PUCO should not require customers to pay for significant cost overruns for capital projects**

Concern about FirstEnergy over-spending/not properly planning capital projects is not a new issue. In fact, in the 2013 DCR Rider audit, the audit report acknowledged that

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<sup>1</sup> Compliance Audit of the 2015 Delivery Capital Riders of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company at 9 (April 22, 2016) *hereinafter* “Audit Report”.

FirstEnergy was not fully vetting the scope of IT-related capital projects before the Utility launched into implementation of the projects.<sup>2</sup> Through a settlement with Staff, FirstEnergy agreed to conduct an internal review of the processes it uses for approving IT programs.

As part of the current audit, Blue Ridge found that the Utility conducted the recommended IT review and made a number of changes in the process as of March 31, 2016 (which is after the audit period covered in this case).<sup>3</sup> OCC inquired about the status of FirstEnergy implementing the Blue Ridge recommendation contained in the audit report dated April 22, 2016 regarding initiating a non-IT budget process review. Yet as of February 9, 2017, almost ten months after Blue Ridge made this recommendation, FirstEnergy had only begun to have “internal discussions regarding this recommendation.”<sup>4</sup>

In this audit, Blue Ridge recommended that the FirstEnergy companies review their project planning process for non IT- related projects to ensure that projects are fully scoped prior to implementation.<sup>5</sup> This recommendation stemmed from a review of work orders that Blue Ridge selected for analysis where a sizable number of the work orders were significantly over budget. Out of a total 94,768 work orders from the three FirstEnergy operating utilities and the service company, Blue Ridge selected a sample of 56 work orders for more detailed analysis and testing.<sup>6</sup> From this sample, Blue Ridge

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<sup>2</sup> Audit Report at 27.

<sup>3</sup> Audit Report at 28.

<sup>4</sup> OCC Set 3, INT-24.

<sup>5</sup> Audit Report at 21.

<sup>6</sup> Audit Report at 57.

found that fifteen of the work orders (or approximately 27 percent) were significantly over budget (by over 15%).<sup>7</sup> The specific projects and the amount of money FirstEnergy spent over project budget are provided in Table 1 below.

**Table 1: Sample of Over-budget Capital Projects**<sup>8</sup>

<b>Work Order Number</b>	<b>Capital Project Cost</b>	<b>Amount Over Budget</b>	<b>Original Capital Project Budget<sup>9</sup></b>	<b>Percentage Over Budget</b>
CECO 14077587	\$3,448,633	\$1,144,655	\$2,303,978	49.70%
CECO 14584608	\$3,069,275	\$681,997	\$2,387,278	28.60%
CECO CE-700319	\$423,910	\$184,847	\$239,063	77.30%
CECO CE-710001	\$1,865,775	\$1,275,140	\$590,635	215.90%
CECO 13542943	\$1,185,355	\$1,111,990	\$73,365	1515.70%
OECO 14072601	\$2,274,158	\$914,734	\$1,359,424	67.30%
OECO 14158512	\$2,811,441	\$2,766,449	\$44,992	6148%
OECO OE-700333	\$356,931	\$266,309	\$90,622	293.90%
OECO PA-82997440	\$10,628,842	\$7,798,071	\$2,830,771	275.50%
FECO IF-SC-0000641-1	\$495,828	\$303,693	\$192,135	158.10%
FECO ITS-SC-000223-1	\$6,740,295	\$1,264,872	\$5,475,423	23.10%
FECO ITS-SC-000345-1	\$242,819	\$116,488	\$126,331	92.20%

<sup>7</sup> Audit Report at 60.

<sup>8</sup> Audit Report at 61-65.

<sup>9</sup> OCC determined the original budgeted amounts from the Audit Report by subtracting the Amount over budget from the Capital Project Cost.

FECO ITS-SC-000386-1	\$3,060,065	\$649,491	\$2,410,574	26.90%
FECO XIT-000003-1	\$5,145,665	\$1,538,625	\$3,607,040	42.70%
FECO ITS-SC-000296-1	\$5,678,057	\$817,461	\$4,860,596	16.80%
<b>Total</b>	<b>\$47,427,049</b>	<b>\$20,834,822</b>	<b>\$26,592,227</b>	<b>78.35%<sup>10</sup></b>

Proper project planning and accurate capital budgeting/spending is important because the DCR Rider effectively shifts the financial risks for imprudent investments from FirstEnergy's shareholders onto its customers. The risk is shifted to consumers, because the DCR allows FirstEnergy to collect a return on and of investment in distribution infrastructure without having to go through a traditional rate case under R.C. 4909.18.<sup>11</sup> In much the same way that shareholders would not tolerate inadequate project planning and cost overruns, the PUCO also should not tolerate inadequate project planning and cost overruns. The PUCO should act to protect customers from paying for these rates that stem from FirstEnergy's inadequate project planning and cost overruns.

As shown in Table 1, for the fifteen projects identified as over-budget by Blue Ridge, the amount that the projects were over budget is approximately \$20.8 million or over 78% of the costs budgeted for these projects.<sup>12</sup> If the Auditor's sample size was statistically relevant, then the number of projects that could actually be over budget and

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<sup>10</sup> OCC determined this number by taking the Amount over budget and dividing it by the total original Capital Project Budget.

<sup>11</sup> Nov. 30, 2016 Prehearing Conference, Tr. at 10-11:24-3.

<sup>12</sup> Audit Report at 57.

the amount of the over spending that customers are being made to pay for could be astonishing.

And FirstEnergy may not even be tracking the amount of work orders that were over budget. In response to discovery, the Utility was asked how many of the work orders exceeded their project cost budget by more than 15 percent.<sup>13</sup> (The 15% threshold value was used because Blue Ridge concluded that many of the projects in the 56 work orders that it reviewed were within +/- 15% of the approved project budget.)<sup>14</sup> But in trying to obtain this type of information relative to the total number of FirstEnergy work orders, the standard discovery response was that “the requested analysis does not exist.”<sup>15</sup>

OCC supports Blue Ridge’s recommendation that FirstEnergy “review their project planning process to ensure that the methodology allows for projects to be fully scoped prior to execution.”<sup>16</sup> OCC additionally recommends that, when the PUCO next selects an independent auditor to examine the DCR, the auditor be instructed to also review FirstEnergy’s efforts in reducing cost overruns related to project management. As part of this additional review, FirstEnergy should be required to provide the independent auditor with all work orders over \$1 million that have exceeded their scoped budget by 15%. This would then allow the independent auditor to accurately judge the extent to which the total DCR expenditures that customers are paying are subject to significant cost overruns. OCC also recommends that for projects that are 30% over the scoped budget, the PUCO determine that such cost overruns will be presumed imprudent. This

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<sup>13</sup> OCC Set 3, INT-15; OCC Set 3, INT-16; OCC Set 3, INT-17.

<sup>14</sup> Audit Report at 60.

<sup>15</sup> OCC Set 3, INT-15; OCC Set 3, INT-16; OCC Set 3, INT-17.

<sup>16</sup> Audit Report at 65.

would be a rebuttable presumption that FirstEnergy could overcome by presenting evidence of prudence related to the cost overruns. Such a standard would be protective of customers and would create an incentive for FirstEnergy to minimize costs charged to customers under Rider DCR.

**B. OCC has identified two accounting discrepancies that should be addressed in future audits.**

After a lengthy and often unnecessarily protracted process of attempting to simply receive information from FirstEnergy about the independent audit, the OCC was able to identify two issues that should be explicitly addressed in future audits. The first of these issues relates to the Utility's Asset Retirement Obligations and the second issue concerns FirstEnergy's Accumulated Deferred Income Taxes. The concerns raised by these issues should be appropriately addressed in the next annual audit by the PUCO's independent auditor.

**1. FirstEnergy's accounting of Asset Retirement Obligations may have caused customers to overpay under the DCR rider.**

The accrued liability for the Asset Retirement Obligations is presently included in Account 230. In Case No. 07-551-EL-AIR ("2007 Rate Case"), the Asset Retirement Obligations account (which at the time was included in Account 254) was deducted from plant in service in the determination of rate base, which was appropriate.<sup>17</sup> FirstEnergy did not include the change in the balance of the Asset Retirement Obligations since May

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<sup>17</sup> *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Increase Rates for Distribution Service, Modify Certain Accounting Practices and For Tariff Approvals*, Case No. 07-551-EL-AIR, Staff Report of Investigation, Schedule B-6, page 2 of 5 (Dec. 4, 2007).

31, 2007 for the purpose of determining the DCR rate base.<sup>18</sup> As the Asset Retirement Obligations are directly related to the transmission and distribution (“T&D”) plant that is included in the DCR rate base, the independent auditor should have determined whether the rate base reduction should have flowed through to the calculation of the DCR. If so, the DCR is potentially overstated and customers have paid too much. This issue should be appropriately addressed in the next annual audit, by the PUCO’s independent auditor.

**2. FirstEnergy’s accounting of Accumulated Deferred Income Taxes may have adversely affected the costs charged to consumers.**

OCC has identified an area of concern in the audit report regarding the consistency of the accounting practices in the DCR when compared to those approved previously by the PUCO. Accumulated Deferred Income Taxes (“ADIT”) are deducted from plant in service in the determination of the net rate base used in the calculation of the DCR revenue requirement. As noted in the Audit Report, the Opinion and Order and Combined Stipulation from Case No. 10-388-EL-SSO provides that:

The net capital additions included for recognition under Rider DCR will reflect gross plant in service not approved in the Companies' last distribution rate case less growth in accumulated depreciation reserve and accumulated deferred income taxes associated with plant in service since the Companies' last distribution rate case.<sup>19</sup>

The Audit review of the ADIT balance consisted of mathematical verification and source data validation. Based on these audit steps, the Audit report “concludes that the ADIT is not unreasonable.”<sup>20</sup> The report does not explicitly address the treatment of

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<sup>18</sup> OCC Set 3, INT-1.

<sup>19</sup> Audit Report at 72.

<sup>20</sup> Audit Report at 71-73.

regulatory assets and liabilities directly related to ADIT in the determination of the DCR rate base and its conformity to past precedent.

In the 2007 Rate Case, the FirstEnergy companies included “Customer Receivables for Future Income Tax” in the determination of their rate bases. The “Customer Receivables for Future Income Tax” was described by FirstEnergy Witness Harvey L. Wagner:

“Customer Receivables for Future Income Tax” represent amounts due from customers for future income taxes payable by the Company that were recognized with the adoption of the liability method of accounting for deferred income taxes under Statement of Financial Accounting Standards (SFAS) 109. These costs were traditionally recovered through the ratemaking process prior to the issuance of SFAS 109 by using a “flow-through” accounting approach to identify cost recovery for income taxes. Following the implementation of SFAS 109, the same ratemaking economic effect results from fully normalizing all income tax timing differences in combination with recovery of the SFAS 109 regulatory asset. When the SFAS 109 regulatory asset (Customer Receivables for Future Income Tax) was originally established, there was an equal deferred tax liability established – net rate base was therefore unaffected. *If the SFAS 109 regulatory asset were excluded from rate base, but all accumulated deferred income taxes served to reduce rate base, net rate base would be inappropriately measured.*<sup>21</sup>

In other words, the “Customer Receivables for Future Income Tax,” also referred to as the SFAS 109 Regulatory Asset, was a direct offset to the SFAS deferred tax liability that was booked at the time of the adoption of SFAS 109. The “Customer Receivables for Future Income Taxes” is the net balance of line items appearing in two separate accounts: Account 182.3 – Other Regulatory Assets (a debit balance that increases rate base) and Account 254 – Other Regulatory Liabilities (a credit balance that

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<sup>21</sup> Case No. 07-551-EL-AIR, Company Exhibit 3, Direct Testimony of Harvey L. Wagner, Pages 3-4, (emphasis added)



decreases rate base). The net balance of the “Customer Receivables for Future Income Tax” in those accounts was included in rate base in the 2007 Rate Case, because as Mr. Wagner explained, to do otherwise would result in an inappropriate measurement of rate base.

FirstEnergy recognizes changes in the SFAS 109 balance itself since May 31, 2007 for the purpose of determining the DCR rate base.<sup>22</sup> However, FirstEnergy does not take account of changes in the balance of the “Customer Receivables for Future Income Tax” (that is, the SFAS 109 regulatory asset) since May 31, 2007 for the purpose of determining the DCR rate base.<sup>23</sup> The “Customer Receivables for Future Income Tax” is directly related to T&D plant and to the balance of ADIT included in the determination of the DCR rate base, and it was included in rate base in the 2007 Rate Case. As was explained in the 2007 Rate Case, if this item is ignored then net rate base is not properly measured and possibly overstated. The next annual independent audit should address whether it is appropriate for FirstEnergy to disregard changes in balance of the “Customer Receivables for Future Income Tax” since May 31, 2007 for the purpose of determining the rate base used in the calculation of the DCR revenue requirement.

### **III. CONCLUSION**

The PUCO and FirstEnergy engage in these audits on an annual basis, and billions of customer dollars will pass through this rider to support FirstEnergy’s distribution investment. However, the review of this DCR should not be perfunctory, especially when

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<sup>22</sup> OCC Set 3, INT-4.

<sup>23</sup> OCC Set 3, INT-6.

FirstEnergy strives at every opportunity to limit the involvement of any party that attempts to open this Pandora's Box.

Customers should not be asked to provide a blank check for FirstEnergy's distribution investment. The independent auditor has highlighted a problem with FirstEnergy's persistent overspending on capital projects. This is a serious issue for consumers who pay for the DCR Rider. As recommended above, the PUCO should order a more in-depth review and adopt standards that are more protective of customers when it comes to paying for the DCR rider.

OCC's review of FirstEnergy DCR and the Audit Report have revealed a number of accounting discrepancies and raised a number of questions regarding FirstEnergy's project management. Consistent with the comments filed above, OCC recommends that the next time the PUCO issues an RFP to audit FirstEnergy's DCR, the accounting issues regarding ADIT and the Asset Retirement Obligation be specifically addressed.

Respectfully submitted,

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### **CERTIFICATE OF SERVICE**

I hereby certify that a copy of these Comments was served on the persons stated below via electronic transmission, this 23<sup>rd</sup> day of June, 2017.

/s/ Jodi Bair  
Jodi Bair  
Assistant Consumers' Counsel

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Case No. 15-1739-EL-RDR  
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of  
Ohio Edison Company, The Cleveland Electric Illuminating Company,  
and the Toledo Edison Company

**RESPONSES TO REQUEST**

- OCC Set 3  
– INT-1** Referring to the December 31, 2015 DCR Filing, Revenue Requirement Calculation, Page 2, do the changes in the Accumulated Reserve from 5/31/2007 to 11/30/2015 include the effect of the accrued Asset Removal Cost included in FERC Account 254 or Account 230? If the response is negative, please explain why not.
- Response:** Assuming that the question is asking if FERC Accounts 254 and 230 are included in the 11/30/2015 balances used in the Rider DCR filing, no, pursuant to Case No. 12-1230-EL-SSO, as approved by the Commission.

Case No. 15-1739-EL-RDR  
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of  
Ohio Edison Company, The Cleveland Electric Illuminating Company,  
and the Toledo Edison Company

RESPONSES TO REQUEST

**OCC Set 3  
– INT-4** Referring to the December 31, 2015 DCR Filing, Revenue Requirement Calculation, do the changes in the ADIT balances from 5/31/2007 to 11/30/2015 take account of changes in the “FAS 109 Adjustment” included in FERC Account 190 and/or Account 283? If the response is negative, please explain why not.

**Response:** Consistent with the Companies’ ESP III as approved by the Commission, the December 31, 2015 Rider DCR filing includes ADIT balances associated with plant in service. FAS 109 adjustments booked to Account 190 that are related to property are included in the ADIT balances included in the Rider DCR filing. FAS 109 adjustments booked to Account 190 that are not related to property are not included in the ADIT balances included in the Rider DCR filing.

Likewise, FAS 109 gross-up adjustments booked to Account 283 that are related to property are included in the ADIT balances included in the Rider DCR filing.

Case No. 15-1739-EL-RDR  
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**RESPONSES TO REQUEST**

**OCC Set 3  
– INT-6** Referring to the December 31, 2015 DCR Filing, Revenue Requirement Calculation, do the changes in the ADIT balances since 5/31/2007 take account of changes in the “Customer Receivable/Payable for Future Income Tax” included in FERC Account 182 net of the “Customer Receivable/Payable for Future Income Tax” included in FERC Accounts 254 and/or 283? If the response is negative, please explain why not.

**Response:** For the balances included in Rider DCR over the audit period in this case, no, pursuant to Case No. 12-1230-EL-SSO, as approved by the Commission.

## OCC Set 3

Case No. 15-1739-EL-RDR  
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of  
Ohio Edison Company, The Cleveland Electric Illuminating Company,  
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### RESPONSES TO REQUEST

**OCC Set 3** Referring to the Compliance Audit on page 57, Table 20, how many of the 41,243 Ohio  
**– INT-15** Edison Work Orders exceeded the capital project cost budget by more than 15 percent?

**Response:** The requested analysis does not exist.

Case No. 15-1739-EL-RDR  
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of  
Ohio Edison Company, The Cleveland Electric Illuminating Company,  
and the Toledo Edison Company

**RESPONSES TO REQUEST**

**OCC Set 3** Referring to the Compliance Audit on page 57, Table 20, how many of the 17,522 Toledo  
**– INT-16** Edison Work Orders exceeded the capital project cost budget by more than 15 percent?

**Response:** The requested analysis does not exist.



Case No. 15-1739-EL-RDR  
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of  
Ohio Edison Company, The Cleveland Electric Illuminating Company,  
and the Toledo Edison Company

**RESPONSES TO REQUEST**

**OCC Set 3** Referring to the Compliance Audit on page 57, Table 20, how many of the 313 Service  
**– INT-17** Company Work Orders exceeded the capital project cost budget by more than 15 percent?

**Response:** The requested analysis does not exist.

Case No. 15-1739-EL-RDR  
Annual Compliance Audit of Delivery Capital Recovery Rider (DCR) of  
Ohio Edison Company, The Cleveland Electric Illuminating Company,  
and the Toledo Edison Company

**RESPONSES TO REQUEST**

**OCC Set 3** Referring to the Compliance Audit at page 65, has the Company initiated a non-IT budget  
– **INT-24** process review as recommended by the auditor?

**Response:** Internal discussions regarding this recommendation have been initiated.

**This foregoing document was electronically filed with the Public Utilities**

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**Case No(s). 15-1739-EL-RDR**

Summary: Comments Comments by the Office of the Ohio Consumers' Counsel electronically filed by Ms. Deb J. Bingham on behalf of Bair, Jodi Ms.