

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA19-3-000

July 30, 2020

San Diego Gas & Electric Company
Attention: Dan Skopec
Vice President Regulatory Affairs
8330 Century Park Ct., CP33A
San Diego, CA 92123

Dear Mr. Skopec:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (Commission) has completed an audit of San Diego Gas & Electric Company (SDG&E). The audit covered the period from January 1, 2016 through February 4, 2020.

2. The audit evaluated SDG&E's compliance with: (1) its formula rate transmission owner tariff; (2) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, under 18 C.F.R. § 141.1; and (4) requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125. The enclosed audit report contains 11 finding and 55 recommendations that require SDG&E to take corrective action.

3. On July 16, 2020, you notified DAA that SDG&E accepts the 11 findings and 55 recommendations in the draft audit report and will submit within 30 days of the issuance of the final audit report a plan for implementing the audit recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.

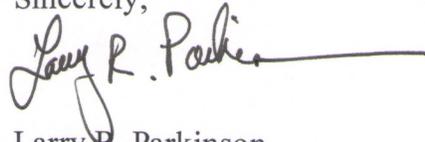
4. SDG&E should submit its implementation plan to comply with the recommendations within 30 days of this letter order. SDG&E should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311. This letter order constitutes final agency action. SDG&E may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713.

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of non-compliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Steven D. Hunt, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-6084.

Sincerely,

A handwritten signature in black ink that reads "Larry R. Parkinson". The signature is written in a cursive style and is followed by a horizontal line.

Larry R. Parkinson
Director
Office of Enforcement

Enclosure



Federal Energy Regulatory Commission
Office of Enforcement
Division of Audits and Accounting

AUDIT REPORT

Audit of San Diego Gas & Electric Company's compliance with: its formula rate transmission owner tariff; accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees; reporting requirements of the FERC Form No. 1, Annual Report; and requirements in Preservation of Records of Public Utilities and Licensees.

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I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) in the Office of Enforcement of the Federal Energy Regulatory Commission (Commission) has completed an audit of San Diego Gas & Electric Company (SDG&E). The audit evaluated SDG&E's compliance with: (1) its formula rate transmission owner tariff;¹ (2) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, under 18 C.F.R. § 141.1; and (4) requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125. The audit covered the period from January 1, 2016 to February 4, 2020.

B. San Diego Gas & Electric Company

SDG&E is a subsidiary of Enova Corporation, which in turn is a wholly owned subsidiary of Sempra Energy (Sempra), a public utility holding company based in San Diego, California. Sempra provides, through subsidiaries and affiliates, various electric, natural gas, and energy-related products and services.

SDG&E is engaged in the transmission, distribution, and sale of energy services under the jurisdictions of the Commission and the California Public Utilities Commission (CPUC). SDG&E distributes electricity to approximately 3.7 million consumers through 1.4 million electric meters in San Diego and Orange Counties, California. Additionally, SDG&E has received Commission authority to sell wholesale power and ancillary services at market-based rates.² SDG&E has transferred operational control over its transmission facilities to the California Independent System Operator Corporation (CAISO), and is a Participating Transmission Owner in CAISO.

¹ San Diego Gas & Electric Company, FERC FPA Electric Tariff, SDG&E Transmission Owner Tariff, Original Volume No. 11, Appendix VIII, TO Appendix VIII, 6.0.0.

² See *San Diego Gas & Elec. Co.*, Docket No. ER19-2054-000 (Jul. 17, 2019) (delegated order); see also San Diego Gas & Electric Company, FERC FPA Electric Tariff, SDG&E MBR Tariff, SDG&E Baseline MBR Tariff, SDG&E FERC Electric Tariff Original Volume No. 10, 7.0.0.

On October 29, 2014, SDG&E filed a petition for declaratory order seeking authorization for certain transmission rate incentives pursuant to section 219 of the Federal Power Act³ (FPA) and Order No. 679⁴ for its Southern Orange County Reliability Enhancement (SOCRE) project. In its filing, SDG&E requested two incentives: (1) authorization to recover 100 percent of all prudently-incurred development and construction costs if the SOCRE project is abandoned or cancelled, in whole or in part, for reasons beyond SDG&E's control (Abandonment Incentive); and (2) a 100 basis points adder to SDG&E's return on equity (ROE) to address risks and challenges associated with the SOCRE project. On April 3, 2015, the Commission issued an order granting SDG&E the Abandonment Incentive and denying the request for a 100 basis points adder to its ROE.⁵ The SOCRE project consists of approximately 16.7 linear miles of new 230 kilovolt (kV) transmission line connecting the Sycamore Canyon and Peñasquitos substations, including steel pole installations and underground wire. During the audit period, the project was under construction.

C. Summary of Compliance Findings

Audit staff's compliance findings are summarized below. Details of these findings are in section IV. Audit staff found 11 areas of noncompliance:

1. *Allowance for Funds Used During Construction* – SDG&E's methods for calculating its Allowance for Funds Used During Construction (AFUDC) base and rate were deficient. Specifically, SDG&E improperly included unpaid contract retention accruals in its construction work in process (CWIP) balance, and unamortized debt discounts and losses on reacquired debt in the determination of its long-term debt balance. As a result, SDG&E miscalculated its AFUDC base and rate. This led it to over-accrue AFUDC, which resulted in an overstatement of CWIP and plant in service balances. This resulted in SDG&E overbilling wholesale transmission customers because the excessive AFUDC costs were included in utility plant that impacted wholesale formula rate determinations.

³ 16 U.S.C. § 824s (2018).

⁴ *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 116 FERC ¶ 61,057, *order on reh'g*, Order No. 679-A, 117 FERC ¶ 61,345 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007). The Commission provided additional guidance regarding the application of its transmission incentive policies in *Promoting Transmission Investment through Pricing Reform*, 141 FERC ¶ 61,129 (2012).

⁵ *San Diego Gas & Elec. Co.*, 151 FERC ¶ 61,011 (2015).

2. *Accounting for Commitment Fees* – SDG&E improperly accounted for upfront fees it paid that were associated with revolving line of credit agreements in Account 182.3, Other Regulatory Assets, and improperly accounted for quarterly commitment fees associated with the agreements in Account 923, Outside Services Employed. In addition, SDG&E improperly included the amortization of upfront line of credit fees in its calculation of long-term debt interest expense used to compute its AFUDC rate.
3. *Allocation of Overhead Costs to CWIP* – SDG&E capitalized overhead costs to Account 107, Construction Work in Progress – Electric, using an allocation method that was not based on the actual time that employees were engaged in construction activities or on a representative time study. This led to SDG&E charging costs to Account 107 that did not have a definite relationship to construction. As a result, SDG&E may have overstated construction costs recorded in Account 107 and electric plant in service, as well as accumulated depreciation and accumulated deferred income tax (ADIT) balances, and may have understated operating expenses. Moreover, this accounting may have led SDG&E to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.
4. *Accounting for EV Charging Stations* – SDG&E improperly accounted for electric vehicle (EV) charging station distribution assets in Account 398, Miscellaneous Equipment. SDG&E's accounting resulted in the cost of the assets and associated expenses being incorrectly included in accounts that are wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.
5. *Regulatory Commission Expenses* – SDG&E improperly accounted for regulatory commission expenses. SDG&E's accounting resulted in regulatory commission expenses being incorrectly included in accounts that are wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

6. *Accounting for Distribution-Related Expenses* – SDG&E improperly accounted for distribution-related operation costs in a transmission operation expense account. SDG&E’s accounting resulted in expenses being incorrectly included in accounts that were wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.
7. *Accounting for Donations and Lobbying Expenses* – SDG&E misclassified donation payments and costs incurred to support activities to influence public opinion with regard to legislation. SDG&E’s accounting resulted in such expenses being incorrectly included in accounts that were wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.
8. *Accounting for Outside Services Employed* – SDG&E improperly accounted for external consultant fees incurred to support general services not applicable to a particular operating function. SDG&E’s accounting resulted in expenses being incorrectly included in an account that is a wholesale transmission formula rate input. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.
9. *Filing of Tariff Records* – SDG&E did not properly file all Tariff Records, as required, in the Commission’s electronic tariff (eTariff) database. Specifically, SDG&E’s eTariff filing omitted Attachment 2, its Formula Rate Spreadsheet, from its tariff filed in the eTariff database. This impacted interested parties’ ability to access and review the attachment through the Commission’s eTariff Public Viewer.
10. *Premature Destruction or Loss of Records* – SDG&E could not verify the existence of an asset, or provide documentation associated with the asset’s cost, that was recorded in Account 154, Plant Materials and Operating Supplies. SDG&E’s inability to produce the documentation represents an instance of premature destruction or loss of records.
11. *Filing Associated with Electric Plant Purchased* – SDG&E did not file its proposed journal entries for the purchase of electric plant within six months, as required. This hindered the Commission’s and other interested parties’ ability to timely review and monitor the transaction.

D. Summary of Recommendations

Audit staff's recommendations to remedy the audit findings are summarized below. Details are in section IV. Audit staff recommends that SDG&E:

Allowance for Funds Used During Construction

1. Revise policies and procedures for calculating the AFUDC base and rates to be consistent with Electric Plant Instruction (EPI) No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to prevent inclusion of unpaid contract retention accruals in AFUDC base calculations and processes to prevent improper inclusion of balances in Accounts 189 and 226 in the AFUDC rate calculations.
2. Revise policies, procedures, and accounting systems, as necessary, to calculate the AFUDC base and rates consistent with the requirements of EPI No. 3.
3. Train relevant staff on the revised AFUDC base and rate calculation methods and provide periodic training, as needed.
4. Recalculate AFUDC accrued in accordance with EPI No. 3(A)(17) for the contract retention accruals error from 2014 through the date of the final audit report and the other items from 2016 through the date of the final audit report. Also, submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that considers the amount of AFUDC improperly capitalized to plant in service, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
5. Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC within 60 days of receiving the final audit report.
6. Revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC after receiving DAA's assessment of the proposed accounting entries per Recommendation No. 5 and restate and footnote the FERC Form No. 1 for current and comparative years as necessary.

7. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

Accounting for Commitment Fees

8. Revise existing accounting policies, procedures, and practices relating to accounting for credit agreement expenses, such as upfront, commitment, quarterly, revolving line of credit, and letter of credit fees, to be consistent with Commission accounting requirements.
9. Revise policies and procedures for calculating the AFUDC rate to be consistent with EPI No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to exclude commitment fees from AFUDC rate calculations unless the costs are associated with debt issuances and are approved by the Commission for inclusion.
10. Train relevant staff on the revised accounting policies and provide periodic training, as needed.
11. Within 60 days of receiving the final audit report, submit proposed accounting entries and supporting documentation to DAA that reflect the transfer of credit agreement-related balances improperly recorded in Account 182.3 to Account 186.
12. Revise miscellaneous deferred debit balances to appropriately account for and report credit agreement-related balances after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.

Allocation of Overhead Costs to CWIP

13. Retain an independent third-party entity to conduct a representative labor time study for allocation of overhead costs incurred in 2019 to CWIP, and to assist with the development of procedures SDG&E shall use to periodically determine the allocation of overhead labor and labor-related costs capitalized into the cost of construction after 2019. Report the progress of the study within 120 days and provide the time study results to DAA for review and consideration within 180 days of the date of the final audit report and the developed allocation procedures when complete. At a

minimum, the developed allocation procedures should provide a method for overhead cost allocation and capitalization to construction based on actual timecard distributions or where this procedure is impractical, based on periodic time studies.

14. Revise written policies, practices, and procedures governing the methods used to account for, track, report, and review overhead labor, labor-related costs, and all other costs allocated to construction projects to be consistent with Commission accounting requirements. In addition, adopt procedures to retain formal documentation supporting the amount of overhead costs allocated to electric plant accounts.
15. Train relevant staff on the revised overhead allocation procedures and documentation, and provide periodic training in this area, as needed.
16. Within 30 days of the completion of Recommendation No. 13, submit an estimate to DAA, including the calculations and determinative components, of overhead costs that would have been allocated to CWIP during the audit period consistent with the requirements of EPI No. 4 and GI No. 9. The estimate should be based on a recalculation of 2016 and subsequent years overhead cost allocated to construction with labor and labor-related costs removed from the cost of plant that were not associated with construction activities based on the methodology developed in response to Recommendation No. 13.
17. With the response to Recommendation No. 16, submit proposed accounting entries to DAA that remove the overhead costs that were allocated to electric plant in CWIP and in service during the audit period that exceed the amount of costs that would have been allocated to the accounts based on the methodology developed in response to Recommendation No. 13. Also, provide proposed accounting entries to remove associated amounts from other accounts and balances affected by the inappropriately allocated cost such as the accumulated depreciation and ADIT accounts, and AFUDC balances capitalized into CWIP and plant in service. If the adjusting entries result in a significant impact to income for the current year, SDG&E may account for the transaction as a correction of a prior period error in Account 439, Adjustments to Retained Earnings. Such an entry should be submitted with the proposed accounting entries.
18. Revise account balances for utility plant, accumulated depreciation, ADIT, and other account balances impacted by the inappropriate allocation of

unsupported overhead cost after receiving DAA's assessment of the proposed accounting entries per Recommendation No. 17, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.

19. Submit a refund analysis to DAA that explains and details the following: (1) calculation of refunds that result from the overstatement of transmission plant due to the improper capitalized of labor costs, as determined by the labor time study, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
20. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

Accounting for EV Charging Stations

21. Revise policies, procedures, and practices to track, report, review and account for EV charging stations to be consistent with Commission accounting requirements.
22. Train relevant staff on the revised accounting methods and provide periodic training, as needed.
23. Within 30 days of implementing Recommendation No. 21, submit proposed accounting entries and supporting documentation to DAA that reflect the removal of the EV charging station costs improperly recorded in Account 398.
24. Revise the Account 398 balance to appropriately account for and report EV charging stations after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.
25. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that includes the amount of inappropriate recoveries during the audit period that resulted from the improper accounting for EV charging stations, plus interest; (2) determinative components of the refund;

(3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

26. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

Regulatory Commission Expenses

27. Revise policies, procedures, and practices to track, report, review, and account for regulatory commission expenses to be consistent with Commission accounting requirements.
28. Train relevant staff on the revised methods to account for regulatory commission expenses and provide periodic training, as needed.
29. Perform an analysis of transmission operation expense accounts to identify administrative and general (A&G) expenses, such as regulatory commission expenses, improperly charged to the accounts during the audit period. Within 60 days of the date of the final audit report, provide the results of the analysis to audit staff.
30. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for A&G expenses recorded in operation and maintenance (O&M) accounts as identified pursuant to the analysis performed in response to Recommendation No. 29, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
31. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

Accounting for Distribution-Related Expenses

32. Strengthen policies and procedures to account for distribution-related expenses consistent with Commission accounting requirements.
33. Train relevant staff on the methods to account for distribution-related expenses and provide periodic training, as needed.

34. Perform an analysis of costs incurred at substations during the audit period to determine whether distribution-related expenses were charged to the correct account(s) and that the appropriate allocators were used to charge costs to transmission and distribution expense accounts when applicable. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.
35. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for distribution-related O&M expenses in transmission expense accounts, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
36. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

Accounting for Donations and Lobbying Expenses

37. Develop and implement procedures and policies to track, report, review, and account for donations and for expenses of activities associated with influencing legislation and with other political activity consistent with the Commission's accounting requirements.
38. Train relevant staff on the procedures and policies and provide periodic training, as needed.
39. Perform an analysis of A&G expense accounts to identify nonoperating expenses, such as donations and lobbying costs, improperly charged to the accounts during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.
40. Submit a refund analysis to DAA, within 60 days of receiving the final audit report, that explains and details the following: (1) calculation of refunds that include the amount of inappropriate recoveries during the audit period that resulted from the improper accounting for below-the-line expenses recorded in A&G expense accounts as identified pursuant to the analysis performed in response to Recommendation No. 39, plus interest; (2) determinative components of the refund; (3) refund method;

(4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

41. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

Accounting for Outside Services Employed

42. Revise policies, procedures, and practices to maintain and retain documentation to be consistent with Commission record retention requirements.
43. Revise policies, procedures, and practices to track, report, review, and account for outside service expenses to be consistent with Commission accounting requirements.
44. Train relevant staff on the revised methods and provide periodic training, as needed.
45. Perform an analysis of transmission operation expense accounts to identify expenses, such as management consultant fees, improperly charged, in whole or in part, to transmission operations during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.
46. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for A&G expenses recorded in O&M accounts as identified pursuant to the analysis performed in response to Recommendation No. 45, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
47. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

Filing of Tariff Records

48. Develop procedures and controls to help ensure all tariff records are properly filed and available for disclosure in the Commission's eTariff database.

49. Provide training to relevant staff on the procedures and controls to electronically file tariff records in the eTariff database and provide periodic training, as needed.
50. Notify DAA upon filing the omitted Tariff Records for the currently effective version of the Transmission Owner Transmission Tariff in the eTariff database.

Premature Destruction or Loss of Records

51. Strengthen procedures to maintain and retain documentation consistent with Commission record retention requirements.
52. Revise policies, procedures, and practices to track, report, review, and account for inventory to be consistent with Commission accounting requirements. Among other things, implement processes and procedures to audit inventories of plant materials and supplies on a cyclical basis and make necessary adjustments to bring Account 154 into agreement with the actual inventories.
53. Train relevant staff on the revised methods and provide periodic training, as needed.

Filing Associated with Electric Plant Purchased

54. Revise procedures and controls to timely file proposed journal entries for purchases or sales of operating units to be consistent with the Commission's requirements.
55. Train relevant staff on the revised methods and provide periodic training, as needed.

E. Implementation of Recommendations

Audit staff further recommends that SDG&E submit the following:

- A plan for implementing the recommendations within 30 days after the final audit report is issued;

- Quarterly reports describing progress in completing each corrective action recommended. Quarterly nonpublic submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the audit report is issued, and continuing until all recommended corrective actions are completed; and
- Copies of written policies and procedures developed in response to recommendations. These documents should be submitted in the first quarterly filing after the development of a written policy or procedures.

II. Background

A. California Independent System Operator

SDG&E is a Transmission Owner participant in CAISO and transferred operational control of its transmission system to CAISO. While CAISO operates SDG&E's transmission system, SDG&E owns and maintains its transmission facilities.

CAISO provides transmission services to eligible wholesale transmission customers over SDG&E's and other transmission owners' high-voltage transmission facilities pursuant to its Commission-approved Open Access Transmission Tariff. SDG&E's Transmission Owner Tariff sets forth its revenue requirement, rates, and charges for transmission access to the CAISO-controlled grid.⁶ During the audit period, SDG&E recovered the costs associated with its transmission facilities and the operation and maintenance of those facilities pursuant to its Commission-approved wholesale transmission formula rate mechanism in Appendix VIII of its tariff as delineated in the associated attachments: the Formula Rate Protocols (Attachment 1) and the Formula Rate Spreadsheet (Attachment 2).

B. Wholesale Transmission Formula Rate

SDG&E calculated its base transmission revenue requirement each year using the formula rate spreadsheet to derive charges assessed to recover costs from wholesale and retail electric customers associated with owning, operating and maintaining its transmission facilities. SDG&E's wholesale transmission formula rate mechanism consisted of: (1) a base period cost of service reflecting expenses recorded in its FERC Form No. 1, Annual Report, and underlying ledger accounts for the previous calendar year; (2) costs of forecasted transmission-related plant capital additions; (3) a true-up adjustment; and (4) an interest true-up adjustment. The rates established under the formula rate took effect beginning January 1st of each year and ran through December 31st of the same year. To the extent estimated costs included in rate determinations for a rate period were lower or higher than actual costs, SDG&E was required to true-up the difference in the subsequent rate period. SDG&E annually submitted an informational filing that reflected the true-up adjustments to be made in calculating its base transmission revenue requirement for the subsequent rate period.

⁶ San Diego Gas & Electric Company, FERC FPA Electric Tariff, SDG&E Transmission Owner Tariff, Original Volume No. 11, Appendix VIII, TO Appendix VIII, 6.0.0.

The base transmission revenue requirement was \$817.7 million in 2018 and \$851.4 million in 2019. The revenue requirement consisted of the summation of return on rate base and expenses. The expenses included O&M expenses, depreciation expense, income taxes, taxes other than income taxes, and administrative and general (A&G) expenses. Revenue credits were also factored into the revenue requirement. SDG&E's initial formula rate mechanism went into effect in 2003.⁷ Prior to the wholesale transmission formula rate mechanism, SDG&E had fixed or stated rates that remained in effect until it filed for a rate change under section 205 of the FPA or had its rates challenged and changed under section 206 of the FPA.

C. Accounting System

SDG&E used Systems, Applications, and Products in Data Processing (SAP), as its accounting system during the audit period. General ledger activity was reflected in three SAP modules used for financial accounting: Financial (FI) Module, Controlling (CO) Module, and the Special Purpose Ledger (SPL). SDG&E posted all financial transactions to the General Ledger (G/L) in the FI Module using internal G/L accounts categorized by its internal chart of accounts structure for external financial reporting requirements such as those required by the Commission and the U.S. Securities & Exchange Commission. The FI Module fed financial transactions into the CO and SPL Modules.

The CO Module supported internal cost management reporting and included cost settlements and assessments to and from cost objects, including those belonging to affiliated entities. The SPL was used to convert SDG&E's internal accounts to accounts under the Commission's Uniform System of Accounts (USofA) for accounting and reporting information to the Commission in its reporting forms. The SPL reflects the posting activity from both the G/L and CO Modules. The SPL postings were categorized on a functional basis using the USofA structure. Each transaction line item posted in the G/L was posted to the SPL with an assigned Commission USofA account. The account assignment was determined by automated processing routines using combinations of values in data fields such as the natural G/L account, cost center, internal work order, and other transaction indicators to map costs from its internal G/L accounts to Commission USofA accounts.

D. Prior Wholesale Transmission Formula Rate Audit of SDG&E

On November 17, 2011, the Commission commenced an audit of SDG&E. The audit evaluated SDG&E's compliance with the requirements of its wholesale

⁷ *San Diego Gas & Elec. Co.*, 143 FERC ¶ 61,246 (2013).

transmission formula rate mechanism and the Commission's accounting and reporting requirements. On June 10, 2014, SDG&E was issued a delegated letter order with an attached audit report on the results of the audit.⁸

The 2014 Audit resulted in 8 findings and 32 recommendations for corrective actions to help SDG&E attain and maintain compliance with Commission statutes, rules, regulations, and orders. During the implementation phase of the audit,⁹ SDG&E submitted proposed policies and procedures to audit staff for review, and supporting documentation in some instances, that it represented as corrective actions that had been or would be implemented going forward in 2014 and subsequent periods. Audit staff's 2014 review during the implementation phase involved an assessment of SDG&E's representations of proposed corrective actions to determine whether the proposals could adequately and sufficiently help SDG&E attain and maintain a compliant stature, if and when actually implemented.

Through this process, audit staff accepted SDG&E's representations that it had already implemented, or would be implementing, its corrective actions. However, during the current audit, it was discovered that SDG&E had not sufficiently implemented certain corrective actions in a manner consistent with its representations during the 2014 Audit.

Specifically, three areas of noncompliance were identified in the current audit that were also found in the 2014 Audit: (1) inappropriate accrual of AFDUC on unpaid contract retention amounts (2014 Audit Finding No. 1); (2) improper accounting for outside service expenses and charitable contributions (2014 Audit Finding No. 2); and (3) misclassification of industry association dues (2014 Audit Finding No. 5). Based on corrective action representations made by SDG&E during the 2014 Audit, SDG&E should have implemented policies and procedures to help prevent reoccurrence of noncompliance in these areas. Audit staff believes SDG&E failed adequately to oversee the implementation of the corrective actions. The repeated areas of noncompliance are explained in detail in section IV of this report.

⁸ *San Diego Gas & Elec. Co.*, Docket No. FA12-8-000 (Jun. 10, 2014) (delegated order) (2014 Audit).

⁹ The implementation phase of an audit commences after issuance of the final audit report. During this phase, an audited entity submits information to audit staff that responds to the recommendations of the audit report that the entity will implement. This information includes discussion of activities that an audited entity has initiated as of the submittal or that it plans to initiate at a subsequent period to become compliant with Commission requirements and/or controls to help maintain compliance.

III. Introduction

A. Objectives

The audit evaluated SDG&E's compliance with its transmission owner tariff, and Commission accounting, reporting and record retention requirements. The audit covered the period from January 1, 2016 to February 4, 2020.

B. Scope and Methodology

Audit staff performed the following actions to facilitate the testing and evaluation of SDG&E's compliance with Commission requirements relevant to the audit objectives:

- *Review of Public Information* – Reviewed publicly available information relating to SDG&E's operations, structure, history, regulatory oversight, tariff, and other pertinent business and regulatory aspects prior to commencing the audit. Some of the materials reviewed included SDG&E's FERC Form No. 1 reports, Commission filings and orders, its transmission owner tariff and corporate website, and trade press and news articles.
- *Conferring with Commission Staff* – Conferred with Commission staff in other offices to ensure audit report findings were consistent with Commission precedent and policy.
- *Regulatory Standards and Criteria* – Identified regulatory requirements and criteria to evaluate SDG&E's compliance with audit objectives, including the rates, terms, and conditions in its transmission owner tariff, Commission accounting and reporting requirements in 18 C.F.R. Parts 101 and 141, and other Commission rules, regulations, and orders generally applicable to jurisdictional public utilities. The review also included SDG&E's rate and accounting filings to understand that history.
- *Data Collection and Data Requests* – Issued data requests for information and audit evidence, including SDG&E's internal policies and procedures, financial accounting and transactional data, support for and disclosures in SDG&E's FERC filings, internal and external audit reports, Board of Directors and Audit Committee meeting minutes, corporate compliance program procedures, and other items not publicly available.
- *Site Visit to SDG&E's Headquarters* – Conducted three site visits to SDG&E's corporate headquarters to discuss, observe, and evaluate SDG&E's procedures,

practices, and controls for ensuring compliance with the Commission's regulations. The visits enabled audit staff to:

- Discuss SDG&E's corporate structure, departmental functions, and employee responsibilities, and meet with key company officials;
- Learn about SDG&E's transmission system and operations, in particular the assets, departments, activities, functions, systems, and processes used;
- Interview executives, managers, and staff responsible for accounting, financial reporting, transmission operations, and corporate compliance;
- Review Board of Directors and Audit Committee meeting minutes and internal and external audit reports;
- Discuss management and operation of SDG&E's corporate compliance program; and
- Discuss and observe accounting and reporting procedures, processes, and controls relevant to audit scope.

Audit staff also performed specific tests and evaluations of SDG&E's compliance with the tariff, rates, and accounting and reporting requirements. Below are the significant areas evaluated:

Transmission Owner Tariff

- *Formula Rate Protocols (Attachment 1) and the Formula Rate Spreadsheet (Attachment 2)* – Reviewed SDG&E's wholesale transmission formula rate protocols and spreadsheet template included as attachments in Appendix VIII of SDG&E's transmission owner tariff. Reviewed SDG&E's rate filings with the Commission related to these tariff items to understand the history and evolution of the attachments.
- *Commission Rate Proceedings* – Reviewed initial and all subsequent Commission orders relating to SDG&E's formula rate, including SDG&E filings and orders approving related settlements.
- *Rate Processes and Procedures* – Evaluated processes, procedures, and controls to prepare and review the transmission owner formula rate and annual updates, true-ups, and informational filings.

- *Rate Components* – Determined the level of functionalization, derivation of allocation factors, return on equity, rate base, accumulated depreciation, and other expenses included in the revenue requirement. Reviewed background information about specific cost treatments, deferrals, disallowances, and other matters disclosed as part of approving the derivation of the formula rate.
- *Rate Mechanics* – Reviewed formula rate mechanics (forward-looking, true-up, and informational filings), including a comprehensive overview that SDG&E provided.
- *Formula Rate Allocation Factors* – Reviewed the allocation factors used to support SDG&E’s wholesale transmission formula rate to determine whether the correct factors had been applied in the calculations. As part of this review, audit staff verified a sample of components from allocation factors by reconciling balances back to the FERC Form No. 1.
- *Reconciliation of Inputs* -- Reconciled formula rate inputs derived from the FERC Form No. 1 to SDG&E’s books and records. Evaluated compliance with the USofA for the inputs under review, including related guidance, accounting releases, and Commission rate orders.
- *Evaluated Reporting Processes and Procedures* – Evaluated the FERC Form No. 1 processes and procedures to determine whether there was accurate and complete reporting. As part of this evaluation, audit staff reconciled FERC Form No. 1 data with formula rate calculations and reviewed all discrepancies.
- *Reviewed Annual FERC Filings* – Reviewed the FERC Form No. 1, including related notes to financial statements, to identify major accounting matters. Audit staff highlighted significant notes to understand financial statement and formula rate implications and identified underlying accounting entries for these matters.
- *Audit Sampling* – Evaluated various account balances that were included in the formula rate spreadsheet for compliance with relevant accounting regulations in the USofA.

Accounting, Recordkeeping, and Financial Reporting

To evaluate compliance with Commission accounting, recordkeeping, and financial reporting regulations, audit staff:

- *Evaluated Accounting Processes and Procedures* – Audit staff evaluated SGD&E’s financial reporting processes, procedures, and internal controls for complying with the Commission’s regulations under 18 C.F.R Part 141. Audit staff assessed SDG&E’s procedures and practices to verify the accuracy and completeness of the reported account data. Audit staff interviewed SDG&E’s employees who worked directly on daily reporting and in management oversight about ensuring filing accuracy.
- *Evaluated Financial Reporting Instructions* – Audit staff evaluated SDG&E’s financial reporting to determine whether it complied with general reporting instructions in the FERC Form No. 1. Specifically, audit staff reviewed select schedules and pages in the form.
- *Confirmed Reported Financial Statement Account Balances* – Audit staff traced account balances in the FERC Form No. 1 to SDG&E’s general ledger.
- *Performed Variance Analysis* – Audit staff performed variance analyses on those accounts in the FERC Form No. 1 with large balances, unusual activity, and/or significant year-to-year fluctuations. Audit staff discussed with SDG&E each account fluctuation to understand the nature of the transactions and, where necessary, obtained additional information and support.
- *Reviewed Notes to Financial Statements* – Audit staff reviewed the Notes to Financial Statements of the FERC Form No. 1 for significant accounting matters and followed up with SDG&E to understand financial statements and wholesale transmission formula rate implications, if any.
- *Preservation of Records* – Reviewed the retention schedules that were included in the record retention program. Interviewed employees responsible for record retention to understand processes, procedures, and controls for administration and maintenance of records. Sampled selected records to ascertain whether their retention period aligned with Commission preservation of records regulations, and any records prematurely destroyed or lost were reported to the Commission.

IV. Findings and Recommendations

1. Allowance for Funds Used During Construction

SDG&E's methods for calculating its Allowance for Funds Used During Construction (AFUDC) base and rate were deficient. Specifically, SDG&E improperly included unpaid contract retention accruals in its construction work in process (CWIP) balance, and unamortized debt discounts and losses on reacquired debt in the determination of its long-term debt balance. As a result, SDG&E over accrued AFUDC included in CWIP and utility plant accounts, and overbilled wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Electric Plant Instruction No. 3, Components of Construction Cost, states in part:

The costs of construction properly includable in the electric plant accounts shall include, where applicable, the direct and overhead costs as listed and defined hereunder:

(1) "Contract work" includes amounts paid for work performed under contract by other companies, firms, or individuals, costs incident to the award of such contracts, and the inspection of such work.
- 18 C.F.R. Part 101, Electric Plant Instruction No. 3(A)(17), Allowance for Funds Used during Construction, states in part:

The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year.
- *System Energy Resources, Inc.*, Opinion No. 446, 92 FERC ¶ 61,119, at 61,449 (2000), *reh'g denied*, Opinion No. 446-A, 96 FERC ¶ 61,165 (2001), states in relevant part:

It is the gross proceeds of a company's long-term debt, i.e., the total principal outstanding, that belong in the capital structure because this reflects the company's total obligation with respect to long-term debt.

- Opinion No. 446-A, 96 FERC ¶ 61,165 at 61,740, states in relevant part:

Using the total principal outstanding, or gross proceeds, accurately represents the amount of debt outstanding and allows for a more accurate picture of SERI's capital structure, and, in turn, results in the correct calculation of SERI's cost of capital.

Background

AFUDC represents the financing cost of construction and consists of two components: Allowance for Borrowed Funds (debt) and Allowance for Other Funds (equity). The Commission's predecessor agency, the Federal Power Commission (FPC), in FPC Order No. 561,¹⁰ established the formula for capturing these two components of AFUDC that is still used today and which, for public utilities, is found in the Electric Plant Instructions in the USofA. EPI No. 3(A)(17) provides the uniform formula for calculating a utility's maximum AFUDC rate. Audit staff reviewed SDG&E's AFUDC rate calculations and the inputs that SDG&E factored into the debt and equity components during the audit period, as well as SDG&E's application of AFUDC to CWIP during the audit period. This included interviewing SDG&E'S plant accounting staff and testing a sample of construction work orders, invoices, and other supporting documents for several construction projects.

Audit staff identified three issues relating to SDG&E's calculation and application of AFUDC, which are as follows:

Contract Retention Accruals

SDG&E improperly included unpaid contract retention accruals from 2014 through the present in the CWIP balances of its AFUDC base determinations, which was

¹⁰*Amendments to Uniform System of Accounts for Public Utilities and Licensees and For Natural Gas Companies (Classes A, B, C and D) to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports, Order No. 561, 57 FPC 608 (1977), reh'g denied, Order No. 561-A, 59 FPC 1340 (1977), order on clarification, 2 FERC ¶ 61,050 (1978).*

not consistent with Commission accounting regulations.¹¹ In accordance with EPI No. 3, contract costs includible in CWIP balances (and thus in AFUDC base), must represent amounts actually *paid* for work performed under a contract. Contract retention accruals that are not paid until future periods are not includible in the AFUDC base. This was also an issue of noncompliance with the accounting requirements in the 2014 Audit of SDG&E.¹²

In the 2014 Audit report, there were eight recommendations for corrective action associated with the contract retention accruals finding that overall required SDG&E to (1) remove the improper impact of contract retention accruals from CWIP and plant in service existing at that time; (2) refund inappropriate charges to wholesale transmission customers impacted by the error; and (3) implement internal control measures to help prevent the error from reoccurring in subsequent periods after the removals. Audit staff found that SDG&E implemented the corrective actions of items (1) and (2) but did not establish the effective controls required by item (3) that would have helped prevent reoccurrence of the error in periods subsequent to the 2014 Audit.

Unamortized Discounts on Long-Term Debt

SDG&E improperly included amounts recorded in Account 226, Unamortized Discount on Long-Term Debt – Debit, with the long-term debt balances used to compute its AFUDC rates.¹³ This practice reduced SDG&E's gross balance of outstanding long-term debt leading it to include the net long-term debt proceeds in AFUDC rate calculations. However, in accordance with Commission policy, SDG&E is required to use the gross proceeds of outstanding long-term debt as the long-term debt balance of the capital structure; it may not include a reduction of the balance to recognize an

¹¹ SDG&E defined unpaid contract retentions as the portion withheld from invoice payments to a vendor for products or services received until the contracted work is substantially complete and satisfactory to SDG&E's requirements.

¹² See 2014 Audit, Finding No. 1, Allowance for Funds Used During Construction, at pp. 19-27.

¹³ A discount "as applied to securities issued or assumed by a utility, means the excess of the... face value of the securities plus interest... accrued at the date of the sale over the cash value of the consideration received from their sale." Definition No. 13, Discount, 18 C.F.R. Part 101. Further, an unamortized discount is the balance of the discount that remains to be amortized over the remaining life of securities issued or assumed.

unamortized discount.¹⁴ Accordingly, SDG&E should have excluded amounts recorded in Account 226 from the long-term debt balance used to calculate its AFUDC rate.

Unamortized Losses on Reacquired Debt

SDG&E improperly included amounts recorded in Account 189, Unamortized Loss on Reacquired Debt, in calculating its long-term debt balances used to compute its AFUDC rates. This practice increased the amount of the long-term debt included in AFUDC rate calculations above the amount of long-term debt actually outstanding. As previously indicated, Commission policy requires that SDG&E include the gross proceeds of outstanding long-term debt in the AFUDC rate calculation.¹⁵ Losses on reacquired debt are not part of the gross proceeds of outstanding debt. Therefore, SDG&E should have excluded amounts recorded in Account 189 from the long-term debt balance used to calculate its AFUDC rate.

Conclusion

As a result of these errors, SDG&E over accrued AFUDC, which then was capitalized as a component cost of construction and subsequently included in Account 106, Completed Construction Not Classified – Electric (Major Only), or Account 101, Electric Plant in Service (Major Only). SDG&E overbilled wholesale transmission customers for the excessive AFUDC costs in utility plant that was included in wholesale formula rate determinations through rate base and depreciation charges. SDG&E should stop continued errors in AFUDC accruals identified in this and prior audits. Specifically, SDG&E should strengthen its manual and automated controls to enhance its detective, preventive, and corrective capabilities to help exclude inappropriate items from AFUDC base and rate calculations.

¹⁴ Opinion No. 446, 92 FERC ¶ 61,119 at 61,449 (“It is the gross proceeds of a company’s long-term debt, i.e., the total principal outstanding, that belong in the capital structure because this reflects the company’s total obligation with respect to long-term debt.”), *reh’g denied*, Opinion No. 446-A, 96 FERC ¶ 61,165 at 61,740 (“Using the total principal outstanding, or gross proceeds, accurately represents the amount of debt outstanding and allows for a more accurate picture of SERI’s capital structure, and, in turn, results in the correct calculation of SERI’s cost of capital.”).

¹⁵ *Id.*

Recommendations

We recommend that SDG&E:

1. Revise policies and procedures for calculating the AFUDC base and rates to be consistent with EPI No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to prevent inclusion of unpaid contract retention accruals in AFUDC base calculations and processes to prevent improper inclusion of balances in Accounts 189 and 226 in the AFUDC rate calculations.
2. Revise policies, procedures, and accounting systems, as necessary, to calculate the AFUDC base and rates consistent with the requirements of EPI No. 3.
3. Train relevant staff on the revised AFUDC base and rate calculation methods and provide periodic training, as needed.
4. Recalculate AFUDC accrued in accordance with EPI No. 3(A)(17) for the contract retention accruals error from 2014 through the date of the final audit report and the other items from 2016 through the date of the final audit report. Also, submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that considers the amount of AFUDC improperly capitalized to plant in service, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
5. Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC within 60 days of receiving the final audit report.
6. Revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC after receiving DAA's assessment of the proposed accounting entries per Recommendation No. 5 and restate and footnote the FERC Form No. 1 for current and comparative years as necessary.
7. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

2. Accounting for Commitment Fees

SDG&E improperly accounted for upfront fees it paid that were associated with revolving line of credit agreements in Account 182.3, Other Regulatory Assets, and improperly accounted for quarterly commitment fees associated with the agreements in Account 923, Outside Services Employed. In addition, SDG&E improperly included the amortization of upfront line of credit fees in its calculation of long-term debt interest expense used to compute its AFUDC rate.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 186, Miscellaneous Deferred Debits, states in part:
 - A. For Major utilities, this account shall include all debits not elsewhere provided for... which are in process of amortization...
- 18 C.F.R. Part 101, Account 930.2, Miscellaneous General Expenses (Major Only), states:
 - This account shall include the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere.

Background

SDG&E entered into two revolving line of credit agreements with financial institutions during the audit period. As a condition of these agreements, SDG&E was required to pay upfront fees associated with establishing each agreement. SDG&E also incurred quarterly commitment fees associated with the credit agreements. Both line of credit agreements had five-year terms.

From January 1, 2016 to April 30, 2019, SDG&E incurred total upfront fees of \$1,250,500 and quarterly commitment fees of \$1,303,819. SDG&E recorded the upfront fees for establishing the lines of credit by charging Account 182.3, Other Regulatory Assets. During the audit period, SDG&E had no debt outstanding on its revolving lines of credit. SDG&E amortized the upfront fees recorded in Account 182.3 over the five-year term of the line of credit agreements through charges to Account 930.2, Miscellaneous General Expenses, and included the amortized cost in its calculation of long-term debt interest expense used to compute its AFUDC rate. Further, SDG&E accounted for the quarterly commitment fees paid that were associated with the lines of credit in Account 923, Outside Services Employed.

SDG&E's accounting to record the upfront fees associated with establishing the lines of credit by charging Account 182.3 is inappropriate. Account 182.3 provides for recording regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies. The upfront fees incurred by SDG&E did not result from ratemaking actions of regulators. The fees are more appropriately accounted for in Account 186, Miscellaneous Deferred Debits. Account 186 provides for the recording of debits not elsewhere provided for in the USofA which are in process of amortization, such as the cost of the upfront fees incurred by SDG&E.

Additionally, audit staff found that the revolving line of credit agreements were not established in conjunction with the acquisition of debt or directly associated with outstanding debt. Rather, SDG&E represented that it entered into the agreements to create liquidity for general purpose needs. Audit staff finds that quarterly commitment fees associated with the revolving line of credit agreements that SDG&E accounted for in Account 923 are more appropriately recorded in Account 930.2, Miscellaneous General Expenses.¹⁶ Account 930.2 provides for the cost of labor and expenses incurred for the general management of a utility not provided for elsewhere in the USofA, and we find that the quarterly commitment fees most resemble a banking charge to support SDG&E's utility operations as a whole when the credit facility is not associated with debt.

SDG&E included the amortization of upfront line of credit fees as a component of the cost of long-term debt included in AFUDC rate calculations. However, the fees are not directly associated with the company's debt, and as such there is no basis to consider the fees as a cost of debt. SDG&E should exclude the amortization of upfront line of credit fees from the cost of debt when calculating its AFUDC rate consistent with Commission requirements stipulating that for inclusion (1) the fees must be associated with credit facilities acquired in compliance with the provisions of specific debt agreements; and (2) the company receive prior Commission approval.¹⁷

¹⁶ Upfront and quarterly commitment fees for credit facilities acquired in compliance with the provisions of specific debt agreements should be recorded as interest expense and included as a cost of the short-term or long-term debt they support, consistent with Commission precedent. See *System Energy Resources, Inc.*, 48 FERC ¶ 61,321 at 3 (1989) (holding that bank fees for letters of credit associated with construction bonds for nuclear generating plant lowered the cost of interest on the specific issuances of long-term construction bonds, thereby functioning as interest on such bond issuances, and should be recorded in Account 427, Interest on Long-Term Debt).

¹⁷ Order No. 561, 57 FPC 608 at 611.

Recommendations

We recommend that SDG&E:

8. Revise existing accounting policies, procedures, and practices relating to accounting for credit agreement expenses, such as upfront, commitment, quarterly, revolving line of credit, and letter of credit fees, to be consistent with Commission accounting requirements.
9. Revise policies and procedures for calculating the AFUDC rate to be consistent with EPI No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to exclude commitment fees from AFUDC rate calculations unless the costs are associated with debt issuances and are approved by the Commission for inclusion.
10. Train relevant staff on the revised accounting policies and provide periodic training, as needed.
11. Within 60 days of receiving the final audit report, submit proposed accounting entries and supporting documentation to DAA that reflect the transfer of credit agreement-related balances improperly recorded in Account 182.3 to Account 186.
12. Revise miscellaneous deferred debit balances to appropriately account for and report credit agreement-related balances after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.

3. Allocation of Overhead Costs to CWIP

SDG&E capitalized overhead costs to Account 107, Construction Work in Progress – Electric, using an allocation method that was not based on the actual time that employees were engaged in construction activities or on a representative time study. This led to SDG&E charging costs to Account 107 that did not have a definite relationship to construction. As a result, SDG&E may have overstated construction costs recorded in Account 107 and electric plant in service, as well as accumulated depreciation and accumulated deferred income tax (ADIT) balances, and may have understated operating expenses. Moreover, this accounting may have led SDG&E to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, General Instruction No. 9 (GI No. 9), Distribution of Pay and Expenses of Employees, states:

The charges to electric plant, operating expense and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance, and operations, shall be based upon the actual time engaged in the respective classes of work, or in case that method is impracticable, upon the basis of a study of the time actually engaged during a representative period.

- 18 C.F.R. Part 101, General Instruction No. 10 (GI No. 10), Payroll Distribution, states:

Underlying accounting data shall be maintained so that the distribution of the cost of labor charged direct to the various accounts will be readily available. Such underlying data shall permit a reasonably accurate distribution to be made of the cost of labor charged initially to clearing accounts so that the total labor cost may be classified among construction, cost of removal, electric operating functions (steam generation, nuclear generation, hydraulic generation, transmission, distribution, etc.) and nonutility operations.

- 18 C.F.R. Part 101, Electric Plant Instruction No. 3 (EPI No. 3), Components of Construction Cost, states in part:

(A)(2) *Labor* includes the pay and expenses of employees of the utility engaged on construction work, and related workmen's compensation insurance, payroll taxes and similar items of expense. It does not include the pay and expenses of employees which are distributed to construction through clearing accounts nor the pay and expenses included in other items hereunder.

- 18 C.F.R. Part 101, Electric Plant Instruction No. 4 (EPI No. 4), Overhead Construction Costs, states:

A. All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.

B. As far as practicable, the determination of pay roll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.

C. For Major utilities, the records supporting the entries for overhead construction costs shall be so kept as to show the total amount of each overhead for each year, the nature and amount of each overhead expenditure charged to each construction work order and to each electric plant account, and the bases of distribution of such costs.

Background

Audit staff evaluated a sample of charges allocated to SDG&E by Sempra, SDG&E's parent, and interviewed employees, reviewed supporting documentation, and

identified the accounts used to record the charges. Audit staff discovered that of the sampled allocated costs of \$9.7 million incurred in 2018, SDG&E capitalized \$3.9 million of the costs, which represented overhead labor and non-labor related costs, to construction projects.¹⁸ As such, SDG&E capitalized approximately 41.37 percent of costs allocated from some Sempra departments.

To support the capitalization of the costs, SDG&E represented that Sempra employees working in certain departments supported all SDG&E operations, including its construction operations. However, SDG&E did not distinguish between Sempra departments and employees that supported construction operations and those that did not in its determination of the allocated costs that it capitalized. Rather, audit staff found that SDG&E determined the costs that were capitalized to achieve its 41.37 percent capitalization rate based on a capital labor ratio. Throughout the audit period, the capital labor ratio was calculated as the ratio of the total direct labor costs charged to all capital work orders to all salaries and wages incurred each year. As such, SDG&E's allocation method did not consider whether departments with costs allocated and capitalized to construction projects actually supported construction operations.

In accordance with the accounting requirements of EPI No. 4, Overhead Construction Costs, and GI No. 9, Distribution of Pay and Expenses of Employees, labor costs capitalized as plant expense must have a definite relation to construction, and must be based on time card distributions or be allocated based on a study of the time actually engaged in construction related activities during a representative period. SDG&E acknowledged that it had neither performed a representative labor-time study nor assessed timecard distributions to determine capitalizable cost. Consequently, since the labor costs that SDG&E allocated to the construction overhead cost pool that it charged to construction were neither based on time employees actually engaged in construction activities as supported by time card distributions nor on a representative time study of such engagement, the charged costs did not have a definite relation to construction.

SDG&E's accounting for labor charges capitalized was not consistent with Commission accounting requirements and may have resulted in the company including inappropriate costs in constructed utility plant and, consequently, in transmission service formula rate determinations. This may have led to SDG&E overcharging wholesale transmission ratepayers.

¹⁸ Non-labor costs included other costs incurred by Sempra such as dues and subscriptions, rent, etc.

Recommendations

We recommend that SDG&E:

13. Retain an independent third-party entity to conduct a representative labor time study for allocation of overhead costs incurred in 2019 to CWIP, and to assist with the development of procedures SDG&E shall use to periodically determine the allocation of overhead labor and labor-related costs capitalized into the cost of construction after 2019. Report the progress of the study within 120 days and provide the time study results to DAA for review and consideration within 180 days of the date of the final audit report and the developed allocation procedures when complete. At a minimum, the developed allocation procedures should provide a method for overhead cost allocation and capitalization to construction based on actual timecard distributions or where this procedure is impractical, based on periodic time studies.
14. Revise written policies, practices, and procedures governing the methods used to account for, track, report, and review overhead labor, labor-related costs, and all other costs allocated to construction projects to be consistent with Commission accounting requirements. In addition, adopt procedures to retain formal documentation supporting the amount of overhead costs allocated to electric plant accounts.
15. Train relevant staff on the revised overhead allocation procedures and documentation, and provide periodic training in this area, as needed.
16. Within 30 days of the completion of Recommendation No. 13, submit an estimate to DAA, including the calculations and determinative components, of overhead costs that would have been allocated to CWIP during the audit period consistent with the requirements of EPI No. 4 and GI No. 9. The estimate should be based on a recalculation of 2016 and subsequent years overhead cost allocated to construction with labor and labor-related costs removed from the cost of plant that were not associated with construction activities based on the methodology developed in response to Recommendation No. 13.
17. With the response to Recommendation No. 16, submit proposed accounting entries to DAA that remove the overhead costs that were allocated to electric plant in CWIP and in service during the audit period that exceed the amount of costs that would have been allocated to the accounts based on the methodology developed in response to Recommendation No. 13. Also,

provide proposed accounting entries to remove associated amounts from other accounts and balances affected by the inappropriately allocated cost such as the accumulated depreciation and ADIT accounts, and AFUDC balances capitalized into CWIP and plant in service. If the adjusting entries result in a significant impact to income for the current year, SDG&E may account for the transaction as a correction of a prior period error in Account 439, Adjustments to Retained Earnings. Such an entry should be submitted with the proposed accounting entries.

18. Revise account balances for utility plant, accumulated depreciation, ADIT, and other account balances impacted by the inappropriate allocation of unsupported overhead cost after receiving DAA's assessment of the proposed accounting entries per Recommendation No. 17, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.
19. Submit a refund analysis to DAA that explains and details the following: (1) calculation of refunds that result from the overstatement of transmission plant due to the improper capitalized of labor costs, as determined by the labor time study, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
20. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

4. Accounting for EV Charging Stations

SDG&E improperly accounted for electric vehicle (EV) charging station distribution assets in Account 398, Miscellaneous Equipment. SDG&E's accounting resulted in the cost of the assets and associated expenses being incorrectly included in accounts that are wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 370, Meters, states in part:
 - A. This account shall include the cost installed of meters or devices and appurtenances thereto, for use in measuring the electricity delivered to its users, whether actually in service or held in reserve.
- 18 C.F.R. Part 101, Account 371, Installations on Customers' Premises, states in part:

This account shall include the cost installed of equipment on the customer's side of a meter when the utility incurs such cost and when the utility retains title to and assumes full responsibility for maintenance and replacement of such property.

Background

Audit staff performed variance analyses on accounts in the FERC Form No. 1 with large balances, unusual activity, and/or significant year-to-year fluctuations. Audit staff discussed with SDG&E each account fluctuation to understand the nature of the transactions and, where necessary, obtained additional information and support. Audit staff found that SDG&E incurred costs associated with implementation of an Electric Vehicle-Grid Integration (VGI) Pilot Program that was authorized by the CPUC.¹⁹ Pursuant to the program, SDG&E was authorized to invest \$45 million in the installation of 3,500 EV charging stations at 350 sites in California, plus cost recovery through future general rate case proceedings for justified capital and operations and maintenance expenses.

¹⁹ CPUC adopted the Electric Vehicle-Grid Integration Pilot Program in Decision 16-01-045, 2016 Cal. PUC LEXIS 67 (2016).

To incorporate rate design changes and the related VGI rate associated with the pilot program into its tariff, SDG&E filed, pursuant to section 205 of the FPA²⁰ and Sections 35.13 and 385.205 of the Commission's regulations,²¹ proposed revisions to Appendices VII and IX of its tariff.²² In the filing, SDG&E represented that the proposed revisions were limited to implementing the VGI Pilot Program and did not affect any other rates that were effective at the time, including the base transmission revenue requirement that is calculated using SDG&E's wholesale transmission formula rate.²³

On June 6, 2016, the Commission issued an order accepting SDG&E's proposed tariff revisions.²⁴ The Commission relied on SDG&E's representations in accepting its proposal. Specifically, the Commission noted that its acceptance of the proposal was based on SDG&E's representation that "no customers other than the VGI customers will be affected" by the tariff changes.²⁵ However, audit staff found that SDG&E's accounting for its investment in the EV charging stations led to the inclusion of the costs in accounts that are inputs to SDG&E's wholesale transmission formula rate, which resulted in the company billing a portion of the cost to wholesale transmission formula rate customers. Moreover, audit staff determined that SDG&E recorded its investment in the assets in the incorrect utility plant account.

SDG&E explained that it initially recorded the cost of the EV charging stations as distribution assets in Account 371, Installations on Customers' Premises, but later decided that while the functional classification of the assets was appropriate, the account was not. Consequently, SDG&E transferred the cost from Account 371 to Account 398,

²⁰ 16 U.S.C. § 824d (2018).

²¹ 18 C.F.R. §§ 35.13 and 385.205 (2019).

²² San Diego Gas & Electric's Transmission Owner Tariff, FERC Electric Tariff, Original Volume No. 11, Appendix VII, Reliability Must-Run Charges for End-Users; and Appendix IX, Determination of SDG&E's End Use Customer Class Transmission Charges, Low Voltage Access Charge, and High Voltage Utility-Specific Rate, and Allocation of BTRR Applicable to High Voltage and Low Voltage Transmission Facilities.

²³ San Diego Gas & Elec. Co. Filing, Docket No. ER16-1374-000, Transmittal at 4, Fang Testimony at 3-5 (filed Apr. 8, 2016).

²⁴ *San Diego Gas & Elec. Co.*, 155 FERC ¶ 61,244 (2016).

²⁵ *Id.* P 5.

Miscellaneous Equipment. SDG&E maintained that its use of Account 398 was appropriate because the account provides for the recording of “the cost of equipment, apparatus, etc., used in the utility operations, which is not includible in any other account of the USofA.” However, the text of Account 398 also notes that equipment “wherever practicable shall be included in the utility plant accounts on a functional basis.” This language restricts the use of Account 398 to property of a general nature that does not fit into any particular function.

The correct account classification of an item is dependent on the nature of the item. The EV charging stations are dissimilar in nature to those assets properly includible in Account 398. Based upon review of the record, including SDG&E’s use and operations of the EV charging stations, audit staff believes the assets serve a distribution function. SDG&E’s EV charging stations allow retail end-use customers in its distribution service territory access to low voltage power to charge electric vehicles. As assets of a distribution nature, the EV charging stations cannot appropriately be accounted for as general plant in Account 398 because the assets are more properly accounted for in a distribution plant account.

The EV charging stations are made of several components that include hardware and software that facilitate retail end-use customer access to a low voltage power supply with control and monitoring oversight by SDG&E. The control and monitoring capabilities of the EV charging stations are similar in operation and function to utility smart meters. Given the nature of the assets and their control and monitoring capabilities, audit staff believes that the EV charging stations are more appropriately recorded to Account 370, Meter or Account 371 than Account 398. Account 370 provides for recording the cost of meters, and Account 371 provides for recording the cost of equipment on the customers’ side of meters. Accordingly, SDG&E may decide to use one or both accounts to record components of the assets or record the assets in a subaccount of a single account and must maintain records to support the cost and depreciation of the assets.

SDG&E did not seek guidance from the Commission on the appropriate accounting for the EV charging station assets. To the extent SDG&E was unsure of the appropriate accounting for EV charging stations, it should have submitted a request to the Commission for accounting guidance consistent with the requirements of General Instruction No. 5, Submittal of Questions.²⁶ The Commission provides this guidance to maintain uniformity of accounting among the companies in each industry that it regulates.

²⁶ General Instruction No. 5, Submittal of Questions, 18 C.F.R. Part 101 (2019).

In accordance with section 301(a) of the FPA and Section 41.8 of the Commission's regulations, the burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry.²⁷ Here, audit staff determined that SDG&E did not justify its proposed accounting treatment for the EV charging station assets. As the Commission has explained in a similar context in past cases, where a utility finds the appropriate accounting treatment of a particular cost doubtful, and where a utility has opportunities available to it to ascertain the appropriate treatment of that particular cost and chooses not to avail itself of those opportunities, a Commission finding that the utility incorrectly accounted for the cost, and so must correct its accounting and billing, and pay refunds, is proper.²⁸ SDG&E, not having availed itself of the opportunities available to it to raise this matter with the Commission or with the Chief Accountant, should not be excused from correcting its accounting and its billing and from making refunds.

Recommendations

We recommend that SDG&E:

21. Revise policies, procedures, and practices to track, report, review and account for EV charging stations to be consistent with Commission accounting requirements.
22. Train relevant staff on the revised accounting methods and provide periodic training, as needed.
23. Within 30 days of implementing Recommendation No. 21, submit proposed accounting entries and supporting documentation to DAA that reflect the removal of the EV charging station costs improperly recorded in Account 398.

²⁷ See 16 U.S.C. § 825(a) (2018); 18 C.F.R. § 41.8 (2019), respectively.

²⁸ See, e.g., *Indianapolis Power & Light Co.*, Opinion No. 328, 48 FERC ¶ 61,040, at 61,202-61,203, *reh'g granted*, 48 FERC ¶ 61,328 (1989) (granting rehearing and clarifying refund obligation); *Cent. Ill. Pub. Serv. Co.*, Opinion No. 309-A, 47 FERC ¶ 61,043, at 61,124, *reh'g denied*, Opinion No. 309-B, 48 FERC ¶ 61,008 (1989), *rev'd on other grounds and remanded*, *Cent. Ill. Pub. Serv. Co. v. FERC*, 941 F.2d 622 (7th Cir. 1991); *Ky. Utilities Co.*, 45 FERC ¶ 61,409, at 62,293-62,294 (1988); *Minn. Power & Light Co.*, 45 FERC ¶ 61,369, at 62,158 (1988); *ITC Holdings Corp.*, 139 FERC ¶ 61,112, at PP 63-66 (2012).

24. Revise the Account 398 balance to appropriately account for and report EV charging stations after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.
25. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that includes the amount of inappropriate recoveries during the audit period that resulted from the improper accounting for EV charging stations, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
26. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

5. Regulatory Commission Expenses

SDG&E improperly accounted for regulatory commission expenses. SDG&E's accounting resulted in regulatory commission expenses being incorrectly included in accounts that are wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 928, Regulatory Commission Expenses, states in part:

A. This account shall include all expenses (except pay of regular employees only incidentally engaged in such work) properly includible in utility operating expenses, incurred by the utility in connection with formal cases before regulatory commissions, or other regulatory bodies, or cases in which such a body is a party, including payments made to a regulatory commission for fees assessed against the utility for pay and expenses of such commission, its officers, agents, and employees.

Background

Audit staff selected a sample of transactions recorded to transmission O&M and A&G expense accounts. As part of this review, audit staff examined SDG&E's invoicing and accounts payable processes, assessed supporting documentation, and interviewed employees who performed relevant accounting functions.

Audit staff discovered witness fees for preparing FERC electric rate case testimony were recorded to Account 566, Miscellaneous Transmission Expenses, and witness fees for preparing CPUC general rate case testimony were recorded to Account 923, Outside Services Employed. The instructions to Account 928, Regulatory Commission Expenses, require that all expenses in connection with formal cases before regulatory commissions, such as witness fees, be recorded to Account 928. Therefore, in accordance with Commission accounting regulations, SDG&E should have recorded witness testimony fees in connection with formal cases before regulatory commissions in Account 928 and not Accounts 566 and 923.

Balances recorded in Accounts 566, 923, and 928 are cost component inputs used to populate SDG&E's transmission formula. Through operation of the transmission formula, amounts recorded in Account 566 may be 100 percent charged as a cost of

transmission service; while amounts recorded in Accounts 923 and 928 are subjected to an allocator such that approximately 18 percent of a balance may be charged as a cost of transmission service in accordance with the allocation methodology for the account as provided for in the wholesale transmission formula rate. SDG&E's improper use of Account 566 to record regulatory commission expenses resulted in wholesale transmission formula rate customers being charged 100 percent of the cost instead of the 18 percent provided for by the transmission formula. This led the company to overcharge its wholesale transmission customers.

Recommendations

We recommend that SDG&E:

27. Revise policies, procedures, and practices to track, report, review, and account for regulatory commission expenses to be consistent with Commission accounting requirements.
28. Train relevant staff on the revised methods to account for regulatory commission expenses and provide periodic training, as needed.
29. Perform an analysis of transmission operation expense accounts to identify A&G expenses, such as regulatory commission expenses, improperly charged to the accounts during the audit period. Within 60 days of the date of the final audit report, provide the results of the analysis to audit staff.
30. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for A&G expenses recorded in O&M accounts as identified pursuant to the analysis performed in response to Recommendation No. 29, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
31. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

6. Accounting for Distribution-Related Expenses

SDG&E improperly accounted for distribution-related operation costs in a transmission operation expense account. SDG&E’s accounting resulted in expenses being incorrectly included in accounts that were wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 562, Station Expenses (Major Only), states in relevant part:

This account shall include the cost of labor, materials used and expenses incurred in operating transmission substations and switching stations....

ITEMS

Labor:

.....

Item 8. Care of grounds, including snow removal, cutting grass, etc.

- 18 C.F.R. Part 101, Account 582, Station Expenses (Major Only), states in relevant part:

Accounts 581.1 through 584 shall include, respectively, the cost of labor, materials used and expenses incurred in the operation of overhead and underground distribution lines and stations.

ITEMS

.....

Station Labor:

.....

Item 8. Care of grounds, including snow removal, cutting grass, etc.

Background

Audit staff selected a sample of transactions recorded to transmission O&M expense accounts. As part of this review, audit staff examined SDG&E’s invoicing and

accounts payable processes, assessed supporting documentation, and interviewed employees who performed relevant accounting functions.

Audit staff identified landscaping and other related activities performed at substations with costs that were charged as transmission operation expenses in Account 562, Station Expenses.²⁹ SDG&E represented that the substations supported both transmission and distribution operations; however, SDG&E recorded all the expenses to its transmission operations. SDG&E represented that, when SDG&E transferred control of its transmission facilities to the CAISO and implemented the first transmission owner rate tariff, determinations had to be made for ratemaking purposes on the treatment of land. For any substation with at least one 69kV or higher line entering the substation and a distribution voltage exiting the substation, the land is allocated 50 percent to transmission rate base and 50 percent to distribution rate base. Since the substation land is allocated to distribution and transmission operations equally, the expenses related to their operation should have been apportioned to the appropriate O&M expense accounts associated with each function. Accounts 562 and 582 provide for the recording of expenses incurred in the care of grounds at substations. Therefore, SDG&E should have recorded an applicable portion of the landscaping and other related activities costs in both Account 562 and Account 582.

The cost of the landscaping totaled \$3.6 million. Based on records evaluated, audit staff determined that 50 percent of the \$3.6 million (\$1.8 million) cost should have been charged to distribution operations using Account 582. SDG&E's improper accounting for the distribution operations-related portion of the cost overstated transmission operation expenses included in SDG&E's wholesale transmission formula rate determinations. As a result, SDG&E overbilled wholesale transmission customers for the excessive operation expenses included in its wholesale formula rate determinations.

Recommendations

We recommend that SDG&E:

32. Strengthen policies and procedures to account for distribution-related expenses consistent with Commission accounting requirements.
33. Train relevant staff on the methods to account for distribution-related expenses and provide periodic training, as needed.

²⁹ The substations included the Avocado, Batiquitos, Friars, Paradise, Point Loma, Proctor Valley, and Rose Canyon substations, among others.

34. Perform an analysis of costs incurred at substations during the audit period to determine whether distribution-related expenses were charged to the correct account(s) and that the appropriate allocators were used to charge costs to transmission and distribution expense accounts when applicable. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.
35. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for distribution-related O&M expenses in transmission expense accounts, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
36. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

7. Accounting for Donations and Lobbying Expenses

SDG&E misclassified donation payments and costs incurred to support activities to influence public opinion with regard to legislation. SDG&E's accounting resulted in such expenses being incorrectly included in accounts that were wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 426.1, Donations, states:

This account shall include all payments or donations for charitable, social or community welfare purposes.

- 18 C.F.R. Part 101, Account 426.4, Expenditures for Certain Civic, Political and Related Activities, states:

This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing referenda, legislation or ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

Background

Audit staff tested a sample of charges made to A&G accounts to determine whether the charges were recorded consistent with Commission accounting requirements. As part of this review, audit staff examined SDG&E's invoicing and accounts payable processes, assessed supporting documentation, and interviewed employees who performed relevant accounting functions. Audit staff's analysis of the charges found that SDG&E misclassified costs associated with charitable donations and with activities to influence public opinion with regard to legislation. This was also an issue of

noncompliance with Commission accounting requirements found during the 2014 Audit of SDG&E.³⁰

In the 2014 Audit report, there were four recommendations for corrective action associated with the finding that overall required SDG&E to (1) implement internal control measures to help prevent the error from reoccurring in periods after the 2014 Audit; and (2) refund inappropriate charges to wholesale transmission customers impacted by the error. Audit staff found that SDG&E provided the refunds but did not establish the effective controls required by the 2014 Audit that would have helped prevent reoccurrence of the error in subsequent periods.

SDG&E awarded economic development grants to non-profit entities that serve the community. SDG&E also made charitable donations through payments to an industry association as a portion of its membership dues paid. Audit staff discovered through an assessment of the sampled data that SDG&E improperly accounted for donations of approximately \$742,000. The sampled donations were comprised of \$674,174 of economic development grants and \$67,500 in the charitable giving portions of industry association membership dues. The donations were recorded as A&G expenses in Account 930.2, Miscellaneous General Expenses. However, Account 426.1, Donations, provides for the recording of donations for charitable, social or community welfare purposes such as those made by SDG&E. SDG&E should have accounted for its donations in Account 426.1.

SDG&E also improperly accounted for payments that were associated with activities to influence public opinion with regard to legislation. Audit staff discovered in sampled data that SDG&E recorded approximately \$390,000 of such payments in Accounts 921, Office Supplies and Expenses; 923, Outside Services; and 930.2, Miscellaneous General Expenses. The sampled payments were comprised of \$114,000 paid to consultants hired to perform lobbying activities on SDG&E's behalf and \$275,522 constituting the portion of industry association membership dues paid to support associations' efforts to influence legislation. However, Account 426.4, Expenditures for Certain Civic, Political and Related Activities, provides for the recording of expenditures made for these purposes. SDG&E should have recorded the expenses in Account 426.4

Amounts recorded in Accounts 921, 923, and 930.2 are included in SDG&E's wholesale transmission formula rate. SDG&E's improper accounting for donations and lobbying-related expenses resulted in the costs being included in the determination of

³⁰ See 2014 Audit, Finding No. 5, Industry Association Dues and Lobbying Activities, at 41-43.

wholesale transmission service rates and inappropriately billed to wholesale transmission customers. Moreover, since the misclassified costs identified by audit staff were based on a sample, wholesale transmission customers SDG&E should perform an analysis of its A&G accounts to identify other donations and lobbying costs that may be misclassified during the audit period.

Recommendations

We recommend that SDG&E:

37. Develop and implement procedures and policies to track, report, review, and account for donations and for expenses of activities associated with influencing legislation and with other political activity consistent with the Commission's accounting requirements.
38. Train relevant staff on the procedures and policies and provide periodic training, as needed.
39. Perform an analysis of A&G expense accounts to identify nonoperating expenses, such as donations and lobbying costs, improperly charged to the accounts during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.
40. Submit a refund analysis to DAA, within 60 days of receiving the final audit report, that explains and details the following: (1) calculation of refunds that include the amount of inappropriate recoveries during the audit period that resulted from the improper accounting for below-the-line expenses recorded in A&G expense accounts as identified pursuant to the analysis performed in response to Recommendation No. 39, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.
41. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

8. Accounting for Outside Services Employed

SDG&E improperly accounted for external consultant fees incurred to support general services not applicable to a particular operating function. SDG&E's accounting resulted in expenses being incorrectly included in an account that is a wholesale transmission formula rate input. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, General Instruction No. 2, Records, states in part:
 - A. Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto.
 - B. The books and records referred to herein include not only accounting records in a limited technical sense, but all other records, such as minute books, stock books, reports, correspondence, memoranda, etc., which may be useful in developing the history of or facts regarding any transaction.
- 18 C.F.R. Part 101, Account 923, Outside Services Employed, states in part:
 - A. This account shall include the fees and expenses of professional consultants and others for general services which are not applicable to a particular operating function or to other accounts. It shall include also the pay and expenses of persons engaged for a special or temporary administrative or general purpose in circumstances where the person so engaged is not considered as an employee of the utility.
- 18 C.F.R. § 125.3, Schedule of Records and Periods of Retention, provides in pertinent part that:

Construction in progress ledgers, work orders, and supplemental records [must be retained for] 5 years after clearance to a plant

account, provided continuing plant inventory records are maintained; otherwise 5 years after plant is retired.

Background

Audit staff tested a sample of transactions recorded to transmission O&M expense and plant accounts. As part of this review, audit staff examined SDG&E's invoicing and accounts payable processes, assessed available supporting documentation, and interviewed employees who performed relevant accounting functions.

Pursuant to this review, audit staff found that SDG&E accounted for external consultant fees of \$3.3 million in Accounts 560, Operation Supervision and Engineering, and 107, Construction Work in Progress-Electric. The consultants were hired in January 2017 to work on a project involving integration of SDG&E information technology systems. The project was ultimately abandoned, and associated amounts written off in September 2019.

Audit staff found that SDG&E did not retain documentation, as required by Commission accounting and record retention policy, regarding its basis for charging the external consultant fees to Accounts 107 and 560. Specifically, in accordance with GI No. 2, Records, SDG&E was required to maintain documentation to support all relevant facts regarding the transaction. In addition, in accordance with the Commission's schedule of records and periods of retention, 18 C.F.R. § 125.3, SDG&E was required to maintain records associated with the cost charged to Account 107 for five years after clearance of the cost to plant in service accounts or five years after the plant was retired, as appropriate. SDG&E's abandonment of the project was akin to its retirement of the plant. Therefore, SDG&E should have retained documentation to support its accounting for the project in accordance with GI No. 2.

Based on audit staff's review of documentation that was available and discussions with SDG&E staff, the work of the consultants was not applicable to a particular SDG&E operating function; instead, it was intended to support SDG&E's information technology systems for all its operating functions. Account 923 provides for the recording of fees and expenses of professional consultants which are not applicable to a particular operating function. As such, SDG&E should have accounted for the noncapitalized portion of the fees, amounting to approximately \$1 million, in Account 923 instead of Account 560.

Balances recorded in Accounts 560 and 923 are cost component inputs used to populate SDG&E's wholesale transmission formula rate. Through operation of the wholesale transmission formula rate, amounts recorded in Account 560 may be 100 percent charged as a cost of transmission service, while amounts recorded in Account 923

are subject to an allocator such that approximately 18 percent of a balance may be charged as a cost of transmission service, in accordance with the allocation methodology for the account as provided for in the wholesale transmission formula rate. SDG&E's improper use of Account 560 to record the consultant fees resulted in wholesale transmission formula rate customers being charged 100 percent of the approximately \$1 million cost instead of 18 percent of the cost as provided for by the wholesale transmission formula rate. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

As a result of the present audit, SDG&E reclassified the capitalized portion of the fees, amounting to approximately \$2.3 million, from Account 107 to Account 426.5, Other Deductions. This accounting excludes the cost from future transmission service rate determinations. However, audit staff's evaluation of the transmission O&M expense and plant accounts was based on a sample; it is possible there are more errors, and as a result, additional costs inappropriately billed to wholesale transmission customers.

Recommendations

We recommend that SDG&E:

42. Revise policies, procedures, and practices to maintain and retain documentation to be consistent with Commission record retention requirements.
43. Revise policies, procedures, and practices to track, report, review, and account for outside service expenses to be consistent with Commission accounting requirements.
44. Train relevant staff on the revised methods and provide periodic training, as needed.
45. Perform an analysis of transmission operation expense accounts to identify expenses, such as management consultant fees, improperly charged, in whole or in part, to transmission operations during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.
46. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for A&G expenses recorded in O&M accounts as identified pursuant to the analysis performed in response to Recommendation No. 45, plus interest; (2) determinative

components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

47. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

9. Filing of Tariff Records

SDG&E did not properly file all Tariff Records, as required, in the Commission's electronic tariff (eTariff) database. Specifically, SDG&E's eTariff filing omitted Attachment 2, its Formula Rate Spreadsheet, from its tariff filed in the eTariff database. This impacted interested parties' ability to access and review the attachment through the Commission's eTariff Public Viewer.

Pertinent Guidance

- 18 C.F.R. § 35.9(b), Requirements for Filing Rate Schedules, Tariffs or Service Agreements, states:

(b) Open Access Transmission Tariffs (OATT) filed by utilities that are not Independent System Operators or Regional Transmission Organizations must be filed either as individual sheets or sections. If filed as sections, the sections must be no larger than the 1.0 level, although each schedule or attachment may be a single section. Individual service agreements that are entered into pursuant to the OATT may be filed as entire documents.

- *Electronic Tariff Filings*, Order No. 714, 124 FERC ¶ 61,270, at P 12 (2008) (footnotes omitted), states in part:

The [electronic filing] standards define an extensible markup language (XML) schema that will permit filers to assemble an XML filing package that includes the tariff changes, the accompanying tariff-related documents, such as the transmittal letter, rate schedules, and spreadsheets that are required to accompany various tariff filings, and other required information such as the proposed effective date of the filing.

Background

SDG&E electronically filed its Transmission Owner Transmission Tariff on the Commission's eLibrary and eTariff databases. The Commission provides its eTariff Public Viewer to effectuate public access and retrieval of electronically filed tariffs that are included in the eTariff database. Tariffs filed for inclusion in the eTariff database are

required to be filed as individual sheets or sections.³¹ SDG&E filed its tariff as individual sections.

Audit staff reviewed SDG&E's filing for completeness and found that an attachment was omitted from the eTariff database. Specifically, SDG&E omitted the Attachment 2, Formula Rate Spreadsheet, that includes the company's wholesale transmission formula rate used to determine the rate for wholesale transmission service.³² SDG&E acknowledged that the attachment was erroneously omitted from the eTariff database but reasoned that the attachment was nonetheless available to the public through eLibrary. However, in Order No. 714, the Commission considered and rejected arguments that the availability of tariffs in eLibrary could be a substitute for a complete filing in the eTariff database.³³

Recommendations

We recommend that SDG&E:

48. Develop procedures and controls to help ensure all tariff records are properly filed and available for disclosure in the Commission's eTariff database.
49. Provide training to relevant staff on the procedures and controls to electronically file tariff records in the eTariff database and provide periodic training, as needed.
50. Notify DAA upon filing the omitted Tariff Records for the currently effective version of the Transmission Owner Transmission Tariff in the eTariff database.

³¹ 18 C.F.R. § 35.9, Requirements for Filing Rate Schedules, Tariffs or Service Agreements.

³² See San Diego Gas & Electric Company, FERC FPA Electric Tariff, SDG&E Transmission Owner Tariff, Original Volume No. 11, Appendix VIII, TO Appendix VIII, 6.0.0, Attachment II.

³³ *Electronic Tariff Filings*, Order No. 714, 124 FERC ¶ 61,270, at PP 30-31 (2008), *order on reh'g*, Order No. 714-A, 147 FERC ¶ 61,115 (2014).

Corrective Action

- During the audit, SDG&E submitted a filing to comply with a Commission order³⁴ approving an uncontested settlement agreement for SDG&E's Fifth Transmission Owner Formula Rate (Compliance Filing), which Compliance Filing included the Attachment 2, Formula Rate Spreadsheet, discussed in the background of this finding.³⁵ This effort satisfies the requirement of Recommendation No. 50.

³⁴ *San Diego Gas & Elec. Co.*, 170 FERC ¶ 61,240, at P 10 (2020).

³⁵ See San Diego Gas & Electric Company, FERC FPA Electric Tariff, SDG&E TO Tariff Filing, Appendix I, TO Appendix I, 3.0.0, Appendix VIII, TO Appendix VIII, 13.0.0, Attachment 1 – Protocols, 1.0.0, Attachment 2 – Formula Rate Spreadsheet, 1.0.0, Formula Rate Protocols, TO Appendix VIII – Attachment 1, 8.0.0. See also *San Diego Gas & Elec. Co.*, Docket No. ER19-221-003 (June 26, 2020) (letter order accepting Compliance Filing effective June 1, 2019).

10. Premature Destruction or Loss of Records

SDG&E could not verify the existence of an asset, or provide documentation associated with the asset's cost, that was recorded in Account 154, Plant Materials and Operating Supplies. SDG&E's inability to produce the documentation represents an instance of premature destruction or loss of records.

Pertinent Guidance

- 18 C.F.R. § 125.2(k), Rate Case, states:

Notwithstanding the minimum retention periods provided in these regulations, if a public utility or licensee wants to reflect costs in a current, future, or pending rate case, or if a public utility or licensee has abandoned or retired a plant subsequent to the test period of the utility's rate case, the utility must retain the appropriate records to support the costs and adjustments proposed in the current or next rate case.

- 18 C.F.R. Part 101, Account 154, Plant Materials and Operating Supplies, states in part:

This account shall include the cost of materials purchased primarily for use in the utility business for construction, operation and maintenance purposes.

Background

Audit staff tested a sample of charges in various accounts that were inputs to the wholesale transmission formula rate to determine whether the charges were accounted for consistent with Commission accounting requirements. As part of this review, audit staff interviewed employees who performed relevant accounting functions and examined a sample of invoices and other documentation that supported balances recorded in the accounts. Based on the sample of items reviewed, audit staff found that SDG&E retained required documentation for most of the items recorded in the accounts but could not locate documentation to support a \$200,000 charge in Account 154, Plant Materials and Operating Supplies. In accordance with Commission record retention requirements, SDG&E must retain records of material costs included in rate determinations.

The charge was associated with a core deposit made to acquire reels of cable from a supplier. SDG&E explained that the deposit would be recovered upon its return of the empty reels to the supplier, unless additional reels of cable were acquired. When

additional reels of cable were acquired, the supplier would apply the already held deposit toward SDG&E's acquisition of the new reels. Over time, due to administrative oversight and changes to its accounting software, SDG&E could not find the reels that were related to the deposit and the documentation associated with the transaction.

As a result of the audit, SDG&E reclassified the cost from Account 154 to Account 426.5, Other Deductions. This accounting excludes the cost from future transmission rate determinations. However, SDG&E should have had processes and procedures to monitor and periodically check its materials inventory to help ensure inclusion of appropriate materials cost in its accounts and transmission rate determinations.

Recommendations

We recommend that SDG&E:

51. Strengthen procedures to maintain and retain documentation consistent with Commission record retention requirements.
52. Revise policies, procedures, and practices to track, report, review, and account for inventory to be consistent with Commission accounting requirements. Among other things, the revisions should include processes and procedures to audit inventories of plant materials and supplies on a cyclical basis and make necessary adjustments to bring Account 154 into agreement with the actual inventories.
53. Train relevant staff on the revised methods and provide periodic training, as needed.

11. Filing Associated with Electric Plant Purchased

SDG&E did not file its proposed journal entries for the purchase of electric plant within six months, as required. This hindered the Commission's and other interested parties' ability to timely review and monitor the transaction.

Pertinent Guidance

- 18 C.F.R. Part 101, EPI No. 5(A), Electric Plant Purchased or Sold, states:
 - A. When electric plant constituting an operating unit or system is acquired by purchase, merger, consolidation, liquidation, or otherwise, after the effective date of this system of accounts, the costs of acquisition, including expenses incidental thereto properly includible in electric plant, shall be charged to account 102, Electric Plant Purchased or Sold.
- 18 C.F.R. Part 101, Account 102, Electric Plant Purchased or Sold, states:
 - A. This account shall be charged with the cost of electric plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and shall be credited with the selling price of like property transferred to others pending the distribution to appropriate accounts in accordance with electric plant instruction 5.
 - B. Within six months from the date of acquisition or sale of property recorded herein, the utility shall file with the Commission the proposed journal entries to clear from this account the amounts recorded herein.

Background

SDG&E purchased certain electric distribution facilities on June 1, 2018 from Southern California Edison Company. These facilities were previously used to support the San Onofre nuclear generation station. SDG&E agreed to purchase the facilities for \$271,577.

Audit staff found that SDG&E properly used Account 102, Electric Plant Purchased or Sold, to record the cost of electric plant acquired. The instructions of Account 102 required SDG&E to file proposed journal entries with the Commission within six months from the date of acquisition of property recorded to the account.

Through inquiries with SDG&E, audit staff concluded that SDG&E did not file its proposed journal entries with the Commission as required by the Commission's regulations. SDG&E acknowledged that its failure to file was the result of administrative oversight. This error hindered the Commission's and other interested parties' ability to timely review and monitor the transaction.

As a result of the audit, SDG&E filed its proposed journal entries with the Commission on June 14, 2019, one year after the effective date of the purchase. The proposed journal entries were approved by the Chief Accountant on July 23, 2019.³⁶

Recommendations

We recommend that SDG&E:

54. Revise procedures and controls to timely file proposed journal entries for purchases or sales of operating units to be consistent with the Commission's requirements.
55. Train relevant staff on the revised methods and provide periodic training, as needed.

³⁶ *San Diego Gas & Elec. Co.*, Docket No. AC19-160-000 (Jul. 23, 2019) (delegated order).

V. SDG&E's Response to Draft Audit Report



Dan Skopec
Vice President, Regulatory Affairs

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July 16, 2020

Steven D. Hunt
Director and Chief Accountant
Division of Audits and Accounting
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street NE, Room 5K-13
Washington, D.C. 20426

**Re: San Diego Gas & Electric Company
Docket No. FA19-3-000**

Dear Mr. Hunt:

San Diego Gas & Electric Company (SDG&E) has reviewed the draft audit report dated June 30, 2020 (Draft Report) issued by the Federal Energy Regulatory Commission's (FERC or Commission) Division of Audits and Accounting (DAA). DAA's audit evaluated SDG&E's compliance with: (1) its formula rate transmission owner tariff; (2) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, under 18 C.F.R. § 141.1; and (4) requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125. The audit covered the period January 1, 2016 through February 4, 2020.

SDG&E's response to the Draft Report is attached. As set forth in SDG&E's response, SDG&E does not contest the findings identified in the Draft Report.

SDG&E will submit a plan for implementing the audit's recommendations within 30 days after the final audit report is issued, and will submit quarterly reports describing progress in completing each corrective action within 30 days after the end of each calendar quarter, beginning with the first quarter after the audit report is issued, and continuing until all recommended corrective actions are completed. SDG&E will also submit copies of written policies and procedures developed in response to recommendations in the first quarterly filing after the development of a written policy or procedures.

Mr. Steven D. Hunt
July 16, 2020
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SDG&E takes compliance with the Commission's accounting requirement seriously, and in that regard, SDG&E wishes to thank DAA and audit staff for their professionalism in conducting this audit. SDG&E further appreciates audit staff's time and attention in providing recommendations as to how SDG&E can strengthen its practices going forward.

SDG&E looks forward to working with DAA and audit staff to resolve the items in this audit.

Sincerely,

/s/ Dan Skopec
Dan Skopec
Vice President – Regulatory Affairs

**San Diego Gas & Electric Company
Response to Draft Audit Report dated June 30, 2020
July 16, 2020**

SUMMARY OF RESPONSE

San Diego Gas & Electric Company (SDG&E) does not contest the findings identified in the Draft Audit Report dated June 30, 2020 (Draft Audit Report) issued by the Federal Energy Regulatory Commission's (FERC or Commission) Division of Audits and Accounting (DAA).¹ With respect to SDG&E's planned implementation of certain recommendations contained within the Draft Audit Report, SDG&E's response includes clarifications that reflect discussions with audit staff.

RESPONSES TO FINDINGS AND RECOMMENDATIONS

Finding 1: Allowance for Funds Used During Construction

SDG&E's methods for calculating its Allowance for Funds Used During Construction (AFUDC) base and rate were deficient. Specifically, SDG&E improperly included unpaid contract retention accruals in its construction work in process (CWIP) balance, and unamortized debt discounts and losses on reacquired debt in the determination of its long-term debt balance. As a result, SDG&E miscalculated its AFUDC base and rate. This led it to over-accrue AFUDC, which resulted in an overstatement of CWIP and plant in service balances. This resulted in SDG&E overbilling wholesale transmission customers because the excessive AFUDC costs were included in utility plant that impacted wholesale formula rate determinations.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 1: *Revise policies and procedures for calculating the AFUDC base and rates to be consistent with Electric Plant Instruction (EPI) No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to prevent inclusion of unpaid contract retention accruals in AFUDC base calculations and processes to prevent improper inclusion of balances in Accounts 189 and 226 in the AFUDC rate calculations.*

SDG&E Response: SDG&E has developed and implemented a custom SAP program that is being utilized to offset retained accruals on capital projects, in order to ensure amounts are properly excluded from CWIP. SDG&E has revised its policies and procedures for calculating the AFUDC base and rates to be consistent with EPI No. 3(A)(17) and other applicable Commission requirements, including processes to prevent inclusion of unpaid contract retention accruals in AFUDC base calculations and processes to prevent improper inclusion of balances in Accounts 189 and 226 in the AFUDC rate calculations.

¹ SDG&E does not waive its right to advocate any position before the Commission in the future that might be contrary to any principle or legal matter contained in this audit.

***Recommendation 2:** Revise policies, procedures, and accounting systems, as necessary, to calculate the AFUDC base and rates consistent with the requirements of EPI No. 3.*

SDG&E Response: SDG&E has revised its policies, procedures, and accounting systems, as necessary, to calculate the AFUDC base and rates consistent with the requirements of EPI No. 3.

***Recommendation 3:** Train relevant staff on the revised AFUDC base and rate calculation methods and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised methods.

***Recommendation 4:** Recalculate AFUDC accrued in accordance with EPI No. 3(A)(17) for the contract retention accruals error from 2014 through the date of the final audit report and the other items from 2016 through the date of the final audit report. Also, submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that considers the amount of AFUDC improperly capitalized to plant in service, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.*

SDG&E Response: SDG&E will recalculate AFUDC accrued in accordance with EPI No. 3(A)(17) for the contract retention accruals error for the periods reflected in Recommendation No. 4, and, within 60 days of receiving the final audit report, will submit a refund analysis to DAA for review as required by this recommendation.

***Recommendation 5:** Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC within 60 days of receiving the final audit report.*

SDG&E Response: Within 60 days of receiving the final audit report, SDG&E will submit proposed accounting entries and supporting documentation to DAA reflecting the correction of the CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC.

***Recommendation 6:** Revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC after receiving DAA's assessment of the proposed accounting entries per Recommendation No. 5 and restate and footnote the FERC Form No. 1 for current and comparative years as necessary.*

SDG&E Response: SDG&E will revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by AFUDC over-accrual after receiving DAA's assessment of the proposed accounting entries provided pursuant to Recommendation 5, and will restate and footnote its FERC Form No. 1 for current and comparative years as necessary.

Recommendation 7: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

SDG&E Response: SDG&E will file a refund report after receiving DAA's assessment.

Finding 2: Accounting for Commitment Fees

SDG&E improperly accounted for upfront fees it paid that were associated with revolving line of credit agreements in Account 182.3, Other Regulatory Assets, and improperly accounted for quarterly commitment fees associated with the agreements in Account 923, Outside Services Employed. In addition, SDG&E improperly included the amortization of upfront line of credit fees in its calculation of long-term debt interest expense used to compute its AFUDC rate.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 8: *Revise existing accounting policies, procedures, and practices relating to accounting for credit agreement expenses, such as upfront, commitment, quarterly, revolving line of credit, and letter of credit fees, to be consistent with Commission accounting requirements.*

SDG&E Response: SDG&E will revise its existing accounting policies, procedures, and practices relating to accounting for credit agreement expenses to be consistent with Commission accounting requirements.

Recommendation 9: *Revise policies and procedures for calculating the AFUDC rate to be consistent with EPI No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to exclude commitment fees from AFUDC rate calculations unless the costs are associated with debt issuances and are approved by the Commission for inclusion.*

SDG&E Response: As noted in response to Recommendation 1, SDG&E will revise its policies and procedures for calculating the AFUDC rate to be consistent with EPI No. 3(A)(17) and other applicable Commission requirements, and consistent with this recommendation.

Recommendation 10: *Train relevant staff on the revised accounting policies and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised accounting policies.

Recommendation 11: *Within 60 days of receiving the final audit report, submit proposed accounting entries and supporting documentation to DAA that reflect the transfer of credit agreement-related balances improperly recorded in Account 182.3 to Account 186.*

SDG&E Response: SDG&E will submit proposed accounting entries and supporting documentation to DAA that reflect the transfer of credit agreement-related balances improperly recorded in Account 182.3 to Account 186 within 60 days of receiving the final audit report.

***Recommendation 12:** Revise miscellaneous deferred debit balances to appropriately account for and report credit agreement-related balances after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.*

SDG&E Response: After receiving DAA's assessment of the proposed accounting entries, SDG&E will revise its miscellaneous deferred debit balances to appropriately account for and report credit agreement-related balances and will restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report as necessary.

Finding 3: Allocation of Overhead Costs to CWIP

SDG&E capitalized overhead costs to Account 107, Construction Work in Progress – Electric, using an allocation method that was not based on the actual time that employees were engaged in construction activities or on a representative time study. This led to SDG&E charging costs to Account 107 that did not have a definite relationship to construction. As a result, SDG&E may have overstated construction costs recorded in Account 107 and electric plant in service, as well as accumulated depreciation and accumulated deferred income tax (ADIT) balances, and may have understated operating expenses. Moreover, this accounting may have led SDG&E to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 13: *Retain an independent third-party entity to conduct a representative labor time study for allocation of overhead costs incurred in 2019 to CWIP, and to assist with the development of procedures SDG&E shall use to periodically determine the allocation of overhead labor and labor-related costs capitalized into the cost of construction after 2019. Report 1. the progress of the study within 120 days and 2. provide the time study results to DAA for review and consideration within 180 days of the date of the final audit report and the developed allocation procedures when complete. At a minimum, the developed allocation procedures should provide a method for overhead cost allocation and capitalization to construction based on actual timecard distributions or where this procedure is impractical, based on periodic time studies.*

SDG&E Response: As discussed with audit staff, SDG&E will retain an independent third-party entity to validate SDG&E's allocation of overhead costs incurred in 2019 to CWIP, which in turn will assist with the development of procedures consistent with this recommendation that SDG&E will use to periodically determine the allocation of overhead labor and labor-related costs capitalized into the cost of construction after 2019. SDG&E will (i) report the progress of this project within 120 days of the date of the final audit report, (ii) provide the results to DAA for review and consideration within 180 days of the date of the final audit report, and (iii) provide the developed allocation procedures when complete.

Recommendation 14: *Revise written policies, practices, and procedures governing the methods used to account for, track, report, and review overhead labor, labor-related costs, and all other costs allocated to construction projects to be consistent with Commission accounting requirements. In addition, adopt procedures to retain formal documentation supporting the amount of overhead costs allocated to electric plant accounts.*

SDG&E Response: SDG&E will revise its written policies, practices, and procedures consistent with this recommendation.

***Recommendation 15:** Train relevant staff on the revised overhead allocation procedures and documentation, and provide periodic training in this area, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised procedures and documentation.

***Recommendation 16:** Within 30 days of the completion of Recommendation No. 13, submit an estimate to DAA, including the calculations and determinative components, of overhead costs that would have been allocated to CWIP during the audit period consistent with the requirements of EPI No. 4 and GI No. 9. The estimate should be based on a recalculation of 2016 and subsequent years overhead cost allocated to construction with labor and labor-related costs removed from the cost of plant that were not associated with construction activities based on the methodology developed in response to Recommendation No. 13.*

SDG&E Response: SDG&E will provide to DAA the estimate required pursuant to this recommendation within 30 days of the completion of Recommendation No. 13.

***Recommendation 17:** With the response to Recommendation No. 16, submit proposed accounting entries to DAA that remove the overhead costs that were allocated to electric plant in CWIP and in service during the audit period that exceed the amount of costs that would have been allocated to the accounts based on the methodology developed in response to Recommendation No. 13. Also, provide proposed accounting entries to remove associated amounts from other accounts and balances affected by the inappropriately allocated cost such as the accumulated depreciation and ADIT accounts, and AFUDC balances capitalized into CWIP and plant in service. If the adjusting entries result in a significant impact to income for the current year, SDG&E may account for the transaction as a correction of a prior period error in Account 439, Adjustments to Retained Earnings. Such an entry should be submitted with the proposed accounting entries.*

SDG&E Response: SDG&E will provide to DAA the proposed accounting entries required pursuant to this recommendation within 30 days of the completion of Recommendation No. 13.

***Recommendation 18:** Revise account balances for utility plant, accumulated depreciation, ADIT, and other account balances impacted by the inappropriate allocation of unsupported overhead cost after receiving DAA's assessment of the proposed accounting entries per Recommendation No. 17, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.*

SDG&E Response: After receiving DAA's assessment of the proposed accounting entries, SDG&E will revise its account balances impacted by any inappropriate allocation of unsupported overhead cost and will restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report as necessary.

Recommendation 19: *Submit a refund analysis to DAA that explains and details the following: (1) calculation of refunds that result from the overstatement of transmission plant due to the improper capitalized of labor costs, as determined by the labor time study, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.*

SDG&E Response: SDG&E agrees to submit a refund analysis to DAA that includes the items required by this recommendation.

Recommendation 20: *File a refund report with the Commission after receiving DAA's assessment of the refund analysis.*

SDG&E Response: SDG&E will file a refund report after receiving DAA's assessment of its refund analysis.

Finding 4: Accounting for EV Charging Stations

SDG&E improperly accounted for electric vehicle (EV) charging station distribution assets in Account 398, Miscellaneous Equipment. SDG&E's accounting resulted in the cost of the assets and associated expenses being incorrectly included in accounts that are wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 21: *Revise policies, procedures, and practices to track, report, review and account for EV charging stations to be consistent with Commission accounting requirements.*

SDG&E Response: SDG&E will revise its policies, procedures, and practices to track, report, review and account for EV charging stations to be consistent with Commission accounting requirements.

Recommendation 22: *Train relevant staff on the revised accounting methods and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised accounting methods.

Recommendation 23: *Within 30 days of implementing Recommendation No. 21, submit proposed accounting entries and supporting documentation to DAA that reflect the removal of the EV charging station costs improperly recorded in Account 398.*

SDG&E Response: SDG&E will submit proposed accounting entries and supporting documentation to DAA to reflect the removal of the EV charging station costs recorded in Account 398 within 30 days of implementing Recommendation No. 21.

Recommendation 24: *Revise the Account 398 balance to appropriately account for and report EV charging stations after receiving DAA's assessment of the proposed accounting entries, and will restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.*

SDG&E Response: SDG&E will revise the Account 398 balance to appropriately account for and report EV charging stations after receiving DAA's assessment of its proposed accounting entries, and will restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report as necessary.

***Recommendation 25:** Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that includes the amount of inappropriate recoveries during the audit period that resulted from the improper accounting for EV charging stations, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.*

SDG&E Response: Within 60 days of receiving the final audit report, SDG&E will submit a refund analysis to DAA for review as required by this recommendation.

***Recommendation 26:** File a refund report with the Commission after receiving DAA's assessment of the refund analysis.*

SDG&E Response: SDG&E will file a refund report after receiving DAA's assessment of its refund analysis.

Finding 5: Regulatory Commission Expenses

SDG&E improperly accounted for regulatory commission expenses. SDG&E's accounting resulted in regulatory commission expenses being incorrectly included in accounts that are wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 27: *Revise policies, procedures, and practices to track, report, review, and account for regulatory commission expenses to be consistent with Commission accounting requirements.*

SDG&E Response: SDG&E will revise its policies, procedures, and practices for regulatory commission expenses to be consistent with Commission accounting requirements.

Recommendation 28: *Train relevant staff on the revised methods to account for regulatory commission expenses and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised accounting methods.

Recommendation 29: *Perform an analysis of transmission operation expense accounts to identify A&G expenses, such as regulatory commission expenses, improperly charged to the accounts during the audit period. Within 60 days of the date of the final audit report, provide the results of the analysis to audit staff.*

SDG&E Response: SDG&E will perform an analysis of transmission operation expense accounts to identify A&G expenses, such as regulatory commission expenses, improperly charged to the accounts during the audit period, and will provide the results to audit staff within 60 days of the date of the final audit report.

Recommendation 30: *Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for A&G expenses recorded in O&M accounts as identified pursuant to the analysis performed in response to Recommendation No. 29, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made*

SDG&E Response: Within 60 days of receiving the final audit report, SDG&E will submit a refund analysis to DAA for review as required by this recommendation.

Recommendation 31: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

SDG&E Response: SDG&E will file a refund report after receiving DAA's assessment.

Finding 6: Accounting for Distribution-Related Expenses

SDG&E improperly accounted for distribution-related operation costs in a transmission operation expense account. SDG&E's accounting resulted in expenses being incorrectly included in accounts that were wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 32: *Strengthen policies and procedures to account for distribution-related expenses consistent with Commission accounting requirements.*

SDG&E Response: SDG&E will revise its policies, procedures, and practices for distribution-related expenses consistent with Commission accounting requirements.

Recommendation 33: *Train relevant staff on the methods to account for distribution-related expenses and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised accounting methods.

Recommendation 34: *Perform an analysis of costs incurred at substations during the audit period to determine whether distribution-related expenses were charged to the correct account(s) and that the appropriate allocators were used to charge costs to transmission and distribution expense accounts when applicable. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.*

SDG&E Response: SDG&E will perform an analysis of costs incurred at substations during the audit period to determine whether distribution-related expenses were charged to the correct account(s) and that the appropriate allocators were used to charge costs to transmission and distribution expense accounts when applicable. As discussed with audit staff, SDG&E will analyze invoiced amounts in Account 562 – Station expenses (Major only) and Account 570 – Maintenance of station equipment (Major only). SDG&E will provide the results of the analysis to audit staff within 60 days of the date of the final audit report.

Recommendation 35: *Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for distribution-related O&M expenses in transmission expense accounts, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.*

SDG&E Response: Within 60 days of receiving the final audit report, SDG&E will submit a refund analysis to DAA for review as required by this recommendation.

Recommendation 36: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

SDG&E Response: SDG&E will file a refund report after receiving DAA's assessment.

Finding 7: Accounting for Donations and Lobbying Expenses

SDG&E misclassified donation payments and costs incurred to support activities to influence public opinion with regard to legislation. SDG&E's accounting resulted in such expenses being incorrectly included in accounts that were wholesale transmission formula rate inputs. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 37: *Develop and implement procedures and policies to track, report, review, and account for donations and for expenses of activities associated with influencing legislation and with other political activity consistent with the Commission's accounting requirements.*

SDG&E Response: SDG&E will develop and implement procedures and policies for donations and for expenses of activities associated with influencing legislation and with other political activity consistent with the Commission's accounting requirements.

Recommendation 38: *Train relevant staff on the procedures and policies and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its procedures and policies.

Recommendation 39: *Perform an analysis of A&G expense accounts to identify nonoperating expenses, such as donations and lobbying costs, improperly charged to the accounts during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.*

SDG&E Response: SDG&E will perform an analysis of A&G expense accounts to identify nonoperating expenses improperly charged to the accounts during the audit period, and will provide the results of the analysis to audit staff within 60 days of the date of the final audit report.

Recommendation 40: *Submit a refund analysis to DAA, within 60 days of receiving the final audit report, that explains and details the following: (1) calculation of refunds that include the amount of inappropriate recoveries during the audit period that resulted from the improper accounting for below-the-line expenses recorded in A&G expense accounts as identified pursuant to the analysis performed in response to Recommendation No. 39, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.*

SDG&E Response: Within 60 days of receiving the final audit report, SDG&E will submit a refund analysis to DAA for review as required by this recommendation.

Recommendation 41: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

SDG&E Response: SDG&E will file a refund report after receiving DAA's assessment of its refund analysis.

Finding 8: Accounting for Outside Services Employed

SDG&E improperly accounted for external consultant fees incurred to support general services not applicable to a particular operating function. SDG&E's accounting resulted in expenses being incorrectly included in an account that is a wholesale transmission formula rate input. This led the company to overstate its wholesale transmission revenue requirement and overcharge wholesale transmission customers.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 42: *Revise policies, procedures, and practices to maintain and retain documentation to be consistent with Commission record retention requirements.*

SDG&E Response: SDG&E will revise its policies, procedures, and practices to maintain and retain documentation to be consistent with Commission record retention requirements.

Recommendation 43: *Revise policies, procedures, and practices to track, report, review, and account for outside service expenses to be consistent with Commission accounting requirements.*

SDG&E Response: SDG&E will revise its policies, procedures, and practices for outside service expenses to be consistent with Commission accounting requirements.

Recommendation 44: *Train relevant staff on the revised methods and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised methods.

Recommendation 45: *Perform an analysis of transmission operation expense accounts to identify expenses, such as management consultant fees, improperly charged, in whole or in part, to transmission operations during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of the final audit report.*

SDG&E Response: SDG&E will perform an analysis of transmission operation expense accounts to identify expenses, such as management consultant fees, improperly charged, in whole or in part, to transmission operations during the audit period, and will provide the results of the analysis to audit staff within 60 days of the date of the final audit report.

Recommendation 46: *Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds resulting from improper accounting for A&G expenses recorded in O&M accounts as identified*

pursuant to the analysis performed in response to Recommendation No. 45, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

SDG&E Response: Within 60 days of receiving the final audit report, SDG&E will submit a refund analysis to DAA for review as required by this recommendation.

Recommendation 47: *File a refund report with the Commission after receiving DAA's assessment of the refund analysis.*

SDG&E Response: SDG&E will file a refund report after receiving DAA's assessment of its refund analysis.

Finding 9: Filing of Tariff Records

SDG&E did not properly file all Tariff Records, as required, in the Commission's electronic tariff (eTariff) database. Specifically, SDG&E's eTariff filing omitted Attachment 2, its Formula Rate Spreadsheet, from its tariff filed in the eTariff database. This impacted interested parties' ability to access and review the attachment through the Commission's eTariff Public Viewer.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 48: *Develop procedures and controls to help ensure all tariff records are properly filed and available for disclosure in the Commission's eTariff database.*

SDG&E Response: To more closely align with organizational responsibilities, SDG&E has implemented changes to staff responsible for ensuring that tariff records are appropriately submitted and available in the Commission's eTariff database, and will further enhance its procedures and controls consistent with this recommendation.

Recommendation 49: *Provide training to relevant staff on the procedures and controls to electronically file tariff records in the eTariff database and provide periodic training, as needed.*

SDG&E Response: As part of the realignment of staff responsible for ensuring that tariff records are correctly submitted and available in the Commission's eTariff database, SDG&E is ensuring that responsible individuals have the appropriate training, and will continue to provide for training as needed.

Recommendation 50: *Notify DAA upon filing the omitted Tariff Records for the currently effective version of the Transmission Owner Transmission Tariff in the eTariff database.*

SDG&E Response: As reflected in the Draft Report, SDG&E has satisfied the requirement of this recommendation.

Finding 10: Premature Destruction or Loss of Records

SDG&E could not verify the existence of an asset, or provide documentation associated with the asset's cost, that was recorded in Account 154, Plant Materials and Operating Supplies. SDG&E's inability to produce the documentation represents an instance of premature destruction or loss of records.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 51: *Strengthen procedures to maintain and retain documentation consistent with Commission record retention requirements.*

SDG&E Response: SDG&E will strengthen its procedures for retaining documentation consistent with Commission record retention requirements.

Recommendation 52: *Revise policies, procedures, and practices to track, report, review, and account for inventory to be consistent with Commission accounting requirements. Among other things, the revisions should include processes and procedures to audit inventories of plant materials and supplies on a cyclical basis and make necessary adjustments to bring Account 154 into agreement with the actual inventories.*

SDG&E Response: SDG&E will revise its policies, procedures, and practices for inventory to be consistent with Commission accounting requirements.

Recommendation 53: *Train relevant staff on the revised methods and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised methods.

Finding 11: Filing Associated with Electric Plant Purchased

SDG&E did not file its proposed journal entries for the purchase of electric plant within six months, as required. This hindered the Commission's and other interested parties' ability to timely review and monitor the transaction.

SDG&E Response: SDG&E does not contest this finding.

Recommendation 54: *Revise procedures and controls to timely file proposed journal entries for purchases or sales of operating units to be consistent with the Commission's requirements.*

SDG&E Response: SDG&E will add the procedures and controls to its Other General Plan policy to ensure timely filing of proposed journal entries for purchases and sales of operating units to be consistent with Commission requirements.

Recommendation 55: *Train relevant staff on the revised methods and provide periodic training, as needed.*

SDG&E Response: SDG&E will provide training to relevant staff on its revised methods.