February 23, 2006

Members of the Legislative Audit Committee:

The Office of Public Utility Counsel’s (Office) performance measure “Bill Savings for Electric Customers” does not accurately reflect the utility bill savings the Office achieves through its representation of residential and small commercial consumers in utility rate proceedings. As required by Texas Utilities Code, Section 13.007, the State Auditor’s Office and the Legislative Budget Board have coordinated to audit this performance measure.

The Office reported that its efforts resulted in utility bill savings of $58.16 million in fiscal year 2004 and $2.66 billion in fiscal year 2005. Auditors’ calculations of bill savings ranged from $30 million to $35 million for fiscal year 2004 and from $240 million to $274 million for fiscal year 2005.

Auditors’ estimates differ from the Office’s reported results because:

- The Office included utility bill savings for all consumer classes. However, Texas Utilities Code, Section 13.001, limits the Office’s representation to only residential and small commercial consumers.

- The Office included utility bill savings that would be realized during the next 15 years, not just in fiscal years 2004 and 2005. For the reported performance measures to serve as an accurate reflection of the utility bill savings in fiscal years 2004 and 2005, only bill savings realized in those specific fiscal years should be reported in the performance measures for those years.

A proceeding in which the Office participates can result in utility bill savings in future years. To report the utility bill savings in future years, a separate performance measure should be developed. There are multiple ways to measure future utility bill savings. For example, calculating the savings on a simple lump sum basis, auditors estimated that the utility bill savings to be achieved in future years from proceedings in fiscal year 2005 would range from $1.4 billion to $1.6 billion. No future utility bill savings would be achieved from proceedings that occurred in fiscal year 2004.

The portion of utility bill savings that was directly attributable to the Office’s participation in individual utility rate proceedings could not be determined because the Office is typically one of numerous interveners involved in these proceedings.
The performance measure as it is currently designed has a vague definition that does not adequately specify the elements to be included. Additionally, as discussed above, a single performance measure is not sufficient to provide information concerning the Office’s participation in the utility proceedings that result in utility bill savings.

During this audit, the Legislative Budget Board, in cooperation with the Governor’s Office of Budget, Planning, and Policy:

- Made changes to the performance measure definition to more accurately reflect the utility bill savings the Office achieves.
- Developed a new outcome measure that will calculate future bill savings for electric consumers.

Additional details on the current definition and the proposed revised definitions are provided in the attachment to this letter.

The Office agrees with our recommendations, and its responses are presented in Appendix 4 in the attachment to this letter.

We appreciate the Office’s cooperation during this audit. If you have any questions, please contact John Keel, State Auditor; John O’Brien, Deputy Director, Legislative Budget Board; or Verma Elliott, State Auditor’s Office Audit Manager.

Sincerely,

John Keel, CPA    John O’Brien, Deputy Director
State Auditor     Legislative Budget Board

Attachment

cc: Ms. Suzi Ray McClellan, Public Counsel, Office of Public Utility Counsel
Chapter 1
Utility Bill Savings the Office Reported in Fiscal Years 2004 and 2005 Do Not Accurately Reflect the Savings Achieved in Those Years

The Office of Public Utility Counsel’s (Office) performance measure “Bill Savings for Electric Customers” does not accurately reflect the bill savings the Office achieves.

The Office reported that its efforts resulted in utility bill savings of $58.16 million in fiscal year 2004 and $2.66 billion in fiscal year 2005. Auditors’ calculations of bill savings ranged from $30 million to $35 million for fiscal year 2004 and from $240 million to $274 million for fiscal year 2005.

The Office’s bill savings calculations did not accurately reflect the utility bill savings the Office achieved because the Office:

- Included utility bill savings for all consumer classes. However, Texas Utilities Code, Section 13.001, limits the Office’s representation to only residential and small commercial consumers.

- Included utility bill savings that would be realized during the next 15 years, not just in fiscal years 2004 and 2005. For the reported performance measures to serve as an accurate reflection of the utility bill savings in fiscal years 2004 and 2005, only bill savings realized in those specific fiscal years should be reported in the performance measures for those years.

Auditors calculated billings savings to (1) exclude bill savings for industrial and transportation consumers and (2) include bill savings realized only in the fiscal year.

Auditors coordinated with the Legislative Budget Board and the Office and performed independent research to develop a model that (1) excluded bill savings for industrial and transportation consumers and (2) included only utility bill savings realized in fiscal years 2004 and 2005. The model was based on information available from the U.S. Department of Energy and can calculate bill savings based on national retail sales of kilowatt hours, state retail sales of kilowatt hours, or state retail revenue sales earned by all electric companies that sell electricity in Texas. The alternative bases for the model account for the ranges in the auditors’ estimates of utility bill savings.

Auditors determined that from 65 percent to 75 percent of total sales and revenue were related to residential and commercial customers. Auditors then (1) calculated a three-year moving average for each market segment to
minimize the fluctuation in the market, (2) applied the model to the Office’s “bill savings” dockets from fiscal years 2004 and 2005, and (3) recalculated the estimated bill savings for residential and small commercial customers.

To estimate bill savings realized only in fiscal years 2004 and 2005, auditors divided total utility bill savings by the number of years affected. Only the resulting utility bill savings allocated to fiscal years 2004 and 2005 were included in auditors’ estimates.

Excluding the bill savings for industrial and transportation consumers and excluding savings realized in future fiscal years reduced the Office’s reported fiscal year 2004 savings of $58.16 million to between $30 million and $35 million. For fiscal year 2005, it reduced the Office’s reported $2.66 billion in savings to between $240 million and $274 million.

It is important to note that the Office can be one of several interveners participating in utility rate proceedings. However, as Chapter 3 discusses in more detail, auditors could not determine the portion of the utility bill savings that was directly attributable to the Office’s participation in proceedings. For that reason, auditors’ estimates of utility bill savings may still be overstated because those estimates may include bill savings resulting from other interveners’ participation in proceedings. In addition, auditors’ estimates could also be overstated because the available data for small commercial customers and large commercial customers could not be separated; therefore, auditors used commercial data totals to make estimates.

**Bill savings achieved in future years should be addressed in a separate performance measure.**

As discussed above, a proceeding in which the Office participates can result in utility bill savings in future years (in other words, utility bill savings are not restricted to the fiscal year in which the proceeding occurred). To report the utility bill savings in future years, a separate performance measure should be developed.

There are multiple ways to measure future utility bill savings. For example, calculating the savings on a simple lump sum basis, auditors estimated that the utility bill savings to be achieved in future years from proceedings in fiscal year 2005 would range from $1.4 billion to $1.6 billion. No future utility bill savings would be achieved from proceedings that occurred in fiscal year 2004.

Another alternative for reporting future years’ utility bill savings would be to annualize those savings. For example, auditors reviewed the Office’s participation in proceedings in fiscal years 2002 and 2003 to identify utility bill savings achieved in fiscal years 2004 and 2005. Based on that analysis, which was done on a straight-line basis, auditors estimated that proceedings in which the Office participated in fiscal years 2002 and 2003 would result in
additional savings of $169.3 million to $193.0 million for fiscal year 2004 and fiscal year 2005.

Recommendations

The Office should:

- Include only residential and small commercial bill savings in its calculation of bill savings.
- Coordinate with the Legislative Budget Board to develop a separate performance measure to report utility bill savings achieved in fiscal years other than the fiscal year in which proceedings occur.
Chapter 2

There Are Weaknesses in the Current Design of the Performance Measure

The “Bill Savings for Electric Customers” performance measure as it is currently designed has a vague calculation methodology and, therefore, does not adequately provide an estimate of utility bill savings. The current calculation methodology for this performance measure is the “difference between the total rate that was originally requested and the total amount actually approved in the final order.”

In addition, the performance measure definition lacks the following:

- A description of the specific sources of information for calculating the performance measure and how that information should be collected
- Clear and specific descriptions of how the performance measure is calculated
- Identification of limitations about the performance measurement data, including factors that may be beyond the Office’s control
- Specification of whether the data is cumulative or not cumulative

Additionally, as discussed in Chapter 1, one performance measure may not be sufficient to provide information concerning the Office’s participation in utility rate proceedings.

During this audit, the Legislative Budget Board, in cooperation with the Governor’s Office of Budget, Planning, and Policy:

- Made changes to the performance measure definition to more accurately estimate the amount of electricity used by residential and small commercial market sectors.
- Developed a new outcome measure that will calculate future bill savings for electric customers.

Appendix 2 provides more details on the definitions that the Legislative Budget Board developed in cooperation with the Governor’s Office of Budget, Planning, and Policy.

Recommendation
The Office should coordinate with the Legislative Budget Board to finalize the changes to the definition of its “Bill Savings for Electric Customers” performance measure.
Chapter 3

The Impact of the Office’s Participation in Individual Utility Rate Proceedings Could Not Be Determined

Based on the evidence available, auditors could not determine the portion of utility bill savings directly attributable to the Office’s participation in utility rate proceedings. The Office currently claims full credit for its participation in utility rate proceedings on behalf of residential and small commercial consumers. It does not take into account the other interveners that may represent the same rate class the Office represents (residential and small commercial). It also does not consider other rate classes (industrial and large commercial) that may be involved in the proceedings.

For example, various cities that are affected by utility rate increases can be interveners (see Appendix 3 for a list of interveners). The goals of the cities and the Office in individual proceedings can be the same or they can be different.

There is no clear way to determine the utility bill savings directly attributable to the Office’s participation (or any other intervener’s participation) in a proceeding. For example, for one of the proceedings auditors reviewed, there were a total of 16 interveners; the Office made 43 filings in this proceeding and the other interveners made 170 filings. There is no clear indication that the information in the filings of any of these particular interveners was the deciding factor in this proceeding. Therefore, auditors could not determine the exact impact the Office had.
Appendices

Appendix 1
Objectives, Scope, and Methodology

Objectives
Texas Utilities Code, Section 13.007, required the State Auditor’s Office, in coordination with the Legislative Budget Board, to conduct a management audit of the Office of Public Utility Counsel (Office) “to evaluate the office’s performance measures to determine the accuracy of the calculations and whether the measures accurately depict the impact of the office. The audit must include estimation of savings to residential and small commercial consumers directly attributable to office participation in proceedings.”

Scope
The scope of this audit covered fiscal years 2004 and 2005.

Methodology
The audit methodology included collecting and reviewing information and documentation, performing selected tests, analyzing and evaluating the results of testing, and conducting interviews with Office staff and Legislative Budget Board staff. This audit did not include a review of information technology.

Information collected and reviewed included the following:

- U.S. Department of Energy Web site
- Performance measure audits for fiscal years 1996 and 2005
- Sunset Advisory Commission, Full Staff Report on the Office of Public Utility Counsel, March 2004

Procedures and tests conducted included the following:

- Reviewed the “Bill Savings for Electric Customers” performance measure definition and methodology
- Reviewed the process for tracking the performance measure and documented relevant controls for that measure to ensure the information reported is reliable
- Reviewed the source documentation used to calculate the measure
Recalculated the summary documents and traced amounts to the target report.

Reviewed the *Guide to Performance Measure Management* to determine the criteria for a performance measures.

Reviewed the *Annual Energy Review 2004 Report*.

Reviewed retail sales of electricity by state by sector.

Identified and analyzed energy market sector.

Developed amortization methods.

**Criteria used** included the following:

- Texas Utilities Code, Section 13.007
- Policies and procedures

**Other Information**

Audit fieldwork was conducted from October 2005 through January 2006. This audit was conducted in accordance with generally accepted government auditing standards.

The following members of the State Auditor’s staff performed the audit:

- Barbette Mays (Project Manager)
- Mary Goldwater (Assistant Project Manager)
- Christine Henderson
- J. Scott Killingsworth, CIA, CGFM, (Quality Control Reviewer)
- Verma Elliott, MBA, CGAP (Audit Manager)
Below are revised performance measures for the Office that the Legislative Budget Board developed in cooperation with the Governor’s Office of Budget, Planning, and Policy. (The acronym “OPUC” used below refers to the Office of Public Utility Counsel.)

**Outcome Measure Change - Current Year Bill Savings for Residential and Small Commercial Electric Customers (in millions)**

Short Definition: Bill savings measure the impact on residential and small commercial customers’ bills. Different types of proceedings result in rate adjustments on customers’ bills such as rate increases/decreases, surcharges, refunds, incentives, mark-ups, transition charges, and fuel charges.

Purpose/Importance: OPUC will participate in proceedings to ensure the maximum bill savings on residential and small commercial customers’ bills. This measure will quantify the impact in the current year for participation in the current year’s proceedings on a state-wide basis.

Source/Collection of Data: OPUC records

Method of Calculation: OPUC calculates the bill savings as the difference between a requested amount for a rate adjustment and the amount actually approved, for the current fiscal year. Bill savings should include only residential and small commercial. Industrial and transportation customers will be removed using information from the U.S. Department of Energy.

Impact on industrial and transportation customers will be separated out using the most recently available information from the U.S. Department of Energy. The calculation is based on using one of the following: national retail sales of kilowatt hours, state retail sales of kilowatt hours, or state retail revenue earned by all electric companies that sell electricity in Texas. In addition, information from the U.S. Department of Energy should be used to calculate a three-year moving average for residential and small commercial market sector to minimize the fluctuation in the market.

Data Limitations: Small commercial customers and large commercial customers cannot be separated based on the information currently available. Therefore, the “Commercial” information will be substituted for “Small Commercial.”

Calculation Type: Cumulative.

New Measure: No

Desired Performance: Higher than Target
New Outcome Measure - Future Bill Savings for Residential and Small Commercial Electric Customers (in millions)

Short Definition: Future bill savings measure the impact on residential and small commercial customers’ bills. Different types of proceedings result in rate adjustments on customers’ bills, such as rate increases/decreases, surcharges, refunds, incentives, mark-ups, transition charges, and fuel charges.

Purpose/Importance: OPUC will participate in proceedings to ensure the maximum bill savings on residential and small commercial customers’ bills. This measure will quantify the impact in future years for participation in the current year’s proceedings on a state-wide basis.

Source/Collection of Data: OPUC records

Method of Calculation: OPUC calculates the bill savings as the difference between a requested amount for a rate adjustment and the amount actually approved, for bill savings from Stranded Cost Cases. Future years’ savings calculation should not include any savings to consumers in the current year.

Bill savings should only include residential and small commercial. Industrial and transportation customers will be removed using information from the U.S. Department of Energy.

Impact on industrial and transportation customers will be separated out using the most recently available information from the U.S. Department of Energy. The calculation is based on using one of the following: national retail sales of kilowatt hours, state retail sales of kilowatt hours, or state retail revenue earned by all electric companies that sell electricity in Texas. In addition, information from the U.S. Department of Energy should be used to calculate a three-year moving average for residential and small commercial market sector to minimize the fluctuation in the market.

Data Limitations: Small commercial customers and large commercial customers cannot be separated based on the information currently available. Therefore, the “Commercial” information will be substituted for “Small Commercial.”

Calculation Type: Cumulative.

New Measure: Yes

Desired Performance: Higher than Target
The table below lists examples of interveners in utility rate proceedings.

<table>
<thead>
<tr>
<th>Examples of Interveners in Utility Rate Proceedings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office of Public Utility Counsel</td>
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<tr>
<td>CPL Retail Energy</td>
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<tr>
<td>City of Dallas</td>
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<tr>
<td>Houston Council for Health and Education</td>
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<tr>
<td>Texas Industrial Energy Consumers</td>
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<tr>
<td>Power Resource Group Inc. a</td>
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<tr>
<td>Air Products and Chemicals a</td>
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<tr>
<td>Nucor Corporation</td>
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<tr>
<td>Occidental Chemical Corporation</td>
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<tr>
<td>East Texas Cooperatives a</td>
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<tr>
<td>South Texas Electric Cooperative, Inc. a</td>
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<tr>
<td>Dow Chemical Company</td>
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<tr>
<td>Texas-New Mexico Power Company</td>
</tr>
<tr>
<td>Brownsville Public Utilities Board</td>
</tr>
<tr>
<td>Structural Metals, Inc. a</td>
</tr>
<tr>
<td>Brazos Electric Power Cooperative, Inc.</td>
</tr>
<tr>
<td>Bryan Texas Utilities a</td>
</tr>
</tbody>
</table>

* a In majority of the cases involved, the party represented itself.

Source: Texas Public Utility Commission Web site
Office of Public Utility Counsel
P.O. Box 12397
Austin, Texas 78711-2397
(Tel.) 512/936-7500  (Fax) 512/936-7525

February 14, 2006

The Honorable John Keel, CPA
The State Auditor of Texas
P.O. Box 12067
Austin, TX 78711-2067

Dear Mr. Keel:

I have reviewed the draft Audit Report on the Office of Public Counsel’s Performance Measure for Utility Bill Savings which provides recommendations for the agency’s measures. The agency agrees to implement the recommendations and, accordingly, will continue to work with the Legislative Budget Board and the Governor’s Office of Budget and Planning on the new measures.

I appreciate the efforts of the staff of both the State Auditor’s Office and the Legislative Budget Board during the audit. The professionalism and insightfulness of the staff helped our office focus on improving our measure to more accurately capture the efforts we make to benefit residential and small commercial utility ratepayers.

I am certain that these improvements will further the agency’s efforts to provide the Legislature with the most meaningful and accurate information possible.

Sincerely,

Suzi Ray McClellan
Public Counsel

cc: Mr. John O’Brien
Legislative Budget Board