Docket No. 05-0748
ICC Staff Exhibit 4.0

REDACTED

REBUTTAL TESTIMONY

of

Dianna Hathhorn
Accountant

Accounting Department
Financial Analysis Division
Illinois Commerce Commission

Reconciliation of Revenues Collected Under Gas Adjustment Charges With Actual Costs Prudently Incurred

North Shore Gas Company

Docket No. 05-0748

April 25, 2007

CONFIDENTIAL VERSION
Confidential Information Identified As
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SCHEDULES

ATTACHMENT

Witness Identification

Q. Please state your name and business address.

A. My name is Dianna Hathhorn. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Have you previously filed testimony in this proceeding?

A. Yes. My direct testimony was filed on January 18, 2007 as ICC Staff Exhibit 1.0.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony responds to Respondent's Exhibit E, Rebuttal Testimony of Linda M. Kallas, regarding my banked gas adjustment and prior period adjustment. I also update Staff's calculation of the Factor O Refund, and respond to North Shore Gas Company's ("North Shore" or the "Company") response to my Recommendation 2 (ICC Staff Exhibit 1.0, page 16) concerning the estimated cost of gas lost as a result of damage to gas lines by third parties.

Q. Are you sponsoring any schedules as part of your rebuttal testimony?

A. Yes. I prepared the following schedules for the Company that show data for the reconciliation year ending September 30, 2005:

Schedule 4.1 PGA Reconciliation Summary

Schedule 4.2	Reconciliation of Commodity Gas Charge
Schedule 4.3	Adjustments to Commodity Gas Charge
Schedule 4.4	Reconciliation of Non-Commodity Gas Charge, Demand Gas Charge and Aggregation Balancing Gas Charge
Schedule 4.5	Reconciliation of Transition Surcharge
Schedule 4.6	Banked Gas Reconciliation Adjustment
Schedule 4.7	Prior Period Adjustment

Attachments

Q. Have you included any attachments as part of your rebuttal testimony?

A. Yes, I have included the Attachment A, which is the Company's partial response to Staff data request DLH-5.03 and complete response to DLH-6.01.

Q. How do your schedules compare with those you sponsored in ICC Staff Exhibit 1.0?

A. The schedules are the same except that the amount of my banked gas reconciliation adjustment reflected in Schedule 4.6, Banked Gas Reconciliation Adjustment, changed. The change results in a revised Factor O Refund of $1,004,785.40 reflected on Schedule 4.1, PGA Reconciliation Summary.

Banked Gas Reconciliation Adjustment

Q. Please describe Schedule 4.6, Banked Gas Reconciliation Adjustment.

A. Schedule 4.6 presents my revised proposed disallowance of $388,126.48 for a reconciling adjustment for banked gas made by North Shore in May of 2005. I am maintaining the disallowance of the reconciling adjustment because I am unable to verify whether the adjustment is accurate or includes amounts for periods prior to the reconciliation year. In addition, the reconciling adjustment relies on questionable internal controls for banked gas. The Company's adjustment is described in Respondent's Exhibit C, Supplemental Testimony of Linda M. Kallas.

Q. Why is your adjustment revised?

A. I have reduced my adjustment to account for the change in LIFO prices at the beginning of the reconciliation year through May 2005, when the adjustment was recorded. This calculation is reflected at Respondent's Exhibit C, Schedule 1 and discussed further at Respondent's Exhibit E, pages 4-5.

Q. One of your main concerns regarding the Company's adjustment is that you are unable to determine if the adjustment amount is accurate. (ICC Staff Exhibit 1.0, pages 7-10) The Company responds by stating that its transportation customers must daily nominate the quantity of gas they will be delivering that day, and that these nominations are handled through a system that has external checks and balances. (Respondent's Exhibit E, page 6, lines 108-112) Do these checks and balances allay your concerns about the accuracy of the Company's adjustment?

A. No. The nomination system may contain checks and balances, but they were not sufficient. For example, the difference between decatherms ("Dth") billed to customers based on the customer billing records and the general ledger was not investigated for many years. The Company's response to my adjustment regarding its external checks and balances and its confidence in the accuracy[1] of the adjustment provides me no assurances.

Q. Please explain in more detail what reconciliation the Company performed to calculate its adjustment to banked gas.

A. Attachment A contains the workpapers the Company provided to support its adjustment, in response to Staff data requests DLH-6.01 and DLH-5.03. Page 4 of Attachment A is the Company's reconciliation of the Dth between the customer billing records (in a system known as "C-First") and general ledger system (in a system known as "SAP"). The general ledger volumes for the calendar month of April in SAP is supported by many queries and supporting schedules (Attachment A, pages 7 through 17).

[1] Respondent's Exhibit E, page 7, lines 128-129.

These volumes are then compared to the billing records in C-First. However, the only documentation of the billing records is a print out from C-First. More specifically, the Allowable Bank of ***BEGIN CONF END CONF*** Dth on the reconciliation (page 4) traces only to a screen print of the Allowable Bank Balance from C-First on page 18. These volumes account for the majority of the difference with the general ledger system.

Q. Why is the Company's reconciliation insufficient?

A. The Company did not reconcile any customer bills from the customer billing system to the general ledger system to confirm that the C-First records should be used instead of the SAP records. (Company response to Staff data request DLH-12.01) Instead, North Shore based its decision to dismiss the general ledger data on the fact that it had "controls" in the customer system.[2] The Company stated it attempted to reconcile the gas bank account volumes from the entire customer billing records, for those that have banked gas, to the entire gas bank account volumes reflected in the general ledger. (Company response to Staff data request DLH-12.01) However, the workpapers provided to me do not verify that this reconciliation was performed. Instead, again from Attachment A, page 4, one can see that the Company compared the total volumes per its billing records of ***BEGIN CONF END CONF*** Dth with the volumes reflected in the general ledger of 498,112. The difference in these volumes was multiplied by the September LIFO rate to calculate the Company's adjustment.

A more appropriate reconciliation would begin with the volumes in one system and then have one or more adjustments to reconcile to the volume stated in the other system. The Company's version of a reconciliation relied solely on the C-First balances, and is merely adjusting its general ledger records to agree with its customer billing records without verifying the cause of the differences. This is not a sufficient audit procedure to prove that PGA gas customers are liable for an additional $388 thousand in costs.

Q. The Company states that the basis for your opinion that customers were harmed by the adjustment is that the customers in 2005 whose gas costs were affected by the adjustment were not necessarily the same customers who were on the system when the underbilling occurred. (Respondent's Exhibit E, page 7, lines 130-136) Is this statement accurate?

A. No. The Company is correct that 83 Ill. Adm. Code 525 does provide for customers to either be charged or refunded amounts for time periods when they were not customers. Factor O is distributed to current

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[2] *See* ICC Staff Exhibit 1.0, pages 9-10, at lines 188-210; the Sarbanes-Oxley audit team

customers, without regard to when the customers entered or exited the system. The same can be said for the unamortized balance. The unamortized balance may be amortized through Factor A for up to twelve months. The possibility always exists that current customers were not on the system when the unamortized balance was generated.

Therefore, the Company is oversimplifying my concern. As discussed above, every adjustment made in a PGA reconciliation proceeding runs the risk of affecting customers that were not on the system during the time of the under/over collection that originated the adjustment. In this way, the adjustment at issue is not unique.

My concern is that gas costs for all PGA customers were increased during the 2005 reconciliation year for the Company's adjustment, yet the adjustment cannot be verified and relates to multiple past time periods. Therefore the Company's testimony concerning how long its customers remain on its system[3] misses the point.

Q. The Company states "Accepting that this adjustment is the Company's "fault" does not change the fact that any adjustment may be inequitable from a single customer's specific circumstances, nor does it render the costs imprudent." (Respondent's Exhibit E, page 8, lines 153-155) Is your adjustment based on how a single customer would be affected?

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determined that the controls surrounding the banked gas procedures in FY 2005 were deficient.

A. No. The Company's adjustment was created out of a system of poor internal controls over a number of years. In order to correctly charge PGA customers, the banked gas balances needed to be reconciled with the general ledger.

Q. The Company presents Schedule 1 to Respondent's Exhibit E to show what portion of the customers were on the system both in years when the understatement of the banked gas liability began to develop and in 2005. (Respondent's Exhibit E, page 9, beginning line 173) What is your response to the information presented in Schedule 1?

A. Again, the Company has missed the point. The Company's rebuttal testimony focuses mainly on why it is appropriate to charge this cost to current customers and to show that customers in the current period were common to the period of the understatement. What the Company does not do, for I believe it cannot, is explain why it is appropriate for any customer to pay for costs due to a process that lacked internal controls. The Company repeatedly argues its point as if the adjustment is 100% correct but for the time period charged, yet the Company cannot substantiate that claim.

Q. What is your overall conclusion regarding the Company's adjustment?

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[3] Respondent's Exhibit E, pages 7-8, lines 144-152.

A. I recommend the Commission disallow the substantial portion of the cost for the liability for banked gas because: (1) it was caused by a lack of internal controls by the Company, (2) it is unverifiable, and (3) an unknown, unquantifiable amount of it relates to time periods prior to FY 2005.

Prior Period Adjustment

Q. Please describe Schedule 4.7, Prior Period Adjustment.

A. Schedule 4.7 is identical to Schedule 1.7 as my rebuttal position has not changed from my direct position. It presents my proposed disallowance of $279,054.45 because the costs are a correction of an error related to FY 2004, which is beyond the scope of this reconciliation proceeding. The Commission entered an Order on the reconciliation for FY 2004 in Docket No. 04-0682. In order to adjust the FY 2004 reconciliation, the docket would need to be reopened.

Q. How does the Company respond to your adjustment?

A. The Company compares the correction to the routine true-up of gas costs and revenues which result through Factor A. (Respondent’s Exhibit E, page 12, lines 242-248)

Q. Do you agree that the correction is comparable to Factor A?

A. No. Factor A is an on-going automatic adjustment that flows the under/over recovery of actual gas costs and revenues from the second prior month into the calculation of the rate to charge customers. My adjustment does not relate to the routine true-up of gas costs to suppliers or revenues affected by usage. Rather, my adjustment is the result of a one-time error during the time period that was the subject of a global settlement. The Company advocated, and the Commission accepted, a settlement which rendered any analysis of Respondent's gas costs and revenues of these prior periods moot. By correcting this error within FY 2005, the Company is attempting to better its deal from that provided in the settlement of the prior years' reconciliations.

Q. Is it possible that other errors in FY 2004 could have resulted in lower gas costs to ratepayers if FY 2004 had not been included in the settlement?

A. Yes. However, Staff does not know what errors could have been in the FY 2004 reconciliation because Staff did not review the FY 2004 reconciliation activity. Therefore, it is inappropriate to allow increases to gas costs for FY 2004 because the issue, by default, was handled in the settlement. If the Company believes the costs in Schedule 4.6 are material and that additional errors in the other direction would not be found, the Company should petition the Commission to re-open Docket No. 04-0682.

Lost Gas Revenue Adjustment and Policy

Q. How has the Company responded to your adjustment concerning gas lost as a result of damages to gas lines by third parties (ICC Staff Exhibit 1.0, Schedule 1.8)?

A. The Company stated it does not contest this proposed disallowance. (Respondent's Exhibit D, page 4, line 68)

Q. How has the Company responded to your recommendation concerning gas lost as a result of damages to gas lines by third parties?

A. The Company stated it accepted my recommendation and that amounts recovered from third parties for lost gas will be flowed through the PGA. (Respondent's Exhibit D, page 4, lines 73-75)

Q. What is your response to how North Shore proposes to estimate the quantity of gas lost?

A. I have no reason at this time to object to it.

Summary of Conclusions and Recommendations

Q. Please summarize your recommendations.

A. I recommend the following:

Recommendation 1:

I recommend that the Commission adopt Staff's proposed PGA reconciliation as reflected on ICC Staff Exhibit 4.0, Schedule 4.1. Staff's reconciliation shows that $1,004,785.40 is to be refunded to North Shore's PGA customers via the Commodity Gas Charge (CGC) through an Ordered Reconciliation Factor (Factor O) to be reflected in the Company's first monthly PGA filing submitted after the date a Final Order is entered in this proceeding;

Recommendation 2:

I recommend that the Company revise its process to consistently and routinely bill third parties for its estimated cost of gas lost as a result of damage to gas lines by third parties, and that any such revenues collected be flowed through the PGA; (the Company has accepted this recommendation) and

Recommendation 3:

I recommend that the Commission's Final Order in this docket contain finding and ordering paragraphs which provide that this proceeding is subject to being reopened pending the outcome of the Company's management audit, Docket No. 06-0556.

Q. Does this conclude your prepared rebuttal testimony?

A. Yes, it does.