Internal Audit Services

Peoples Energy, LLC Services and Transfers Agreement Audit (Audit #2012-1005)

April 20, 2012

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Background

Peoples Energy, LLC ("PEC") entered into a Services and Transfers Agreement ("Agreement") on February 7, 2007, with The Peoples Gas Light and Coke Company and its subsidiaries ("PGL"), North Shore Gas Company and its subsidiaries ("NSG") and other PEC subsidiaries. The Agreement sets forth policies and procedures to govern transactions relating to furnishing of facilities, provision of services, and asset transfers between any parties to the Agreement and the allocation of joint service costs between them.

The Illinois Commerce Commission's ("ICC") Order approved this Agreement in Docket 06-0540. Consistent with the approvals granted by the ICC, PEC became a wholly owned subsidiary of Integrys Energy Group, Inc., PGL and NSG remained wholly owned subsidiaries of PEC, and Integrys Business Support ("IBS") was created as the new shared services company, effective January 1, 2008. On March 1, 2011, PEC converted to a limited liability company, becoming Peoples Energy, LLC and the ICC approved transferring the Agreement to Peoples Energy, LLC in Docket 10-0588.

PGL and NSG filed the annual report required by Article X.4 of the Agreement ("Report") with the ICC and provided a copy to the ICC Staff on March 30, 2012 to comply with the reporting requirements of the Agreement. Article X.4 of the Agreement requires that the Report include the following:

(i) A description of services and charges provided by PGL and/or NSG to other parties under the Agreement;
(ii) A description of services and charges provided by other parties to PGL and/or NSG under the Agreement;
(iii) PGL's and NSG's monthly billing to, and payments received from, other parties under the Agreement;
(iv) The amounts of any allocated costs under the Agreement; and
(v) Supporting calculations for each allocation.

Article X.3 of the Agreement requires an audit of the Report and intercompany transactions by April 30 of each year. By submitting this audit report to the ICC by April 30, we are fulfilling the audit requirement for calendar year 2011.

Objectives and Scope

Objectives

The objectives of this audit were to review the following on a sample basis:

- Services and charges, including allocated costs and supporting calculations, provided by PGL and NSG to and from other parties under the Agreement, and
- Accuracy of the Report filed with the ICC on March 30, 2012 (90 days after the end of PGL/NSG's fiscal year).

Scope

The scope of this audit was the intercompany transactions outlined in the Agreement for 2011. We used a statistical sampling methodology to review \$10.9 million of the \$31.8 million of reported transactions. We also judgmentally sampled additional billings to ensure that adequate combinations of billings and charges were included in our sample. In addition, we selected a statistical sample of months to validate the accuracy of reported charges on the Report filed with the ICC.

Conclusion

During our review, we did not find any errors in the 2011 intercompany billings tested. In addition, we did not identify any errors in the Report submitted to the ICC on March 30, 2012. We concluded that intercompany billings and the information submitted in the Report were accurately reported and met the requirements as defined by Article X.4 of the Agreement.

We would like to thank all parties involved for their cooperation and assistance during the course of this review.

We conducted the audit in accordance with the *International Standards for the Professional Practice of Internal Auditing.*

Positive Observations

1.0 PGL/NSG Intercompany Bills

Observation:

For the 2011 PGL and NSG intercompany bills selected in our sample, we performed the following detailed tests:

- Verified the bills agreed to the General Ledger ("GL"). For any bills that did not directly agree to the GL, we obtained support from IBS Accounting and validated the appropriateness of the reconciling items;
- Reviewed intercompany charges processed outside of the normal intercompany billing process for reasonableness;
- Selected a sample of direct charges on the bills based on charge type and materiality and agreed them to source documentation; and
- Reviewed the charges sampled to ensure that they were appropriate, accurate, at cost, and either directly charged or allocated based on appropriate allocation methods.

All charges we reviewed on the intercompany bills were accurate, appropriate, and reasonable and we did not note any issues.

2.0 Accuracy of the Annual Report

Observation:

During our review, we noted the following:

- PEC timely submitted the 2011 Report to the ICC as required by Article X.4 of the Agreement on March 30, 2012 (due on March 31, 2012).
- We compared amounts reported on the 2011 Report to supporting documentation for both reasonableness and accuracy. Based on our testing, we did not identify any issues and all items reported agreed to adequate supporting documentation and reflected proper intercompany services between PEC and its subsidiaries.