CITIZENS' ELECTRIC COMPANY
WELLSBORO ELECTRIC COMPANY
VALLEY ENERGY, INC.

MANAGEMENT EFFICIENCY INVESTIGATION

Evaluating the Implementation of the Recommendations from the 2014 Focused Management and Operations Audit Report

**Prepared by the
Pennsylvania Public Utility Commission
Bureau of Audits**

Issued December 2016

Docket Nos. D-2016-2537443, D-2016-2537444, D-2016-2537445

PENNSYLVANIA PUC
PUBLIC UTILITY COMMISSION

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I. INTRODUCTION

A. Background

In April 2013, the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission's (PUC or Commission) Bureau of Audits initiated a Focused Management and Operations Audit (Management Audit) of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies. The Audit Staff subsequently completed its work and, in February 2014, issued a final report containing 18 recommendations for improvement. The C&T Companies submitted their Implementation Plan on March 7, 2014, indicating acceptance of all recommendations. On April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244, the Commission made both the audit report and Implementation Plan public and directed the C&T Companies to:

- Proceed with its March 7, 2014 Implementation Plan, and

- Submit progress reports on the implementation annually, by March 1, for the next three years.

Since April 2014, the C&T Companies have submitted two Implementation Plan updates as requested by the Commission to ascertain their progress in implementing the recommendations from the management audit report. Based on a review of these updates, the Audit Staff elected to conduct a Management Efficiency Investigation (MEI) of the C&T Companies progress in implementing all 18 of the original recommendations. Specific items of management effectiveness and operational efficiency may be investigated pursuant to Title 66 Pa. C.S. § 516(b).

B. Objective and Scope

The objective of this MEI was to review and evaluate the effectiveness of the C&T Companies efforts to implement the recommendations contained in the Focused Management and Operations Audit Report released in April 2014. The scope of this evaluation encompassed the C&T Companies efforts in implementing all 18 prior management audit recommendations in the functional areas of:

- Executive Management and Organizational Structure
- Corporate Governance
- Affiliated Interests and Cost Allocations
- Financial Management
- Electric Operations
- Gas Operations
- Materials Management
- Customer Service

- Human Resources and Diversity

In addition, the Audit Staff performed an updated review of the Emergency Preparedness functional area.

C. Approach

This MEI was performed by the Audit Staff of the PUC's Bureau of Audits. Actual field work began on May 16, 2016 and continued intermittently through September 16, 2016. The fact gathering process included:

- Interviews with Company personnel.

- Analysis of selected Company records, documents, reports, and other information for the period 2012 through September 2016.

II. SUMMARY OF MANAGEMENT EFFECTIVENESS AND OPERATIONAL EFFICIENCY

The Audit Staff found that Citizens', Wellsboro, and Valley have effectively or substantially implemented 13 of the 18 prior Management Audit recommendations. The management of the C&T Companies has reviewed and taken some action on the remaining 5 recommendations. Among the more notable improvements achieved by the management of the C&T Companies are:

- Management incentive compensation/bonus policies have been developed with emphasis on the achievement of established performance objectives or goals.

- Written policies have been developed which require the external audit firm to rotate the managing or engagement partner and lead auditor at least every five years.

- The C&T Enterprises (C&T) and Valley allocation factors are now reviewed annually, resulting in an appropriate allocation of costs among affiliates.

- Commercial lease agreements between Wellsboro and C&T were updated to accurately reflect operating practices.

- The C&T call center allocation methodology has been updated to more accurately distribute call center fixed costs.

- Wellsboro and Valley have developed detailed customer service procedures manuals.

- Wellsboro and Valley have launched various social media accounts to assist in customer communications.

- A clearly defined vehicle use policy for employees was adopted by Citizens' and Wellsboro.

- Citizens', Wellsboro, and Valley now file annual diversity reports with the Commission that meet the 1997 PUC Diversity Filing guidelines.

- The reported number of reported outages caused by an unknown factor has declined to more reasonable levels for Wellsboro.

- Wellsboro has removed the generic tree outage code from the Outage Management System (OMS).

- Wellsboro has included a storm clean-up expense in its 2016 Operations & Maintenance (O&M) budget.

- Valley has sufficiently investigated the causal factors contributing to negative unaccounted-for-gas levels, with the negative UFG most likely due to meter precision.

While these accomplishments are commendable, the Audit Staff has identified further improvement opportunities in certain areas. In particular, the C&T Companies need to:

- Document the succession plan of Citizens', Wellsboro and Valley to include key positions, any potential successor(s) within the C&T organization, and developmental opportunities completed or planned.

- Ensure that Committee Charters have sufficient details as identified in the template provided by the Audit Staff.

- Include the same level of detail in the meeting minutes of Valley's Audit Committee as are included in the meeting minutes of the Wellsboro and Citizens' Audit Committees.

- Prepare written explanations by line item for variances greater than 10% in the Wellsboro Capital and O&M budgets.

- Wellsboro Electric Company has not yet completed the establishment of economic order points and economic order quantities for all materials in stock in order to adequately analyze and determine a reasonable inventory turnover goal, and needs to fully train the newly created Technical Assistant position.

Exhibit II-1 summarizes the 18 prior recommendations reviewed and the Audit Staff's follow-up findings, conclusions, and recommendations.

C&T COMPANIES
MANAGEMENT EFFICIENCY INVESTIGATION
SUMMARY OF APRIL 2014 MANAGEMENT AUDIT RECOMMENDATIONS AND STAFF'S FOLLOW-UP FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Prior MA Recommendations	MEI Follow-up Findings And Conclusions	MEI Follow-up Recommendations
III. EXECUTIVE MANAGEMENT AND ORGANIZATIONAL STRUCTURE		
Establish management succession planning for key management positions by striving to collaborate with affiliates across the entire C&T organization.	Although a succession planning process has been established, the C&T Companies have not documented the plans to include key positions, potential successors within the C&T organization, and developmental opportunities completed or planned for candidates.	Document the succession plan of Citizens', Wellsboro and Valley to include key positions, any potential successor(s) within the C&T organization, and developmental opportunities completed or planned.
Explore the use of quantitative tools to aid in determining incentive pay/bonuses for management at Citizens', Wellsboro and Valley.	Management incentive compensation/bonus policies have been developed with emphasis on the achievement of established performance objectives or goals.	None.
IV. CORPORATE GOVERNANCE		
Review and update Committee Charters with more detailed information on Committee purpose, responsibilities, structure and operations, member qualification, appointment and removal to/from the committee, meeting frequency, record keeping and reporting to the Board, management or external auditors.	Committee Charters still do not have sufficient detail.	Ensure that the Committee Charters have the sufficient details identified in the template provided by the Audit Staff.

C&T COMPANIES
MANAGEMENT EFFICIENCY INVESTIGATION
SUMMARY OF APRIL 2014 MANAGEMENT AUDIT RECOMMENDATIONS AND STAFF'S FOLLOW-UP FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Prior MA Recommendations	MEI Follow-up Findings And Conclusions	MEI Follow-up Recommendations
IV. CORPORATE GOVERNANCE (CONT.)		
Record complete minutes of all Audit Committee meetings.	Minutes of all Audit Committee meetings are now recorded; however, Valley's Audit Committee minutes lack the amount of detail found in the Audit Committee minutes for Citizens' and Wellsboro.	Include the same level of detail in the Audit Committee meeting minutes of Valley that are included in the minutes of Wellsboro and Citizens'.
Develop a written policy requiring the rotation of the managing or engagement partner and lead auditor of the external audit firm at least every five years.	Written policies requiring the rotation of the managing or engagement partner and lead auditor of the external audit firm at least every five years have been developed.	None.
V. AFFILIATED INTERESTS AND COST ALLOCATIONS		
Perform periodic detailed reviews of the allocation factors used to distribute costs between Citizens', Wellsboro, Valley, Tri-County, and Claverack; and among Valley's Operating Segments for accuracy.	C&T and Valley's allocation factors are reviewed each year and costs have been allocated appropriately.	None.
Update the Commercial Lease Agreements between Wellsboro and C&T to accurately reflect operating practices.	Lease agreements were updated and reflect operating practices.	None.
Perform a review of the C&T call center allocation methodology to determine the most accurate causal relationship to distribute call center fixed costs.	The C&T call center allocation methodology has been updated to more accurately distribute the call center fixed costs.	None.

C&T COMPANIES
MANAGEMENT EFFICIENCY INVESTIGATION
SUMMARY OF APRIL 2014 MANAGEMENT AUDIT RECOMMENDATIONS AND STAFF'S FOLLOW-UP FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Prior MA Recommendations	MEI Follow-up Findings And Conclusions	MEI Follow-up Recommendations
VI. FINANCIAL MANAGEMENT		
Prepare written variance explanations by line item for the Wellsboro Capital and O&M budgets.	Wellsboro does not prepare written variance explanations by line item for the Capital and O&M budgets.	Prepare written explanations by line item for variances greater than 10% in the Wellsboro Capital and O&M budgets.
VII. ELECTRIC OPERATIONS		
Reduce the number of unknown outages to more reasonable levels for Wellsboro.	The reported number of outages caused by an unknown factor has declined.	None.
Eliminate the general tree causal factor from the OMS for Wellsboro.	Wellsboro has removed the generic tree outage code from the OMS.	None.
Incorporate an estimate of storm-related tree trimming expenses into the annual operating budget for Wellsboro.	Wellsboro has included a storm clean-up expense in its 2016 O&M budget.	None.
VIII. GAS OPERATIONS		
Investigate the causal factors contributing to negative UFG levels and take corrective actions, if applicable.	Valley has sufficiently investigated the potential UFG factors.	None.
IX. EMERGENCY PREPAREDNESS		
		None.
X. MATERIALS MANAGEMENT		
Develop annual inventory turnover rate goals at each of the regulated utilities and strive to improve inventory turnover rates to 2.0 turns.	Citizens' Electric Company and Valley Energy, Inc. are achieving sufficient inventory turnover based on an inventory optimization analysis performed by the Audit Staff.	None.

C&T COMPANIES
MANAGEMENT EFFICIENCY INVESTIGATION
SUMMARY OF APRIL 2014 MANAGEMENT AUDIT RECOMMENDATIONS AND STAFF'S FOLLOW-UP FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Prior MA Recommendations	MEI Follow-up Findings And Conclusions	MEI Follow-up Recommendations
X. MATERIALS MANAGEMENT (CONT.)		
	Wellsboro Electric Company has not yet completed improvements to the materials management inventory process.	Complete the establishment of economic order points and economic order quantities for all materials in stock at Wellsboro in order to adequately analyze and determine a reasonable inventory turnover goal, and fully train the newly created Technical Assistant position.
XI. CUSTOMER SERVICE		
Develop and document uniform customer service procedures at Wellsboro and Valley.	Wellsboro and Valley have developed detailed customer service procedures manuals.	None.
Investigate the use of additional methods of communication to reach customers at Wellsboro and Valley.	Wellsboro and Valley have launched various social media accounts to assist in customer communications.	None.
XII. HUMAN RESOUCES AND DIVERSITY		
Create and distribute a clearly defined vehicle use policy for employees that address the personal use of company vehicles.	A company vehicle use policy was adopted by Citizens' and Wellsboro.	None.
Prepare and file annual diversity reports to the Commission according to the 1997 PUC Diversity Filing guidelines, including human resources and procurement efforts.	Citizens', Wellsboro, and Valley now file annual diversity reports with the Commission that meet the 1997 PUC Diversity Filing guidelines.	None.

III. EXECUTIVE MANAGEMENT AND ORGANIZATIONAL STRUCTURE

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244, contained two recommendations within the Executive Management and Organizational Structure chapter. The Audit Staff rated this functional area as needing moderate improvement. In this chapter, the two prior recommendations and two prior situations are reviewed and two follow-up findings and one follow-up recommendation are presented.

Prior Recommendation – Establish management succession planning for key management positions by striving to collaborate with affiliates across the entire C&T organization.

Prior Situation – Citizens', Wellsboro, and Valley had pending retirements of key management positions and field personnel. Each of the C&T Companies was responsible for conducting its own management succession planning. Citizens' had identified 13 of its 16 employees as being eligible for retirement in the next ten years, including both top management and field-level employees. Wellsboro and Valley also had top management employees nearing retirement as well as some field employees. In addition, the parent company, C&T Enterprises, was facing the potential retirement of some key positions within a few years. Each of the C&T Companies, as well as C&T Enterprises, had initiated planning for the upcoming transitions, particularly at the President and Chief Executive Officer (CEO) level. Cross-training was being provided to certain employees who were potential replacements for the President and CEO. In addition, the institutional knowledge of the President and CEO was documented in the form of policies or procedures. The Audit Staff felt that there was an opportunity to improve management succession planning across all C&T Companies by identifying potential internal candidates for key positions across the entire C&T organization and providing increased responsibility and cross-training to such individuals. Effective management succession planning across the entire C&T organization could increase the pool of prospective internal candidates for these key management positions.

Follow-up Finding and Conclusion No. III-1 – Although a succession planning process has been established, the C&T Companies have not documented the plans to include key positions, potential successors within the C&T organization, and developmental opportunities completed or planned for candidates.

Management succession planning at Citizens', Wellsboro, and Valley now considers employees across the entire C&T organization and sufficient developmental opportunities are being provided to potential candidates. Citizens', Wellsboro, and Valley have each developed a policy on succession planning (Citizens' in December 2014, Wellsboro in January 2015, and Valley in June 2015) with a goal towards identifying candidates from all C&T affiliates for consideration and development. The President and CEO of each of the C&T Companies was able to describe to the Audit Staff the succession planning process for top management positions, including identification of potential successor(s) and developmental opportunities provided or planned for candidates. For example:

- The successor to the President and CEO at one of the C&T Companies has been identified; the Board of Directors (Board) has encouraged the current President and CEO to ensure that this individual is exposed to all aspects of the position, including topics such as wholesale power supply, rate making and reliability, and the functioning of the PJM Interconnection[1].

- The successor to the Vice President of Operations at one of the C&T Companies has not been identified within the entire C&T organization; this position will likely be filled by searching for external sources of talent.

- The successor to the Vice President & Treasurer at one of the C&T Companies has not been identified within the individual utility; a broader search within the C&T organization or an external search would be required. This search would begin well in advance of the planned retirement date to provide for a smooth transition. The Human Resources Department within the C&T organization would post the job opening, and then recruit externally if necessary.

- Two lineman apprentice positions have been hired at one of the C&T Companies to eventually replace future retirees; both individuals completed lineman training school in Georgia prior to starting with the utility.

Although each of the C&T Companies is proactively planning for the future retirement of key positions, such consideration has not been documented within a management succession plan out of a concern to maintain the confidentiality of potential candidates. It is a sound business practice to use formal succession planning to document the identification and development of candidates for future openings in key positions that may become vacant. The three basic goals of succession planning are the identification of critical management positions within the organization, the identification of future vacancies in those positions, and the identification of employees (if any) who would potentially fit into these vacancies. Internal candidates for key positions are, therefore, known in advance of actual need. Prior identification permits opportunities for mentoring and developmental activities to improve an employee's readiness to succeed in specific positions. Formal succession planning enables continuity in leadership and helps to avoid extended and costly vacancies in key positions. The succession plan and the actions taken to implement the plan should be documented to ensure that the original intentions of succession planning were

[1] PJM Interconnection LLC is a regional transmission organization (RTO) in the United States. It is part of the Eastern Interconnection grid operating an electric transmission system serving all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, and the District of Columbia.

accomplished, particularly in the event of an untimely departure of those involved with the succession planning process. Moreover, a formal succession process is also a key factor in good corporate governance.

<u>Staff's Follow-up Recommendation</u> – Document the succession plan of Citizens', Wellsboro and Valley to include key positions, any potential successor(s) within the C&T organization, and developmental opportunities completed or planned.

<u>Prior Recommendation</u> – Explore the use of quantitative tools to aid in determining incentive pay/bonuses for management at Citizens', Wellsboro and Valley.

<u>Prior Situation</u> – The Audit Staff found that Citizens', Wellsboro, and Valley did not have the proper tools to administer an incentive compensation program. Each of the C&T Companies operated independently with respect to determining merit-based increases, cost-of-living increases or incentive pay/bonuses. Management's incentive pay bonus programs had been based on subjective criteria and general awareness/discretion of the Board. Over the period 2009 to 2012, bonuses had been awarded to Wellsboro management personnel on a routine basis. However, over the same time period, bonuses had rarely been awarded to Valley management personnel and never awarded to Citizens' management personnel. There had not been a uniform corporate approach or guidance on awarding bonuses other than using subjective criteria. A consistent incentive/bonus compensation program should enumerate corporate and departmental goals, individual goals and career development plans, and performance reviews. Ideally, incentive/bonus compensation should be awarded based upon achievement of both enterprise and individual goals and should center on quantitative or measurable results. The Audit Staff felt that a more quantitative approach could be employed to award incentive pay/bonuses, thereby reducing the discretionary nature of the existing program.

<u>Follow-up Finding and Conclusion No. III-2</u> – Management incentive compensation/bonus policies have been developed with emphasis on the achievement of established performance objectives or goals.

All bonuses for senior management must be authorized by each respective Board for the C&T Companies. Proposed bonuses for senior managers other than the President and (CEO) may be recommended to the Board by the CEO for consideration. Such recommendations must be presented to the Board and include the rationale for the bonus. Bonuses for the CEO are awarded at the sole discretion of the Board. The Board considers the awarding of bonuses based on the financial position of the company and the manager's performance. A manager's performance is based on the achievement of performance objectives or goals that have been established; such goals may include operational, financial, customer service, administration, safety, etc. Considerations may also be given to performance in managing special projects or work that is beyond the normal scope of work for the position. For example, the 2016 goals and objectives for Wellsboro were categorized under operations (three goals related to construction, the maintenance program, and system reliability), engineering/special projects (three goals related to technology, the engineering work plan, and cyber security), finance/human resources (two goals related to a rate case and financial integrity), and administration/policy (six goals related to communications with customers, customer choice, succession planning, safety, legislative/regulation, and reliability improvements). Some of these goals can be objectively measured (e.g., safety and reliability) while other goals are more subjective in nature (e.g., a Company's reputation in the community). The Audit Staff believes that, to the extent possible, quantitative tools are being used to aid in the determination of incentive pay/bonuses for management.

Incentive policies were developed by Citizens' in April 2015, Valley in June 2015, and Wellsboro in April 2016. The use of quantitative goals and objectives is being employed, to the extent possible, thereby limiting the use of discretionary or subjective criteria in determining incentive pay/bonuses for management.

Staff's Follow-up Recommendation – None.

IV. CORPORATE GOVERNANCE

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244 contained three recommendations within the Corporate Governance chapter. The Audit Staff rated this functional area as needing minor improvement. In this chapter, the three prior recommendations and prior situations are reviewed and three follow-up findings and two follow-up recommendations are presented.

Prior Recommendation – Review and update Committee Charters with more detailed information on Committee purpose, responsibilities, structure and operations, member qualification, appointment and removal to/from the committee, meeting frequency, and record keeping and reporting to the Board of Directors (Board), management or external auditors.

Prior Situation – For most corporations, Board charters, policies, and procedures are governed by the Sarbanes-Oxley Act of 2002 (SOX), other U.S. Securities and Exchange Commission (SEC) regulations, and the New York Stock Exchange (NYSE) Corporate Governance Rules. However, due to their unique organizational structure, as wholly owned subsidiaries of a holding company controlled by two rural electric cooperatives, Citizens', Wellsboro, and Valley were not legally required to adhere to SOX, SEC regulations, or NYSE Corporate Governance Rules. As a result of recommendations issued as part of the 2007 Management Audit and subsequent 2009 Management Efficiency Investigation, the C&T Companies developed corporate governance policies and procedures, including committee charters, needed to more closely adhere to the spirit and intent of (SOX) and other corporate governance rules and regulations; however, some of the necessary details were missing.

Citizens', Wellsboro, and Valley all had committee charters which described basic information about each committee such as its purpose and general responsibilities. The Audit/Budget & Finance Committee charter did not address key information such as: appointment or removal from the committee; any detail on member qualification other than "independent with some financial experience"; committee structure or operating procedures; meeting frequency; or reporting to the Board, management or external auditors.

While the Charters did not contain all necessary information and detail, the C&T Companies did maintain separate procedures which were relevant and should have been included as part of the individual charters. Examples included the following:

- Citizens' and Wellsboro maintained a policy which further outlined responsibilities of the Nominations Committee as well as the qualifications taken into consideration for eligibility on the Board.

- Citizens' had a general policy on Board committees which again contained information on committee organization and operations, and discussed the process for the appointment of Directors to committees by the Chairman of the Board.

- Valley had a policy pertinent to the external auditors that covered three points:

    - An independent audit will be performed as of December 31st each year by an independent auditor.
    - The auditing firm will be retained for one or more years at the discretion of management.
    - The Board will sign an audit agreement with the audit firm. While this policy contained valid points, it should have been expanded upon and included in the Budget and Finance Committee Charter.

While the policies provided by Citizens', Wellsboro, and Valley contained a solid foundation, none of the C&T Companies' Committee Charters had all the necessary elements or detail required to function as a stand-alone charter.

Follow-up Finding and Conclusion No. IV-1 – Committee Charters still do not have sufficient detail.

Citizens' Committee Charters were revised December 5, 2014 and April 17, 2015, Wellsboro's Committee Charters were revised January 30, 2015 and April 18, 2016, and Valley's Committee Charters were revised on June 8, 2015. The Audit Staff reviewed the revised Committee Charters and determined these Committee Charters still do not have the detail that was recommended during the 2014 Management Audit. The Audit Staff provided templates to the President and Chief Executive Officer of each of the C&T Companies. Management indicated its intention to meet and draft new Committee Charters using the templates.

Each Committee Charter, particularly for the Audit, Nominating, and Compensation Committees, should include detailed information on a committee's purpose, responsibilities, structure and operations, member qualification, appointment and removal to/from the committee, and record keeping and reporting to the Board. Without detailed committee charters to guide committee members, the committees could, over time, not perform their function in a manner that is consistent with their duties.

Staff's Follow-up Recommendation – Ensure that the Committee Charters have the sufficient details identified in the template provided by the Audit Staff.

Prior Recommendation – Record complete minutes of all Audit Committee meetings.

Prior Situation – Citizens', Wellsboro, Valley, and their parent, C&T Enterprises, each had Audit/Budget & Finance Committees that typically met two times per year mainly to review and approve the annual budget and to meet with the external auditors concerning the annual financial audit. C&T Enterprises kept minutes for every Audit/Budget & Finance Committee meeting indicating, among other things, the date, the Directors and Managers in attendance, a summary of the topics and discussions of the meetings and any decision made of recommendations to be presented to the full Board. However, the Citizens', Wellsboro, and Valley Audit/Budget & Finance Committees did not keep a written record or minutes of their meetings. Upon request for Finance Committee minutes, Wellsboro did provide the Audit Staff with documentation resembling an agenda for each meeting.

Instead of recording the minutes at each of the Audit/Budget & Finance Committee meetings, the Chairman of each Finance Committee took notes to aid in presenting key information from the Audit Committee meeting to the full Board. As a result, there was no formal record of the participants, actions, discussions, and decisions of the Audit/Budget & Finance Committees for Citizens', Wellsboro, and Valley other than a short summary recorded in the Board minutes from the oral presentation.

Follow-up Finding and Conclusion No. IV-2 – Minutes of all Audit Committee meetings are now recorded; however, Valley's Audit Committee minutes lack the amount of detail found in the Audit Committee minutes for Citizens' and Wellsboro.

The Audit Staff reviewed Audit/Budget & Finance Committee meeting minutes for each of the C&T Companies. Audit/Budget & Finance Committee meeting minutes for Citizens' were recorded beginning with the March 31, 2014 meeting, and all others afterward. Audit/Budget & Finance Committee meeting minutes for Wellsboro were recorded beginning with the November 17, 2015 meeting and all others afterward. Agendas were used for the April 2, 2014, March 27, 2014, and November 21, 2014 Audit/Budget & Finance Committee meetings at Wellsboro before they began to regularly record minutes. Audit/Budget & Finance Committee meeting minutes for Valley were recorded beginning with the December 13, 2013 meeting and all others afterward, but their minutes lacked the amount of detail found in the Audit/Budget & Finance Committee minutes for Citizens' and Wellsboro such as summaries of conferences with the external auditing firm, financial statement overviews, review of budgets and approvals, etc.

Staff's Follow-up Recommendation – Include the same level of detail in the Audit Committee meeting minutes of Valley that are included in the minutes of Wellsboro and Citizens'.

Prior Recommendation – Develop a written policy requiring the rotation of the managing or engagement partner and lead auditor of the external audit firm at least every five years.

Prior Situation – Section 203 of SOX, as it relates to publicly traded companies, prohibits a public accounting firm from providing audit services if the audit partner has provided audit services in five consecutive previous years to the auditee. C&T Enterprises, Citizens', Wellsboro, and Valley are privately held and do not fall under the requirements of SOX. As a result, no written guidelines had been established requiring the C&T Companies to follow the spirit of SOX, and rotate the managing partner/lead auditor of the external audit firm at least every five years. However, by developing a policy addressing the rotation of the lead external audit partner and/or lead auditor the utilities' corporate governance practices would be strengthened.

The respective Boards for Citizens', Wellsboro, Valley, and C&T Enterprises indicated their intention to rotate the lead partner periodically as a best practice but had not created an internal policy. None of the Boards were aware if the external audit firm had a policy requiring the rotation of the managing or engagement partner and lead auditor.

Follow-up Finding and Conclusion No. IV-3 – Written policies requiring the rotation of the managing or engagement partner and lead auditor of the external audit firm at least every five years have been developed.

All four entities adopted, amended, approved, revised or wrote new policies requiring the rotation of the managing or engagement partner and lead auditor of the external audit firm at least every five years. Wellsboro's Board approved these policies January 30, 2015, Citizens' Board adopted these policies on December 5, 2014, Valley's Board revised these policies on June 16, 2016, and C&T Enterprise's Board amended these policies on December 19, 2014. The 2015 audit was the first year for a new partner at the external audit firm that provides audit services to the C&T Companies.

Staff's Follow-up Recommendation – None.

V. AFFILIATED INTERESTS AND COST ALLOCATIONS

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244, contained three recommendations within the Affiliated Interests and Cost Allocations chapter. The Audit Staff rated this functional area as needing moderate improvement. In this chapter, the three prior recommendations and prior situations are reviewed and three follow-up findings are presented.

Prior Recommendation – Perform periodic detailed reviews of the allocation factors used to distribute costs between Citizens', Wellsboro, Valley, Tri-County, and Claverack; and among Valley's Operating Segments for accuracy.

Prior Situation – The parent company, C&T Enterprises (C&T), did not have an Internal Audit Department to periodically evaluate cost allocations and methodologies to ensure costs were being correctly allocated from C&T for shared support services and Valley for splitting costs between the Pennsylvania (PA), New York (NY), and Valley's non-regulated service organization (i.e., heater and furnace installation and maintenance service). Although the external auditors reviewed a sample of internal controls each year, internal cost allocations between the Valley PA and NY operating segments were often not a high concern for the external auditing firm as these allocations did not affect consolidated financial information for Valley or C&T.

Separate accounting ledgers were maintained for the operations in Valley's PA and NY regulatory jurisdictions. Valley's costs were allocated to PA or NY operations by using either direct assignment, if a cost could be attributed directly to either PA or NY operations, or by using one of two allocators referred to as the Average Factor and Utility Only Factor if costs could not be assigned directly. The allocators were derived from using the average of four factors which consisted of the Operating Expense Ratio, the Investment in Plant Ratio, the Average Customer Ratio, and the Payroll Ratio. The Average Factor was used to allocate costs applicable to PA, NY, and Valley's non-regulated service organization. The Utility Only Factor was used to allocate costs that were applicable to only Valley's PA and NY regulated operations. The four factors as well as the two allocators were recomputed annually based on the prior year end's financial statements and the number of customers.

The Audit Staff's review of Valley's 2011 allocation factors revealed errors used in the spreadsheet formulas to calculate three of the four factors used in the four factor allocator. As a result, the two cost allocators derived from the four factors were also incorrect. The Audit Staff reviewed the C&T Support Services factors used to allocate shared C&T support services costs between Citizens', Wellsboro, Valley, Tri-County, and Claverack.[2] During the review, the Audit Staff also identified an error in one of the factors used by C&T to allocate costs. C&T's Support Services and Administrative expenses were to be allocated to affiliates based on a weighted average of 60% of active meters and 40% of revenue. However, the Audit Staff's review found that the factor was calculated using number of customers rather than active meters. While the impact of using the number of customers rather than active meters was insignificant, it was not in compliance with the approved affiliated interest agreement. Furthermore, an inadvertent mistake in the 2011 test year resulted in the use of average customers instead of year end customers for Valley further contributing to the allocation factor error.

The formulas used in the allocation spreadsheets for both Valley and C&T were reviewed each year. However, due to the small, immaterial nature of the errors and associated allocation factors, the errors were overlooked by management during the review process. As a result of Valley's allocation errors, the PA regulatory jurisdiction was over allocated expenses by approximately $8,000 during the 2011 test year and $5,000 in 2012. Moreover, C&T's Support Services Allocation Factor errors resulted in an under allocation to Valley of approximately $2,000 in support service costs during the 2011 test year; while Citizens, Wellsboro, Tri-County, and Claverack were each over allocated support costs albeit by less significant amounts. Based on the isolated event that created this error (i.e., using average customers instead of year end customers) it was deemed that the misallocation of expenses should not occur again in the future. After the allocation errors were brought to the attention of the Treasurer/Chief Financial Officers (CFO) of both Valley and C&T, corrections were made to the allocation spreadsheets used by each company effective June 2013.

Follow-up Finding and Conclusion No. V-1 – C&T and Valley's allocation factors are reviewed each year and costs have been allocated appropriately.

The allocation factor reviews and source documentation was provided to and checked by the Audit Staff. The reviews of allocation factors are completed each year at C&T and Valley, and costs are being allocated accurately at C&T and Valley.

Staff's Follow-up Recommendation – None.

Prior Recommendation – Update the Commercial Lease Agreements between Wellsboro and C&T to accurately reflect operating practices.

Prior Situation – C&T maintained offices in Wellsboro and Mansfield, PA. Due to the small size of Wellsboro and C&T, efficiencies were gained by utilizing one office building and sharing office space. Two commercial lease agreements were in place between Wellsboro and C&T with Wellsboro being the Lessor and owning the physical building, and C&T being the Lessee. One lease was for third floor office space and the other was for the second floor call center located in the same building.

[2] Each of the C&T Companies is 100% owned by C&T Enterprise which, in turn, is 50% owned by Claverack Rural Electric Cooperative (Claverack) and 50% owned by Tri-County Rural Electric Cooperative (Tri- County).

During the Audit Staff's review of the commercial lease agreements, discrepancies in the terms of the two lease agreements were identified. The lease for third floor office space indicated the Lessee (i.e., C&T) would be responsible for the payment of all utilities. The lease also indicated that any payment received six or more days after the due date would be assessed a $25.00 late fee. Conversely, the second floor call center lease stated that the Lessor (i.e., Wellsboro) would be responsible for the payment of utilities with the exception of telephone and television services. Also the lease indicated that any payment received ten or more days after the due date would be assessed a 10% late fee. Management indicated that, in practice, C&T was only responsible for the payment of cleaning services while Wellsboro was responsible for payment of all utilities under both lease agreements.

To create the lease agreements for the use of Wellsboro's office space and call center, standard lease agreements were used which did not fully adhere to the actual operating practices between the two companies. As a result, the Commercial Lease Agreements that were in place did not accurately reflect the current lease arrangements used by the companies. A lease agreement between entities outlined the legal terms, and conditions, of using the Lessor's property.

<u>Follow-up Finding and Conclusion No. V-2</u> – Lease agreements were updated and reflect operating practices.

The lease agreements and a sample of monthly utility bills were provided to the Audit Staff. Wellsboro pays for gas, water, sewer, and removal of garbage. They do not bill themselves for electric usage. They also have a base cable service that is only used by Wellsboro employees. C&T pays the telephone bill. All bills were paid in accordance with the lease agreements, and no late fees were assessed due to timely payments.

<u>Staff's Follow-up Recommendation</u> – None.

<u>Prior Recommendation</u> – Perform a review of the C&T call center allocation methodology to determine the most accurate causal relationship to distribute call center fixed costs.

<u>Prior Situation</u> – The C&T Call Center received all after-hours calls and provided dispatching for all C&T affiliates (i.e., Citizens', Wellsboro, Valley, Claverack, and Tri-County) and three non-affiliate companies (collectively referred to as Call Center Customers). C&T Management recruited outside Call Center Customers to help offset the cost of call center operations without incurring additional costs by more fully utilizing existing Call Center capacity and resources. Call Center costs were allocated by charging a flat monthly base fee to each Call Center Customer plus associated variable per call charges. The variable charge was an aggregate of charges from multiple call center services (i.e., manual and automated inbound or outbound calls and scanning) which were charged at different per call or hourly rates. Each of the Call Center Customers utilized the various call center services in differing proportions (i.e., based on actual call volume incurred). Therefore, in any given month there were variations in the amount and type of services making up the variable call center charges to each Call Center Customer. Since charges from the Call Center were not based on actual costs incurred, as was done for most other C&T service charges, all Call Center costs were accumulated during the year. At year end, all charges (received as income) and expenses from the Call Center were netted. Any difference in Call Center charges was credited or billed to all C&T affiliates based on each affiliate's particular call volume throughout the year. The non-affiliate companies were not credited, or charged, for any difference in income and expense based on the existing contracts between C&T and each non-affiliate company.

The flat fee charged to the Call Center Customers was intended to collect the fixed costs incurred by the Call Center with the remaining costs to be recovered through the variable service fee. C&T Management indicated that each affiliates number of customers was used as the basis to determine the percentage of the flat fee amounts allocated to each C&T affiliate, whereas the flat fee for the non-affiliate customers was simply a negotiated amount agreed upon by C&T and each non-affiliate company.

Monthly call center charges were not based on the actual costs incurred throughout the year and any difference in call center charges was credited or billed to all C&T affiliates based on each affiliates particular annual call volume. However, the Audit Staff discovered that the C&T Call Center was budgeting such that it planned for a sizeable true-up (i.e., ranging from approximately 9% to 17% of overall costs for the period 2010 to 2012) at year end to recover its total costs. While some variation in call center cost was expected due to the need (or lack thereof) for additional personnel during storm situations, a material true up should not have been expected, if effectively budgeting to cover costs. All budgeted Call Center costs should have been recovered through the monthly charges to the Call Center Customers. C&T Management indicated that no material incremental cost was incurred by C&T to provide services to the non-affiliate customers as only existing Call Center capacity and resources were used to provide service. Therefore, revenue from the non-affiliates was used to offset the monthly charges to the C&T affiliates based on each C&T affiliates respective call volume. The allocation method used by C&T to allocate fixed Call Center costs to C&T affiliates, based on number of customers, would have initially been a reasonable factor based on the assumption that more customers will yield more calls. However, the allocation methodology used by C&T to allocate Call Center fixed costs had not been updated since C&T initially provided Call Center Services to reflect actual experience.

Given the allocation methodology used by C&T to distribute the Call Center costs, the variation in charges between Call Center Customers should have been attributed to the variable service fees. However, when fixed call center costs were isolated, the effective per call fixed charges to the Call Center Customers varied significantly.

The Audit Staff's analysis showed that actual historic call volumes could have been used as a more accurate method of allocating Call Center fixed costs. Exhibit V-1 illustrates the difference between actual fixed C&T Call Center charges and the restructured or adjusted fixed charges[3] (including what is currently classified as the year-end true up) based on 2012 call volume rather than number of customers. While the exhibit represents allocations based on a recovery of all costs, it is important to note that variances between actuals and projections do occur annually; however, the proposed allocation method would have more accurately distributed fixed costs between the C&T affiliates resulting in a minor end of year true up. Exhibit V-2 illustrates the effective fixed per call charge to each Call Center Customer based on actual and adjusted 2012 allocation charges from Exhibit V-1.

Exhibit V-1
C&T Call Center Customers
Actual Versus Adjusted Call Center Fixed Cost Allocations
For the Year 2012

Company	Actual 2012 Fixed Cost Allocations	Adjusted 2012 Fixed Cost Allocations	Amount of Over/(Under) Allocation
Claverack	$83,050	$98,812	($15,762)
Tri-County	$87,653	$118,548	($30,895)
Wellsboro	$28,749	$20,357	$8,392
Citizens	$25,806	$7,742	$18,064
Valley	$25,156	$4,954	$20,202
Non-Affiliate Customer	$30,000	$30,000	$0
Non-Affiliate Customer	$4,800	$4,800	$0
Totals	$285,213	$285,213	$0

Source: 2014 Management Audit Exhibit V-2

Exhibit V-2
C&T Call Center Customers
Actual Versus Adjusted Fixed Per Call Cost Charges
For the Year 2012

Company	Actual 2012 Fixed Per Call Cost Allocations	Adjusted 2012 Fixed Per Call Cost Allocations	Amount of Per Call Over/(Under) Charge
Claverack	$2.30	$2.73	($0.43)
Tri-County	$2.02	$2.73	($0.71)
Wellsboro	$3.86	$2.73	$1.13
Citizens	$9.11	$2.73	$6.38
Valley	$13.88	$2.73	$11.15
Non-Affiliate Customer	$4.32	$4.32	$0
Non-Affiliate Customer	$3.37	$3.37	$0

Source: 2014 Management Audit Exhibit V-3

[3] Restructured charges presented in the 'Adjusted 2012 Fixed Cost Allocations' column were derived by allocating all fixed costs (end of year true up + total annual base fees) less revenue from the non-affiliates using 2012 call volume from 2010 through 2012. Non-Affiliate Companies billings remained the same since these are based on negotiated charges.

The Audit Staff calculated the difference between total actual C&T Call Center charges (i.e., fixed and variable charges including annual true-ups) for 2012 and the total 2012 charges had the fixed costs been allocated using the adjusted method described above. By restructuring the C&T Call Center allocation methodology, the Audit Staff estimated that Citizens', Wellsboro, and Valley could have realized annual savings from reduced call center charges of approximately $18,000, $8,000, and $20,000, respectively.

<u>Follow-up Finding and Conclusion No. V-3</u> – The C&T call center allocation methodology has been updated to more accurately distribute the call center fixed costs.

Beginning in January 2015, C&T reviewed its call center allocation methodology before the Call Center charges were billed. It was determined that the allocation of call center costs should be modified to accurately distribute call center fixed costs. The call center fixed costs from each year are offset by revenue generated from providing call center service to three non-affiliated customers. These three non-affiliated customers are charged a base fee each month that offsets the fixed costs for the five affiliated entities. The new methodology utilizes a mix of five allocation factors as follows: Gross Transmission & Distribution Plant; Operating and Maintenance Expenses; Transmission & Distribution Revenue; Number of Meters (year-end); and Number of Call Minutes.

Two immaterial errors were discovered during the Audit Staff's review and were discussed with C&Ts CFO. One was a transposition error in gross transmission & distribution plant in 2015 and the other was a miscalculation error of the gross transmission & distribution plant in 2015 and 2016. Adjustments will be used for the billing moving forward to correct the errors.

True-ups are still being used for each of the three companies; however, they are much lower than in previous years. This is especially true in 2015 when the new call center monthly fixed cost calculation was used for the first time. Amounts of the true-ups for each company and by year are shown below:

- Citizens
    - 2015 – $258 or 0.9%
- Valley
    - 2015 – $149 or 0.5%
- Wellsboro
    - 2015 – $582 or 2.2%

The Audit Staff estimates as shown in Exhibit V-3 that Citizens', Valley, and Wellsboro have realized average annual savings of approximately $3,000, $12,000, and $3,000, respectively by revising their allocation methodology for the call center fixed costs.

Exhibit V-3
C&T Call Center Cost Savings
New Cost Calculation vs. Previous Cost Calculation
For the Years 2015 and 2016

2015	Citizens	Valley	Wellsboro
Actual Annual Charge	$28,880	$27,618	$26,197
Previous Annual Charge (number of meters only)	$31,765	$38,611	$29,027
Cost Savings	$2,885	$10,993	$2,830
2016	**Citizens**	**Valley**	**Wellsboro**
Actual Annual Charge	$32,589	$31,878	$30,522
Previous Annual Charge (number of meters only)	$36,265	$44,706	$32,826
Cost Savings	$3,676	$12,828	$2,304
Average Annual Savings	$3,281	$11,911	$2,567

Source: Data Request AI-3 and Auditor Analysis

<u>Staff's Follow-up Recommendation</u> – None.

VI. FINANCIAL MANAGEMENT

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244 contained one recommendation in the Financial Management chapter. The Audit Staff rated this functional area as needing minor improvement. In this chapter, the prior recommendation and prior situation are reviewed and one follow-up finding and one follow-up recommendation are presented.

Prior Recommendation – Prepare written variance explanations by line item for the Wellsboro Capital and O&M budgets.

Prior Situation – Wellsboro was not preparing written budget variance explanations by line item for the Capital and Operation & Maintenance (O&M) budgets. The C&T Companies all had policies and procedures in place for the monitoring and reporting of variances between actual expenditures and budgeted amounts for the capital and O&M budgets. Each of the C&T Companies had relatively low O&M budget variances for the period analyzed. Wellsboro had capital budget variances that were consistently higher than Citizens' and Valley who both displayed periodic high variances due to changes/cancellations of planned work in a specific year.

Each of the C&T Companies had a threshold in place requiring the explanation of significant variances of plus or minus 10% of the amount budgeted and at least $10,000 for both the capital and O&M budgets. As part of the monthly financial reporting process, the Vice President of Finance for each of the C&T Companies prepared budget variance reports for the capital and O&M budgets for review by management. This analysis was used by management to track project status, determine if reallocation of available funds between budgeted items was needed, or if the original budget needed to be modified. Although O&M and capital budget variances (i.e., dollar amounts and percentages) were reviewed monthly, written variance reports and explanations for significant deviations were only prepared following the end of the second, third, and fourth quarters for the O&M budget and at year end for the capital budget by Valley. Citizens' prepared written explanations for both the O&M and capital budget variances for each Board meeting with the first report at the July meeting (Board meetings were held in April, July, October, and December). At the April Board meeting, the prior year end variance report was reviewed and presented to Citizens' Board.

Wellsboro prepared written explanations for the O&M budget variances monthly during 2008 and 2009 and quarterly in 2010 and 2011. In 2012 no written explanations for O&M budget variances were prepared by Wellsboro and no capital budget variance explanations could be provided for the Audit Staff's review for the period 2008 through 2012. Wellsboro's management indicated that variance causal factors were communicated among management, and the Board, by simply asking/questioning the responsible individual. Management believed the small size of Wellsboro allowed for close working relationships and easy frequent informal communications.

<u>Follow-up Finding and Conclusion No. VI-1</u> – Wellsboro does not prepare written variance explanations by line item for the Capital and O&M budgets.

The Audit Staff reviewed Capital budget reports, Financial Statements, and Statements of Income and Expense for Wellsboro, and although these documents contained budget variances by line item, no explanations were provided for the variances. The total capital budget had a 67% variance over budget in 2014 and an 86% variance under budget in 2016 from January through March. The O&M budgets had several significant variances in the financial statements. In 2013, from October through December, total maintenance expense, sales promotion expense, and total administration and general expense had variances of 12.9%, 79.3%, and 12.3% over budget, respectively. In 2014, sales promotion expense had a variance of 77.6% over budget. In 2015, total operations expense and sales promotion expense had variances of 23.4% and 64.2% over budget, respectively. In 2016, from January through March, total operations expense, total maintenance expense, total distribution expense, and sales promotion expense had variances of 18.3%, 13.6%, 14.8%, and 37.4% over budget, respectively. It is worth noting, however; that total O&M expenses did not exceed a budget variance of plus or minus 10% in any of the years reviewed.

Wellsboro stated that variance explanations are communicated to the Board and management verbally. Variance discussions including causal factors are held with the Board at the monthly meetings using the financial statements as a guide. No action is taken after that. Management and the Board review financial statements (including notes to the financial statements) monthly and bi-monthly, respectively. These financial reports show variances, but no explanations for variances that exceed plus or minus 10% of budget.

It is a sound business practice to prepare written explanations for budget variances that exceed plus or minus 10% of budget. By not preparing written explanations for deviations from budgeted amounts there is no recorded information for the variance causal factors, which inhibits the ability to observe trends and limits the tools available to the responsible manager in making future decisions and the ability to improve project estimates.

<u>Staff's Follow-up Recommendation</u> – Prepare written explanations by line item for variances greater than 10% in the Wellsboro Capital and O&M budgets.

VII. ELECTRIC OPERATIONS

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released in April 3, 2014 at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244, contained three recommendations within the Electric Operations chapter. The Audit Staff rated this functional area as needing moderate improvement. In this chapter, the three prior recommendations and three prior situations are reviewed and three follow-up findings are presented.

Prior Recommendation – Reduce the number of unknown outages to more reasonable levels for Wellsboro.

Prior Situation – Wellsboro had a large percentage of its outages attributed to unknown causes. In fact, as presented in Exhibit VII-1, Wellsboro had the highest percentage of outages reported as unknown in 2012 of all Pennsylvania jurisdictional electric distribution companies (EDCs). It was noted that Wellsboro operates a large portion of its system within rural northern Pennsylvania with distribution lines running through remote areas, which was further supported by the disproportionate impact of unknown outages on Wellsboro's System Average Interruption Frequency Index (SAIFI)[4] for 2012. Therefore, it may not have been equitable to compare Wellsboro with other EDCs, but it was clear that Wellsboro had too many outages coded as unknown. Wellsboro management was aware of this problem and routinely performed post outage analyses to determine if a cause could be established. However, this analysis was often performed 12 to 24 hours after an outage and this time gap eroded potential evidence in determining a cause. Accurate identification of outage causes would enable proper Operations & Maintenance (O&M) and Capital investments to be made in areas most affected by outages.

Exhibit VII – 1
Wellsboro Electric Company
Unknown Outages by Pennsylvania EDCs
For the Year 2012

Company	% of Unknown Outages	% of SAIFI caused by Unknown
Citizens'[A]	3.13	5.37
PPL	8.38	6.58
PECO	4.44	3.61
EGU	3.95	16.87
Pike[A]	5.45	0.83
Met-Ed	13.51	12.94
Penelec	17.74	14.27
Penn Power	1.92	1.46
West Penn Power	10.55	11.01
Duquesne[A]	13.08	10.15
Wellsboro	**27.66**	**15.50**

[A]Citizens, Pike and Duquesne do not have separate unknown category, instead these companies combine unknown and lesser categories into an 'other' category.

Source: 2014 Management Audit

Follow-up Finding and Conclusion No. VII-1 – **The reported number of outages caused by an unknown factor has declined.**

[4] The System Average Interruption Frequency Index measures how often the average customer experiences a sustained interruption over a predefined period of time. It is the ratio of the number of customer interruptions per total number of customers served.

Wellsboro management held refresher training in July 2013 with field personnel (i.e., linemen and a field technician). The refresher training included a course in different Outage Management System (OMS) causal codes. Also, management emphasized that its first priority is to safely restore power to the customer(s). After the area is deemed safe and electric service has been restored, the linemen are then to evaluate the nearby area thoroughly to identify the cause of an outage. If a first responder or lineman is unable to identify a cause, management will send out a field technician to walk the circuit to inspect the electric infrastructure. Lastly, if there is no easily identifiable cause, the cause of the outage will then be recorded as "unknown."

Wellsboro outage statistics are shown in Exhibit VII-2 by causal code along with the number of outages and customers affected. Wellsboro experienced a significant decrease in the number of outages reported as unknown from 2012 to 2015. Unknown outages decreased from 65 (27.7%) in 2012 to 2 (1.2%) in 2015. Subsequently, the number of customers affected by an unknown cause also decreased from 864 (15.5%) in 2012 to just 2 (or <0.1%) for the year 2015.

Exhibit VII – 2
Wellsboro Electric Company
Number of Outages & Customers Affected by Cause
For the Years 2012 through 2015

	2012		2013		2014		2015	
	# of Outages	Customers Affected	# of Outages	Customers Affected	# of Outages	Customers Affected	# of Outages	Customers Affected
Animals	59	1,033	13	268	39	762	69	2,596
Vehicles	5	618	3	280	2	39	1	193
Electrical Overload	-	-	4	1368	1	1	-	-
Equipment Failure	46	997	37	272	54	1,239	35	730
Fire	-	-	-	-	3	95	-	-
Ice, Sleet, Frost	-	-	-	-	2	2	-	-
Lightning	14	169	12	164	5	210	8	39
Public Contact	4	917	-	-	-	-	-	-
Phone/Cable Co	-	-	-	-	1	20	-	-
Trees	26	532	4	54	-	-	-	-
Trees on ROW	6	245	8	97	10	142	6	32
Trees off ROW	7	169	14	589	21	773	49	1,617
Unknown	***65***	***864***	***18***	***325***	***33***	***382***	***2***	***2***
Wind	3	29	31	6	3	183	-	-
Total	235	5,573	144	3,423	174	3,848	170	5,209
% Unknown	**27.7%**	**15.5%**	**12.5%**	**9.5%**	**19.0%**	**9.9%**	**1.2%**	**<0.1%**

Source: 2012, 2013, 2014 and 2015 Annual Electric Reliability Report

<u>Staff's Recommendation</u> – None.

Prior Recommendation – Eliminate the general tree causal factor from the OMS for Wellsboro.

Prior Situation – In 2009, Wellsboro modified its generic tree outage causal code in order to specifically identify tree related outages as either On Right-of-Way (ROW) or Off ROW tree caused outages. This enabled Wellsboro to analyze the performance of its tree trimming and hazard tree programs. For instance, On ROW outages are typically caused by trees that should have been trimmed and therefore generally considered preventable; whereas, Off ROW outages are beyond the utility's control but can be partially improved by a hazard tree removal program. However, Wellsboro failed to remove the general 'tree' causal code from its OMS in 2009 which resulted in its continued use thereby mitigating the Company's ability to effectively assess its tree trimming and hazard tree programs.

Follow-up Finding and Conclusion No. VII-2 – Wellsboro has removed the generic tree outage code from the Outage Management System.

In August 2013, Wellsboro modified the OMS to remove the generic tree outage code as an option for linemen to identify outage causes. Going forth, linemen have only On ROW and Off ROW as options to use for reporting tree-related outages. As shown in Exhibit VII-3, the generic tree code was last used in 2013; simply On ROW and Off ROW are currently utilized to identify tree outages.

Exhibit VII – 3
Wellsboro Electric Company
Number of Outages & Customers Affected for Tree-Related Outages
For the Years 2008 through 2015

Year	Cause	No. of Outages	Customers Affected	Hours Interrupted
2008	Tree	42	1,316	2,672
2009	Tree	32	927	1,439
	Off ROW	7	217	422
	On ROW	3	6	3
2010	Tree	24	1,079	1,684
	Off ROW	11	2,035	2,127
2011	Tree	55	783	664
	Off ROW	24	1,419	2,603
2012	Tree	28	2,538	3,824
	Off ROW	7	197	254
	On ROW	6	217	466
2013	Tree	4	54	161
	Off ROW	14	589	922
	On ROW	8	97	108
2014	Off ROW	21	773	1,622
	On ROW	10	142	236
2015	Off ROW	49	1,618	4,969
	On ROW	6	32	58

Source: PUC Annual Reliability Report

Staff's Recommendation – None.

Prior Recommendation – Incorporate an estimate of storm-related tree trimming expenses into the annual budget for Wellsboro.

Prior Situation – Wellsboro developed a tree trimming budget each year as part of its Operation and Maintenance (O&M) budget. Wellsboro further refined its tree trimming budget into nine subcategories. Wellsboro's tree trimming budgets along with the actual expenditures by category for 2008 through 2012 are presented in Exhibit VII-4.

Exhibit VII – 4
Wellsboro Electric Company
Tree-Related Expenditures
For the Years 2008 through 2012

	2008		2009		2010		2011		2012	
	Budget ($)	Actual ($)	Budget ($)	Actual ($)	Budget ($)	Actual ($)	Budget ($)	Actual ($)	Budget ($)	Actual ($)
Storm/System Improvement	0	5,205	0	17,419	0	7,335	0	20,747	0	50,244
Trimming Contract	160,000	150,975	160,000	164,700	160,000	164,700	160,000	164,700	160,000	164,700
Tree Orders	20,000	19,045	10,000	39,736	25,000	19,123	25,000	33,507	25,000	34,305
Chemical Work	20,000	0	10,000	0	7,000	0	10,000	0	10,000	641
Storm/Cleanup	0	14,144	0	27,158	0	0	0	18,143	0	3,723
Infrared Map	600	0	500	0	500	0	500	0	500	0
Spray Crews	500	242	0	288	500	161	500	690	500	0
Minor Storm	0	1,468	0	9,466	0	10,850	0	3,251	0	859
Contracted Work	0	612	0	0	0	1,886	0	0	0	0
TOTAL	201,100	191,691	180,500	258,767	193,000	204,055	196,000	241,038	196,000	254,472

Source: 2012 Management Audit

While Wellsboro strived to provide more detail with its various subcategories for tree trimming, it was noted that various subcategories could be combined. For instance, chemical work expenses were actually part of the trimming contract despite being a separate budgeted line item. However, Wellsboro's overall expenditures were typically above its budgeted expenses. This variance was primarily due to the fact that Wellsboro does not budget for storm-related tree trimming. Historically, Wellsboro incorporated a small allowance for storm-related work within the tree order line item but did not specifically identify it as such. In general, a budget is intended to provide a rough framework for the resources, direction, and capabilities of a utility company. In a regulated environment, the budget helps to ensure that the ratepayers are obtaining effective, reliable and prudent service consistently across the rate base as well as ensuring the utility doesn't overextend or underperform on its financial resources.

<u>Follow-up Finding and Conclusion No. VII-3</u> – Wellsboro has included a storm clean-up expense in its 2016 Operations & Maintenance budget.

At its August 2015 budget meeting, Wellsboro was able to adjust and incorporate budgeted storm-related expenses into its O&M budget for 2016. Additionally, Wellsboro is in the process of refining its identification of tree-related expenses in the O&M budget by revising line item descriptions or adding new line items. The line items can be seen in Exhibit VII-5 and are defined as the following:

- System Improvement – work orders for system improvement projects
- Trimming Contract – annual Right-of-Way trimming bid contract
- Tree Orders – orders from customers concerned about trees that could affect both secondary and primary lines
- Spray Crew – chemical application for both substations and Right-of-Way to control brush
- Urban Tree Trimming – circuits inside the Borough of Wellsboro that require special trimming to meet the requirements of the Shade Tree Commission and/or Wellsboro council
- Tree Placement – placement of trees if needed to satisfy customers or the Shade Tree Commission
- Storm Clean-up – expenses related to the restoration and clean-up caused by a storm

Exhibit VII – 5
Wellsboro Electric Company
Tree-Related Expenditures
For the Year 2016

	Budget ($)	Actual* ($)
System Improvement	0	1,526
Trimming Contract	180,000	178,500
Tree Orders	40,000	50,664
Chemical Work	20,000	855
Urban Trim	10,000	0
Spray Crews	0	0
Tree Placement	0	0
Storm Clean-up	20,000	834
TOTAL	270,000	232,379

*Through August 2016
Source: Data Request EO-5

The 2016 tree-related O&M budget for Wellsboro is detailed in Exhibit VII-5 and reflects actual expenditures through August 2016. The annual budgeted amount is $270,000; up from $196,000 for the 2012 calendar year. The increase in O&M expenses is related to the budgeted amounts for Storm Clean-Up and Urban Tree

Trimming, and an increase in the Tree Trimming contract. The increased O&M budget is now in line with the historical spend amounts for 2013 through 2015, ranging from $233,000 to $246,000. It should be noted that budgeting for storm-related work is difficult due to the variability in occurrence and severity of storms.

Staff's Recommendation – None.

VIII. GAS OPERATIONS

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244 contained one recommendation within the Gas Operations chapter. The Audit Staff rated this functional area as needing moderate improvement. In this chapter, one prior recommendation and prior situation is reviewed and one follow-up finding is presented.

Prior Recommendation – Investigate the causal factors contributing to negative unaccounted-for-gas levels and take corrective actions, if applicable.

Prior Situation – Unaccounted-for-gas (UFG) is defined as the difference between the total amount of gas delivered to the distribution company and the amount of gas that the distribution company subsequently delivers to its retail, commercial, and industrial customers adjusted for company use, temperature, pressure variations, or other allowed variables. Valley determined the gas delivered at the meter receipt points and subtracted all residential, commercial, and industrial metered usage and an adjustment for significant identifiable leak losses. For the time period examined, Valley had negative UFG values calculated for three of five years. From 2008 to 2012, Valley's UFG levels were 0.4%, -0.1%, -0.5%, -1.1%, and 0.0%, respectively. Valley calculated UFG based on meter readings and stated that negative levels are primarily due to cycle billing and slight inaccuracies in customer meter readings and/or daily gas station readings.

Follow-up Finding and Conclusion No. VIII-1 – Valley has sufficiently investigated the potential UFG factors.

Valley investigated and concluded meter measurement and pipe leakage as the primary causes of UFG. Approximately 95% of its meters are pressure and temperature compensated. Management believes the small levels of negative UFG are most likely exclusively due to meter precision based on meter testing that had been conducted. Additionally, the Audit Staff reviewed the rolling 12-month UFG values since the Management Audit, and from January 2013 to May 2016, the average rolling 12-month UFG value was less than 1%. The Audit Staff has concluded that Valley has sufficiently investigated this issue, and Valley's investigation produced meter precision as the main cause and the UFG results are within the meter's accuracy range, no further action is necessary.

Staff's Follow-up Recommendation – None.

IX. EMERGENCY PREPAREDNESS

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy Inc. (Valley), collectively referred to as C&T Companies, conducted by Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244 did not contain any recommendations in the Emergency Preparedness chapter. Although the Audit Staff rated this functional area as meets expected performance level, it was deemed prudent to perform an updated review of the C&T Companies' compliance with PUC regulations at 52 Pa. Code § 101 (Chapter 101) regarding physical security, cyber security, emergency response, and business continuity plans as part of this audit.

In order to protect infrastructure within the Commonwealth of Pennsylvania and ensure safe, continuous and reliable utility service, PUC regulations at 52 Pa. Code §101 (Chapter 101) require all jurisdictional utilities to develop and maintain written physical security, cyber security, emergency response, and business continuity plans. Furthermore, in accordance with 52 Pa. Code §101.1, all jurisdictional utilities are to annually submit a Self-Certification Form to the Commission documenting compliance with Chapter 101. This form, available on the PUC website, is comprised of 13 questions as shown in Exhibit IX-1.

Exhibit IX-1
Pennsylvania Public Utility Commission
Public Utility Security Planning and Readiness Self Certification Form

Item No.	Classification	Response (Yes–No–N/A*)
1	Does your company have a physical security plan?	1.
2	Has your physical security plan been reviewed in the last year and updated as needed?	2.
3	Is your physical security plan tested annually?	3.
4	Does your company have a cyber security plan?	4.
5	Has your cyber security plan been reviewed in the last year and updated as needed?	5.
6	Is your cyber security plan tested annually?	6.
7	Does your company have an emergency response plan?	7.
8	Has your emergency response plan been reviewed in the last year and updated as needed?	8.
9	Is your emergency response plan tested annually?	9.
10	Does your company have a business continuity plan?	10.
11	Does your business continuity plan have a section or annex addressing pandemics?	11.
12	Has your business continuity plan been reviewed in the last year and updated as needed?	12.
13	Is your business continuity plan tested annually?	13.

* Attach a sheet with a brief explanation if N/A is supplied as a response to a question.
Source: Public Utility Security Planning and Readiness Self-Certification Form, as available on the PUC website at http://www.puc.state.pa.us/general/onlineforms/pdf/Physical_Cyber_Security_Form.pdf.

While conducting our Management Efficiency Investigation, the Audit Staff reviewed the most recent (i.e., 2015) Self Certification Forms submitted by Citizens', Wellsboro, and Valley to determine the status of their responses. Each of the C&T Companies maintains its own specific emergency manuals; however, there are various shared services among the three distribution companies, most of which is information technology and cyber security related issues (which is detailed in the manuals). Our examination of the C&T Companies' emergency preparedness included a review of the physical security plans, cyber security plans, emergency response plans, business continuity plans, and associated security measures. Initially, all manuals were deemed complete and appropriate with the exception of the pandemic portion of the business continuity plan for Valley. However, before the audit was complete, this portion was finalized and added to Valley's emergency plans. In addition, the Audit Staff performed inspections at a sample of the C&T Companies' facilities; including headquarters, substations, the call center, and warehouses. Due to the sensitive nature of the information reviewed, any specific information is not revealed in this report but rather the generalities of the information reviewed are summarized.

To protect physical and cyber security, the measures used by the C&T Companies include the following:

- Physical access to buildings, service centers, garages, and maintenance areas is restricted through various security measures.
- Cyber access allows varying levels of access to internet, intranet and software applications. The amount of access permitted is determined by an employee's job description and title.
- The C&T Companies utilize multiple types of clustered industry standard firewalls to secure and protect its critical cyber infrastructure.
- Cyber risk and vulnerability assessments are conducted periodically.

Each of the C&T Companies tests its Physical Security, Cyber Security, Emergency Operations and Business Continuity Plans at least annually and, in some instances, multiple times a year. A review is completed to ensure each plan has been tested, results of testing have been evaluated, and the necessary corrective measures have been taken as necessary. The plans are updated accordingly following the testing and review of the individual plan.

Findings and Conclusions

Our examination of the Citizens', Wellsboro, and Valley's Emergency Preparedness included a review of the physical security plan, cyber security plan, emergency response plan(s) and business continuity plan, vulnerability assessment and all associated security measures. Based on our review of the C&T Companies' emergency preparedness efforts, no evidence came to our attention that would lead the Audit Staff to conclude that the areas reviewed were not being addressed adequately.

Recommendation – None.

X. MATERIALS MANAGEMENT

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) and released by the Pennsylvania Public Utility Commission (PUC or Commission) on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244 contained one recommendation within the Materials Management chapter. The Audit Staff rated this functional area as needing moderate improvement. In this chapter, one prior recommendation and prior situation is reviewed and two follow-up findings and one follow-up recommendation are presented.

Prior Recommendation – Develop annual inventory turnover rate goals at each of the regulated utilities and strive to improve inventory turnover rates to at least 2.0 turns.

Prior Situation – For the five-year period investigated by the Audit Staff (2008 to 2012), Citizens', Wellsboro, and Valley had turns that ranged from 0.98 to 1.37, 0.59 to 0.96, and 1.02 to 1.54, respectively. The Audit Staff suggested that the C&T Companies explore the feasibility of warehouse centralization not only between the regulated companies but also with their affiliated cooperatives, Tri-County and Claverack, as well as using on-time delivery of materials at large project sites where possible. Additionally, there were no documented inventory turnover goals at any of the C&T Companies. The Audit Staff suggested setting an annual inventory turnover goal of 2.0 and regularly tracking inventory turnover rates. If the turnover goal of 2.0 was achieved, the Audit Staff estimated that potential one-time savings for Citizens', Wellsboro, and Valley would have been approximately $50,000, $260,000, and $25,000, respectively.

Follow-up Finding and Conclusion No. X-1 – Citizens' Electric Company and Valley Energy, Inc. are achieving sufficient inventory turnover based on an inventory optimization analysis performed by the Audit Staff.

After the Management Audit, both Citizens' and Valley established turnover goals of 2.0 and studied the practicality of the suggestions from the Audit Staff. It was deemed infeasible to consolidate warehouses, either centrally or even for any two of the C&T Companies or cooperatives. Additionally, due to the locations of the C&T Companies and their respective suppliers, it was also deemed infeasible to use on time deliveries. However, shortly after the Management Audit in April 2014, Citizens' began to have its vendor hold inventory (i.e., conduit) until it was needed at a job site. Also in May 2014, Valley updated its Inventory Management Policy to include tracking turnover ratios for each item (in addition to tracking turnover for the warehouse as a whole), tracking minimum order amounts, establishing emergency items, and the aforementioned establishment of a goal of 2.0 turns.

Another change that occurred directly after the Management Audit in April 2014 at both Citizens' and Valley was the establishment of standard economic order points

(EOPs) and economic order quantities (EOQs) for inventory items, and the EOPs and EOQs are constantly being reviewed and revised as needed. Because of the small size and relatively low needs of these two C&T Companies and the cost savings associated with buying in higher quantities, there are often occurrences where Citizens' and Valley will buy more quantity than is needed and house the material as opposed to buying less quantity at a higher price. This is reflected in the new EOP and EOQ levels. As a result of this situation, the Audit Staff decided to conduct an inventory optimization analysis to determine the optimal use of material and optimal inventory turnover ratio considering the constraints that exist at these smaller distribution companies. The results of this analysis would demonstrate the materials management turnover efficiency of the Citizens' and Valley.

Considering the amount of material and the variety of the items for Citizens' and Valley, a sample was taken by the Audit Staff at the two C&T Companies which involved considering the cost of items, low versus high moving items, and the product of these two factors. A rolling two-year usage analysis was conducted for the period August 2014 through July 2016, and the results were then extrapolated for the entire stock of each of these C&T Companies to determine optimal turnover levels. The results are shown in Exhibit X-1.

Exhibit X – 1
Citizens' Electric Company and Valley Energy, Inc.
Inventory Optimization Analysis
For the Period August 2014 through July 2016

	Citizens'	Valley
Total Warehouse Inventory Amount *	$ 63,500	$ 58,200
Potential One-Time Savings	$ 750	$ 14,800
Potential Annual Savings	$ 19	$ 420
Optimal Turns Based on Rolling 2-Year Weighted Average Usage	1.7	1.0
Actual 2014 Turnover Rate	0.8	1.3
Actual 2015 Turnover Rate	2.3	1.0
** Excludes emergency stock*		

Source: Data Requests MM-9, MM-16, and Auditor Analysis

Based on the analysis, the Audit Staff has concluded that Citizens' and Valley are currently at or near optimization. Note that because Citizens' was still establishing EOPs and EOQs in 2014, there was likely excess stock in 2014. In 2015, when all excess stock was removed, the turns significantly increased. Since the inventory optimization analysis was based on a two-year history that included the 2014 performance when excess stock still existed at Citizens', it is likely that the optimal turnover ratio calculated by the Audit Staff (i.e. 1.7 turns) would in fact be higher. The Audit Staff believes the 2015 turnover performance (i.e., 2.3 turns) more accurately reflects the current situation at Citizens' and that any future analysis using additional data for 2016 and future years (as it becomes available) will likely identify a higher estimate for optimal turns near 2.3 turns. Valley's turnover performance in 2014 and

2015 reflects its optimal turnover level range calculated by the Audit Staff (i.e., 1.0 turn). It appears based on calculated values that Valley is currently overstocked based on the optimization analysis. However, upon further investigation it was discovered that due to the timing of the analysis (mid-summer), there was stock that was in the warehouse that was meant to be used but one of two situations were occurring; 1) either the planned date for a project for the intended material had not yet occurred, or 2) the project was meant to occur already but was delayed. Based upon recent history, there was no evidence to suggest that Valley would not soon return to a near optimal situation in their warehouse. It should also be noted that carrying costs are extremely low for Citizens' and Valley as all facilities are owned (as opposed to rented) and the taxes are low for the geographic areas involved. As a result, the Audit Staff determined the current inventory levels to be at or near optimum, and therefore, any related savings to further inventory reductions would be minimal. The Audit Staff estimates that Citizen's has achieved a one-time savings of approximately $56,000 by improving its inventory turnover rate to 2.3 turns.

<u>Staff's Follow-up Recommendation</u> – None.

<u>Follow-up Finding and Conclusion No. X-2</u> – Wellsboro Electric Company has not yet completed improvements to the materials management inventory process.

As stated in Finding and Conclusion No. 1, both warehouse centralization and on-time deliveries were deemed infeasible for the C&T Companies. Just like Citizens' and Valley, Wellsboro established a turnover goal of 2.0 turns. Wellsboro had two changes to the materials management functions, which was in a state of transition during our period of fieldwork in August 2016. First, a newly hired Technical Assistant started in the summer of 2016. The position was created to assist with materials management related functions. It was estimated that this position would not be fully trained until mid-2017. Additionally Wellsboro estimates that the EOPs and EOQs for its use would not be completed until January 2017.

For the 2015 calendar year, Wellsboro's inventory turnover performance was at 0.7 turns. The Audit Staff intended to conduct an optimization analysis similar to the analyses performed on Citizens' and Valley; however, since Wellsboro has not yet established EOP and EOQ levels this was not possible. Similar to the constraints at Citizens' and Valley that was discussed in Finding and Conclusion No. X-1, it is likely that it may be difficult for Wellsboro to achieve an inventory turnover rate of 2.0 turns, but this cannot be empirically supported without Wellsboro establishing EOPs and EOQs. Once these levels are established and tested as suitable, Wellsboro should then determine a proper goal for inventory turnover.

<u>Staff's Follow-up Recommendation</u> – Complete the establishment of economic order points and economic order quantities for all materials in stock at Wellsboro in order to adequately analyze and determine a reasonable inventory turnover goal, and fully train the newly created Technical Assistant position.

XI. CUSTOMER SERVICE

<u>Background</u> – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244, contained two recommendations within the Customer Service chapter. The Audit Staff rated this functional area as needing minor improvement. In this chapter, the two prior recommendations and two prior situations are reviewed and two follow-up findings are presented.

<u>Prior Recommendation</u> – Develop and document uniform customer service procedures at Wellsboro and Valley.

<u>Prior Situation</u> – Wellsboro and Valley lacked complete and documented customer service procedures. Wellsboro had documented procedures for many of its common customer service activities, with future plans to document procedures for addressing account terminations, payment arrangements, planned outages, removal of service, and application of sales taxes. Valley did have various documented policies which contained the basis for performing customer service activities, but the Audit Staff believed that fully documented procedures would provide specific instructions describing how repetitive tasks are to be executed and allow customer service activities to be handled in a consistent manner. Also, since Valley serves New York and Pennsylvania customers, centralized procedures would have served as a resource for personnel and help to ensure that billing and collection requirements for each state were addressed appropriately. Written procedures would serve to adequately direct customer service personnel to perform routine customer service tasks in a consistent manner.

<u>Follow-up Finding and Conclusion No. XI-1</u> – Wellsboro and Valley have developed detailed customer service procedures manuals.

Wellsboro completed the following procedures manuals in December 2015:

- Customer Service Manual
- Customer Service Manual - Billing
- Customer Care & Billing

All undocumented procedures identified during the Management Audit have been incorporated into Wellsboro's procedures manuals. The Audit Staff reviewed the procedures manuals and found them to be very detailed, thus allowing customer service personnel to perform routine tasks in a consistent manner. Valley developed its own Customer Service Manual, which was completed in December 2014, and is also very detailed and adequately addresses routine customer service functions. The detailed customer service procedure manuals developed at Wellsboro and Valley are very comprehensive and provide specific instructions describing the various tasks to be executed and act as a guide for customer service activities to be handled consistently.

<u>Staff's Follow-up Recommendation</u> – None.

<u>Prior Recommendation</u> – Investigate the use of additional methods of communication to reach customers at Wellsboro and Valley.

<u>Prior Situation</u> – On December 15, 2011, at Docket No. M-2008-2065532, the Pennsylvania Public Utility Commission adopted a Policy Statement with the intent for utilities to improve communications with customers. The Policy Statement recommended the use of social media and other available new technologies. The Policy Statement applied to electric and natural gas distribution utilities as well as water and wastewater utilities. The Policy Statement was designed to:

- Establish acceptable forms of notification to reflect technological advances;
- Have utilities apply the principles of the National Incident Management System and its Incident Command System when managing widespread service outages;
- Have utilities strive to adopt uniform communication throughout the company;
- Ensure crisis communications plans are in writing and consistent with best practices; and
- Encourage utilities to work across geographic regions if applicable.

A utility company's basic function is to provide safe and reliable service; it should strive to maintain a good relationship with customers by improving awareness and education through communications with them. While management personnel at both Wellsboro and Valley had discussed the possible participation in social media as a tool for customer outreach, both utilities had remained focused on traditional communication methods with customers. As a result, Valley and Wellsboro may have been missing an outreach, communication, and educational opportunity, particularly as technology had continued to advance. The Audit Staff suggested that Wellsboro and Valley should explore the use of social media to assist in communications with customers.

<u>Follow-up Finding and Conclusion No. XI-2</u> – Wellsboro and Valley have launched various social media accounts to assist in customer communications.

Wellsboro launched its Facebook page in August 2013 as a tool to reach out to customers to communicate outage information, news alerts, and company news and updates. Wellsboro also updated its website with a link to its Facebook page. Valley launched Facebook and Twitter accounts in January 2014, with links to both accounts on the home page of its website. The Audit Staff reviewed the Facebook and Twitter pages to assess their usefulness in communicating with customers. Both Wellsboro and Valley have a significant number of posts on Facebook with topics such as: outages; homeowners use of ladders around power lines; a phone scam alert targeting residential customers and businesses; the ways to recognize a gas leak besides the smell of gas; office closings, paying a bill with a credit card or checking account over the phone; etc. Valley had four posts on its Twitter account with messages similar to those posted on Facebook. In general, the use of Facebook appears to be a very effective means of communicating with customers. Wellsboro and Valley are making effective use of the latest forms of communication to comply with the Commission's Policy Statement regarding the use of social media and other available new technologies.

Staff's Follow-up Recommendation – None.

XII. HUMAN RESOURCES AND DIVERSITY

Background – The Focused Management and Operations Audit of Citizens' Electric Company (Citizens'), Wellsboro Electric Company (Wellsboro), and Valley Energy, Inc. (Valley), collectively referred to as C&T Companies, conducted by the Management Audit Division (Audit Staff) of the Pennsylvania Public Utility Commission (PUC or Commission) and released on April 3, 2014, at Docket Nos. D-2013-2351140, D-2013-2351242, and D-2013-2351244, contained two recommendations within the Human Resources and Diversity chapter. The Audit Staff rated this functional area as needing minor improvement. In this chapter, the two prior recommendations and two prior situations are reviewed and two follow-up findings are presented.

Prior Recommendation – Create and distribute a clearly defined vehicle use policy for employees that address the personal use of company vehicles.

Prior Situation – Citizens' and Wellsboro did not have documented vehicle use policies. Although the C&T Enterprises Safety Manual included directives for vehicle operations and traffic control, it did not address the personal use of company vehicles. Valley had a documented vehicle use policy which applied to C&T Enterprises employees assigned to Valley; however, no such policy applied to C&T Enterprises' employees assigned to Citizens' or Wellsboro. The Audit Staff recommended that Citizens' and Wellsboro develop vehicle use policies addressing personal use of company vehicles in order to adhere to any applicable business insurance requirements. Without a vehicle use policy for employees, the C&T Companies could be exposed to liability and loss in the event of an accident.

Follow-up Finding and Conclusion No. XII-1 – A company vehicle use policy was adopted by Citizens' and Wellsboro.

Citizens' and Wellsboro developed a vehicle use policy on October 30, 2014 that sets forth guidelines for employee use of company vehicles. The policy gives consideration to the obligation to provide safe service, reporting requirements to the Internal Revenue Service, and exposure to liability. Employees with assigned vehicles are required to be available at all times to respond to emergencies. Such employees may use company vehicles for personal use within the service area when on-call. Officers with assigned vehicles are required to use discretion and good judgement when using the vehicle for personal use and, for tax purposes, are responsible for reporting all personal mileage. Citizens' and Wellsboro have developed a vehicle use policy that adequately addresses the personal use of company vehicles and should help to limit liability and loss in the event of an accident.

Staff's Follow-up Recommendation – None.

Prior Recommendation – Prepare and file annual diversity reports to the Commission according to the 1997 PUC Diversity Filing guidelines, including human resources and procurement efforts.

Prior Situation – The Audit Staff found that the annual diversity reports filed with the Commission were incomplete. In response to a 2007 management audit recommendation, Citizens', Wellsboro, and Valley initiated efforts to develop minority vendor programs and to begin annually reporting their procurement efforts. In April 2010, the Companies filed their 2009 annual diversity reports with the Commission that included a description of their efforts to engage diverse vendors for procurement purposes. Vendors were also sent questionnaires to identify minority-owned, women-owned, and persons with disabilities-owned business enterprises (MWDBE). Although the C&T Companies had filed annual diversity reports, the reports had been limited to procurement efforts only. The C&T Companies neglected to report on their efforts to improve diversity within their workforces. According to Section 516 of the 1997 PUC Diversity Filing Guidelines, utilities are required to include annual updates on human resources initiatives in the annual diversity reports. This includes:

- A tabulation of the utility's workforce composition for the previous five years.
- A narrative description of the utility's diversity initiatives concerning recruiting, advertising, training, promotion, and retention.
- A workforce utilization to service territory availability comparison for the previous year.

The C&T Companies had only partially complied with the 1997 PUC Diversity Filing guidelines, thereby inhibiting the Commission from effectively monitoring the results of their respective human resources and procurement efforts.

Follow-up Finding and Conclusion No. XII-2 – Citizens', Wellsboro, and Valley now file annual diversity reports with the Commission that meet the 1997 PUC Diversity Filing guidelines.

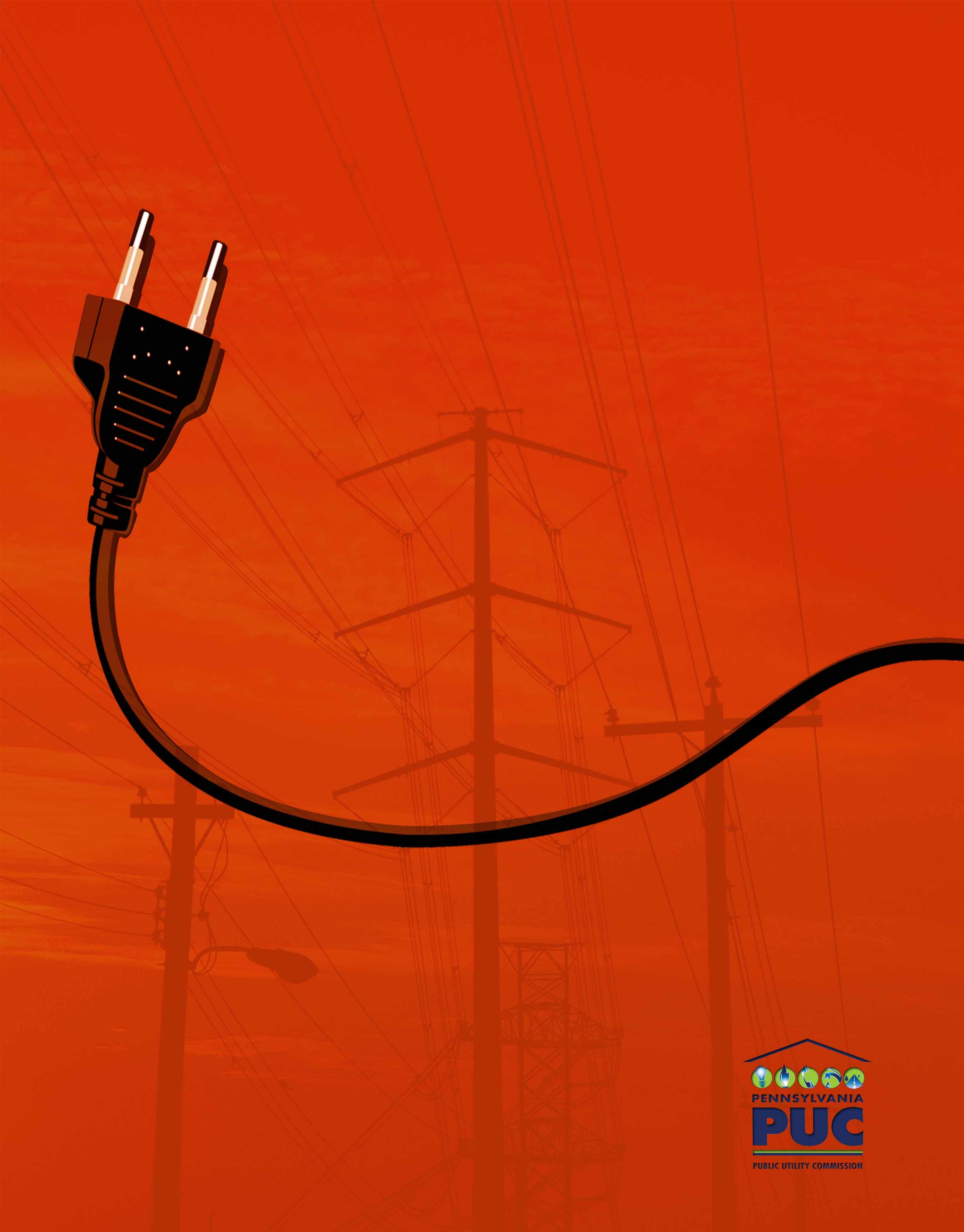
Each of the C&T Companies now files an annual diversity report with the Commission which includes both a human resources and a procurement section in compliance with the 1997 PUC Diversity Filing guidelines. The Commission now has the opportunity to monitor the results of each of the C&T Companies' human resources and procurement efforts.

Staff's Follow-up Recommendation – None.

XIII. ACKNOWLEDGEMENTS

We wish to express our appreciation for the cooperation and assistance given to us during the course of this Management Efficiency Investigation by the officers and staff of Citizens' Electric Company, Wellsboro Electric Company, and Valley Energy, Inc.

This audit was conducted by Bryan Borres, Timothy Kerestes, Eric McKeever, and Craig Bilecki of the Management Audit Staff of the Bureau of Audits.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