

**ANNUAL REPORT
66 PA C.S. § 516 AUDITS
FOR FISCAL YEAR 2018-2019**

**MANAGEMENT AUDITS &
MANAGEMENT EFFICIENCY
INVESTIGATIONS**

**Pennsylvania Public Utility Commission
Bureau of Audits
Issued October 2019**

Docket No. D-2019-3013109

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I. INTRODUCTION

Management Audits (MA) and Management Efficiency Investigations (MEI) periodically examine management effectiveness and operating efficiency of the Pennsylvania jurisdictional fixed utilities. Management Audits determine the extent to which a utility has contained costs, developed reasonable long and short-range plans for the company's continued operations, provided adequate service to the customers it serves, and provided proper management and organizational structure. Management Efficiency Investigations, in part, review utility efforts in implementing prior management audit recommendations.

The MAs and MEIs are required of any electric, gas, telephone or water utility whose plant-in-service is valued at not less than \$10 million (Public Utility Code, 66 Pa. C.S. § 516). MAs are to be conducted at least once every five to eight years. MEIs or investigations of implementation progress are usually conducted two to three years after completion of the MAs.

Currently, MAs and MEIs are performed for 27 large and medium-sized electric, gas, and water companies. Although telecommunications companies with plant-in-service of \$10 million or more are technically covered by the mandate, audits and investigations of these companies have been suspended consistent with approved alternative regulatory plans.

Required audits and investigations are generally conducted by Bureau staff, or, on occasion, by outside consulting firms with the oversight of Bureau personnel. Other special operational and/or financial projects are also performed from time to time by Bureau employees, or by outside consultants with the oversight of Bureau staff.

Section 516(b) of the Pennsylvania Public Utility Code requires that an Annual Report addressing the MAs and MEIs released during the year be provided to the Pennsylvania Public Utility Commission (PUC or Commission), the Bureau of Investigations & Enforcement, and the Office of Consumer Advocate. In this Annual Report, Chapter II contains tables showing the number and categorization of recommendations from the various MEIs (no MA were completed during the fiscal period) released during the fiscal year ended June 30, 2019, as well as a summary analysis of benefits and costs associated with the Management Audit Division's mandated operations. Chapter III of the report provides a brief narrative summary of each MEI. Chapter IV presents a list of the regulated utilities subject to mandated Section 516 MAs as of June 30, 2010, and a list of all Section 516 mandated MAs released to Fiscal Year End 2019 (i.e., June 30, 2019). Complete copies of all audits and investigations have been sent to each of the required parties and are available on the PUC's website.

Please note, this annual report addresses only MAs and MEIs performed pursuant to 66 Pa. C.S. § 516. The results of other projects completed by the Bureau of Audits' Management Audit Division during the fiscal year are available to the extent approved for public release by the Commission. A listing of those projects as well as copies of any issued reports can be obtained by contacting John Clista at (717) 772-0317 or jclista@pa.gov.

TABLE A

FY 2018-2018 Management Efficiency Investigations
Number and Categorization of Recommendations

Evaluation of Prior Recommendations

Company	Total Evaluated	Effectively Implemented	Partially or Not Implemented	Percentage Effectively Implemented
Metropolitan Edison	27	13	14	48%
Pennsylvania Electric				
Pennsylvania Power				
West Penn Power				
Pennsylvania American Water Company	35	10	25	29%
Philadelphia Gas Works	65	28	37	43%
Totals	127	51	76	40%

Staff's Follow-up Recommendations

Company	Total Developed	Accepted	Partially Accepted*	Rejected	Percentage Accepted or Partially Accepted
Metropolitan Edison	14	12	2	0	100%
Pennsylvania Electric					
Pennsylvania Power					
West Penn Power					
Pennsylvania American Water Company	37	36	0	1	97%
Philadelphia Gas Works	47	46	0	1	98%
Totals	98	94	2	2	98%

- Per implementation plan submitted by the company.

TABLE B
FY 2018-2018
Management Efficiency Investigations (MEIs)
Benefit/Cost Summary

	Net Projected Savings or Benefits* Upon Implementation of Current Audit Recommendations		Net Realized Savings or Benefits* After Implementation of Prior Audit Recommendations	
	Annual	One-Time	Annual	Annual
MEIs (7)	\$2.6 million	\$ -	\$1.79 million	\$60.5 million
per MEI	371,429	-	255,714	86,428,571

One-Time Consultant Costs for FY 2018-2019 Audits (Millions)	\$0.0
Approximate Management Audit Division Costs for FY 2018-2019 (Millions)	<u>\$1.9</u>
Total Estimated Cost of MAs and MEIs (Millions)	<u><u>\$1.9</u></u>

* These quantified benefits are net of projected or realized implementation costs. Note that the net realized savings or benefits from implementing management audit recommendations, in 2018-2019 alone, are more than 30 times the total cost of the audits and/or investigations.

Readers should also note that many benefits are qualitative in nature and cannot be measured in specific dollar terms.

IV. SUMMARY OF MANAGEMENT EFFICIENCY INVESTIGATIONS COMPLETED IN FISCAL YEAR 2018-2019

Metropolitan Edison, Pennsylvania Power, Pennsylvania Electric, and West Penn Power Company (D-2017-2626664; D-2017-2626665; D-2017-2626666; D-2017-2626667)

The report on the Management Efficiency Investigation (MEI) of Metropolitan Edison, Pennsylvania Power, Pennsylvania Electric, and West Penn Power Company collectively referred to as the First Energy PA companies was completed by Bureau of Audits' staff and publicly released on October 4, 2018. The scope of this investigation was an examination of the progress in implementing 27 of the 28 original recommendations from the Focused Management and Operations Audit released in February 2015.

During the MEI, the auditors found the companies had effectively or substantially implemented 13 of the 27 prior recommendations reviewed and taken some action on the 14 remaining recommendations. Among the notable improvements achieved by the companies were: improved inventory turnover that led to one-time savings of approximately \$13.4 million in reduced inventory and annual savings from reduced carrying costs of approximately \$1.34 million; periodically rebidding and/or conducting cost comparisons for external audit services resulted in an approximate \$331,000 reduction in audit fees; reduced customer service representative turnover and related costs resulting in annual savings of approximately \$24,000 - \$31,000 while improving contact center performance; a completed vehicle usage analysis that resulted in the elimination of excess vehicles from 2015 to 2017 for an average one-time savings of approximately \$45,000; and, an average annual savings from related maintenance expenses of approximately \$96,000. **As a result of the companies' implementation efforts, annual and one-time savings of approximately \$1.6 million and \$13.5 million were realized.**

The auditors concluded that further improvement was warranted and developed 14 recommendations for improvement. In their September 17, 2018 Implementation Plan, the companies indicated acceptance of 12 and partial acceptance of two follow-up recommendations. The notable follow-up recommendations were to:

- Improve electric reliability performance to meet minimum standards and strive towards achieving benchmark performance through the continued coordination of reliability activities with the PUC's Bureau of Technical Utility Services.
- Enhance workforce planning and reporting to ensure adequate staffing and periodically report on staffing reviews with the PUC's Bureau of Technical Utility Services.
- Conduct a best practice review of Penn Power's worst performing circuit rehabilitation strategy; implement changes across the FirstEnergy-Pennsylvania company footprint based on the review; and continue to coordinate with the PUC's Bureau of Technical Utility Services.

- Enhance the Damage Prevention Program by defining roles and responsibilities, developing mapping standards, and fully referencing all operational practices and manuals within the Damage Prevention Program.
- Continue to periodically review and improve upon the existing safety program and the implementation of new safety programs to attain performance consistent with established safety goals.

Estimated benefits or savings associated with implementation of the MEI recommendations were \$75,000 annually.

Pennsylvania-American Water Company (D-2018-2646503)

The report on the Management Efficiency Investigation (MEI) of Pennsylvania Water Company (PAWC or company), which was completed by Bureau of Audits' staff, was publicly released on February 7, 2019. The scope of this investigation was an examination of the progress in implementing 35 of the 38 original recommendations from the Focused Management and Operations Audit released in March 2016.

During the MEI, the auditors found the company had effectively or substantially implemented 10 of the 35 prior recommendations reviewed and taken some action on the remaining 25 recommendations. Among the notable improvements achieved by PAWC: increased main replacement rates for all operating districts; created a formal cybersecurity awareness and training program; reviewed and updated its Audit Committee Charter; populated existing mains within the GIS; increased the overall test rate of commercial/industrial backflow devices to over 80%; included a disclaimer on customer bills containing both regulated and nonregulated charges; and, formed a dedicated fleet services group to oversee fleet management.

The audit staff concluded that further improvement was warranted and developed 37 recommendations for improvement. In its January 2019 Implementation Plan, the company indicated acceptance of 36 and rejection of one follow-up recommendation. The notable follow-up recommendations were to:

- Improve corporate culture at PAWC and continue to implement positive corporate culture initiatives.
- Review, and upgrade where needed, the physical security of control rooms and IT equipment related to critical business systems and SCADA.
- Correct minor safety and physical security deficiencies.
- Reduce non-revenue water (NRW) levels to 25%, especially at the larger water producing districts which could result in annual saving ranging from \$1.7-\$1.94 million.
- Modify AWWSC's cost allocation processes to include all affiliates benefiting from corporate services.
- Develop a comprehensive damage prevention manual that incorporates all aspects of the damage prevention program.
- Expand the process used to evaluate intercompany charges and request AWWSC to provide additional monthly reporting on AWWSC labor charges distributed to PAWC.
- Implement bi-annual testing of AWWSC's intercompany transactions and cost distribution processes to PAWC.

- Perform a staffing study with cost/benefit components of the Operations Department that weights current and future workload, overtime utilization, and strategic usage of contractors.

Estimated benefits or savings associated with implementation of the MEI recommendations were \$1.94 million annually.

Philadelphia Gas Works (D-2017-2627251)

The report on the Management Efficiency Investigation (MEI) of Philadelphia Gas Works (PGW or Company), which was completed by Bureau of Audits' staff, was publicly released on September 20, 2018. The scope of this investigation was an examination of the progress in implementing 65 of the 76 original recommendations from the Stratified Management and Operations Audit released in October 2015.

During the MEI, the auditors found the company had effectively or substantially implemented 28 of the 65 prior recommendations reviewed and taken some action on the remaining 37 recommendations. Among the notable improvements achieved by PGW: maximized gas purchases from the Marcellus Basin, which resulted in an estimated savings of \$47 million from Aug. 2015 through Oct. 2017; reduction in cast iron main breaks and leaks by incorporating additional factors into its main replacement program; implemented measures to address anticipated retirements and adopted elements of a comprehensive workforce planning process; incorporated diversity into its business strategy, corporate initiatives, employee engagement, training, and development; completion of a management compensation study and realignment of compensation levels for most positions; reduction of expenses related to the internal auditing function by adding staff and reducing reliance on an external auditing firm which related in an annual savings of approximately \$215,000; and, improvement of customer service satisfaction scores. **As a result of its implementation efforts, annual and one-time savings of approximately \$215,000 and \$47 million were realized.**

The audit staff concluded that further improvement was warranted and developed 47 follow-up recommendations for improvement. In its August 28, 2018 Implementation Plan, the company indicated acceptance of 46 recommendations and rejection of one follow-up recommendation. Some of the notable follow-up recommendations were to:

- Aggressively replace cast iron main and all risky pipe.
- Reduce the number of open or backlogged leaks.
- Update all emergency plans annually and consider testing scenarios on a rotating basis.
- Perform disaster recovery tests semi-annually.
- Develop and implement a policy promoting cyber safe usage of electronic communications devices.
- Focus efforts toward preventing or quickly identifying undetected gas use.
- Streamline PGW's corporate governance structure to avoid approximately \$600,000 in annual expenses.
- Make additional efforts to prepare for upcoming retirements within the Gas Control Center.
- Continue to increase diversity in underutilized job categories.

Estimated benefits or savings associated with implementation of the MEI recommendations were \$600,000 annually.

V. APPENDICES

Appendix A – List of Pennsylvania Regulated Utilities Subject to Mandated § 516 Management Audits and Management Efficiency Investigations as of June 30, 2019

Aqua Pennsylvania, Inc.
Columbia Gas of Pennsylvania, Inc.
The Columbia Water Company
Duquesne Light Company
National Fuel Gas Distribution Company
The Newtown Artesian Water Company
PECO Energy Company
Pennsylvania-American Water Company
Philadelphia Gas Works
Pittsburgh Water and Sewer Authority
PPL Electric Utilities Corporation
Suez Water Pennsylvania, Inc.
The York Water Company

Citizens' Electric Company Wellsboro Electric Company Valley Energy, Inc.

Metropolitan Edison Company Pennsylvania Electric Company Pennsylvania Power Company West Penn Power Company

Peoples Natural Gas Company LLC* Peoples TWP LLC

Pike County Light and Power Company Leatherstocking Gas Company LLC
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UGI Utilities, Inc. (includes both electric and natural gas operations) UGI Central Penn Gas, Inc. UGI Penn Natural Gas, Inc.

Note – The utilities listed within the boxes have common ownership and share support functions and therefore the audits are performed concurrently and reported within a combined report.

* Equitable Gas Company became an operating division of Peoples Natural Gas Company effective December 13, 2013.

Appendix B – History of Mandated Management Audits Released

<u>Utility</u>	<u>Month Released</u>	<u>Notes</u>
ALLTEL Pennsylvania, Inc. (Now known as Windstream Pennsylvania, LLC)	8/80, 9/89, 7/97	
Apollo Gas Company/Carnegie Natural Gas Company	8/88, 2/98	(2)
Aqua Pennsylvania, Inc.	11/06, 5/13	
Bell Atlantic – PA (Now known as Verizon Pennsylvania LLC)	1/87, 6/96	
Citizens' Electric Company of Lewisburg	7/07, 4/14	(3)
Citizens Utilities Water Companies of Pennsylvania	6/94	(4)
Columbia Gas of Pennsylvania, Inc.	8/80, 5/90, 5/98, 8/06, 8/13	
Columbia Water Company	7/97, 7/05, 9/11, 5/18	
Commonwealth Telephone Company (d/b/a Frontier Communications Commonwealth Telephone Company)	3/87, 3/96	(5)
Conestoga Telephone & Telegraph Company	10/86, 6/95	(6)
Consumers Pennsylvania Water Companies	5/99	(7)
Continental Telecom, Inc. (PA Operations)	8/87	(8)
Denver & Ephrata Telephone & Telegraph Company (Now known as Windstream D&E, Inc.)	2/92	
Duquesne Light Company	9/82, 5/90, 5/98, 5/06, 3/13	(1)
Equitable Gas Company	2/87, 1/95, 2/03, 6/10	(9, 20)
Frontier Communications (PA TELCOS)	8/87, 12/95	
GTE North – PA Operations (Now known as Verizon North LLC)	11/85, 7/96	
Leatherstocking Gas Company	2/18	
Metropolitan Edison Company	11/79, 1/91, 1/99, 3/07, 2/15	(10,11)
National Fuel Gas Distribution Corporation (PA Operations)	2/89, 3/97, 3/05, 5/12, 4/18	
Newtown Artesian Water Company, The	8/96, 9/04, 1/11.5/17	
North Penn Gas Company & PFG, Inc. (Formerly known as Penn Fuel Gas, Inc.)	7/84, 7/92, 6/02	(12)
North Pittsburgh Telephone Company	6/89, 1/97	(13)
PECO Energy Company	11/79, 9/91, 9/99, 8/07, 10/14	
Pennsylvania-American Water Company	8/85, 10/92, 10/00, 11/08, 3/16	
Pennsylvania Electric Company	11/79, 1/91, 1/99, 3/07, 2/15	(10,11)
Pennsylvania Gas & Water Company	5/79, 10/93	(14)
Pennsylvania Power Company	6/79, 6/90, 6/98, 3/07, 2/15	(10)
Pennsylvania Suburban Water Company (Formerly Philadelphia Suburban Water Company)	4/79, 12/90, 11/98	(15)
Peoples Natural Gas Company LLC (Formerly The Peoples Natural Gas Company)	8/87, 1/95, 2/03, 3/10, 12/16	
Peoples TWP LLC (Formerly T. W. Phillips Gas and Oil Co.)	10/86, 12/93, 12/01, 4/09, 12/16	
PG Energy, Inc.	10/01	(16)
Philadelphia Gas Works	4/01, 2/09, 10/15	
Pike County Light & Power Company	1/10, 2/18	
PPL Electric Utilities Corporation (formerly Pennsylvania Power & Light)	4/86, 6/94, 6/02, 7/09, 12/16	
Roaring Creek Water Company	12/82, 7/92	(17)
Shenango Valley Water Company	11/85, 11/91	(17)
Suez Water Pennsylvania, Inc. (formerly United Water Pennsylvania)	8/88, 5/96, 5/04, 1/11, 3/17	
Superior Water Company, Inc. (d/b/a Superior Water Company)	1/07, 12/13	(15)
UGI Utilities, Inc.	1/82, 6/89, 4/97, 4/05, 5/12	(1)
UGI Central Penn Gas, Inc.	5/12	
UGI Penn Natural Gas, Inc.	5/12	
United Telephone Company of Pennsylvania	9/82, 2/92	(19)
Valley Energy, Inc. – Pennsylvania Division	7/07, 4/14	(3)
Wellsboro Electric Company	7/07, 4/14	(3)
West Penn Power Company	8/83, 6/92, 6/00, 2/08, 2/15	(10)
York Water Company, The	5/82, 6/93, 6/01, 10/08, 5/15	

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Notes to History of Mandated Management Audits Released

- (1) Next audit being initiated or in progress.
- (2) Now part of Equitable Gas Company.
- (3) Subsidiaries of C&T Enterprises, Inc.
- (4) Now part of Pennsylvania-American Water Company.
- (5) Now part of Frontier Communications.
- (6) Became part of D & E Communications d/b/a Conestoga Telephone Company and is now Windstream Conestoga, Inc.
- (7) Became part of Philadelphia Suburban Water Company, then part of Pennsylvania Suburban Water Company, and is now a part of Aqua Pennsylvania, Inc. (See note 17).
- (8) Became part of GTE North – PA Operations and is now a part of Verizon North LLC
- (9) Formerly a Division of Equitable Resources, Inc. and subsidiary of EQT Corporation.
- (10) Subsidiary of FirstEnergy Corporation.
- (11) The 1/99 audit was released under the name GPU Energy (PA Zones).
- (12) Became subsidiaries of PPL Gas Utilities Corporation, a subsidiary of PPL Corporation, and are now a subsidiary of UGI Utilities, Inc. known as UGI Central Penn Gas, Inc.
- (13) Now Consolidated Communications of Pennsylvania Company LLC.
- (14) Gas operations became known as PG Energy (a division of Southern Union Company) and are now a subsidiary of UGI Utilities, Inc. known as UGI Penn Natural Gas, Inc. Water operations became a part of Pennsylvania-American Water Company.
- (15) Now part of Aqua Pennsylvania, Inc.
- (16) Now a subsidiary of UGI Utilities, Inc. known as UGI Penn Natural Gas, Inc.
- (17) Became part of Consumers Pennsylvania Water Companies, and is now a part of Aqua Pennsylvania, Inc. (See note 7).
- (18) The 1/82 audit covered the Electric Division only.
- (19) Became United Telephone Company of Pennsylvania LLC d/b/a Embarq and is now The United Telephone Company of Pennsylvania LLC d/b/a CenturyLink.
- (20) Became an operating division of Peoples Natural Gas Company effective December 17, 2013 as a result of the acquisition and merger filed on March 19, 2013 in which EGC, Peoples Natural Gas Company LLC (Peoples), and Peoples TWP LLC filed with the Commission a Joint Application at Docket Nos. A-2013-2353647, A-2013-2353649 and A- 2013-2353651 requesting all necessary approvals authorizing: the transfer of 100% of the issued and outstanding limited liability company membership interests in EGC, an indirect subsidiary of EQT Corporation (EQT), to PNG Companies LLC (PNG), an indirect subsidiary of SteelRiver Infrastructure Fund North America LP; and, the merger of EGC with Peoples, a wholly-owned subsidiary of PNG, and the operation of EGC as an operating division of Peoples.