

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
BUREAU OF AUDITS**



REPORT ON PHILADELPHIA GAS WORKS

**STATEMENTS OF
DISTRIBUTION SYSTEM IMPROVEMENT CHARGE
JANUARY 1, 2020 — DECEMBER 31, 2021**

**MAY 2, 2024
DOCKET NO. D-2023-3042562**

**PA PUC BUREAU OF AUDITS
DOCKET NO. D-2023-3042562**

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Background

Philadelphia Gas Works (PGW or company) is the nation's largest municipally owned gas utility and is owned by the City of Philadelphia (City). The City manages and oversees PGW's operations through a non-profit corporation, the Philadelphia Facilities Management Corporation (PFMC). According to PGW's annual reports filed with the Pennsylvania Public Utility Commission (PUC or Commission), for the years 2021 and 2020, PGW's total sales revenues from residential, commercial, industrial, and public authorities were \$600,535,128 and \$557,608,686; respectively.

PGW maintains a distribution system of approximately 3,000 miles of gas mains that provide gas service to about half a million residential, commercial, and industrial customers in the City. PGW also owns and operates facilities for the liquefaction, storage, and vaporization of natural gas to supplement the gas supply it draws directly from interstate pipeline and storage companies. PGW has a diverse operation that includes firm service, interruptible service, and transportation service customers. PGW's revenue base is comprised primarily of firm service residential customers.

Prior to July 1, 2000, PGW was solely under the jurisdiction of the Philadelphia Gas Commission. Effective July 1, 2000, pursuant to the passage of the Pennsylvania Natural Gas Choice and Competition Act (Act), PGW came under the dual regulatory authority of the Philadelphia Gas Commission and the PUC. Under the Act, notwithstanding any other provision of the Public Utility Code to the contrary, the PUC must allow the company to follow the same ratemaking methodology and requirements previously applicable in determining PGW's operational revenue requirement and in approving overall rates and charges.

On November 22, 2000, at Docket No. R-00005654, the Commission ordered PGW to achieve a 1% replacement rate in its mains replacement program, the "Baseline Program." The company has applied the Baseline Program as a mileage goal to replace cast iron main at a rate of 18 miles per year. The cost of the Baseline Program is recovered through base rates. From fiscal year 2001 through 2012, PGW replaced or abandoned an average of 18.3 miles per year. For fiscal years 2020 and 2021, the total cast iron replaced through the Baseline Program was 18.05 miles and 18.05 miles, respectively. PGW states that if the fiscal year goal of 18 miles of cast iron main replacement is not met, projects originally intended for DSIC recovery would be shifted to the Baseline Program and would not be eligible for reimbursement through the DSIC mechanism.



Independent Auditor's Report to the Pennsylvania Public Utility Commission

Report on the Financial Statements

We have audited Philadelphia Gas Works' Statements of Distribution System Improvement Charge Over/Under Collections for the 12-month periods ended December 31, 2021 and December 31, 2020.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether these statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in these statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of these statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of these statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of these statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Distribution System Improvement Charge Statements, referred to above, present fairly, in all material respects, the Distribution System Improvement Charge revenue and expenses of Philadelphia Gas Works as of December 31, 2021 and December 31, 2020, in conformity with accounting principles generally accepted in the United States of America and the requirements of the Pennsylvania Public Utility Commission.

Report on Other Legal and Regulatory Requirements

The accompanying statements were prepared for the purpose of complying with the rules and regulations of the Pennsylvania Public Utility Commission and are not intended to be a complete presentation of Philadelphia Gas Works' revenue and expenses.



Kelly A. Monaghan, CPA, CGFM, CFE, CISA
Director
Bureau of Audits
Harrisburg, PA
May 2, 2024

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**Distribution System Improvement Charge (DSIC)¹
Over/(Under) Collections (Section 1307(e))
for the 12 months ended December 31, 2021²**

<u>Month</u>	<u>DSIC Revenue</u> (1)	<u>DSIC Recoverable Costs</u> (2)	<u>Over/(Under) Collections</u> (3) = (1) - (2)
January 2021	\$ 5,473,628	\$ 0	\$ 5,473,628
February	6,396,077	0	6,396,077
March	4,472,921	0	4,472,921
April	2,739,411	0	2,739,411
May	1,682,470	4,754,794	(3,072,324)
June	1,264,293	0	1,264,293
July	1,180,870	0	1,180,870
August	1,185,069	15,876,181	(14,691,113)
September	1,229,873	0	1,229,873
October	1,324,224	0	1,324,224
November	2,661,844	10,048,045	(7,386,201)
December	4,546,672	7,175,564	(2,628,892)
Totals	<u>\$ 34,157,349</u>	<u>\$ 37,854,584</u>	<u>\$ (3,697,235)</u>

¹ As reported to the Commission at Docket No. M-2022-3030680. Arithmetic differences are due to rounding.

² Notes to the Financial Statements are an integral part of this report.

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**Distribution System Improvement Charge (DSIC)³
Over/(Under) Collections (Section 1307(e))
for the 12 months ended December 31, 2020⁴**

<u>Month</u>	<u>DSIC Revenue</u> (1)	<u>DSIC Recoverable Costs</u> (2)	<u>Over/(Under) Collections</u> (3) = (1) - (2)
January 2020	\$ 4,529,152	\$ 0	\$ 4,529,152
February	4,264,732	0	4,264,732
March	3,330,360	0	3,330,360
April	2,664,242	0	2,664,242
May	2,044,220	9,058,380	(7,014,160)
June	1,241,573	0	1,241,573
July	993,194	0	993,194
August	915,750	2,936,931	(2,021,181)
September	1,017,294	0	1,017,294
October	1,178,404	0	1,178,404
November	2,099,987	6,596,894	(4,496,906)
December	3,793,961	9,986,422	(6,192,461)
Totals	<u>\$ 28,072,869</u>	<u>\$ 28,578,627</u>	<u>\$ (505,758)</u>

³ As reported to the Commission at Docket No. M-2021-3023968. Arithmetic differences are due to rounding.

⁴ Notes to the Financial Statements are an integral part of this report.

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Notes to the Financial Statements

1 – Statements

The Distribution System Improvement Charge (DSIC) Over/(Under) Collections presented in this report are condensed from the officially filed statements. The audit was conducted on PGW's officially filed 1307(e) statements submitted to the PUC in accordance with Section 1307(e)(1) of the Public Utility Code on February 1, 2022 and March 19, 2021. The statements are available on the PUC's website (<http://www.puc.pa.gov>) at Docket Nos. M-2022-3030680 and M-2021-3023968.

2 – DSIC Revenue

DSIC Revenue is derived by multiplying the DSIC rate, expressed as a percentage, by the total amount billed to each customer for distribution service (including all applicable clauses and riders), excluding amounts billed for the State Tax Adjustment Surcharge.

3 – DSIC Recoverable Costs

DSIC Recoverable costs are the amounts expended or incurred to purchase and install eligible gas distribution system property and associated financing costs, including debt service, debt service coverage, and issuance costs. The DSIC recoverable costs are the incremental costs above the company's Baseline Program and are recovered in base rates as discussed in the background section of this report.

4 – Over/(Under) Collections

The Over/(Under) Collection is the difference between the DSIC Revenue and the DSIC Recoverable Costs. The resulting amount represents the portion of DSIC Revenue refundable to or DSIC Recoverable Costs recoverable from customers through subsequent DSIC rates. Differences arise for two primary reasons:

- Variations between the actual revenue billed to customers and the projected revenue used to determine the DSIC rate; and,
- Variations between the actual recoverable costs and projected recoverable costs used to determine the DSIC rate.

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Current Audit Findings

Finding No. 1 – Per company operating procedure, PGW does not apply early payment discounts received to the DSIC mechanism.

When reviewing samples of DSIC invoices, the auditors noted that the early payment discounts received by PGW, for paying their DSIC recoverable costs early (i.e., before the due date), were not being used to offset the DSIC recoverable costs reported in the 1307(e) reconciliation statements filed with the PUC. PGW staff stated that the discounts are recorded as revenue from Non-Utility Operations.

PGW should be properly recording the net cost of the DSIC invoices paid, including discounts, not gross invoiced amounts.

Recommendation:

We recommend that PGW cease its practice of recording DSIC early payment discounts as revenue from Non-Utility Operations, and to properly account for and apply the discounts received, to offset the DSIC recoverable costs reported in its 1307(e) reconciliation statements filed with the PUC. We further recommend that PGW develop appropriate procedures and internal controls for ensuring proper and accurate tracking and reporting of DSIC recoverable costs.

Finding No. 2 – PGW stopped reflecting the status of the DSIC over/(under) recovery balance in its accounting records.

PGW has discontinued, reflecting the status of its DSIC over/(under) recovery balance in its general ledger accounts and its financial statements when these balances should either be recorded as a liability or as an asset.

Recommendation:

We recommend that PGW use an asset account to record DSIC deferrals. We further recommend that PGW institute appropriately designed and effectively functioning controls to ensure proper regulatory accounting principles are used in recording transactions and reporting to regulators.

Acknowledgement

We wish to express our appreciation to the officers and staff of Philadelphia Gas Works for their cooperation and assistance. The audit was conducted by Gerville J. Brown, assisted by Jacob L. Fultz.