



Dennis Swanson
Director, Regulatory Affairs

FortisBC Inc.
Suite 100 - 1975 Springfield Road
Kelowna, BC V1Y 7V7
Ph: (250) 717-0890
Fax: 1-866-335-6295
regulatory@fortisbc.com
www.fortisbc.com

June 23, 2009

Via email
Original via mail

Ms. Erica M. Hamilton
Commission Secretary
BC Utilities Commission
Sixth Floor, 900 Howe Street, Box 250
Vancouver, BC V6Z 2N3

Dear Ms. Hamilton:

**Re: FortisBC Inc. Revised Code of Conduct and Transfer Pricing Policy and
Request for Final Approval of the Brilliant Expansion Subcontractor Agreement
- Project No. 3698560**

FortisBC Inc. ("FortisBC" or the "Company") advises that it has no confidentiality issues related to the filing of the 2008 and 2009 Internal Audit Reports regarding Code of Conduct and Transfer Pricing Policy (the "2008 Report" and "2009 Report") in this proceeding.

Accordingly, as per the directives contained in Order G-71-09, the 2008 Report and 2009 Report are provided as Attachment A and Attachment B respectively to this letter.

Sincerely,

A handwritten signature in black ink, appearing to be "DS", written over a horizontal line.

Dennis Swanson
Director, Regulatory Affairs



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Director, Regulatory Affairs

FortisBC Inc.
Suite 100, 1975 Springfield Road
Kelowna BC V1Y 7V7
Ph: (250) 717-0890
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dennis.swanson@fortisbc.com
www.fortisbc.com

July 16, 2008

Ms. Erica M. Hamilton
Commission Secretary
BC Utilities Commission
Sixth Floor, 900 Howe Street, Box 250
Vancouver, BC V6Z 2N3

Dear Ms. Hamilton:

**Re: FortisBC Inc. ("FortisBC") Code of Conduct and Transfer Pricing –
Confidential Filing**

Attached for filing is FortisBC's Internal Audit Report regarding Code of Conduct and Transfer Pricing Policy. The report has been prepared in accordance with the BC Utilities Commission Guidelines issued in April 1997 with respect to utility participation in retail markets downstream of the utility meter. FortisBC requests that the Report, being an internal audit document, be treated in confidence.

Sincerely,

A handwritten signature in black ink, appearing to be "Dennis Swanson", written over a horizontal line.

Dennis Swanson
Director, Regulatory Affairs



Date: July 3, 2008

To: John Walker, President and CEO
David Bennett, Vice President, Regulatory Affairs and
General Counsel
Michele Leeners, Vice President, Finance and CFO

cc: Dennis Swanson, Director, Regulatory Affairs
Joyce Martin, Manager, Regulatory Affairs
Navdeep Gill, Corporate Solicitor
Chuck Lee, Controller

From: Internal Audit

Subject: Audit Report: Code of Conduct and Transfer Pricing

BACKGROUND

In 1997, the British Columbia Utilities Commission ("BCUC" or the "Commission") issued guidance to regulated utilities operating in the province of British Columbia in the document titled *Retail Markets Downstream of the Utility Meter Guidelines ("BCUC Guidelines")*. The document included a discussion of principles that should be reflected in the internal policies prepared by the regulated utility.

The BCUC Guidelines, in Section 5.2 - Transfer Pricing Policy require that the utility, "*bring forward for approval proposed transfer pricing policies at the time they bring forward any application to use utility assets or services in the provision of unregulated goods and services in the downstream retail market.*" This section also stipulates that, "*Utilities will be required to file periodic reports which demonstrate that they are adhering to the transfer pricing policy. The form and timing of the report will be determined by the Commission.*" To clarify the form of the report, reference is made to "*periodic reviews of transactions between a utility and non-regulated businesses ("NRBs").*"

The BCUC Guidelines also require, in Section 5.3 - The Code of Conduct, that the utility "*bring forward for approval a code of conduct for the relationship between the utility and its NRBs or the utility and any division within the utility which offers unregulated goods or services, at the time the utility brings forward any application to use utility assets or services in the provision of unregulated goods and services.*" This section also stipulates, "*The regulated company will formally advise all employees of expected conduct related to these principles and it will undertake to perform periodic audits of the relationships to ensure compliance with these principles. These audits will be performed no less than once a calendar year and filed with the Commission.*"

In 1998, FortisBC Inc. (then West Kootenay Power Ltd.) developed a document titled *Revised Code of Conduct and Transfer Pricing Policy*, (“COC & TPP”) based on the BCUC Guidelines. It was submitted to the Commission and subsequently received their approval. This policy remains in effect today and is the basis for this report.

OBJECTIVES

Management is responsible for establishing and maintaining a system of internal controls to provide reasonable assurance of compliance with the COC & TPP. The audit objectives are summarized as follows:

- confirm the existence of appropriate policies, processes, procedures and business information systems (control procedures) that ensure compliance with the COC & TPP;
- review and determine whether the control procedures established were in effect and operating as of the date of this assessment;
- determine who the key business process owners are;
- assess knowledge and expertise of the individuals carrying out key functions or supervising the activities to ensure the Company’s control processes meet the criteria; and
- evaluate the alignment and consistency between the COC & TPP, current business practices and the BCUC Guidelines.

SCOPE AND APPROACH

Internal Audit’s work focused on a review of the control procedures (i.e. policies, processes, procedures and business information systems) established to facilitate and ensure compliance with the COC & TPP.

In addition, the business and financial transactions between the regulated utility operations of FortisBC and the non-regulated business operations of Fortis Pacific Holdings Inc. were reviewed, tested and assessed

Internal Audit worked with FortisBC management to understand the existing control procedures for each of the discrete policy elements (control objectives) contained in the COC & TPP.

Several key personnel were interviewed to determine the extent to which adequate control procedures have been established. Internal policies and procedures, journal entries and working papers, other internal documents and third-party documents, where appropriate, were reviewed. Furthermore, agreements were reviewed and details of transactions pertaining to NRB activity for the City of Kelowna, Arrow Lakes and Brilliant Dam Expansion were tested. Additionally, discussions were held with FortisBC SAP Specialists to understand the transfer pricing related procedures built into the SAP financial information system.

OBSERVATIONS AND CONCLUSIONS

In general, it can be concluded that FortisBC is operating within the spirit and intent of the COC & TPP. Where instances of non-compliance were found, for the most part, the deviations from the original policies were the result of deliberate and informed decisions to ensure that the regulated customer is not subsidizing any non-regulated business activities of the utility.

Following is a list of specific areas where FortisBC is not in compliance with the COC & TPP:

1.) Code of Conduct:

A.) PARAGRAPH 2: LOCATION OF NRB OPERATIONS: NRBS WILL OPERATE OUT OF SEPARATE AND DISTINCT OFFICES AND LOCATIONS THAN USED BY WKP (FORTISBC).

Audit Ranking¹: Low

Auditors' comments:

Compensating for the lack of physical separation are the effective system controls in SAP (a separate General Ledger, programmed rates and calculations for Transfer Pricing, access and change controls, built in edit checks), as well as segregation of employee duties and accurate reporting of FortisBC resources and employees' time related to any NRB work. Monthly analysis, review and authorization of regulated and non-regulated billings by Finance add an additional level of control to the process.

B.) PARAGRAPH 7: PERIODIC COMPLIANCE AUDITS: WKP (FORTISBC) WILL FORMALLY ADVISE ALL EMPLOYEES OF EXPECTED CONDUCT RELATED TO THESE PRINCIPLES AND IT WILL UNDERTAKE TO PERFORM PERIODIC AUDITS . . . TO ENSURE COMPLIANCE WITH THESE PRINCIPLES. THESE AUDITS WILL BE PERFORMED NO LESS THAN ONCE A CALENDAR YEAR AND FILED WITH THE BRITISH COLUMBIA UTILITIES COMMISSION.

Audit Ranking: Low

Auditors' comments:

There has been a great deal of turnover in management and staff during the past ten years. However, some of the key individuals responsible for administering the COC & TPP have remained with the Company for all of those years and have used their experience to ensure that the policies are being followed to the best of their abilities. It was their leadership that caused the Company to modify the Transfer Pricing loading rates and methodology so that current rates rather than historic rates are being used to invoice for goods and services supplied by the utility to the NRB. There is now a commitment by management to ensure that these audits are completed annually and filed with the Commission.

¹ Internal Audit applies ranking to individual audit findings for which recommendations are made. The ranking is categorized as Low, Medium or High and the criteria are dependent upon the significance of any control environment deficiencies and degree of compliance with policies and procedures.

2.) Transfer Pricing Policy:

A.) PARAGRAPH 4: LOADINGS DEFINED – LOADINGS ARE DEFINED AS THE RECOVERY OF COSTS THAT BY THEIR NATURE, WOULD BE ADMINISTRATIVELY PROHIBITIVE TO CHARGE DIRECTLY TO EACH PROJECT.

Audit Ranking: Low

Auditors' comments:

Certain portions of the TPP have been obsolete for many years, (see Appendix A), specifically the labour and materials loading rates as listed in Schedule 1 of the TPP. Internal audit confirmed that current labour and materials loading rates are being used instead of the rates shown in the schedule. These changes are a reflection of increases to the specific costs included in the loading calculations over time, and the current loading rates are used to ensure that NRBs are charged accurately for work performed on their behalf by FortisBC. It is believed that using current rates is more appropriate and in line with the spirit and intent of the TPP.

B.) PARAGRAPH 5: ANNUAL REVIEW – THE TRANSFER PRICING POLICY SHALL BE REVIEWED ANNUALLY BY WKP (FORTISBC) TO ENSURE ONGOING COMPLIANCE WITH THE POLICY AND ENSURE THAT PRICES ARE ACCURATE, APPROPRIATE AND CONSISTENT WITH THE RETAIL MARKETS DOWNSTREAM OF THE UTILITY METER GUIDELINES DEVELOPED BY THE BRITISH COLUMBIA UTILITIES COMMISSION.

Audit Ranking: Low

Auditors' comments:

See comments in item B.) regarding Paragraph 7 of the COC above.

RECOMMENDATIONS

Based on the results of our review, the following recommendations are proposed:

1. Revisions to Existing Code of Conduct and Transfer Pricing Policy Document

- a) Update the COC & TPP documents and provide an Appendix that shows examples of Transfer Pricing calculations rather than fixed amounts which can become obsolete.
- b) Submit the revised COC & TPP to the Commission for review and approval.
- c) Post the updated and approved COC & TPP on the Company's Intranet for access by employees and contractors.

2. Revisions to Existing Business Processes

- a) Require that the appropriate FortisBC Process Owners and employees working in NRB related activities read and sign-off annually acknowledging their understanding of the COC & TPP, once these policies have been updated. Assigning an individual to

the responsibilities of Compliance Officer would assist in ensuring this annual sign-off is documented.

- b) Ensure that annual audits or reviews are conducted and resulting reports are filed with the BCUC.
- c) Develop improved documentation of the business processes and internal controls. Benefits will include knowledge retention, enhanced job training, and the likelihood that future internal audits will be more efficient and effective. Process owners would be identified and their accountability with respect to the COC & TPP requirements clearly communicated. Internal audit can provide advice and examples of methodology to aid with the preparation of this documentation.
- d) Establish a formal process for handling customer complaints regarding the COC & TPP to ensure that appropriate documentation and communication occurs with stakeholders, and that any contentious issues are brought to management's attention in a timely manner.

MANAGEMENT RESPONSES:

The Regulatory department will update the COC & TPP documents, as suggested, and will file the documents with the Commission no later than March 31, 2009. Once approved by the Commission, these documents will be posted on the Company's Intranet site for access by employees and contractors.

Beginning January 1, 2009, the Finance department will implement an annual sign off procedure for affected employees and contractors to acknowledge their understanding of the COC & TPP.

The Regulatory department will request that an Internal Audit of COC & TPP procedures and transactions be performed each calendar year and will file the results with the Commission no later than April 30th of each year. (Note: Internal Audit is committed to this requirement.)

FortisBC's Finance department will develop and maintain improved documentation for COC & TPP business processes, complaint handling process and internal controls prior to December 31, 2008.

APPENDIX A

SPECIFIC CHANGES HAVE OCCURRED IN THE FOLLOWING AREAS:

1. Salary and Labour Loading Rates

Schedule 1 to the TPP prescribes the following loading rates for salaries and hourly labour (on labour costs excluding overtime):

- Salaried employees 55%
- Hourly employees 45%

The actual benefit loading rates have changed since the original policy was written. The rates were changed in each year that FortisBC changed its own internal benefit loading rates and these updated loading rates were applied to both salaried and hourly labour. The loading rate is reviewed periodically and adjusted when necessary to reflect changes in costs of employee benefits, pension programs and other payroll related charges.

2. Materials and Freight Loading Rates

Schedule 1 to the TPP specifies loading rates for material loading as:

- Inventory: \$0.50 per item
- Shipped directly to job: \$6.00 per transaction
- Small item loading: 14% on applicable inventory
- Freight on inventory: 5% of cost

For practical reasons these rates and calculation methods have been amended over the years due to changes in the information system (move to SAP in 2002) as well as increases in costs to provide materials and services. As a result, the material loading calculation was revised to reflect the following transfer pricing methodology:

- The current material load factor is applied to all material movements transferred to projects.
- In addition, a transfer price (of approximately 12%) is applied to material and labour transfers that occur from regulated to non-regulated entities or between related regulated entities (i.e. FortisBC and Terasen or FortisAlberta). The actual transfer price is comprised of a General and Administrative loading calculated as 10% on the first \$1,000, 2% on the next \$9,000 and 1% on any amount above \$10,000, plus a 10% profit margin on the total.

3. Vehicle and Equipment Charge Out Rates

- As vehicle and equipment charge out rates have changed over the years, these new rates have been applied to the Transfer Pricing calculations.

4. Use of Prescribed Inter-entity Service Agreement Form

The prescribed Inter-entity Service Agreement form (shown as Schedule 3 of the TPP) is no longer used to document transactions between FortisBC and the NRBs. Instead, current practice is to use more robust contracts prepared by legal counsel, which include the specific requirements of the COC & TPP.



Dennis Swanson
Director, Regulatory Affairs

FortisBC Inc.
Suite 100, 1975 Springfield Road
Kelowna BC V1Y 7V7
Ph: (250) 717-0890
Fax: 1-866-335-6295
dennis.swanson@fortisbc.com
www.fortisbc.com

April 30, 2009

Via email
Original via mail

Ms. Erica M. Hamilton
Commission Secretary
BC Utilities Commission
Sixth Floor, 900 Howe Street, Box 250
Vancouver, BC V6Z 2N3

Dear Ms. Hamilton:

Re: FortisBC Inc. ("FortisBC") Code of Conduct and Transfer Pricing

Attached for filing is FortisBC's 2009 Internal Audit Report regarding Code of Conduct and Transfer Pricing Policy. The report has been prepared in accordance with the BC Utilities Commission Guidelines issued in April 1997 with respect to utility participation in retail markets downstream of the utility meter. FortisBC requests that the Report, being an internal audit document, be treated in confidence.

Sincerely,

A handwritten signature in black ink, appearing to be "DS", written over a horizontal line.

Dennis Swanson
Director, Regulatory Affairs



Date: April 27, 2009

To: John Walker, President and Chief Executive Officer
David Bennett, Vice President Regulatory Affairs & General Counsel
Michele Leeners, Vice President Finance and chief Financial Officer
Don Debiegne, Vice President Power Supply and Strategic Planning
Doyle Sam, Vice President Engineering and Operations
Michael Mulcahy, Vice President Customer and Corporate Services

CC: Dennis Swanson, Director, Regulatory Affairs
Joyce Martin, Manager, Regulatory Affairs
Navdeep Gill, Corporate Solicitor
Chuck Lee, Controller

From: Internal Audit

Subject: **Annual Review: Code of Conduct & Transfer Pricing**

Background

In 1997, the British Columbia Utilities Commission ("BCUC", "Commission") issued guidance to regulated utilities operating in the province of British Columbia in the document titled *Retail Markets Downstream of the Utility Meter Guidelines* ("BCUC Guidelines"). The document included a discussion of principles that should be reflected in the internal policies prepared by the regulated utility.

In 1998, West Kootenay Power Ltd. developed a document titled **Revised Code of Conduct and Transfer Pricing Policy**, ("**COC & TPP**") based on the BCUC Guidelines. It was submitted to the Commission and was subsequently approved. This policy remains in effect today, although this annual review was conducted with the knowledge that amendments to the Code of Conduct and the Transfer Pricing Policy have been developed and submitted to the BCUC on March 31, 2009 for approval.

The BCUC Guidelines stipulate in **Section 5.2 - Transfer Pricing Policy**, that, "Utilities will be required to file periodic reports which demonstrate that they are adhering to the transfer pricing policy. The BCUC Guidelines also state, in **Section 5.3 - Code of Conduct**, "The regulated company will formally advise all employees of expected conduct related to these principles and it will undertake to perform **periodic audits** of the relationships to ensure compliance with these principles. These audits will be performed no less than once a calendar year and filed with the Commission".

Objectives

Management is responsible for establishing and maintaining a system of internal controls to provide reasonable assurance of compliance with the **COC & TPP**. The audit objectives are summarized as follows:

- confirm the existence of appropriate policies, processes, procedures and business information systems ("control procedures") that ensure compliance with the **COC & TPP**.
- review and determine whether the control procedures established were in effect and operating as of the date of this assessment.
- determine who the key business process owners are.

- assess knowledge and expertise of the individuals carrying out key functions or supervising the activities to ensure the Company's control processes meet the criteria.
- evaluate the alignment and consistency between the *COC & TPP*, current business practices and the BCUC Guidelines.

Scope and Approach

Internal Audit's work focused on a review of the control procedures (i.e. policies, processes, procedures and business information systems) established to facilitate and ensure compliance with the *COC & TPP*.

Internal Audit worked with FortisBC management to understand the existing control procedures for each of the discrete policy elements ("control objectives") contained in the *COC & TPP*.

Interviews with key personnel determined the extent to which adequate control procedures have been established. In addition, reviews of internal policies and procedures, journal entries and working papers were conducted. Furthermore, we reviewed agreements between FortisBC and Non-Regulated Businesses ("NRB's") and tested details of transactions pertaining to NRB activity.

Observations and Conclusions

While conducting this audit, we observed the review process used by Management (Regulatory and Finance departments) to analyze, verify and update the *COC & TPP* documents.

Where applicable, comments have referenced the related recent submissions made to the BCUC (filed March 31, 2009), which included:

- a revised Code of Conduct,
- a revised Transfer Pricing Policy, and
- an updated Schedule "A" showing proposed loading rates for NRB transactions

In general, it can be concluded that FortisBC Inc. is operating within the spirit and intent of the *COC & TPP*. As reported in the prior Internal Audit review (May 2008) any instances of non-compliance found were primarily deviations from the original policies as a result of deliberate and informed decisions to ensure that the regulated customer is not subsidizing any non-regulated business activities of the utility.

Notwithstanding the overall effectiveness of the control framework, the audit revealed some opportunities for improvement. See the following section for further comments, recommendations and management responses.

Note re Audit Ranking:

Internal Audit applies ranking to individual audit findings for which recommendations are made. The ranking is categorized as Low, Medium or High and each criterion is dependent upon the significance of any control environment deficiencies and degree of compliance with policies and procedures.

Policy Requirements	Recommendations	Owner	Deadline
<p>1. <u>Code of Conduct:</u></p> <p><u>Policy Statement:</u> <i>“All transactions between FortisBC and NRBs are to be in accordance with this Code of Conduct and the attached Transfer Pricing Policy.”</i></p> <p><u>Risk:</u></p> <p>While there is awareness of the COC, it was noted there has been no recent formal, documented training (or re-training). Employees may not have sufficient knowledge of the requirements of the Code of Conduct and Transfer Pricing Policy. There are a number of specific requirements within these documents that must be communicated to ensure compliance. Performance of the recommended actions will reduce this risk.</p> <p>Audit Ranking: Low</p>	<p><u>Internal Audit Recommendations:</u></p> <ol style="list-style-type: none"> 1. When the updated COC & TPP policies have been approved by the BCUC, post a copy of the updated documents on the FortisBC intranet in the Corporate Policies section. 2. The Regulatory Department should ensure that awareness of the COC and TPP is re-visited annually by means of a sign-off document by the relevant employees and contract employees. 3. Core training should be provided to key employees who are involved with Code of Conduct and Transfer Pricing processes to ensure their understanding of the specific requirements. <p><u>Management Responses:</u></p> <ol style="list-style-type: none"> 1. The existing policies were distributed and the updated COC & TPP policies will be posted to the Corporate Policies section of the FortisBC intranet, once approved by the BCUC. 2. The annual sign-off process will be conducted by the end of 2009 with all relevant employees. 3. A training program will be developed and completed by year-end. 	<p>Manager, Regulatory Affairs</p> <p>Manager, Regulatory Affairs</p> <p>Manager, Regulatory Affairs (to coordinate initiative with other departments).</p>	<p>As soon as possible once BCUC approves</p> <p>December 31, 2009</p> <p>December 31 2009</p>

Policy Requirements	Recommendations	Owner	Deadline
<p>2. <u>Transfer Pricing Policy:</u></p> <p><u>Policy Statement:</u></p> <p><u>Objectives</u></p> <p><i>In all cases, the objectives of the transfer pricing policy should be maintained as determined by the British Columbia Utilities Commission. They are:</i></p> <p>a) <i>There must be no subsidy of unregulated business activities, whether undertaken by the utility or the NRB, by utility ratepayers;</i></p> <p>b) <i>The risks associated with participation in the unregulated market must be borne entirely by the unregulated business activity; that is the risks must have no impact on utility ratepayers; and</i></p> <p>c) <i>The most economically efficient allocation of goods and resources for ratepayers should be sought.</i></p> <p><u>Risk:</u> Employees may not have sufficient understanding of the above policy requirements to make correct decisions or identify potential problems unless they have received current training and there is procedure and controls documentation to refer to. Performance of the recommended actions will reduce the risk.</p> <p><u>Audit Ranking:</u> Low</p>	<p><u>Internal Audit Recommendations:</u></p> <p>4. The Transfer Pricing internal documentation should be enhanced by inclusion of operational procedures and controls used by appropriate departments to ensure all work is qualified as non-regulated and that data entered to non-regulated orders is complete, accurate, and authorized.</p> <p>5. Perform an annual review of transfer pricing rates to ensure ratepayers are not negatively impacted. Finance management should document the approach used to determine that these rates are accurate, appropriate and consistent with the BCUC Guidelines.</p> <p><u>Management Responses:</u></p> <p>4. The existing Transfer Pricing documentation will be updated to include the appropriate procedures and controls.</p> <p>5. A review of transfer pricing rates was completed in March 2009 and will continue to occur annually by year-end. A summary of the methodology used to perform the review will be documented as part of this process.</p>	<p>Finance - Accounting Supervisor (to coordinate initiative with other departments)</p> <p>Finance - Accounting Supervisor</p>	<p>December 31, 2009</p> <p>Annually by year-end</p>