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17

Jack L. Haskins
Director of Rates and Regulatory Matters
and Assistant Secretary

**ORIGINAL
FILE COPY**
the southern electric

May 15, 1990

Mr. Steve Tribble, Director
Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee FL 32399-0870

Dear Mr. Tribble:

RE: Docket No. 891345-EI

Enclosed are an original and fifteen copies of Rebuttal
Testimony from G. A. Fell and J. T. Kilgore, Jr. on behalf of
Gulf Power Company to be filed in the above docket.

Sincerely,

Jack L. Haskins

lw

Enclosures

- ACK
- AFA 2
- APP
- CAF
- CMU
- CTR orig
- EAG**
- LEG 1
- LIN 6
- OPC
- RCH
- SEC 1
- WAS
- OTH

Kilgore
DOCUMENT NUMBER-DATE
04260 MAY 15 1990
FPC-RECORDS/REPORTING

Fell
DOCUMENT NUMBER-DATE
04259 MAY 15 1990
FPC-RECORDS/REPORTING

AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 891345-EI

Before me the undersigned authority, personally appeared
G. A. Fell, who being first duly sworn,
deposes and says that he/she is the Manager of Internal
Auditing and Security of Gulf Power Company and that the
foregoing is true and correct to the best of his/her knowledge,
information and belief.

G. A. Fell

Sworn to and subscribed before me this 11th day of
May, 1990.

Candace K. Underhill
Notary Public, State of Florida at Large

My Commission Expires: ~~MY COMMISSION EXPIRES~~ MAY 18, 1991

AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 891345-EI

Before me the undersigned authority, personally appeared
J. Thomas Kilgore, Jr., who being first duly sworn,
deposes and says that he/she is the Manager of Marketing
Planning and Research of Gulf Power Company and that the
foregoing is true and correct to the best of his/her knowledge,
information and belief.



Sworn to and subscribed before me this 11th day of
May, 1990.



Notary Public, State of Florida at Large

My Commission Expires: My Commission Expires
July 25, 1990

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Petition of Gulf Power Company)
for a Rate Increase)
_____)

Docket No. 891345-EI

Certificate of Service

I HEREBY CERTIFY that a copy of the foregoing has been furnished this 15th day of May, 1990 by U. S. Mail or hand delivery to the following:

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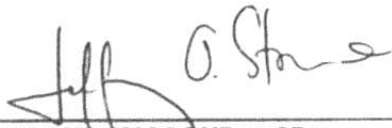
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**ORIGINAL
FILE COPY**

**BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION**

DOCKET NO 891345-EI

**REBUTTAL TESTIMONY
AND EXHIBITS
OF
G. A. FELL**

Gulf Power



**DOCUMENT NUMBER-DATE
04259 MAY 15 1990
FPSC-RECORDS/REPORTING**

1 A. The purpose of my testimony is to rebut items 1, 2 and
2 3 of Roberta S. Bass' testimony, and to allay the
3 concerns the Commission may have regarding the impact
4 of these issues on the financial statements filed by
5 Gulf Power in Rate Relief Docket No. 891345-EI.
6 Essentially, my testimony will show that the
7 allegations raised by Mrs. Bass have, at most, a
8 minimal impact on this rate case.

9
10 Q. Have you prepared an Exhibit that contains information
11 to which you will refer in your testimony?

12 A. Yes.

13 Counsel: We ask that Mr. Fell's Exhibit (GAF-1)
14 comprised of 2 Schedules, be marked for
15 identification as Exhibits ___ through___.

16
17 Q. How are you certain that the issues raised in Mrs.
18 Bass' testimony have no impact on the rate case?

19 A. The Company has conducted investigations of each
20 individual issue and its impact on the accounting
21 records of Gulf. The scope of these investigations
22 included, but was not limited to, research of
23 historical accounting records, interviews with both
24 employees and vendor/contractors, as well as a review
25 of vendor/contractor records, and analysis of the

1 accounting entries associated with these issues and
2 their impact on the budget process.

3

4 Q. Please describe the issues you will be addressing in
5 your testimony?

6 A. I will speak to the following issues raised in
7 Mrs. Bass' testimony:

8 Item 1. The allegation of a \$2,000,000 inventory
9 shortage at the General Warehouse.

10 Item 2. The misappropriations by Kyle Croft; and

11 Item 3. The unsuccessful kick-back scheme perpetrated
12 by a Gulf employee against a contract vendor.

13

14 Q. At page 3 of Mrs. Bass' testimony, it is stated that
15 Carolyn Sirmon, a former warehouse supervisor,
16 testified in the Richard Leeper perjury trial and in a
17 staff-conducted deposition that the 1983 audit was
18 inaccurate because Gulf Power had concealed an enormous
19 shortage, which she estimated at around \$2,000,000, by
20 counting obsolete and damaged items as good items in
21 the inventory. Please describe the audit that was
22 performed and discuss the impact of any inventory
23 shortage on the rate case.

24 A. The audit in question began in August 1982 with an
25 inventory count performed by the General Warehouse

1 personnel. Carolyn Sirmon had been supervisor of the
2 Warehouse since June, 1982. Auditing observed the
3 inventory, conducted test counts, and controlled the
4 flow of paperwork. The first inventory count indicated
5 a net shortage of approximately \$400,000 (not "a net
6 loss of \$10,000" as referred to in Mrs. Bass'
7 testimony, page 2, line 21). Based on the results of
8 the count and observations made of the Warehouse
9 inventory, it was determined that the count was not
10 accurate. As a result, Auditing and the management in
11 charge of the Warehouse determined that a second count
12 would be appropriate. Based on the observations made
13 during the first count, Auditing provided Warehouse
14 management with a list of items requiring corrective
15 action before a second count would be performed. These
16 items included the identification and segregation of
17 all obsolete materials. Warehouse management requested
18 and received permission to reorganize the warehouse in
19 order to facilitate the second count. The second count
20 was conducted in April 1983 by five count teams. Each
21 team consisted of one Warehouse employee, one auditor
22 and one member of General Services and Warehouse
23 management. The auditor's responsibilities during this
24 count included, but were not limited to, the following:
25 o Observing and recording the count,

- 1 o Ensuring that all items on the shelf were properly
- 2 marked and counted,
- 3 o Periodically verifying that boxes were full and
- 4 testing the count, and
- 5 o Although auditors are not experts regarding
- 6 materials, questioning the counting of any
- 7 material that appeared obsolete or damaged.

8

9 Observations made during the second count

10 indicated a considerable improvement in the

11 organization and identification of the materials since

12 the first count performed in 1982. The results of the

13 second count disclosed a net shortage of \$8,462. There

14 were no indications in either count that \$2,000,000 of

15 inventory was either missing and obsolete. It is

16 important to note that the alleged \$2,000,000 shortage

17 would have represented a 54 percent shrinkage of the

18 \$3,700,000 value of the inventory during that time.

19 Schedule 1 provides a detailed account of the audit as

20 well as a discussion of why the 1983 audit failed to

21 disclose the theft of materials by Kyle Croft.

22 The capacity of an audit to detect material

23 irregularity resulting from fraud and collusion is

24 addressed extensively by both professional standards

25 and experts in the field of auditing. Both the

1 American Institute of Certified Public Accountants
2 (AICPA) and the Institute of Internal Auditors (IIA)
3 agree that auditors are not held accountable for
4 detecting fraud accomplished through collusion,
5 management override or falsification of documents - all
6 three of which existed during the 1983 audit period.
7 We consider the \$8,462 net shortage accurate and
8 supported by a well documented audit performed in
9 compliance with professional auditing standards. We
10 consider the allegation of a \$2,000,000 inventory as
11 undocumented and unsupported hearsay. Even Mrs. Sirmon
12 characterized the amount as a figure she had heard.
13 The accounting adjustment to the stores records to book
14 the \$8,462 shortage discovered in the second inventory
15 was processed in 1983 and has no impact on the 1989
16 rate case.

17

18 Q. At page 3 of Mrs. Bass' testimony, the issue is raised
19 concerning the theft of Gulf Power property by Kyle
20 Croft, and reports the amount misappropriated to be
21 around \$300,000. Please describe the situation and any
22 impact which the dollars associated with the
23 misappropriations have on the 1989 rate case.

24 A. As reported in Mrs. Bass' testimony, the \$300,000 is
25 somewhat of an estimate and represents not one

1 situation, but several schemes perpetrated by Kyle
2 Croft to defraud Gulf Power. Verified
3 misappropriations amount to approximately \$133,000.
4 Schedule 2 provides a detailed analysis of the verified
5 schemes involved and their amounts. The last of these
6 misappropriations occurred over five years ago and are
7 not included in the expenses projected to be incurred
8 in 1990. Gulf Power does not budget for employee theft.

9
10 Q. At pages 5 and 6 of Mrs. Bass' testimony, she discusses
11 an attempt on the part of a former Gulf Power employee
12 to extort kickback money from a contract vendor. What
13 are the facts relating to this situation, and are there
14 any dollars associated with it included in the
15 projected 1990 expenses?

16 A. First, there are no dollars associated with this matter
17 included in the projected 1990 expenses. Second, since
18 no money actually changed hands, and the employee
19 involved was immediately terminated upon a
20 determination of his involvement in the attempted
21 extortion, this matter is irrelevant and should not be
22 an issue in the rate case.

23 Very simply, when the Company security department
24 learned that allegations had been made that Mark J.
25 Rubenacker, an employee of Gulf Power, had solicited

1 monetary kickback from a contractual window cleaning
2 service, an investigation was immediately initiated.
3 This investigation resulted in the determination that
4 Mr. Rubenacker had, acting alone, solicited a kickback
5 from the window cleaning company. Again, no payment
6 was made. Gulf Power initially learned of the allega-
7 tions on February 17, 1989. The investigation was
8 concluded on February 24, 1989, with Mr. Rubenacker's
9 termination.

10

11 Q. On page 7 of Mrs. Bass' testimony, she refers to the
12 West Florida Landscaping scheme in which \$40,000 in
13 false invoices were submitted to Gulf Power for
14 payment. Please describe the scheme and any impact it
15 may have on the 1989 rate case.

16 A. The scheme referred to by Mrs. Bass involved Kyle Croft
17 and Dave Cook, owner of West Florida Landscaping. This
18 scheme is actually a component of the \$300,000 in
19 misappropriations described above. Mr. Croft requested
20 that West Florida Landscaping include in their invoices
21 an amount of money for services that were not actually
22 rendered. Croft would then submit to West Florida
23 Landscaping a Line Power invoice for that same amount.
24 Upon receipt of payment by Gulf, West Florida
25 Landscaping would write a check to Line Power, which

1 was supported by the bogus Line Power invoice. Kyle
2 Croft and Lamar Brazwell then converted the West
3 Florida Landscaping checks to Line Power into cash.
4 Between November 1982 and February 1983, 28 false
5 invoices, totalling \$40,023, for services that were not
6 provided, were submitted by West Florida Landscaping
7 and paid by Gulf. As shown in Schedule 2, this amount
8 does not impact 1990 O & M expenses but is included in
9 Cost of Removal. I am told that the effect of this is
10 to increase rate base \$40,000.

11 The amount budgeted to be paid to West Florida
12 Landscaping in 1990 is that amount provided for in the
13 Company's contract with West Florida Landscaping for
14 work to be performed in 1990.

15

16 Q. Mr. Fell, how can the Commission be certain that theft
17 or fraud has not been committed, of which you are
18 unaware, which might impact the 1990 budgeted amounts
19 used in the Company's rate case?

20 A. Very frankly, the Commission is in a position somewhat
21 similar to that of the Company. Neither can guarantee
22 that this type of activity has not and will not occur
23 again. What the Company can do and has done is to take
24 those steps which are prudent and reasonable to deter
25 this type of activity. Management has taken action

1 deemed appropriate against those involved. Policies
2 and procedures have been strengthened. The Company
3 places great emphasis on the importance of and
4 adherence to these policies and procedures and the
5 Company's Code of Ethics. Our audit procedures are
6 sound. Even Mrs. Bass concedes on page 7 of her
7 testimony that Gulf has implemented enhanced safeguards
8 to prevent future misappropriations. I believe that
9 the steps which have been taken by management to deter
10 the recurrence of this type activity in the future are
11 working. As in any Company, some amount of theft will
12 occur. Understandably, we do not specifically budget
13 for this. To the extent practical, probably more so
14 than with any company to come before it in the recent
15 past, the Commission can be assured that theft or fraud
16 within the Company has been thoroughly investigated,
17 and will not be tolerated.

18

19 Q. Mr. Fell, does that conclude your testimony?

20 A. Yes.

21

22

23

24

25

AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 891345-EI

Before me the undersigned authority, personally appeared
G. A. Fell, who being first duly sworn,
deposes and says that he/she is the Manager of Internal
Auditing and Security of Gulf Power Company and that the
foregoing is true and correct to the best of his/her knowledge,
information and belief.

G. A. Fell

Sworn to and subscribed before me this 11th day of
May, 1990.

Candace Klundsmith
Notary Public, State of Florida at Large

My Commission Expires: ~~MY COMMISSION EXPIRES~~ MAY 18, 1991

Warehouse Audit & Alleged \$2,000,000 Shortage

Issue:

Why did the 1983 audit of the General Warehouse not disclose the theft of materials by Kyle Croft?

An employee has stated there was a \$2,000,000 dollar outage yet the audit report indicates a net shortage of \$8,462.

Facts:

Prior to the first count, Auditing provided Warehouse management a list of written instructions to facilitate an accurate count. Failure to follow all of the instructions contributed to the inaccuracy of the count (i.e. all items were not properly identified and tagged resulting in their exclusion from the count).

A routine inventory was taken on August 24, 1982, of the General Warehouse. The results of the inventory indicated the physical count was not accurate and internal auditing required the warehouse personnel to make a second count of the inventory.

Although the first count was performed solely by warehouse personnel (based on the fact that they are solely responsible for their inventory), auditing observed the inventory, performed test counts and controlled the flow of paperwork during the count.

The first count was not accurate because the material was not properly tagged or organized, and obsolete material was not clearly segregated.

The next shortage indicated by the first count amounted to approximately \$400,000, but due to the inaccuracy of the count, did not reflect all of the material on hand.

Observation of the inventory during the first count gave no substantiation to the unsupported allegation of a \$2,000,000 shortage.

As a result of observations made during the first count, Warehouse management was provided a list of items or conditions requiring corrective action before a second count would be effective. These items included the identification and removal of all obsolete material from the inventory.

The material in the warehouse was organized and properly marked and segregated. The second count was conducted in April, 1983, under the supervision of auditing personnel (with one auditor assigned to each count team) and was considered to be accurate.

An inventory consists of counting the material on hand and then comparing the quantities on hand to the quantities on the Company books.

The inventory resulted in a net shortage of \$8,462.11 and represented .23% of the \$3,696,168.41 book value of the inventory.

The inventories prior to and after the audit in question also reflected relatively insignificant net outages as follows:

Year	Net Outage	% of Book Value
1980	Over \$6,243	.21%
1981	Short 8,462	.23%
1982	Short 2,574	.06%

The reference to the \$2,000,000 shortage was made by an individual who states there is no basis for the \$2,000,000 other than "That's the amount I heard." This allegation is therefore based on unsupported hearsay, which is hardly sufficient to warrant the time and financial resources that would be required for its rebuttal. Trying to refute such an allegation is like someone trying to prove that they have never done anything wrong. How do you prove the nonexistence of something? What constitutes evidence that such is the case?

The \$2,000,000 alleged shortage refers to the condition of the inventory at the time of the first count performed in 1982, not the outage at the time of the 83 count. It is impossible then to reconcile the differences of \$8,462.11 and \$2,000,000 especially when there is no basis for the \$2,000,000.

In the case of audit 83-06, the physical count was compared to both the stores system and the Communication Orientated Production, Information & Control System (COPICS) system. The COPICS system was phased implemented beginning with the General Warehouse in January 1984. The COPICS system is an automated inventory control system. The final count became the basis for all COPICS balances.

Mr. Croft had the authority to approve all paperwork affecting the warehouse inventory and applied a very authoritarian management style to effect compliance from all his subordinates.

Question: Why was the theft not discovered in the Audit process?

There are a number of reasons why a theft may not be discovered in the course of a routine audit:

1. No system of control can prevent collusion and management override.
2. Material taken may not have been in inventory. It could have been taken out of the inventory with falsified paperwork.
3. Purchased materials may not have been put in inventory but charged to another account.
4. If the above took place there would have been no outage because the material would not be recorded inventory on the Company books.

It has been proven in court that collusion did exist with warehouse personnel and a local vendor.

It has also been substantiated that management override by Mr. Croft and Mr. Brazwell did exist.

Concerns:

Both the American Institute of Certified Public Accountants (AICPA) and the Institute of Internal Auditors (IIA) agree that auditors are not held accountable for detecting fraud accomplished through collusion, management override or falsification of documents - all three of which existed during the 1983 audit period.

Action Taken:

The employees involved in the kickback scheme are no longer employed at GPC.

Gulf has taken a number of actions which should deter a recurrence. They include but not limited to:

1. Automated inventory management system.
2. Added security.
3. Strengthening the internal control system, which although incapable of detecting collusion and/or management override, was functioning adequately at the time of the thefts.
4. Numerous improvements relating to the selection and utilization of personnel.
5. The implementation of cycle counts and management monitoring of their results.

A Company Code of Ethics was approved and implemented in 1984.

A summary of actions taken by Gulf at various times since 1983 to improve security over company materials and assets are exhibited in Mr. McCrary's direct testimony Schedule 1.

Misappropriations By Kyle Croft

Issue:

What portion, if any, of the \$300,000 misappropriated by Kyle Croft could be in the 1990 expenses.

Facts:

To the best of our knowledge, none of the misappropriated amount is included in 1990 budgeted expenses.

Kyle Croft perpetrated several fraudulent schemes against the Company which are summarized below. In these schemes, Mr. Croft may or may not have been the sole benefactor as other parties were also involved, both vendors and employees.

These schemes were perpetrated as a result of both collusion and management override by Mr. Croft or Mr. Brazwell.

Diversion of materials/labor on Croft's Home	\$ 10,000
Theft of Appliances	10,000
Repair of Line Power Equipment and Trucks	10,000
Theft of Gulf Power Transformers	3,364
Disposal of Line Power PCB contaminated transformers	4,979
West Florida Landscaping billing scheme	40,000
Items taken by Croft	20,348
Other materials & labor diverted by Croft	15,987
Gulf Equipment & Materials located at Line Power	<u>18,044</u>
	<u>\$132,722</u>

The \$40,000 West Florida Landscaping billing scheme was charged to Cost of Removal, which we are told increased the rate base.

There does exist the remote possibility that certain materials could have been capitalized and the depreciated value of the materials remain in plant-in-service in 1989. Any such amount is minimal. Due to our inability to substantiate and identify the materials stolen, we have been unable to ascertain the exact amount involved.

Action Taken:

Kyle Croft, as well as other employees involved in the schemes, are no longer employed by the Company.

A Code of Ethics was approved and implemented in 1984.

A procedure has been implemented to promote the disclosure of possible ethical and criminal wrongdoing by employees. A committee has been formed with the responsibility of reviewing these disclosures and coordinating any necessary corrective action.

Gulf has taken a number of actions which should deter a recurrence. They include but not limited to:

1. Automated inventory management system.
2. Added security.
3. Strengthening the internal control system, which although incapable of detecting collusion and/or management override, was functioning adequately at the time of the thefts.
4. Numerous improvements relating to the selection and utilization of personnel.
5. The implementation of cycle counts and management monitoring of their results.

A summary of actions taken by Gulf at various times since 1983 to improve security over company materials and assets are exhibited in Mr. McCrary's direct testimony Schedule 1.