

State of Florida



Public Service Commission

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DATE: September 27, 2010
TO: Michael Barrett, Regulatory Analyst IV, Division of Economic Regulation
FROM: Clarence Prestwood, Chief of Auditing, Office of Auditing and Performance Analysis
RE: Docket No.:100001-EI
Company Name: Gulf Power Company
Company Code: EI804
Audit Purpose: Hedging Activities – August 2009 – July 2010
Audit Control No: 10-130-1-1

Attached is the final audit report for the utility stated above. I am sending the utility a copy of this memo and the audit report. If the utility desires to file a response to the audit report, it should send a response to the Office of Commission Clerk. There were confidential work papers associated with this audit.

CP/ip
Attachment: Audit Report

cc: (With Attachment)
Office of Auditing and Performance Analysis (Mailhot, Prestwood, File Folder)
Office of Commission Clerk
Office of the General Counsel

(Without Attachment)
Office of Auditing and Performance Analysis (Harvey, Tampa District Office, Miami District Office, Tallahassee District Office)

DOCUMENT NUMBER DATE
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STATE OF FLORIDA



FLORIDA PUBLIC SERVICE COMMISSION

OFFICE OF AUDITING AND PERFORMANCE ANALYSIS
BUREAU OF AUDITING

Tallahassee District Office

GULF POWER COMPANY

HEDGING ACTIVITIES

AUGUST 01, 2009 – JULY 31, 2010

DOCKET NO. 100001-EI
AUDIT CONTROL NO. 10-130-1-1

A handwritten signature in cursive script, appearing to read "Donna Brown", written over a horizontal line.

Donna Brown, Audit Manager

A handwritten signature in cursive script, appearing to read "Debra M. Dobiak", written over a horizontal line.

Debra M. Dobiak, Audit Staff

A handwritten signature in cursive script, appearing to read "Lynn M. Deamer", written over a horizontal line.

Lynn M. Deamer, District Audit Supervisor

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**OFFICE OF AUDITING AND PERFORMANCE ANALYSIS
AUDITOR'S REPORT**

September 28, 2010

TO: FLORIDA PUBLIC SERVICE COMMISSION

We have performed the procedures enumerated later in this report to meet the agreed upon objectives set forth by the Division of Economic Regulation in its audit service request dated May 7, 2010. We have applied these procedures to the schedules prepared by Gulf Power Company in support of its filing on August 13, 2010 for its Hedging Information Report, Docket No. 100001-El.

This audit was performed following general standards and field work standards found in the AICPA Statements on Standards for Attestation Engagements. Our report is based on agreed upon procedures and the report is intended only for internal Commission use.

OBJECTIVES AND PROCEDURES

Hedging Transaction and Information Report Verification

Objective: To review and verify the information presented in Gulf Power's Natural Gas Hedging Transactions Report filed with this Commission on March 11, 2010 and its Hedging Information Report filed with this Commission on August 13, 2010.

Procedures: The audit staff reviewed the 2009 and 2010 Risk Management Plans for Fuel Procurement filed by Gulf Power with this Commission in Docket No. 090001-EI. Audit staff compared pricing strategy included in the plan to the Hedging Reports for the twelve (12) months ended July 31, 2010 as filed by the utility on March 11, 2010 and August 13, 2010.

Accounting Treatments for Financial Contracts

Objective: To verify that the accounting treatments for futures, options, and swap contracts between Gulf Power Company and one or more counterparties are consistent with FPSC Order No. PSC-02-1484-FOF-EI, issued October 30, 2002, and as clarified by FPSC Order No. PSC-08-0316-PAA-EI, issued May 14, 2008 and FPSC Order No. PSC-08-0667-PAA-EI, issued October 8, 2008. To reconcile the data included in the two Hedging Reports with the books and records of the utility including gains (losses), option premiums, swap settlements as well as fees, commissions, and other transaction costs associated with each financial hedging instrument.

Procedures: The audit staff obtained the utility's supporting detail of the hedging settlements for the twelve (12) months ended July 31, 2010. The support documentation was traced to the general ledger transaction detail for Hedging, Account No. 547-4. The audit staff reviewed the adherence of the hedging settlements to the risk management plan and verified that the accounting treatment for the hedging transactions as well as any transaction costs were consistent with FPSC Order No. PSC-02-1484-FOF-EI, issued October 30, 2002.

Risk Management Plan

Objective: To verify that the quantities of gas, residual oil, and purchased power hedged are within the limits specified in Gulf Power's 2009 and 2010 Risk Management Plans. Verify that the individual and group transactions limits and authorizations set forth in the Risk Management Plan have been followed as well as the utility's procedures for separating duties related to its hedging activities per the Hedging Plan. To verify that the hedging operating and maintenance expenses associated with maintaining a non-speculative financial and/or physical hedging program are incremental in nature as set forth in FPSC Order No. PSC-02-1484-FOF-EI, issued October 30, 2002.

Procedures: The audit staff reviewed the quantity limits, individual and group transaction limits and authorizations as well as the procedures for separating duties related to the hedging program as set forth in the Risk Management Plan. We obtained the utility's analysis of the monthly percent of fuel hedged in relation to fuel burned as well as the applicable average price of the financial transactions settled and the average costs of natural gas purchased for the twelve (12)

months ending July 31, 2010 and reviewed for reasonableness. The audit staff noted adherence of the hedging transactions to the Risk Management Plan.

Litigation

Objective: To verify the litigation-related Adjustments to Fuel Costs that the utility has incurred from 2005 through July 2010. To verify that such expenditures were reasonable and prudent.

Procedures: The audit staff reviewed the Coal Sales Agreement (CSA) and all court issued orders from the United States District Court for the Southern District of Illinois and the United States District Court for the Northern District of Florida – Pensacola Division. We traced the litigation-related Adjustments to Fuel Costs from the general ledger to the monthly-filed Schedule A-1 to the supporting invoices from 2005 through July 2010. We noted that the United States District Court for the Northern District of Florida – Pensacola Division granted Gulf Power’s Motion for Partial Summary Judgment which stated that Coalsales LLC breached the CSA. The trial was held on Tuesday, February 9, 2010. No orders awarding damages have been issued as of September 21, 2010. The audit staff determined litigation costs appeared reasonable and prudent.