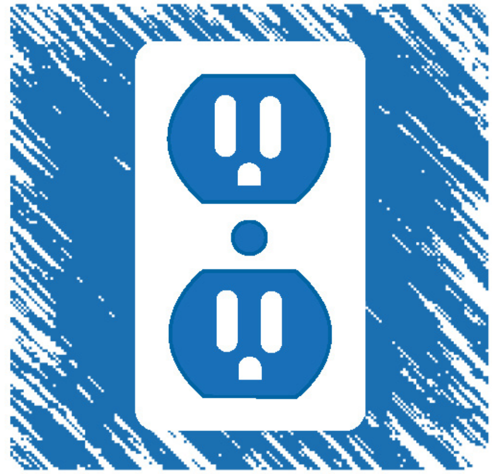

# Review of
# Duke Energy Florida, LLC
# Internal Audit Function

MAY 2017

BY AUTHORITY OF

The Florida Public Service Commission
Office of Auditing and Performance Analysis

# Review of
# Duke Energy Florida, LLC
# Internal Audit Function


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**May 2017**


By Authority of
**The State of Florida**
**Public Service Commission**
**Office of Auditing and Performance Analysis**

**PA-16-08-004**

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# 1.0 Executive Summary

## 1.1 Audit Execution

### 1.1.1 Purpose and Objective

The Office of Auditing and Performance Analysis performed this review to verify the effectiveness and adequacy of the Duke Energy Florida, LLC (Duke/DEF) Internal Auditing function. This review is the third of four to be performed on the major investor-owned electric utilities in Florida. [1] Staff believes that sharing of the non-confidential information contained in this report with other utilities may be of benefit as they manage their respective internal auditing programs.

### 1.1.2 Scope

The audit scope included an assessment of internal audit policies, practices, and procedures for the years 2011 through 2016. Audit staff assessed the following areas:

- Risk assessment
- Audit planning and adequacy of coverage
- Audit planning and approval process
- Audit management and internal controls
- Audit organization and staffing
- Budgeting and schedule controls
- Outsourcing selection and contractor management
- Coordination with the Corporate Compliance function
- Reporting and communication of audit results and findings
- Quality assurance and follow-up

This review places primary importance on internal controls as referenced in the Institute of Internal Auditors *Standards for the Professional Practice of Internal Auditing* and in the *Internal Control - Integrated Framework* developed by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Audit staff's reviews are completed in compliance with *Institute of Internal Auditors Performance Standards 2000 through 2500*. Assessment of internal controls focuses on the five key elements of the COSO framework of internal control: control environment, risk assessment, control activities, information and communication, and monitoring.

### 1.1.3 Methodology

Planning, research, and data collection for this audit was completed during September 2016 through April 2017. Commission audit staff conducted on-site interviews with DEF Internal Audit management in October 2016, to gain understanding of the approach taken for Duke audits.

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[1] Other completed reports can be found at:
http://www.floridapsc.com/Files/PDF/Publications/Reports/General/Electricgas/Gulf_Audit_2014.pdf
http://www.floridapsc.com/Files/PDF/Publications/Reports/General/Electricgas/FPL_Internal_Audit_Report2016.pdf

Specific information requested and reviewed during this audit included:

- Policies and procedures
- Organizational charts
- Planning timeline data
- Internal audit reports
- Quality control reviews

Commission audit staff reviewed a sample of audit work papers to assess internal audit procedural compliance, and a sample of ethics complaints to assess compliance with ethics practices and procedures.

## 1.2 Overview and Staff Observations

The DEF Internal Auditing function is administered through the parent company Corporate Audit Services (CAS). This department conducts audits, consultations, and investigations for all Duke Energy subsidiaries, including DEF.

Internal Auditing is organized in a manner that ensures independence and audit objectivity from the operational business unit level to the Duke Energy Audit Committee and Board of Directors. CAS accountability to senior management, and the Board of Directors through the Audit Committee, ensures that key audit findings are presented to the appropriate management level for resolution.

CAS generally provides an appropriate audit process and utilizes industry recognized audit standards. However, Commission audit staff made four observations that should be examined and addressed by Duke CAS management. Based upon clear trends over the period 2011-2016, Commission audit staff believes the following observations and recommended actions should be addressed by DEF.

**Observation 1: During each year 2012-2016, CAS adjusted the audit plans of Duke Energy's Regulated Utility Operations, resulting in a cumulative net 10.4 percent decrease in the number of completed audits.**

CAS conducts risk-based assessments when developing its annual audit plan. This approach is appropriate in that it includes risks facing DEF's operations. Commission audit staff recognizes the dynamic nature of an audit plan and the need for adjustments as urgent needs arise after the plan is set. Changes are inevitable, but the net risk impact should be evaluated by management to ensure adjustments meet company needs, adequately address risks, and that finite audit resources are efficiently applied. Appropriately, DEF Internal Auditing controls allow management to employ external auditing resources if unexpected needs arise.

Commission audit staff believes that, during the period 2012-2016, a net reduction of 21 originally-planned audits versus audits completed brings into question the adequacy of audit coverage for Duke Energy Florida. Though changes made to the audit plan were intentional and carefully considered by CAS, it is possible that the net reduction negatively impacted the adequacy of DEF audit coverage.

**Recommended Action:** Conduct quarterly analyses, tracking the net risk coverage impact of planned audits that are deferred, cancelled, combined, or added. Consider this net impact in the following year's audit planning, staffing, and budgeting efforts and adjust accordingly to provide satisfactory risk coverage.

**Observation 2: During each year 2011-2016, DEF's internal audit budget was reduced, resulting in a cumulative 46 percent reduction in resources allocated to this function.**

**Observation 3: During each year 2012-2016 Duke Energy's complement of auditors was reduced, resulting in a cumulative 14 percent decrease in audit or full-time equivalents.**

Commission audit staff believes that downward trends in budgeting and staffing bring into question the adequacy of auditing resources and warrants further study. As the budget was reduced each year, actual spending also fell short of the annual budgeted amount, resulting in a cumulative negative budget variance of 15 percent.

In explaining these downward trends in budget variances and a reduction in the number of auditors, leading to fewer audits being completed, DEF cites corporate-wide spending reductions, vacancies due to a two to three month hiring lag, transfers of personnel from Internal Auditing to other DEF departments, and auditors hired away by other employers.

To the extent these conditions are viewed as ongoing problems by management, Commission audit staff recommends that they be taken into consideration in budgeting and staff allocations. Commission staff also notes that these issues are within management's power to resolve. At least in part, this could be addressed by ending the trend of budget reduction or by spending the entire budget amount allocated each year. Additional use of external staffing could also be helpful.

**Recommended Action:** Reassess DEF audit coverage and CAS staffing needs and perform a benchmarking analysis of audit resources deployed among other large public utilities. Analyze the underlying causes, potential impacts, and realized impacts of the trend of cuts in auditing budgets.

**Observation 4: Duke Energy's Audit Charter states that the Board of Directors Audit Committee is to "review the audit plan" and to "review any major changes" rather than requiring the Committee to *approve* both the audit plan and any major changes. The latter approach and wording is recommended by the Institute of Internal Auditors (IIA) in its *Model Board Audit Charter*.**

Though seemingly minor, this wording difference greatly impacts where ultimate authority lies for determining the extent of DEF's internal audit coverage. The present charter explicitly grants the authority to set and revise an audit plan to company managers alone. The Committee only *reviews* those decisions and actions. The clear intent of the IIA's recommended wording places that authority with the Board's Audit Committee. This difference is in keeping with the spirit of Sarbanes Oxley, which sought to require more accountability from boards of directors, increase their active involvement in decision-making, and provide checks and balances against management errors and omissions. Commission audit staff believes the IIA's approach reflects an updated recognition of the proper role of the Board Audit Committee.

Commission audit staff believes placing more decision-making authority in the hands of the Board Audit Committee should result in a higher degree of scrutiny being given to revisions and reductions to the audit plan and audit coverage.

**Recommended Action:** Consider revising the Duke Energy Audit Charter and Corporate Audit Services processes and procedures to comport with the IIA's suggested wording and approach, that the Audit Committee is empowered to approve both the annual audit plan and any major changes to it.

# 2.0 DEF Internal Audit Function

## 2.1 Organization and Structure

### 2.1.1 Corporate Audit Services Responsibilities

Duke Energy expects its Corporate Audit Services department to provide world-class internal audit services and achieve superior company performance through a strong internal audit presence. CAS is required to independently assist all levels of management and the Audit Committee of the Board of Directors. The department is also expected to complete objective evaluations, appraisals, and recommendations of Duke Energy affiliate organizational activities and internal controls.

A secondary departmental mission is to develop executive level management talent within the company. This is accomplished by placing emphasis on individual training, certification, and experience. Duke Energy emphasizes bringing in talented employee resources and growing them into the organization through the internal audit department.

To ensure the Audit Committee and Chief Financial Officer are fully and regularly appraised of CAS activities and performance, the Vice President of Corporate Audit Services (VP-CAS) meets five times annually with the full Audit Committee. These meetings take place in February, April, June, August, and October. Additionally, the VP-CAS may hold private executive sessions at the end of each full Audit Committee meeting, and schedules periodic meetings throughout the year with the Audit Committee Chairman. Occasionally, audit issues with corporate-wide impact are brought before the full Board of Directors.

The VP-CAS Quarterly Summary Report to the Audit Committee summarizes key audits completed during the quarter, significant audit findings, and recommendations to management. The Chief Financial Officer (CFO) and executives reporting to the CFO are kept informed of CAS activities and performance by regular meetings and monthly dashboards presented by the VP-CAS. According to the VP-CAS, in December of each year, the annual audit plan is vetted and approved by the Audit Committee.

Responsibility for Sarbanes Oxley (SOX) testing was moved from CAS to the Controller’s Office in 2012. Since then, CAS provides assistance with SOX-related issues upon request of the Controller. A CAS Audit Director meets periodically with the Controller’s Office to discuss audit findings specific to SOX-related issues and the Controller’s Office gets copies of all completed CAS audits.

### 2.1.2 Corporate Audit Services Organization

Prior to the merger with Duke Energy in 2012, the Progress Energy Vice President of Audit Services was responsible for implementing internal audit and ethics activities for subsidiary business units and affiliates, including Progress Energy Florida. To provide organizational independence, the Vice President reported administratively to the Chief Legal Officer and functionally to the Audit Committee of the Board of Directors, with unrestricted access to senior management and the Audit Committee. The Progress Energy Audit Services department used a pooled staff matrix organization to conduct audits. The overall organization included three managers reporting to the Progress Energy Vice President of Audit Services.

Today, the Duke Energy VP-CAS is responsible for implementing Duke Energy's internal auditing activities for all subsidiary business units and affiliates, including Duke Energy Florida. To provide organizational independence, the VP-CAS reports administratively to the CFO and functionally to the Audit Committee of the Duke Energy Board of Directors. The VP-CAS, has unrestricted access to senior management and the Audit Committee. **Exhibit 1** below shows the Duke Energy Corporate Audit Services organizational structure.

## Duke Energy Corporate Audit Services Organization

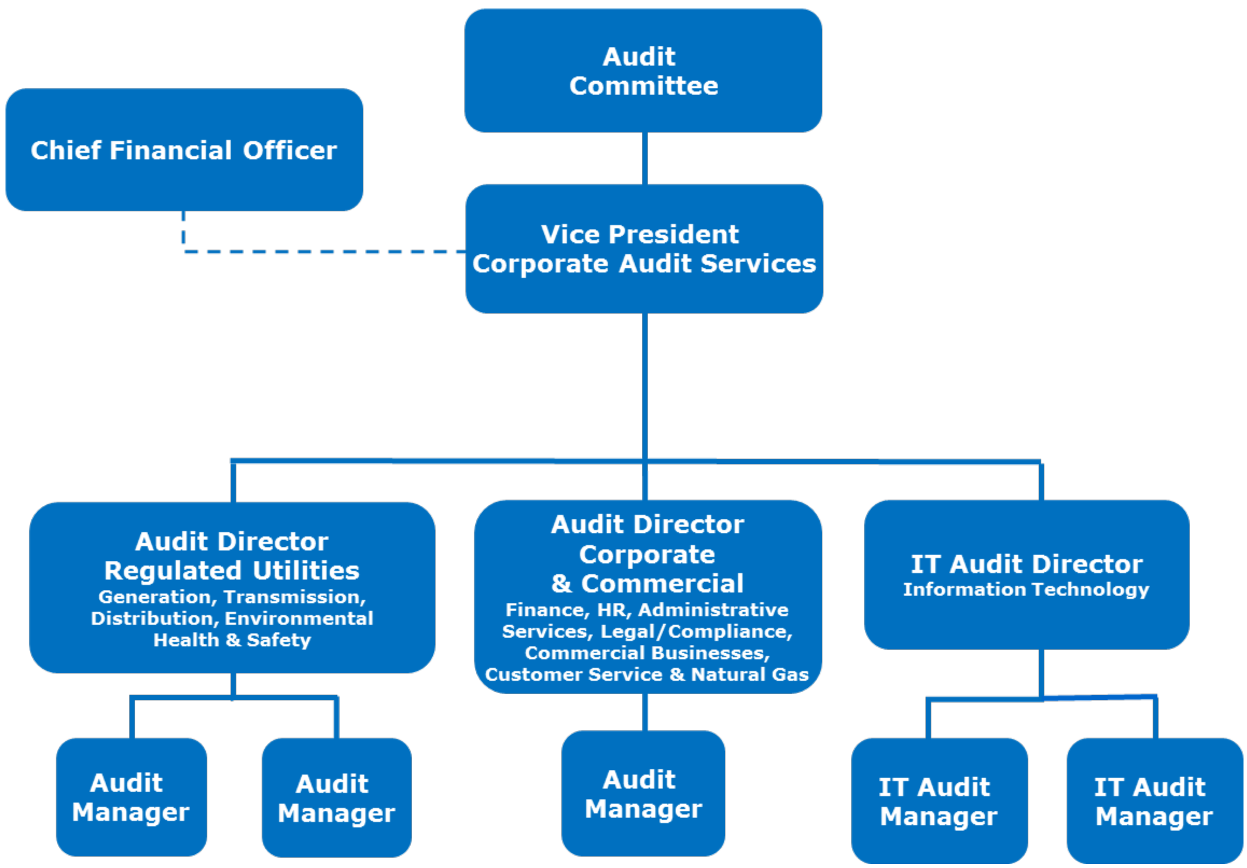


**EXHIBIT 1** *Source: Responses to Document Request 1.7 and 4.1*

The Corporate Audit Services management structure currently consists of three Audit Directors reporting to the VP-CAS. After the 2012 Duke/Progress merger, there were three directors until 2015, when a fourth director was added focusing on Environmental, Health, & Safety (EHS) audits. In December 2016, the EHS Director retired. Effective January 1, 2017, responsibility for EHS audits was assumed by the Director-Regulated Utilities. In addition, the Audit Director-Corporate & Commercial assumed responsibility for Customer Service and Natural Gas, due to the 2016 acquisition of Piedmont Natural Gas.

Similar to the legacy Progress Energy Internal Audit structure, Duke Energy CAS uses an audit resource pool to execute audits using a matrix of audit subject matter experts, audit management, and staff. CAS audit personnel are assigned to projects based upon subject matter, audit expertise, experience, individual development and organizational needs. Each of the 33 current Duke Energy CAS audit staff pool members is administratively assigned to one of the audit managers for reporting, personal development, career planning, and performance reviews.

Information provided by the company shows CAS full-time-equivalent (FTE) levels for pool auditors has declined each year since 2013. At that time, there were 56 FTEs. This dropped to 53 in 2014, 51 in 2015, and 48 in 2016. According to CAS management, the reduction includes both regulated and non-regulated affiliates and is enterprise-wide. CAS does not designate pool auditor FTEs by subsidiary, or by regulated and non-regulated categories. Therefore, it is difficult to attribute FTEs by individual category. The company states, however, that regulated subsidiaries represent approximately 90 percent of all audits performed annually by CAS.

Audit Managers assist with the implementation of the annually approved audit plan, ensure effective completion of planned internal audits, and the achievement of audit objectives. This is accomplished by monitoring, tracking, and evaluating performance towards departmental goals and objectives. Audit Managers are responsible for ensuring audits meet the *International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditing* and the principles of *Risk Based Integrated Auditing (RBIA).*

### 2.1.3 Coordination with Ethics and Compliance

Prior to 2016, the VP-CAS had responsibility for the Ethics and Compliance program, and reported administratively to the Chief Legal Officer. In 2016, a new Vice President and Chief Ethics and Compliance Officer position was created to enhance the importance of ethics and environmental compliance. This position now reports directly to the Chief Legal Officer and is no longer part of the CAS organization.

Though no longer part of CAS, Ethics and Compliance investigations complement the auditing process, with cases assigned to independent ethics subject matter experts from the Ethics and Compliance office, Human Resources, and Enterprise Protective Services. Ethics and Compliance serves as the central point for employee calls, e-mails, and written communications reporting potential ethics and compliance violations. A third-party contractor also receives calls for the department, and issues a personal identification number through which anonymous callers may provide or receive information regarding a complaint.

All complaints coming into the ethics hotline are logged into the Case Management system by Ethics and Compliance personnel. If intervention within a specific area is needed, the department will work with management to resolve the complaint and mitigate the condition. The Case Management system allows Ethics and Compliance to capture and track the status of all complaints, and provide quarterly reports of complaint trends to the Board Audit Committee. When necessary, subject matter experts can be utilized from other departments, based on the nature of an allegation (e.g. Customer Service, Legal, Nuclear Employee Concerns Program, etc.).

CAS assists Ethics and Compliance by investigating complaints regarding material accounting issues, internal accounting controls and auditing matters, complaints regarding circumvention of internal accounting controls, or complaints regarding company accounting policies. CAS also solicits input from Ethics and Compliance management during development of the annual audit plan. On occasion, CAS seeks Ethics and Compliance expertise during the initial stages of planning for specific audit engagements in which the scope and objectives are more closely linked to ethics and compliance (e.g., FERC, NERC-CIP, FCPA, data privacy).

## 2.2 Risk Assessment Process and Audit Planning

Annually, CAS develops a corporate audit plan using a risk-driven evaluation process. The VP-CAS and the internal audit management team work with senior management, key business unit executives, Duke Energy Risk Management, and external auditors to assess potential issues and related risk. To identify risk areas in which the control environment may require additional attention, CAS also considers prior audits identifying control weaknesses.

Operational changes such as new system implementations, key management turnover, or modifications to internal control environments are also vetted as potential risk areas. Enterprise-wide risk assessment focuses on the greatest potential risk threats and perceived impacts to the entire company.

The risk assessment process considers and evaluates Duke Energy and subsidiary company audit risks. During the process, identified risks are evaluated and challenged, qualified for potential severity and probability of occurrence, ranked, and incorporated into a corporate risk matrix. This matrix becomes the foundation for the annual audit plan.

The annual audit plan includes the needs of all Duke Energy subsidiary companies, including Duke Energy Florida. The plan does not guarantee any particular company will receive a specific number of audit projects annually. DEF's risks are included with those of other subsidiary companies in the development of the annual audit plan and matched with available audit resources.

DEF, like all other affiliate companies of Duke Energy, allocates its audit resources based on the corporate audit plan derived from the risk assessment process. DEF audit allocation costs increased annually from 2012 through 2015. During the period, the cost allocation factors increased from 14.39 in 2012 to 17.57 in 2015, and dropped to 16.64 in 2016.

Following the completion of CAS audits, results are reviewed by the Audit Team, Audit Managers, Audit Directors, and the VP-CAS. If remediation of deficiencies is required, actions are established and communicated to management at all levels necessary to implement the recommended changes.

As part of determining the value of each completed audit engagement to the business unit, key executives of the unit audited provide feedback, along with an assessment of the project engagement and any remedial actions or improvements recommended by the audit team. These assessments are part of the overall Audit Team measures that track auditing performance and the value added to audited business units.

According to CAS management, the annual audit plan is reviewed quarterly and revised as necessary during the year to determine whether the plan is on track and whether changing business requirements require adjustments to the plan. During these reviews, CAS may defer, eliminate, or add audits to the plan. CAS management states that the allocation of audit resources is one of the key issues impacting internal audit, and the assignment of audit hours determines how many audits can be completed annually. In the event of high turnover, audit resources may be augmented through outside resources, or the number of low priority audits may be reduced to direct available resources to higher priority audits. The VP-CAS is responsible for making the decision to defer, delete, or add audits to the annual audit plan, then to inform the Audit Committee of changes made to the plan.

According to the company, these changes arise from decisions to combine or split audit scopes, changes in timing to coincide with company initiatives, emergent issues, management requests, sale of key assets, or changes to regulatory requirements. They can also arise from assessments completed by internal corporate governance functions or outside assessors engaged by the business units. CAS management states that these changes do not significantly alter the overall residual risk coverage from the approved plan.

Audit staff asked CAS management to provide copies of all analysis or documentation of the decision-making process to defer, eliminate, or add audits, during the period 2012-2016. Staff intended to determine whether CAS examines the net effect of risks caused by making changes to the annual audit plan. In response, the company provided a list of CAS audit changes made during the period, including CAS comments regarding the replacement audits. The list consisted of 24 audit deferrals, 32 eliminated audits, and 35 added replacement audits.

However, the list of audit changes did not include any assessment of net audit risk increase or decrease associated with making the changes. Therefore, Commission audit staff was unable to determine the relative risk differential between planned audits included in the annual audit plan and those audits deferred, deleted, or added to the plan during the period reviewed. Without being able to identify the relative risk differential when planned audits are replaced, it is not clear whether additional risk was experienced during the years examined by this review.

FPSC audit staff believes that the CAS risk assessment process may benefit from assigning numerical relative risk values for each audit. These can be used to approximate the comparative net risk of deferring, eliminating, or adding specific audits within the annual audit plan to ensure the company has not substantially increased risk.

**Exhibit 2** shows the number of DEF audits deferred, eliminated, and added during the period 2012-2016. The exhibit shows a trend of fewer audits annually over the period, with a total net reduction of 21 audits.

| Duke Energy Florida<br>Internal Audits Deferred, Eliminated, and Added<br>2012-2016 | | | | |
|---|---|---|---|---|
| **Year** | **Deferred** | **Eliminated** | **Added** | **Net Change** |
| 2012 | 5 | 5 | 6 | (4) |
| 2013 | 5 | 12 | 7 | (10) |
| 2014 | 6 | 5 | 10 | (1) |
| 2015 | 4 | 4 | 4 | (4) |
| 2016 | 4 | 6 | 8 | (2) |
| **Total** | **24** | **32** | **35** | **(21)** |

**EXHIBIT 2** *Source: Responses to Document Request 4.8a*

In the four years after the Duke/Progress merger, 2013-2016, CAS changes to approved audit plans within each year resulted in a cumulative net reduction of 17 audits of DEF operations. During this period, 171 audits were completed. The net change is a 9.9 percent reduction in DEF audits. Commission audit staff notes that over the same four-year period CAS changes to audit plans within each year resulted in a corporate-wide net reduction of 29 audits.

## 2.3 Outsourcing, Resources, and Budgeting

### 2.3.1 Internal Audit Budget Process

Duke Energy CAS establishes an annual Internal Auditing budget to fund the activities of the annual audit plan. CAS does not track budget expenditures separately for regulated and non-regulated subsidiary companies. CAS audit expenses are charged to a pool which is allocated to Duke Energy subsidiaries and activities, in accordance with corporate overhead allocation methodologies.

**Exhibit 3** shows the budgeted and actual spending amounts for DEF internal audits during the period 2011-2016. Internal Auditing budget and actual expenditures were highest in 2011, but have declined annually since then.

Actual spending decreased from $1.8 million dollars in 2011 to just over $1 million dollars in 2016. According to CAS management, large negative budget variances experienced in 2011 and 2012 were associated with higher turnover and a lag in backfilling vacant positions in anticipation of the merger.

| Duke Energy Florida<br>Internal Auditing Budget<br>2011-2016 | | | | |
|---|---|---|---|---|
| Year | Budget | Actual | Variance | Percent |
| 2011 | $2,127,076 | $1,807,434 | ($319,642) | (15.0) |
| 2012 | $2,095,146 | $1,578,485 | ($516,661) | (24.7) |
| 2013 | $1,390,835 | $1,268,435 | ($122,400) | (8.8) |
| 2014 | $1,378,910 | $1,162,274 | ($216,636) | (15.7) |
| 2015 | $1,344,053 | $1,165,924 | ($178,129) | (13.3) |
| 2016 | $1,145,067 | $1,043,656 | ($101,411) | (8.9) |

**EXHIBIT 3** *Source: Responses to Document Request 1.16, 4.8a*

CAS management explained that in 2014 and 2015, additional staff reductions caused by employees moving to other positions inside and outside the company again caused higher than anticipated variances. CAS management stated that these vacancies took additional time to replace. The annual audit plan and budget were also adjusted, deferring or dropping low risk audits. CAS management reported that appropriate risk coverage was maintained during both periods of higher than anticipated variances, with executive management and the Audit Committee being regularly informed.

CAS management states that in response to company cost saving objectives during 2016, CAS identified planned audits that could be combined for greater efficiency, used alternative audit techniques that could achieve savings in sampling methodologies, and deferred or dropped lower risk audits that could be eliminated. CAS management stated that, even with these changes, they were able to maintain audit risk coverage without filling available vacant positions.

### 2.3.2 Internal Audit Resources

CAS management states that the annual audit plan requires review by the VP-CAS, Duke Energy corporate senior management, and approval of the Audit Committee of the Board of Directors. However, Commission audit staff notes that the Audit Committee Charter directs the Committee to "Review the internal audit plan and significant changes in planned activities," rather than requiring it to *approve* the audit plan and changes.

The Institute of Internal Auditors' *Model Audit Committee Charter*, charges the Committee with responsibility to "[a]pprove the annual audit plan and all major changes to the plan" and to "[r]eview the internal audit activity's performance relative to its plan."[2] The Institute of Internal Auditors model charter places greater responsibility on the Audit Committee in charging it to *approve* (rather than to merely *review*) changes to the audit plan.

In 1992, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) established a model for evaluating internal controls. This model is widely recognized as the standard for measuring internal controls. From a COSO perspective, audit categories are broken into Compliance, Operations, Reporting, and Strategic types. **Exhibit 4** shows the number of

[2] The Institute of Internal Auditors, Model Audit Committee Charter, page 2 of 3, revised May 2013.

audit projects completed by COSO category, during the period 2011-2016. As shown, CAS performed a total of 254 audit projects for DEF during the period. Operations audits comprised the most frequently performed audit type (70.5 percent). Compliance was the second largest COSO audit category (19.3 percent), focusing on adherence to applicable laws and regulations. Reporting was the third largest audit category, examining the reliability of company reporting (10.2 percent). There were no Strategic audit projects performed during the period, i.e., those addressing high-level goals in support of the company mission.

**Duke Energy Florida**
**Completed Audit Projects by COSO Category**
**2011-2016**

| COSO Category | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Total |
|---|---|---|---|---|---|---|---|
| Compliance | 13 | 8 | 2 | 9 | 11 | 6 | 49 |
| Operations | 35 | 20 | 32 | 31 | 34 | 27 | 179 |
| Reporting | 5 | 2 | 6 | 3 | 4 | 6 | 26 |
| Strategic | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total** | **53** | **30** | **40** | **43** | **49** | **39** | **254** |

**EXHIBIT 4** *Source: Responses to Document Request 1.24, 1.25, and 4.8b*

For its purpose, CAS categorizes audit projects as Enterprise (corporation-wide), Company-specific (e.g. DEF), Design Effectiveness Reviews, and Progress Legacy (Progress Energy Florida). Duke Energy CAS believes that enterprise audits validate whether control concerns are at issue and results may have impact across the entire corporation. According to CAS management, subsidiary company-specific reviews validate concerns related to individual company controls, evaluate whether company processes can be operated more efficiently and effectively, or can deliver added value to individual company operations. CAS management states that Design Effectiveness Reviews are independent reviews performed by CAS at pivotal points of critical projects, usually for new systems implementation. The Progress Legacy audits were completed during the merger period, either by Progress Energy Audit Services or Duke Energy CAS.

**Exhibit 5** shows Duke Energy Florida audit projects completed during 2011-2016, by category and year. As shown in the exhibit, CAS completed significantly more Enterprise Audits during the period than any other category. CAS completed 196 Enterprise Audits (77.2 percent) during the period, but only 29 (11.4 percent) Duke Energy Florida Specific audit projects. The company believes this reflects an effort to identify enterprise-wide risks and complete audits that will address those risks. There were 22 Progress Legacy audits (8.7 percent), reflecting the Progress Florida and Duke Energy merger and transition period. Seven Design Effectiveness Reviews (2.7 percent) were performed related to critical projects from 2012 through 2015.

| Duke Energy Florida<br>Audit Projects by Category<br>2011-2016 | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Category** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **Total** |
| Enterprise Audits | 43 | 7 | 30 | 36 | 45 | 35 | 196 |
| Duke Energy Florida Specific | 10 | 5 | 3 | 5 | 2 | 4 | 29 |
| Design Effectiveness Reviews | 0 | 1 | 2 | 2 | 2 | 0 | 7 |
| Progress Legacy | 0 | 17 | 5 | 0 | 0 | 0 | 22 |
| **Total** | **53** | **30** | **40** | **43** | **49** | **39** | **254** |

**EXHIBIT 5** *Source: Responses to Document Request 1.24, 1.25, and 4.8b*

### 2.3.3 Outsourcing

CAS Internal Auditing Department infrequently outsources work to external auditors, using this resource primarily for temporary staff augmentation, or for specialty skills such as Information Technology, Environmental Health and Safety, Trading, Nuclear Project Management, and Sarbanes-Oxley compliance. Decisions for outsourcing are based on the availability and expertise of internal audit resources, technical requirements of the audit scope, and project audit risks. In all cases, the VP-CAS must approve outside resources for augmentation. Regardless of the source for auditing personnel, CAS provides project oversight, supervision, and management.

The VP-CAS reports each instance of outsourcing to the Duke Energy Audit Committee of the Board of Directors and makes periodic presentations of the progress for all internal and outsourced engagements under Internal Audit's direction.

## 2.4 Procedures, Documentation, and Sampling

### 2.4.1 Auditing Policies, Practices, and Procedures

CAS asserts that the organization conducts each audit in compliance with the Institute of Internal Auditing Standards set forth in the *International Standards for the Professional Practice of Internal Auditing*, revised in 2012.

The *Charter of the Audit Committee of the Board of Directors of Duke Energy Corporation* (February 2016) provides governance, guidelines, procedures, and standards for internal auditing. These documents establish the purpose, authority, and responsibilities for all Duke internal auditing services and activities. Each is reviewed annually and updated as required, subject to the approval of the Duke Energy Audit Committee of the Board of Directors.

CAS *Audit Methodology Guidelines* (March 2016) provide auditors with direction for audit planning, audit execution, roles and responsibilities, audit report finalization, audit observation and follow-up processes. These guidelines define audit engagement types, audit testing, and provide standards for audit work papers. They also provide the authority for auditors to access records, response timelines for audit activity, management approval requirements, and retention periods for audit work papers. The *Audit Methodology Guidelines* are required to be reviewed annually to insure they reflect current CAS policy and procedure.

### 2.4.2 Documenting Audit Work and Findings

The CAS *Work Paper Standards* outline the purpose of audit work papers, provide written auditor instruction, and establish the required level of quality, completeness, and organization of audit work papers. The standard clarifies proper documentation, retention, confidentiality, and required follow-up for audit work papers. CAS *Work Paper Standards* were last revised in 2014.

*TeamMate* is a Windows-based automated audit management system CAS uses to organize and store project-related work papers. It is the storage mechanism for audit notification letters, work notes, project summaries, findings, recommendations, and other audit documentation. The *TeamMate* system consists of five modules providing different functionality for documenting audit activities, observations and recommendations.

In *TeamMate*, project work papers can be updated by auditors until the project is completed and closed. Users are provided only the level of authority and access necessary to accomplish assigned tasks. Supervisors have access to higher level information, in order to evaluate audit performance, scheduling, and project costs. Report and information release authority are approved and controlled by the VP-CAS.

### 2.4.3 Sampling

Commission audit staff sampled 24 CAS audit reports completed for DEF, from the period 2012-2016. All were randomly selected to form a representative sample of the thoroughness of documentation, investigative accuracy, procedural adherence, assignment of responsibility for required remedial action, and audit close-out procedures.

Staff verified whether each audit report complied with internal audit procedures in effect at the time of initiation. Staff also tested whether remediation based on recommendations was completed on schedule and appropriately documented. CAS properly documented resolutions and closed out each report. Specific remediation requirements and dates were communicated to appropriate management through documentation. No issues were identified.

Commission audit staff also sampled 37 ethics complaints from 570 logged by Ethics and Compliance during the period 2012-2016. Complaint investigations were 95.4 percent of the total and inquiries were 4.6 percent. Staff employed the same criteria used for review of audit reports, i.e. thoroughness of documentation, investigative accuracy, assignment of responsibility for required remedial action, and adherence to close-out procedures. No issues were identified.

# 3.0 Company Response

## 3.1 Duke Energy Florida Response

Duke Energy Florida (DEF or the Company) would like to the thank the Staff of the Florida Public Service Commission for the thorough and professional review of its internal audit function, for the collaborative environment in which the audit was completed, and for the opportunity to provide the Company's feedback on Staff's Report and Observations. As discussed below, DEF will attempt to incorporate Staff's recommendations in its audit planning process going forward. DEF also offers the following comments regarding Staff's observations.

**Observation 1: During each year 2012-2016, CAS adjusted the audit plans of Duke Energy's Regulated Utility Operations, resulting in a cumulative net 10.4 percent decrease in the number of completed audit.**

Staff's report states that "*a net reduction of 21 originally-planned audits versus audits completed brings into question the adequacy of audit coverage for Duke Energy Florida. Though changes made to the audit plan were intentional and carefully considered by CAS, it is possible that the net reduction negatively impacted the adequacy of DEF audit coverage*." While the net reduction cited by Staff is accurate, it must be understood in the context of the 2012 Duke Energy-Progress Energy merger. Most notably, two-thirds (2/3) of the 21 audit reductions occurred in the 18 months following the merger, a time of significant change, both organizationally and functionally, across the entire enterprise. It also merits observing that CAS's practice is to review audit plan changes with the audit committee along with reasons for the changes. Generally speaking, an audit can be eliminated for a number of reasons, many, if not all of which, result in no net change to the Company's overall risk profile or audit coverage (for example, the function an audit was planned to assess is itself eliminated, or the purpose of an audit was fulfilled by another internal governance or oversight organization or through expansion to the scope of a separate audit).

While DEF does not share the audit coverage concerns mentioned in Staff's report, the Company agrees it should continue to seek better ways to objectively measure and communicate risk coverage provided by both the CAS audit plan and other Company governance and oversight organizations. Measurement of risk and risk coverage is an issue attempting to be addressed throughout the industry by both internal audit and enterprise risk management functions. That is something Duke Energy is actively pursuing and will incorporate into planning and reporting processes as they develop.

**Observation 2: During each year 2011-2016, DEF's internal audit budget was reduced, resulting in a cumulative 46 percent reduction in resources allocated to the function.**

Please see DEF's comment to observation #3 below.

**Observation 3: During each year 2012-2016, Duke Energy's complement of auditors was reduced, resulting in a net cumulative 14 percent decrease in audit or full-time equivalents.**

A significant driver of the cost and headcount reductions during the 2011-2016 period was the Duke Energy-Progress Energy merger and related business synergies. In addition, DEF's processes have become more efficient as the Company increased the use of data analytics and other audit techniques to achieve coverage with fewer resources. DEF also disagrees with Staff that "*spending the entire budget amount allocated each year*" is an indicator of audit coverage adequacy. The annual budget is prepared based on the budgeted year's projected audit coverage needs. However, as discussed above, those needs change throughout the year as planned audits are eliminated or deferred, and additional audits are added. Moreover, increasing efficiencies and synergies are still being realized as a result of the Duke Energy-Progress Energy merger. Duke Energy continues to believe that its audit coverage is sufficient to manage the Company's risk profile and, as discussed above, will continue to pursue risk measurement and risk coverage metrics.

However, the Company agrees that benchmarking against other similar audit organizations, along with the requisite analysis of the results, is an important action to perform.

**Observation 4: Duke Energy's Audit Charter states the Board of Directors Audit Committee is to "review the audit plan" and to "review any major changes" rather than requiring the Committee to *approve* both the audit plan and any major changes. The latter approach and wording is recommended by the Institute of Internal Auditors (IIA) in its *Model Board Audit Charter*.**

The Company will discuss this recommendation with the Audit Committee to consider revising the wording of the charter as suggested above.