

**REVIEW OF
GULF POWER COMPANY'S
INTERNAL AUDIT FUNCTION**

APRIL 2014

**BY AUTHORITY OF
THE FLORIDA PUBLIC SERVICE COMMISSION
OFFICE OF AUDITING AND PERFORMANCE ANALYSIS**

**REVIEW OF
GULF POWER COMPANY'S
INTERNAL AUDIT FUNCTION**

WILLIAM "TRIPP" COSTON
PUBLIC UTILITY ANALYST IV
PROJECT MANAGER

DAVID F. RICH
PUBLIC UTILITY ANALYST IV

APRIL 2014

**BY AUTHORITY OF
THE STATE OF FLORIDA
PUBLIC SERVICE COMMISSION
OFFICE OF AUDITING AND PERFORMANCE ANALYSIS**

PA-13-11-00

TABLE OF CONTENTS

CHAPTER		PAGE
1.0	EXECUTIVE SUMMARY	
1.1	Audit Execution.....	1
1.2	Overview and Staff Observations.....	2
2.0	GULF POWER INTERNAL AUDIT FUNCTION	
2.1	Organization and Structure	3
2.2	Risk Process and Audit Planning	4
2.3	Outsourcing, Resources, and Budgeting.....	5
2.4	Procedures, Documentation, and Sampling.....	7

TABLE OF EXHIBITS

<u>EXHIBIT</u>		<u>PAGE</u>
1.	Southern Company Internal Auditing Organization	3
2.	Gulf Power Company Internal Auditing Budget 2010-2014	5
3.	Gulf Power Company Annual Project Hours by COSO Category 2010-2013	6
4.	Gulf Power Company Number of Projects by COSO Category 2010-2013	7
5.	Gulf Power Company Number of Projects by Internal Auditing Group 2010-2013	7

1.0 EXECUTIVE SUMMARY

1.1 AUDIT EXECUTION

1.1.1 PURPOSE AND OBJECTIVE

The Office of Auditing and Performance Analysis performed a review of Gulf Power Company's (Gulf Power or the Company) Internal Auditing program and function. The primary objective of the review was to provide the Commission with an independent verification of the company's adequacies of controls, documentation, procedures, budget, risk analysis, and audit coverage for its internal auditing functions. Information in this report may be shared with other utilities to improve their internal auditing programs.

1.1.2 SCOPE

The audit scope was to assess the company's internal audit policies, practices, and procedures for the years 2010 through 2013. Commission staff examined the adequacy of Gulf Power's Internal Auditing (IA) management, staffing, controls, documentation, and results. Commission staff assessed the following areas within the company's audit process:

- ◆ Risk Determination,
- ◆ Audit Planning,
- ◆ Plan Approval Process,
- ◆ Audit Management,
- ◆ Audit Organization,
- ◆ Budgeting and Schedule controls,
- ◆ Outsourcing selection and contractor management, and
- ◆ Quality assurance and follow-up.

This review placed focus on the company's internal controls deployed and employed within its Internal Auditing unit. Commission staff used the Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing* (Standards) and the *Internal Control - Integrated Framework* developed by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission as the industry standards for evaluating the company's approach and practices. According to COSO, the company's internal controls should consist of five interrelated components:

- ◆ Control environment,
- ◆ Risk assessment,
- ◆ Control activities,
- ◆ Information and communication, and
- ◆ Monitoring.

1.1.3 METHODOLOGY

Initial planning, research, and data collection for this audit occurred December 2013 through February 2014. Staff conducted on-site interviews with Southern Company's Internal Auditing management to gain an understanding of the practical approach taken by the company. Specific information reviewed during this audit included:

- ◆ Policies and procedures,
- ◆ Organizational charts,
- ◆ Planning timeline data,
- ◆ Internal audit reports,
- ◆ Quality control reviews,
- ◆ Sampling of workpapers and procedural compliance.

1.2 OVERVIEW AND STAFF OBSERVATIONS

Commission audit staff identified no findings regarding Southern Company's auditing process. Overall, the company has an appropriate process in place that utilizes the appropriate standards for auditing activity. The company's audit division is organized in a manner that ensures independence and objectivity from the main operational organization. The division's accountability to senior management ensures that information is presented to the appropriate level for resolution.

Overall, the Southern Company audit division places the proper focus on risk-based assessments when developing its annual audit plan. This allows the company the opportunity to identify and audit the key risks facing the company. Additionally, the company has made changes to its auditing division, adding additional outside expertise to supplement its internal knowledge.

Commission audit staff recognizes that Gulf Power's corporate relationship with Southern Company provides an opportunity to benefit from the institutional expertise of the entire organization. In several instances, it was shown that the completion of corporate-wide audits allowed Gulf Power the benefits of these evaluations, while expending less resources than if Gulf Power were audited as a stand-alone company.

Despite this benefit, Commission audit staff notes that Gulf Power is the smallest of the Southern Company operating companies. While no instances were identified during this review, any limits in Southern Company's auditing resources could negatively impact the ability for Gulf Power to receive adequate audit coverage. Gulf Power states that oversight provided by the Controls and Compliance Committee of its Board of Directors ensures that Gulf Power's interests and risks are adequately addressed by the auditing group.

2.0 GULF POWER INTERNAL AUDIT FUNCTION

2.1 ORGANIZATION AND STRUCTURE

2.1.1 ORGANIZATION

The Southern Company Chief Audit Executive (CAE) is responsible for the Internal Auditing (IA) program of the Southern Company operating companies and non-regulated subsidiaries.¹ Internal auditing of Gulf Power falls under one of three Directors who report to the Chief Audit Executive. The directors manage the audit efforts and each is responsible for one of the four objective areas of the Enterprise Risk Management Committee of Sponsoring Organizations (COSO) of the Treadway Commission Integrated Framework:

- ◆ Financial Reporting,
- ◆ Operations,
- ◆ Compliance, and
- ◆ Strategic.

In addition, each Director is assigned specific operating companies to serve as the lead for communications and accountability. The IA efforts and resources are allocated by COSO objectives, and across all Southern Company operating companies according to staffing needs, expertise requirements, and the availability of resources. **Exhibit 1** outlines the Southern Company Internal Auditing organization.

SOUTHERN COMPANY INTERNAL AUDITING ORGANIZATION

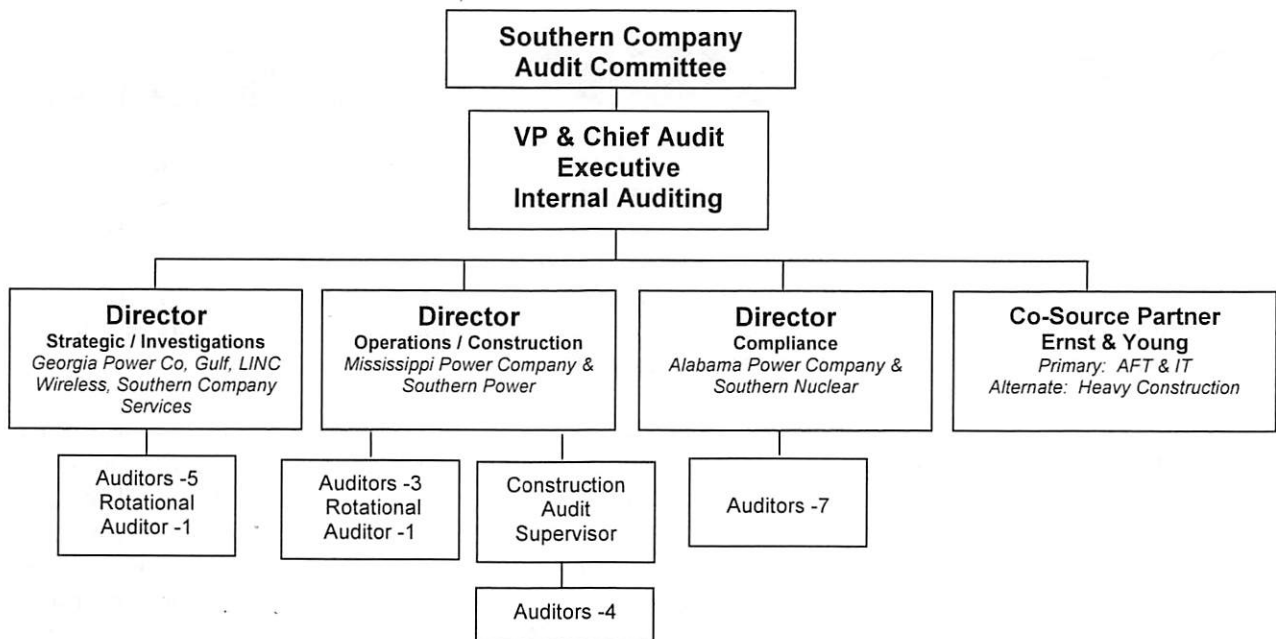


EXHIBIT 1

Source: Document Request 1.4

¹ Traditional operating companies include Alabama Power Company, Georgia Power Company, Gulf Power, and Mississippi Power Company. Other subsidiaries include Southern LINC Wireless, Southern Company Services, Southern Power, and Southern Nuclear.

Ernst & Young is an IA co-source partner, providing focused expertise and supplying approximately 15 annual full-time equivalents to Southern Company Internal Auditing.

2.1.2 RESPONSIBILITIES

Gulf Power's IA function is administered by Southern Company, the parent corporation providing strategic oversight and direction for a corporate internal auditing effort. The IA process is implemented through Southern Company Services (SCS)—the entity responsible for conduct of internal auditing functions throughout the entire Southern Company organization.

IA management believes its current structure and delineation of responsibilities are simultaneously responsive to corporate and subsidiary companies' needs. They describe the system and structure as an effective and efficient alignment of resources satisfying IA needs while adequately addressing risk. Because each subsidiary operating company within the corporate audit universe possesses relatively similar risks and business models, Southern Company states that organizing IA management by COSO objective provides for precise focus on risk and results in more tailored audits.

Following completion of an audit, the results and any requirement for remediation are communicated to subsidiary operating company management and boards of directors by the Director responsible for IA services for that company.

The Ernst & Young effort is primarily focused on compliance with Sarbanes-Oxley legislation and risks identified in IT or accounting, finance, and treasury (AFT). Gulf states that it also relies on, when necessary, the co-source's background in auditing heavy construction audit risks.

2.2 RISK PROCESS AND AUDIT PLANNING

Southern Company develops an annual audit plan using a risk-driven evaluation process. Each fall, the Internal Audit group initiates a company wide risk assessment that focuses on current risk threats facing the company and the perceived potential impacts. The audit team works with mid-level management, executive management, Southern Company Enterprise Risk Management, and its co-source partner (Ernst & Young) to assess and determine current risk issues. To gather the information, the audit team conducts interviews with key personnel and asks participants to complete a risk assessment survey.

Once the group performs its risk-impact analysis, the team meets over several days to vet the overall risk impacts and develop an audit universe plan for the year. During this process, the audit planning team works through a validation process for each risk. The results are incorporated into the audit risk matrix and become the foundation for the draft audit plan. Each risk is evaluated and challenged by the team prior to final inclusion. This plan applies to the entire Southern Company organization and includes all audits performed for the organization. A portion of these audits directly involve Gulf Power. In many cases Gulf Power will benefit, both directly and indirectly, from auditing the shared services (e.g. corporate IT and payment processing reviews) or auditing of other Southern Company operating companies.

The risk review considers each Southern Company subsidiary company's risk separately. These individual assessments are incorporated into the risk identification process. This leads to a Southern Company-wide annual audit plan. Southern Company does not guarantee any one service company a specific number or percentage of annual audits or effort. Instead, Southern Company makes overall risk the key driver of its mission. Under this process of identifying overall risk, the key risks at Gulf Power are included in the overall audit plan. Gulf Power's Controls and Compliance Committee reviews the Gulf Power portion of the plan, verifying and ensuring that it meets Gulf Power's needs.

2.3 OUTSOURCING, RESOURCES, AND BUDGETING

2.3.1 INTERNAL AUDIT BUDGET PROCESS

Gulf Power establishes an annual Internal Auditing budget to fund the auditing process. The budget is developed in mid-summer for the following calendar year. The annual audit plan is finalized at year-end and approved the following February. With this timing difference, the budget is developed using historical spending by the audit team. Over the past four years, Gulf Power's IA budget has remained stable, with a seven percent reduction in 2014 over 2013. Gulf Power's Controls and Compliance Committee believes the budget is adequate to perform the appropriate Gulf Power audits, based on the risk evaluations. The Audit Director did note that the budget would not prevent the IA group from performing additional key risk-based audits if the need arose. If additional resources are necessary to cover the risk, Gulf Power will allot additional resources to cover those costs.

Exhibit 2 details the budget and actual spending for the review period. For each of the years 2010 through 2013, Gulf Power did not spend its entire allocated Internal Audit budget. However, the company states that it was able to cover all applicable Gulf Power-based risks for the period. For 2010 and 2011, the company spent approximately 93 percent of its allotted budget. For the years 2012 and 2013, the company spent 73 percent and 79 percent of its budget, respectively. Gulf Power's audit team believes that it covered all key risks during this period.

GULF POWER COMPANY INTERNAL AUDITING BUDGET 2010-2014			
Year	Budget	Actual	Percent Variance
2010	\$1,030,699	\$ 958,167	(7%)
2011	\$1,087,286	\$1,002,250	(8%)
2012	\$1,005,033	\$ 730,543	(27%)
2013	\$1,057,247	\$ 830,931	(21%)
2014	\$ 984,861	-	-

EXHIBIT 2

Source: Document Request 1.5

Commission audit staff notes that risk development and rankings, while prepared using institutional knowledge and expertise, are subjective. Although the company believes all the key risks were appropriately addressed, some mid- and low-range risk may not be addressed in the audit plan. The company states that it does try to address mid- to low-risk areas, but it must balance the overall auditing resources for the entire organization.

Currently, the company is addressing other Southern Company key risks outside the Gulf Power organization, which are a priority for the internal audit group. The company does not believe staffing these projects impacts the audit team's ability to cover and address Gulf Power-specific key risks. However, the company disagrees with increasing Gulf Power's spending with low-risk audits, just to maximize budget spending.

2.3.2 INTERNAL AUDIT RESOURCES

During the audit planning process, the plan requires review by senior management and the Gulf Power Board of Directors Controls and Compliance Committee. For the period 2010 through 2013, the Southern Company IA group performed a total of 122 audits and status reports that were Gulf Power-specific or Gulf Power benefiting.

From a project hours perspective, the audit group spent approximately 25 percent on compliance audits, 35 percent on operations, 39 percent on reporting audits, and 1 percent on strategic audits. **Exhibit 3** lists the annual break-down of project hours by COSO category for the period.

The chart highlights how the company audit resources fluctuate by COSO categories from year to year. This is a result of the fact that that the company's audit budget is driven by risk assessment and not by COSO categories.

GULF POWER COMPANY ANNUAL PROJECT HOURS BY COSO CATEGORY (PERCENT) 2010-2013				
COSO Category	2010	2011	2012	2013
Compliance Audits	11%	27%	60%	14%
Operations Audits	19%	53%	25%	43%
Reporting Audits	70%	20%	15%	38%
Strategic Audits	-	-	-	5%

EXHIBIT 3

Source: Document Request 2.7

Exhibit 4 provides a listing of the number of projects, by COSO grouping during the review period. The company maintained a focus on the four major COSO categories, with a balanced distribution of audits performed within each grouping. Overall, the company has performed more compliance audits for this period, but these audits took proportionately fewer project hours to perform than those in other categories.

GULF POWER COMPANY NUMBER OF PROJECTS BY COSO CATEGORY 2010-2013		
COSO Category	Number of Projects	Percent of Total Projects
Compliance Audits	39	37%
Operations Audits	35	33%
Reporting Audits	30	29%
Strategic Audits	1	1%

EXHIBIT 4

Source: Document Request 2.6

2.3.4 OUTSOURCING

In 2009, the Southern Company restructured its IA division and increased the number of projects performed by its co-source partner. Audit Management states that Ernst & Young can be efficiently used to fill any internal auditing need. Management states that most outsourced audits are in the areas of Information Technology and Accounting, Finance, and Treasury. As **Exhibit 5** shows, Ernst & Young performed 39 audits during the four year period, approximately 37 percent of the overall Gulf Power audits.

Southern Company IA has in place a process to monitor and evaluate the work and results of all IA work products performed by Ernst & Young. The co-sourced auditor must comply with all Southern Company IA practices. Southern Company IA management and Ernst & Young teams work together and meet regularly to ensure all work is being performed appropriately.

GULF POWER COMPANY NUMBER OF PROJECTS BY INTERNAL AUDITING GROUP 2010-2013	
Southern Company Services (In-house)	66
Ernst & Young (Co-sourced)	39
Total Projects	105

EXHIBIT 5

Source: Document Request 2.5

2.4 PROCEDURES, DOCUMENTATION, AND SAMPLING

2.4.1 AUDITING POLICIES, PRACTICES, AND PROCEDURES

Southern Company conducts internal audits in accordance with The Institute of Internal Auditing (IIA) Standards as set forth in the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These standards were last revised in 2012.

Key Southern Company documents guide the internal auditing effort. They are the *Southern Company Internal Auditing Policy* and the *Southern Company Internal Auditing Guidelines for Conducting Internal Investigations*.

The *Southern Company Internal Auditing Policy* is derived from the IIA Standards and establishes the purpose, authority, and responsibilities for internal auditing activities. Additionally, the *Southern Company Internal Auditing Policy* provides guidelines for retention of Ernst & Young LLP as an IA co-source partner.

The original Southern Company policy, effective in 2006, was modified in 2012 and 2013. Among other things, the document establishes responsibilities in the areas of auditor's access to records; response timelines; management approval requirements; and use of co-sourcing support.

The *Southern Company Internal Auditing Guidelines for Conducting Internal Investigations*, version 2, provides basic guidelines for investigations, from notification to retention and security of documentation. This document was last updated in October 2011.

2.4.2 DOCUMENTING AUDIT WORK AND FINDINGS

Internal Auditing notification letters, work notes, summaries, findings, and other audit documentation is created, reported, and retained using a commercially available computer application called Auto Audit. Auto Audit is software specifically designed for audit use. Though not the latest software available, the company believes it is responsive to all current and anticipated auditing requirements.

Auto Audit work papers can be updated by auditors until the audit is completed and closed. Users of the system are provided only the level of authority within the program to accomplish their assigned tasks. Report approval authority and information release authority are controlled at the Audit Director level.

The company believes that Auto Audit is universally understood by auditors, is easy to use, and has no immediate plans to update the software or switch to another system. Auto Audit was last updated in 2009, with some forms and record templates undergoing revision during the process. The company stated that, as a result, review of pre-2010 documents may prove problematic.

Auto Audit is also the company historical repository for audit records. All documentation is retained for the balance of the completion year plus seven additional years.

2.4.3 STAFF SAMPLING

A total of 122 Gulf Power-specific audits—17 of which were status reports²—were performed during the period 2010 through 2013. Commission audit staff randomly selected ten for sampling, conducting a review of all documentation using Auto Audit. Nine audits were new audits; the tenth was initiated as a result of findings from a previous audit.

Commission staff verified that each of the audits were in compliance with the company's IA procedures. In each audit reviewed, the Gulf auditors identified findings and observations. In each case, the audit team worked with management to develop a remediation plan to address

² Status Reports relate to work completed for which a formal audit report may not be required or issued as of the respective quarter-end.

the findings. The Gulf audit team performed follow-up audits to verify that each finding was resolved appropriately. These results were communicated to senior management and the follow-up documentation was included in the audit workpapers.

Commission audit staff noted that the possibility of minor difficulties in correlating pre- and post-2010 documentation exists in the Auto Audit system. However, staff found no exceptions to established Gulf Power internal audit procedures.

