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ORIGINAL
FILE COPY

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

the southern electric system

June 11, 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 twenty-five copies of Gulf Power Company's response to the Commission Audit Staff's final audit report under audit control number 90-037-1-1. The audit report was delivered to the Company on May 31, 1990.

The Company's response enclosed herewith has been identified as an exhibit to the hearings beginning June 11, 1990 on Gulf's request for rate relief. According to Staff Counsel, the Company's response has been assigned Exhibit No. 299 for purposes of the hearing. Please distribute the enclosed response accordingly.

Sincerely,

Jack L Haskins

lw

Enclosure

cc: Counsel of record

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AUDIT EXCEPTION NUMBER 1

SUBJECT: Over Accrual of AFUDC on Work Order 110953
Units 1-7 Control Air Dryer Replacement

COMPANY COMMENT:

We acknowledge the over accrual of AFUDC on work order 110953. An adjustment was made in March 1990 business to reverse the over accrual.

While we agree that this item is an audit exception, this is in no way an indication of any weaknesses in the current work order system. The adequacy and appropriateness of the Company's work order system is fully addressed under Audit Disclosure No. 6. In 1989, 1802 General Work Orders were processed and closed to Account 106. This particular work order and the one addressed in Audit Exception No. 2 represent 0.1% of total work orders for 1989. A significant variance, far more than 0.1%, would indicate a weakness in the system. Systems of internal control are developed to provide reasonable, but not absolute assurance, that assets are safeguarded and that the books and records of the Company reflect only authorized transactions of the Company. Limitations exist in any system of internal control based on the recognition that the cost of the system should not outweigh its benefits. Again, two audit exceptions in no way indicate that there is an overall weakness in the internal control structure. The work order system and Gulf's overall system of internal controls are more than adequate to assure the proper safeguards.

AUDIT EXCEPTION NUMBER 2

SUBJECT: Over Accrual of AFUDC on Work Order 408506
Navarre 46/12 KV Substation

COMPANY COMMENT:

We acknowledge the over accrual of AFUDC on work order 408506. An adjustment will be made in May 1990 business to reverse the over accrual.

While we agree that this item is an audit exception, we do not agree that any weakness exists in our current work order system. This work order is currently in Account 106, Completed Construction Unclassified, and is still receiving charges. We estimate it closing to Account 101 before year-end. Upon closing to Account 101, each work order is reconciled for estimated to actual charges. Additionally, AFUDC is reviewed to ensure that no more was calculated past the cut-in letter date. In other words, this adjustment would have been made anyway before closing the work order to Account 101.

AUDIT DISCLOSURE NO. 2

SUBJECT: Energy Generated 1986 to 1989

COMPANY COMMENT:

Amounts shown on this disclosure are kilowatthours generated from steam power only. The total kilowatthours generated for Gulf's plants are as follows:

(Thousands)	
1986	8,456,590
1987	11,470,003
1988	11,208,802
1989	8,793,434

The relevance of this information to the rate case is unclear.

AUDIT DISCLOSURE NO. 3

SUBJECT: Internal Control Structure Weakness

COMPANY COMMENT:

The Company maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that books and records reflect only authorized transactions of the Company. Limitations exist in any system of internal controls, however, based on a recognition that the cost of the system should not exceed its benefits. The Company believes its system of internal accounting controls maintains an appropriate cost/benefit relationship.

The Company's system of internal controls is evaluated on an ongoing basis by the Company's qualified internal audit staff. Enhancements are made to the Company's system of internal controls as appropriate. The Company's independent public accountants also consider certain elements of the internal control system in order to determine their auditing procedures for the purpose of expressing an opinion on the financial statements.

Gulf during recent years has had numerous audits by Arthur Andersen & Co., the Federal Energy Regulatory Commission, the Florida Department of Revenue, the Internal Revenue Service, Southern Company Services, Gulf's Internal Auditing Department, as well as the Florida Public Service Commission. None of these audits indicated any significant weakness in Gulf's internal accounting controls.

Control Environment Weakness

Organization

The first portion of this item concerning organizational charts is addressed in disclosure # 9.

The PSC auditors' second concern is that the Company department responsible for regulatory reporting does not report to the controller. The Company's financial statements, including assets, capital and liabilities, and income are under the direct control of the controller. Jurisdictional calculations are performed by the corporate planning function, but this in no way affects the integrity of the financial statements. In fact, both the controller's function and the corporate planning function report to the chief financial officer who is ultimately responsible for all of the Company's financial statements.

AUDIT DISCLOSURE NO. 3

SUBJECT: Internal Control Structure Weakness

COMPANY COMMENT: (Cont'd)

Unit Power Sales

Unit Power Sales source data is maintained and supplied by various departments at Gulf due to the detailed and specialized nature of the data involved and the division of responsibilities within Gulf's Accounting department. For example, Plant Accounting accounts for and maintains total investment and depreciation dollars related to Plant Scherer. The monthly balances are given to the Tax and Contract Accounting department which coordinates the flow of all actual data to SCS for UPS billing calculations. It would be costly, duplicative, and imprudent for the Tax and Contract Accounting department to keep its own Plant records and system just for UPS purposes. Gulf's and SCS's UPS reporting process is continually audited by SCS internal auditing, Gulf internal auditing, FERC, Arthur Anderson, and the UPS customers themselves. These audits are a lengthy, detailed process which test the validity of UPS-allocated revenues and expenses to the very source of their origin. These audits also assure Gulf, SCS, and the UPS customers' managements that all internal controls for UPS accounting are adequate.

UPS costs incurred for the most part can directly be traced to specific accounts. Costs that cannot be traced because they are a result of allocating a particular account can be traced to various well-documented worksheets either at Gulf Power or Georgia Power. UPS billings are done by Southern Company Services because Southern Company Services is the agent on behalf of all the other Southern Companies responsible for entering into and directing the UPS contracts. It is more beneficial and less costly to the Southern system to have one entity be responsible for all the billings.

For more discussion on Gulf's Accounting for UPS, see Company comment on Disclosure No. 5.

Plant

Gulf's of the opinion that the auditor is misusing the term "complete work order system." After much discussion and reading documentation provided by the auditor, it is very clear that use of the phrase "complete work order system" in this disclosure actually means "Corporate Filing System." The "Plant Accounting System" or "Work Order System" utilized by Gulf was designed to accurately account for construction expenditures and to provide automation for the many manual processes done in the past. Gulf, Mississippi and Georgia Power Companies utilize this plant accounting system

AUDIT DISCLOSURE NO. 3

SUBJECT: Internal Control Structure Weakness

COMPANY COMMENT: (Cont'd)

for their plant accounting activities. We have had numerous audits conducted since 1982 by the FERC, A.A. & Co., Southern Company Services and others, including the FPSC, and not one recommendation has been made that Gulf revert back to a "manual filing system" as suggested by the audit staff. Please refer to Disclosure No. 6 for further comments regarding this subject.

Managers within Gulf's Accounting department are not allowed to make changes in appropriate Company accounting procedures based on verbal orders from auditors. The 38 subaccounts for Account 183 were set up to accurately account for and provide enough detail at the time expenditures are made to answer auditor's and other's questions. This process is much more efficient than continually having to look up detail charges after the fact. We have found it much more efficient to handle transactions with enough detail the first time. There were no transactions in Account 183 during 1989 and our detail provides very specific information about the study cost. We fail to see how this is an "Internal Control Weakness."

Management Philosophy

The item concerning the allocation of time in 1989 to non utility activities is addressed in item 35.

Accounting Systems

Regulatory

The FPSC Surveillance Report information was based on the Company's actual per book amounts with the regulatory adjustments required to reflect the ratemaking treatment in Gulf's 1984 rate case and current Commission policy. All amounts can be reconciled to the books and records of the Company.

The preferred stock issuing costs and premiums have been properly accounted for in accordance with the FERC System of Accounts. There are no deferred taxes associated with preferred stock.

Plant

It is evident that the FPSC Audit Staff does not have a good understanding of the plant accounts because the Company does not maintain "duplicative work in progress accounts." Even after the Audit Staff contacted FERC and was informed that

AUDIT DISCLOSURE NO. 3

SUBJECT: Internal Control Structure Weakness

COMPANY COMMENT: (Cont'd)

Gulf, along with many other utilities throughout the country, was in complete compliance in the use of Account 106. It is apparent that the Audit Staff still did not grasp the appropriate use and concepts of the account. Account 107, Construction Work in Progress, carries detail plant Accounts 300-399. Once a work order is transferred to Account 106, Completed Construction Not Classified (Plant in Service), all of the detail 300-399 accounts are also transferred leaving only one set of detail accounts. This process is computerized and requires no additional employees. A report is printed each month for each work order until it is transferred to Account 101, Electric Plant in Service. The Company fails to understand how proper use of Accounts 106 and 107 can be an "Internal Control Structure Weakness."

The Audit Report is incorrect concerning the statement, "The utility is unable to properly depreciate its plant." The Depreciation Subsystem calculates depreciation very accurately and to our knowledge no exceptions were reported by the FPSC Audit Staff. We agree that we record the depreciation expense one month in arrears, but we believe this procedure to be better than estimating monthly and then reversing these estimates each month. The Company believes that our current procedures are very good, with outstanding accuracy and auditability capabilities. Unless a major project is placed in service, the amount of depreciation not recorded in a given month is very insignificant, ranging from $120 to $14,000 in a given month. If, in the future, the Company has a major facility placed in service, that event will be recorded in the in service month.

Company accounting procedures provide for accrual of AFUDC on land purchases <u>only if</u> the workorder meets the criteria in Rule.25-6.0141 <u>(1) (a)</u>, F.A.C. Land bought well in advance of construction, usually one year or more, is recorded in Account 105-Plant Held for Future Use as provided in Order No. 14030, Docket No. 840086-EI. We cannot determine the relevance of the Audit Report comment regarding removing unwanted buildings on land purchased. Charges to the workorder detailed in this report in Rate Base Disclosure No. 13 certainly qualifies for AFUDC because it meets the existing rules and it was purchased over the construction period of the construction workorder. Expenditures of this nature require financing just as other construction expenditures. Please refer to Disclosure No. 8 for specific details explaining this subject.

AUDIT DISCLOSURE NO. 3

SUBJECT: Internal Control Structure Weakness

COMPANY COMMENT: (Cont'd)

Data

A portion of the General Ledger source data was lost due to an error in the tape copy routine for monthly journal entries. This was a procedural error in the timing of the copy routine which has been corrected. Even though a portion of the Journal Voucher source data was lost, a hard-copy of the data was maintained in the Accounting department.

Gulf Power will continue to maintain the detail General Ledger source data which will be loaded to a tape on a quarterly basis for the F.P.S.C. A routine will be run to place the monthly data in each detail record prior to forwarding the information to the F.P.S.C. This data tape can then be loaded into the F.P.S.C. computer without the staff having to run an additional routine to add this data to the file.

Control Procedures

Plant

Copies of the four work orders referenced in this disclosure have been obtained from Georgia and are in Gulf's files. The five work orders without signatures and completion dates are in Account 106, Completed Construction Unclassified. Completion dates and "Closeout Signatures" are not required on the work orders until after they are signed off as complete and ready to transfer from Account 106 to Account 101, Electric Plant in Service.

Land records such as sales contracts and closing statements are appropriately maintained in the Land Department, not Plant Accounting.

AUDIT DISCLOSURE NO. 4

SUBJECT: Perceived Audit Problems

COMPANY COMMENTS:

Over the past 10 years, numerous rate case and other audits have been conducted by the FPSC audit staff. In each instance, use of the Document Request Form, an FPSC form, has been the standard procedure used to obtain documents from the Company. In the initial conference between the audit manager and Company personnel, it was agreed that the document request procedure would be followed for this audit. To the knowledge of the Company, there have been no prior objections by FPSC auditors to following this procedure. This procedure provides several benefits that accrue to all parties:

1. Quickly directs the request to the appropriate Company employee.

2. Enables Gulf to track and follow-up on data requests in order to expedite the Company's response.

3. Compiles a set of the documentation to provide a basis from which to analyze audit disclosures.

4. Provides an opportunity to review the data for accuracy and to ensure it fulfills the data request requirement.

Significantly, the Document Request Form provides for confidential treatment to be afforded certain documents or for the Company to object to the production of the documents. It should not be unexpected that the Company would request its attorneys to review certain of the Document Requests and the proposed responses to assist in this determination. As noted in the Executive Summary of the Audit, out of 135 requests for documents, only three requests for confidential treatment were made, and one of those was withdrawn. As a matter of fact, Gulf's attorneys reviewed very few of the responses.

With respect to the telephone conversation between the audit supervisor and Company counsel, the facts as stated in this disclosure are incorrect. At no time during that conversation were any new "requirements" attempted to be imposed on the audit team. Instead, upon being advised that the Commission's own written audit data request procedure was not being followed, counsel merely requested that the audit staff attempt to abide by its own and the agreed upon procedure whenever possible in order to facilitate the orderly and accurate production of information to the auditors. The audit supervisor was specifically advised during the course of this conversation that the request was in no way intended to restrict the auditors' access to information, and that Gulf

AUDIT DISCLOSURE NO. 4

SUBJECT: Perceived Audit Problems

COMPANY COMMENTS: (Cont'd)

employees and attorneys would remain flexible under the circumstances instead of relying on a strict application of the written audit data request procedure in all cases.

Contrary to the disclosure, the audit staff was never requested nor did they in fact coordinate their interviews through the contact person. In fact, when requesting the contact person to identify the appropriate employee to respond to a particular request, the auditor was encouraged to interview the respondent such that they could better identify the data available and/or the best process to employ in analyzing the data available.

Shortly before the week in question, it was determined that the FPSC audit staff had made several attempts to circumvent the agreed upon request procedure, rather than notifying Gulf to seek a mutually satisfactory modification to the existing process. In order to maintain most of the benefits associated with the original procedure, Gulf proposed a modification designed to expedite the process further by eliminating the task of preparing a written audit request.

This process was implemented on April 13, 1990, and allowed the FPSC auditor to meet with any employee, identify and request data required, supervise the duplication of the data (one copy for auditor, one copy for the contact person - Gulf's record), and take possession of their copy. Gulf then prepared a Data Request reflecting the documentation requested/provided. It should be noted that this process, although unduly burdensome on the Company, could have been initiated earlier had the FPSC audit staff requested.

Gulf personnel went to great lengths to comply with the audit data requests under the time contraints created by short due date periods. The fact that the Company requested the FPSC audit staff to act in good faith and follow their own procedure was in no way an attempt to be non-cooperative.

AUDIT DISCLOSURE NO. 5

SUBJECT: Unit Power Sales - Overview

COMPANY COMMENT:

SUMMARY:

The Company records O & M expenses related to Scherer & Daniel in unique Loc-FERC-Sub Accounts.

Contrary to the statement of fact in this disclosure, it is very easy to identify the amounts billed the Company.

Construction costs are recorded in unique P.E.'s/CPR locations, making it very easy to trace costs billed to the Company.

The Company has detailed written procedures which detail accounts and amounts to bill UPS customers.

Gulf's financial planning department reconciles amounts reported to the Commission. The capacity information supplied to SCS by Gulf is reconciled to the KWH rate which SCS calculates and bills the UPS customer. All of this information is currently audited by:

A. FERC
B. Arthur Anderson and Company
C. SCS Internal Auditors
D. Gulf's Internal Auditors

All of these Auditors have been able to trace amounts recorded and billed.

In reference to the statement of fact by the Auditor, the example given on page 18 of the audit report contains several errors:

1. It incorrectly assumes energy is allocated on the same basis as capacity.

2. It ignores the fact that UPS sales occur from other than just the Daniel and Scherer Units and that the cost of fuel must follow the sale.

3. It erroneously states that the UPS customers benefited in 1987 and 1988 by $27,928,636 and $22,648,183 and lost $15,076,188 in 1989. The errors are simply caused by the wrong assumptions noted in No. 1 and 2 above.

The Company properly allocates costs to both the retail and UPS customer for what they purchase. The retail customers get credit through the Fuel Clause for fuel sold to UPS customers from Gulf units. The retail customers also gets credit through the monthly Surveillance Report for the O & M component charged to unit power sales. The energy purchased from the system units for UPS Sales is charged to the UPS customer.

AUDIT DISCLOSURE NO. 5

SUBJECT: Unit Power Sales - Overview

COMPANY COMMENT: (Cont'd)

GENERAL COMMENTS:

In addition, the disclosure mistakenly states that the $198,419,262 reported for the month ending December 31, 1989, represented total plant in service for Plant Scherer and Transmission. This amount includes the correct amount for Plant Scherer, but the amount of Transmission Plant included is at the UPS level. Furthermore, the reported UPS expenses of $34,445,671 is incorrect. The correct amount is $35,278,987. The difference is due to an adjustment related to the UPS Gulf States Utility uncollectible amount, and because Financial Planning recalculates the income taxes based on the UPS investment, including unamortized ITC, and does not use the income tax amount provided by tax accounting.

The UPS invoice detail is in fact a reconciling item for expenses allocated to UPS. However, certain items, such as prepayments and general plant, are not directly traceable to unique accounts because the amounts are allocated out of applicable accounts. However, these allocations can be found in subsidiary worksheets.

The detailed invoice of the amounts billed to UPS customers is sent to the customer. FPL is currently in the process of auditing its 1987 and 1988 capacity charges billed by SCS.

The amounts reported to the FPSC are summaries of the UPS data, which can be traced to their origins and detail accounts if one starts with the raw accounting data, takes that data through the complete UPS calculation, and finally to its end result on the UPS income statement.

Invoices which the staff auditor looked at for capacity billings show the monthly capacity purchase and budgeted capacity rate by the Company. Since this bill is sent as a representation of total Southern Company UPS billings it is not necessary for each individual Company to be identified on the invoice for true-ups, adjustments and interest. Each Company gets a copy of a memorandum detailing its portion of all the revenues included on the "official" invoice. Thus the monies due Gulf are identified. As far as the energy invoices are concerned, they were not sent by SCS Birmingham to Gulf since monthly UPS energy revenues per customer are detailed on the Intercompany Interchange Contract billing. Gulf will now obtain copies of the energy invoices on a monthly basis.

This disclosure also states that "1989 costs incurred at the generating plants, Daniel and Scherer, is considerably less

AUDIT DISCLOSURE NO. 5

SUBJECT: Unit Power Sales - Overview

COMPANY COMMENT: (Cont'd)

than UPS costs billed under the terms of the contracts." A supporting schedule is also shown. There are two problems with this schedule:

1. The auditor's schedule compares total plant production costs identified by unique plant location account numbers to total UPS production costs. Total UPS production costs reported by Gulf, however, include variable O & M and fuel for UPS energy sales other than those from the base unit identified by the unique location number. UPS energy sales other than base energy are Schedule R, alternate, supplemental, and discretionary. These may be sold out of other system plants but allocated to Gulf thru the Power Pool along with associated expenses or they may be sold out of Gulf's other plants.

2. The auditor's schedule also incorrectly shows total production costs, including fuel, as being allocated to UPS based on capacity entitlement ratios. This is incorrect for two reasons: The first reason is described in Paragraph 1 above. The second reason is that total fuel burn at the plant cannot be allocated to UPS on capacity ratios because the UPS customer does not have to take that amount of energy related to the capacity ratio but can take up to the capacity entitlement out of that specific plant.

The audit report states that total UPS fuel costs were prorated down to purchased capacity levels and compared to reported contractual fuel. For the reasons previously mentioned in the preceding paragraphs, the statement that the UPS customer benefited by $27,828,636 and $22,648,183 in 1987 and 1988 and lost $15,076,188 in 1989 is incorrect.

All UPS-related costs can be reconciled to the account level. All production O & M accounts are maintained within a unique plant location account number. On accounts which are allocated to UPS, detailed procedures and worksheets are kept showing how these allocations are made. Fuel costs which cannot specifically be identified by a specific account number are captured in purchased power and are traceable to the IIC bill.

Actual Gulf capacity charges used to bill the UPS customers by SCS are reconciled monthly by Gulf's Tax and Contract Accounting department. It takes approximately 2 to 3 hours per month to reconcile the information provided to SCS to the KWH rate that SCS charges the customer.

AUDIT DISCLOSURE NO. 5

SUBJECT: Unit Power Sales - Overview

COMPANY COMMENT: (Cont'd)

Several utility accountants from different organizational units within the Company account for various parts of Unit Power Sales due to the division of responsibilities within Gulf's Accounting department. Internal accounting controls for Unit Power Sales are monitored by Gulf's Internal Auditing, SCS's Internal Auditing, Arthur Anderson, and any auditors which the UPS customers may desire to have audit the UPS process. To date no significant inadequacies have been identified.

AUDIT DISCLOSURE NUMBER 6

SUBJECT: Gulf Power Company Work Order System

COMPANY COMMENT:

Adequacy of Work Order System

Gulf Power Company's work order system is maintained by a computerized Standard Plant Accounting System (SPAS). Gulf's plant accounting system surpasses the minimal requirements of nature, cost, source of cost, and electric plant account(s) to which amounts are charged or credited for each addition or retirement. SPAS is a complex system, yet, it is effective and efficient. The SPAS reports are generated in various groups: CWIP, RWIP, posting registers which post amounts from the five sources, and month end reports. The Plant Accounting file room contains hard copies of all files pertaining to current year and the previous years' work order activity. All plant reports are microfilmed and placed in a file cabinet located in the Plant/Construction Accounting area. The microfiche are filed by month and year and include all information regarding specific work orders. The work order system is not difficult to audit. The Federal Energy Regulatory Commission (FERC), Arthur Andersen & Company, Southern Company Services and this Commission have audited Gulf's Plant Accounting System numerous times in the past and not one audit team has mentioned a problem of ready access to plant information. We agree with the comments made by the Audit Staff in the exit conference that enough time was not available to audit. The Company is of the opinion this lack of time in the FPSC Audit Schedule is the problem rather than ready access of records. For example, the FERC staff spent the better part of 4 months auditing plant expenditures on each of their last two audits compared to several weeks by this FPSC staff.

SPAS generates numerous monthly reports which reflect charges and balances of work orders. These reports are available by PE and CPR location sequence and list all charges for the current month, year-to-date, and project to date for each work order. The FPSC audit team have in their possession copies of these reports which Plant Accounting presented on request. Plant Accounting personnel devoted many hours in explaining the work order process and the process of classifying plant costs. While expressing an understanding of the system, no attempt was made by the auditors to test the adequacy of the system. Again, the problem is one of time, not of adequacy. Those experts, external to Gulf, who have tested the system have found it fully functional.

Gulf Power Company is in full compliance with record retention policies as stated in 18 CFR 125.2 General Instructions (j). SPAS unitizes work orders once the work orders are transferred to Account 101. These costs are incorporated into a Continuing

AUDIT DISCLOSURE NUMBER 6

SUBJECT: Gulf Power Company Work Order System

COMPANY COMMENT: (Cont'd)

Property Record. Additions to, and retirements from, plant are reflected on the Continuing Property Record. Gulf's property records are updated within 30 days of closure to Account 101 for any given work order.

Signatures on Work Orders

The FPSC audit team notes that "completed work orders should have the signature of the project engineer along with the date that the project was completed." The comment insinuates Gulf's work orders are not signed and dated when completed. Audit Exception No. 1 states that "Work Order No. 110953 was signed 9/89 by the work order engineer as being completed." Audit Exception No. 2 states "A letter dated February 8, 1989 from a work order engineer to the Supervisor of Plant Accounting states all major construction was completed on Gulf Power Company GWO No. 408506." The two aforementioned contradictions are indicative of the inconsistencies contained in this audit report. Completed work orders are signed and dated.

Clocking in of Work Orders

Plant Accounting does stamp, as received, documents incoming to Plant accounting. The stamp reflects month, day, year, and indicates receipt by Plant Accounting.

Affiliate Work Orders

Expenses related to affiliate company work orders are booked through the same plant accounting system as Gulf's own work orders. The same reports are created with these work orders. FPSC auditors have copies of these reports.

Manual Work Order System

It appears that the audit staff is advocating that the Company maintain a separate manual work order file solely for the purposes of their audit. The Company does not have in its current personnel complement sufficient personnel to perform the additional filing and manual record keeping. Manual record keeping is not conducive to productivity. The paperwork, personnel and office space necessary to maintain such a system would be counter productive and of little or no benefit to the Company. Gulf Power is committed to taking advantage of current computer technology. The manual filing system estimated cost to duplicate existing files reported to the auditor was a compilation of a schedule derived from estimates of several departments. Attachment (A) is an estimated cost of such a manual work order system.

AUDIT DISCLOSURE NUMBER 6

SUBJECT: Gulf Power Company Work Order System

COMPANY COMMENT: (Cont'd)

The audit report insinuates the work order system is in such a terrible state as "it would take several months to test plant additions." As pointed out earlier the FERC Audit Staff spent the better part of 4 months at Gulf Power auditing plant accounting records on their last audit, which has been the norm for the last several audits. We are of the opinion the time allocated by the FPSC staff was insufficient even for auditors experienced in plant accounting/auditing.

Gulf Power Company's plant accounting system is very efficient and cost effective. The same plant accounting system is used by Mississippi Power Company and a major component of the system is used by Georgia Power Company. We have been audited twice by the FERC, numerous times by Arthur Andersen & Co., Southern Company Services, as well as the FPSC. The current audit is the only audit we have received which questions the integrity of Gulf's work order system.

Attachment A

ESTIMATED COST OF WRITTEN
WORK ORDER SYSTEM

1.	Cost of program changes in Plant Accounting System to provide reports for filing in folders.	$ 50,000
2.	Annual cost of additional personnel required to maintain files in Plant Accounting.	67,000
3.	Additional lateral file cabinets for manual files.	21,840
4.	Three additional workstations @ $3,000 each.	9,000
5.	Additional office space requirements.	77,000
6.	Annual O&M (heat, lights, etc.).	2,500
7.	Annual microfilm cost increase to accommodate indexing.	6,000
8.	Annual costs of other departments required to support filming in Plant Accounting	67,000
	Total Estimated Cost	$300,340

NOTE

The above is an estimate for a manual filing system that duplicates existing files that are readily available at Gulf Power Company. The Company cannot recommend duplicating cost where adequate records and audit trails already exist.

AUDIT DISCLOSURE NUMBER 7

SUBJECT: Account 106 - Completed Construction (Not Classified)

COMPANY COMMENT:

Company procedures for work order processing including the handling of Account 106 are as follows:

> General Work Orders are originated by the engineer, they identify PE, FERC, RUC, CPR location, a justification for the work order, and identify additions and, if applicable, retirements, cost of removal, salvage, transfers, and O & M expenses. All work orders must have proper management approval. When received in Accounting, work orders are assigned a number and authorized for the work or purchase. The original work order is returned to the engineer.
>
> Upon completion of work, either a "signed-off" completed work order or a "cut-in" letter is sent to Accounting. The work order is transferred to account 106, Completed Construction Unclassified. At this time, all AFUDC calculations stop and depreciation begins. The "cut-in" letter signifies that the work is complete but all of the construction charges to the order have not been received from the vendor. Upon such time all charges are received and reconciled by the engineer, the engineer sends the signed original work order to Accounting.

Projects can be reported partially in Account 107, 106, and 101. Projects or PE's may consist of several work orders. Since each work order is a unique portion of planned construction, it is possible for some work orders to be completed while others are in various stages of construction, either Account 107 or 106.

Due to the design of the Financial Model, Account 106 is not necessary. The Construction Budget operates at the PE (Project Expenditure) level not at a detailed work order level. The Financial Model moves project dollars directly from CWIP to Plant-in-Service, upon which time depreciation begins. The Financial Model does not operate at account number level (ie. Accounts 106 and 101), it operates at a functional level (Plant-in-Service).

All work orders closing to Account 106 have been <u>classified</u> to primary FERC accounts. However, they have not been reconciled to ensure all charges for labor and materials have been received, all retirements, transfers, and cost of removal have been completed. According to the <u>Code of Federal Regulations</u>, Part 101, Page 328, Account 106, Note: "For the purpose of reporting to the Commission the classification of electric plant in service by accounts is required, the utility

AUDIT DISCLOSURE NUMBER 7

SUBJECT: Account 106 - Completed Construction (Not Classified)

COMPANY COMMENT: (Cont'd)

shall also report the balance in this account tentatively classified as accurately as practicable according to prescribed Account Classifications."

By closing work orders to Account 106, all delayed charges for those orders are properly tracked to the project. The Standard Plant Accounting System adds Accounts 106 and 101 to compile total Plant-in-Service. It is rather straightforward and automated and avoids additional, unnecessary work.

Commission Rule 25-6.0141(1)(d)3. states that "when a project is completed and ready for service, it shall be immediately transferred to the appropriate plant account(s) or Account 106, and may no longer accrue AFUDC." We are in complete compliance with this rule.

This audit disclosure was totally resolved when discussed in detail with Mr. Freeman and his audit staff. Everything was verbally explained to their satisfaction at that time. They were walked through specific work orders from beginning to end, including the activities required by Construction Accounting Staff and system generated transactions and treatments of Accounts 107, 106, and 101.

AUDIT DISCLOSURE NUMBER 8

SUBJECT: Accumulated Depreciation Methodology

COMPANY COMMENT:

Prior to the implementation of Gulf's new Depreciation Accounting System, depreciation accounting at Gulf Power was a manual process of collecting and estimating investment data, and loading that data to a personal computer application to calculate monthly depreciation expense by FERC account.

In 1986, a number of developments significantly increased the complexity of depreciation accounting and concurrently increased the time to accomplish the monthly depreciation accounting function. FPSC rules were adopted allowing certain classes of property to be recovered/amortized rapidly over 5 and 7 year periods. Separate depreciation rates by generating plants, and also separate accrual rates for recovery of the future cost of final dismantlement of generating plants were also approved by the FPSC in 1988. Depreciation rates by generating units and by subaccount are also currently anticipated. (Reference Docket No. 840204-EU.)

With the advent of these new complexities, Gulf recognized the need for a more comprehensive, and flexible computerized system in order to efficiently accomplish the depreciation accounting function. Gulf's new Depreciation Accounting has accomplished this and has avoided the need for additional personnel, despite the fact that workload increased.

Due to the computerization of the depreciation system and also the General Ledger closing requirements, booking depreciation expense on a one month lag is the only method which will permit monthly closing of the Company's books on a timely basis.

The Company recovers depreciable plant investment using approved remaining life depreciation rates. The composite remaining life is 19 years, or 228 months. The Company contends that booking one month late has no material effect over a 228 month remaining life, because the full investment will be recovered. For December 1989, the difference between booked depreciation and actual depreciation was $14,064, or .3% of the total booked depreciation for that month. It is Gulf's opinion that this amount is immaterial. Whenever a major project which would have a significant effect on depreciation, is placed into service a manual adjustment is recorded in addition to the monthly depreciation expense calculated by the Depreciation System.

To summarize, the Company's current depreciation procedures follow good, sound accounting principles to ensure that depreciation expense is booked in the appropriate year and also to ensure that the Company recovers its investment over the life of the asset.

AUDIT DISCLOSURE NO. 9

SUBJECT: Failure to Provide an Organizational Chart

COMPANY COMMENT:

Audit Data Request (ADR) No. 4 requested 9 items, only one of which was an organizational chart (Chart) by planning unit. In response to this item, Gulf produced a copy of the Company's most current set of organizational charts as maintained by the Employee Relations department. The auditors were notified that there was no prepared Chart by planning unit, and that the Charts previously provided were the only ones prepared by the Company. ADR No. 13 again requested a Chart by planning unit citing that one was provided in the last case. After the audit, Gulf personnel have determined that the Organizational Charts provided for the specific areas requested in 881167-EI were in fact the same type of chart provided in response to Audit Disclosure Request No. 4. Gulf also provided the FPSC audit staff with a 2 hour presentation of the Budget Process on February 20, 1990 in order to facilitate their understanding. In addition to the presentation, a multitude of information was available which should have been sufficient to enable the audit staff to evaluate the operational budgets.

Throughout the audit, this request for an Organizational Chart seem to go through a metamorphosis, transforming from one by planning unit to a detailed Chart reporting the names and titles of some 1600 full and part time employees. Gulf's organizational charts identify the name and title of exempt employees from supervisor and above, with exempt positions below supervisor and non-exempt positions identified in total. Gulf's Organizational Charts are standard for the industry and have proved sufficient for audits by Arthur Andersen & Company, Southern Company Services, Federal Energy Regulatory Commission and all prior rate case audits by the FPSC.

In an effort to accommodate the audit staff's concern regarding lack of detail, the Company offered them the telephone book, sorted by department, and advised how it could be used to supplement the existing Organizational Chart. The statement of fact would have the reader believe that the telephone book was offered in lieu of a detailed Organizational Chart. This was not the case. The two documents (Organizational Chart and telephone book) together provide more than adequate information on which to base audit work.

Gulf constructed a detailed Organizational Chart by combining the Company's existing charts with the Company's departmental listing of employees so as not to appear uncooperative. The Chart was provided to the audit staff on April 19.

Gulf Power maintains those organizational charts necessary for its purposes. The organizational chart requested is unnecessary for Gulf's purposes, or for purposes of performing

AUDIT DISCLOSURE NO. 9

SUBJECT: Failure to Provide an Organizational Chart

COMPANY COMMENT: (Cont'd)

an audit. Although unnecessary, Gulf made every attempt to provide the information requested.

This example increases Gulf's concerns that the FPSC audit staff frequently makes requests for unnecessary and/or non-existent documentation without regard to the cost to Gulf and its customers of providing this data or any benefit the documentation may have toward their audit effort.

AUDIT DISCLOSURE NO. 10

SUBJECT: Budgeted Rate Base Overstated In 1989

COMPANY COMMENTS:

The audit report comparison of jurisdictional rate base for the withdrawn rate case for 1989 and actual for 1989 is misleading because the amounts reported are not based upon consistent data. In Gulf's rate filing for the 1989 test year, no Daniel investment was allocated to Unit Power Sales since those sales were ending in January 1989. However, in the 1989 actual surveillance report, some Daniel investment was allocated to Unit Power Sales in two months (December 1988 and January 1989) of the thirteen month average. Of the differences in rate base noted in the audit report, $17,085,000 of the net utility plant difference of $28,449,000, and $1,131,000 of the working capital difference of $4,794,000 is related to Daniel UPS.

The audit report should compare Gulf's rate base on a system basis. For 1989, 13-month average net utility plant on a system basis was only $12,950,000 under budget. This was due in large part to the salvage value related to the retirement of the Plant Daniel Coal Cars that was not budgeted, which amounted to $5 million on a 13-month average basis. The remaining $8 million variance is due mainly to delays in construction of certain projects which caused the 13-month average to be under budget, although many of these projects were caught up by year-end 1989.

The audit report does not address the 1990 test year. Through March 1990, the main variance in net plant is due to the purchase price adjustments related to Plant Scherer that were recorded in November and December of 1989, for which Gulf is agreeing to adjust the forecast. Other than this, Gulf's projected plant data is essentially on budget. Through March, construction expenditures are approximately $1.5 million under budget, due primarily to delays of 1-3 months in a few large production projects.

AUDIT DISCLOSURE NO. 11

SUBJECT: Cost of Plant Scherer

COMPANY COMMENT:

The amount Gulf reports as investment in Plant Scherer for UPS purposes is $189,277,315. Gulf Power Company's Plant-in-Service investment in Plant Scherer at December 31, 1989 was $178,553,885. The Plant-in-Service investment amount is derived from the sum of Plant-in-Service-Classified (101) and Plant-in-Service-Unclassified (106). In addition, the $8,665,448 unamortized portion of Account 114, Electric Plant Acquisition Adjustment, is included for Unit Power Sales. Gulf is allowed to recover a portion of general plant through Unit Power Sales. An allocation of salaries and wages is allocated to Plant Scherer's Plant-in-Service investment to derive the balance for Unit Power Sales purposes. The allocation of General Plant to Plant Scherer was $2,060,436 at December 31, 1989.

The reference to the operating reports of Georgia Power Company was the result of an incomplete analysis. The $126,157,179 reported by FPSC auditors was the amount expended on Georgia Power Company's PE 0046. PE 0046 was Georgia's major generating PE for Plant Scherer. The FPSC auditors did not consider the remaining PEs which comprise the balance of Gulf Power's investment in Plant Scherer.

The FPSC auditor did not request a reconciliation of any alleged differences for Gulf's investment in Plant Scherer. There certainly was no need for Gulf Power to have on hand the reconciliation of the difference between one PE and the total PE comprising all of Gulfs investment in Scherer. As we have demonstrated, the auditor accumulated data from various sources and formulated an incomplete synopsis of Plant Scherer. Following the exit of the FPSC audit team, Mr. William Davis, an engineer with the FPSC, has indicated that he is in the process of writing a report detailing the method of accounting for Plant Scherer and that Gulf has proven to his full satisfaction that the Company's Plant Scherer balances are correct.

The auditor appears to be concerned because of Gulf's purchase of CWIP rather than a completed plant. The decision must be viewed at the point of sale. Gulf was considering the construction of a generating facility at the Caryville site. The opportunity to participate in the construction of Plant Scherer was viewed as the best use of resources by Gulf. Gulf was not afforded the option to wait until completion of construction. There is no difference in the impact on the total cost under either scenario. The FPSC has stated in three dockets the purchase of Plant Scherer was beneficial to Gulf's customers. Order No. 9628, Docket No. 800001-EU, page 7

AUDIT DISCLOSURE NO. 11

SUBJECT: Cost of Plant Scherer

COMPANY COMMENT: (Cont'd)

states, "realization of the purchase upon the terms contemplated by Gulf would be beneficial to Gulf's ratepayers...". Order No. 10557, Docket No. 810136-EU, page 39 references, "economic benefits to be derived from purchasing Scherer capacity in lieu of building the Caryville unit." The FPSC reasserts its position in Order No. 11498, Docket No. 820150-EU page 15 when it states, "Nothing of an evidentiary nature has been offered in this case to persuade us to reverse our earlier findings."

AUDIT DISCLOSURE NUMBER 12

SUBJECT: Plant Scherer Acquisition Adjustment

COMPANY COMMENT:

The FPSC Audit Report's Statement of Fact is incorrect. The report states, "Gulf asserts the acquisition adjustment is the payment of reasonable carrying costs, but to date, has not provided a complete work order file fully accounting for: (1)original cost of Plant Scherer No. 3., (2)original cost of all common facilities and (3)calculation of the acquisition adjustment." The original cost of Plant Scherer No. 3 is not related to the Plant Scherer acquisition adjustment, however, the original cost of Scherer Unit No. 3 was provided to FPSC Audit Staff. The original cost of all Scherer common facilities along with details relating to the calculation and recording of the acquisition adjustment, were also provided to the FPSC Audit Staff on April 19, 1990.

As indicated under the heading Statement of Fact, Gulf did not purchase the common facilities from Dalton and Oglethorpe until November 1987. The Company could not know the amount the purchase price would be in excess of original cost in 1984 since the sales price was not calculated until November, 1987. The FPSC was notified of the acquisition adjustment in the rate case filed in 1988 and withdrawn in 1989.

Contrary to the Audit Opinion Statement, the cost of the acquisition adjustment was carefully documented, recorded on the Company books and the proper accounts used when the common facilities were purchased. All of this documentation is in the Company's Plant accounting records, audited by the FERC, A.A.&Co. and others with no errors/exceptions reported.

CFR 101, Account 102, Electric Plant Purchased or Sold, allows six months from the date of acquisition to file for approval. After all of the cost relating to the acquisition was accumulated on the Company books, Gulf filed with the FERC well within the required six month period. Amortization did not begin until approval was received. A retroactive adjustment was made with an effective period of January 1, through December 31, 1988. No amortization was recorded in 1987.

The Statement of Fact insinuates that the Company, by not using Account 115, Accumulated Provision for Amortization of Acquisition Adjustments, has not followed proper accounting procedures. On September, 27, 1988, the accounting for the acquisition adjustment that included a direct write-off procedure was submitted to, and subsequently approved, by the FERC.

AUDIT DISCLOSURE NUMBER 13

SUBJECT: Transfer of AFUDC Accrued on Raw Land

COMPANY COMMENT:

Established internal policies require that land be purchased on a work order separate from the work order for construction of facilities. If construction proceeds within one year, then AFUDC is calculated on both the land and the construction facility.

The Rule 25-6.0141(1)(a), Florida Administrative Code, defines eligible projects as gross additions to plant in excess of $25,000 and completed in excess of one year after commencement of construction.

A project is budgeted in a PE (Plant Expenditure). Each PE could have several work orders associated with the major project. If the project qualifies for AFUDC then the work orders could receive AFUDC treatment if they meet the above criteria.

Gulf's treatment of AFUDC accrual on land is consistent with applicable accounting rules and principles.

AUDIT DISCLOSURE NO. 14

SUBJECT: AFUDC Rate

COMPANY COMMENT:

In reporting AFUDC on the income statement the debt and equity split is based on the FERC formula. This is done to comply with a previous FERC audit report that stated:

> "The Uniform System of Accounts contemplates that when less than the maximum AFUDC rate is used, the allowance for borrowed funds included in Account 432 should be computed as though the maximum AFUDC rate was used. The remainder of the AFUDC should be considered as having been derived from other funds and should be included in Account 419.1."

However, the Company calculates AFUDC using the rate approved by the Florida Public Service Commission. Deferred taxes are calculated utilizing the debt component calculated utilizing the FPSC methodology. Therefore, the deferred taxes are correctly recorded under the FPSC formula.

AUDIT DISCLOSURE NO. 15

SUBJECT: Rate Base Allocated to Non-Utility Appliance Sales and Service

COMPANY COMMENT:

The FPSC audit report's Statement of Fact regarding non-utility appliance sales and service investment worksheets being "disorganized" and providing "no audit trail" is an incorrect statement. Plant Accounting personnel spent numerous hours with FPSC auditors "walking-thru" these workpapers. It is true that these workpapers are in some cases complex and report a great deal of information, but this is necessary in order to ensure the investment and depreciation calculations are correct for the appliance sales and service operation.

The appliance sales and service study is conducted annually in August or September by Plant Accounting personnel. The depreciation expense booked in the current year is then "trued-up." MFRs B-9a & B-9b reflected the actual amounts for January thru August 1989 for investment and depreciation reserve, however, we understated the true-up which was recorded in late 1989 because the MFR's were already filed by that time. The Company agrees that an adjustment is appropriate due to the understatement of the appliance sales and service adjustments in the rate base and net operating income. The investment, the accumulated depreciation reserve and depreciation expense should be adjusted by an additional $218,000, ($7,000) and $12,000 respectively. The overall result of these adjustments is to decrease jurisdictional rate base by $220,000 and decrease jurisdictional depreciation expense by $12,000.

Gulf's recommended adjustment is lower than that of the FPSC auditor because, subsequent to the 1989 Appliance Sales and Service Study, additional information was received by Plant Accounting regarding the square footage used by the appliance sales and service personnel located in one of the divisions. Initially, the occupancy rate reported was overstated, as was the corresponding investment, depreciation reserve and depreciation expense. An adjustment was recorded in April 1990 to reflect the accumulated depreciation reserve and depreciation expense as it relates to current occupancy for the appliance sales and service operation. Copies of supporting documentation will be furnished upon request.

AUDIT DISCLOSURE NO. 16

SUBJECT: Additional Hawkshaw Land Purchases

COMPANY COMMENT:

The facts stated in the audit disclosure are correct.

AUDIT DISCLOSURE NO. 17

SUBJECT: Additional Pace Boulevard Land Purchases

COMPANY COMMENT:

The facts stated in the audit disclosure are correct.

AUDIT DISCLOSURE NO. 18

SUBJECT: Navy House

COMPANY COMMENT:

Most of the facts stated in the audit disclosure are correct. However, the disclosure erroneously suggests that the purchase price or $110,000 was solely for the house located at 621 South Navy Boulevard (Navy House), while in fact the purchase price was incurred for the sole purpose of securing land to support a necessary transmission line facility at the site. The need for the property investment of $110,000 to support the transmission line work is in no way affected by the decisions made on use or disposal of the structure. The following clarifications should also be noted:

1. Meetings have been historically held away from the Corporate Office. The availability of the Navy House did not initiate the need for meetings away from the Corporate Office.

2. A portion of the telephone charges are long distance toll costs which the Company would have absorbed regardless of the location of the meeting.

AUDIT DISCLOSURE NO. 19

SUBJECT: Cancelled Projects

COMPANY COMMENTS:

The Crist Waste to Energy Facility was cancelled in the October 1, 1989 revision to the capital additions budget following notification from the Escambia County Commission of its intent to terminate its participation in the project. Once it was determined that the project would not be constructed, Gulf charged the appropriate operating expense account as permitted in CFR 18, Part 101, Account 183, Preliminary Survey and Investigation Charges, Paragraph A. The correct 13-month average amount in Account 183 for 1989 is $203,312, not $200,932 as shown in the audit report.

The Company agrees with the facts stated regarding the Valparaiso land. The project was cancelled in the February 1, 1989 budget revision before any money was spent. Therefore, no investment related to this property is included in 1989 actual data or 1990 projected data.

The Company has properly handled the SCS building cancellation in the tax rule filings, and in the 1990 test year. In its 1988 tax filing, the investment was removed as shown on Mr. McMillan's Schedule 5 to his prefiled testimony (note that this adjustment reflects the jurisdictional investment amount). The 13-month average amount on the Company's books in 1989 was $133,249, not the $160,051 shown in the audit report; this has been removed in the 1989 tax filing as shown on Attachment 2 of that filing. Also, the write-off of the building has been removed from expenses as shown on Attachment 1 of the 1989 filing. The write-off of these charges had already occurred when Gulf's 1990 Budget was prepared, so none of the investment or write-off expense is included in the 1990 test year.

AUDIT DISCLOSURE NUMBER 20

SUBJECT: Plant Held for Future Use

COMPANY COMMENT:

In the statement of fact, the chart on Page 44, mistakenly identifies Account 183 as the account number for Miscellaneous Deferral Debits. Account 186 is the correct account number. Also, on Page 45 the revenue for Centipede Sales and St. Augustine Sales are inverted.

The Company disagrees with the Audit Opinion and Conclusion. The subaccounts in Account 183 and descriptions were set up to accurately account for and describe the preliminary survey study cost at Caryville. Managers are not allowed to change established and appropriate accounting procedures and records based on verbal demands from auditors. Attached is a detail listing of subaccounts from our General Ledger System at December 31, 1989, that gives a brief description and cost for each activity.

Gulf fails to see any extreme difficulty in following the transactions in this account since there were no transactions during 1989. Combining these subaccounts as recommended by the auditors could possibly lead to the loss of the specific contents included in each account. Therefore, the Company deems the conclusions of the audit opinion to be unsupported and deems any changes to be inappropriate.

Finally, while this disclosure states, on page 44 that "The Sod Farm operation has four employees...," it should be pointed out that only one full-time employee is employed by the Sod Farm. A part-time bookkeeper and three to five part-time workers are also employed at the sod farm. The Supervisor of Land and the Secretary of the Land Section work part-time in the administration of the sod farm operation and a portion of their salaries are charged to the non utility, below the line accounts.

AUDIT DISCLOSURE NO. 21

SUBJECT: Records Retention

COMPANY COMMENT:

Gulf's records retention policy and procedures are in full compliance with federal regulations. The Company disagrees with the Audit Opinion and the Conclusion. On May 16, 1980, the Company's Vice President of Finance spoke with Mr. Morris Fitzgerald, head of Audits for the Federal Energy Regulatory Commission, concerning the requirements for retention of plant records under 18 CFR 125.2(j). As noted in the disclosure 18 CFR 125.2(j) allows retention of plant related records for less than 25 years upon the Commission's approval of accounting adjustments. According to Mr. Fitzgerald, the letter from the FPC to Gulf Power Company, dated April 28, 1967, covering the period January 1, 1937, through December 31, 1965, constituted approval required under that section for that period. He also said that subsequent FPC/FERC compliance audits, although not specifically mentioning the approval of accounting adjustments referred to in Section 125.2(j), granted approval for the periods covered by such audits.

Consequently, Mr. Fitzgerald's position was that Gulf had received FPC/FERC approval required under Section 125.2(j) through the period covered by our latest compliance audit and accordingly was authorized to destroy all plant records in accordance with the normal retention periods, subject to the other requirements of section 125.2(j).

This information was relayed to the FPSC Auditor verbally and by copy of the internal documents which recorded this conversation. In addition, the auditor was provided with a copy of the Records Retention Schedule of our Plant Accounting Section which indicates that we are maintaining our plant records in accordance with 18 CFR 125.3 and with the Florida Administrative Code, Rule 25-6.015, which requires that "All records be preserved in accordance with the Federal Energy Regulatory Commission's regulations, entitled "Preservation of Records of Public Utilities and Licenses' as revised, April 1, 1987."

AUDIT DISCLOSURE NO. 22

SUBJECT: UPS Working Capital Erroneous

COMPANY COMMENT:

In the 1984 rate case filed by Gulf Power Company, the Florida Public Service Commission calculated the amount of working capital in rate base utilizing the balance sheet approach. Gulf's system or total company working capital and each jurisdiction (retail, wholesale, and UPS) have been calculated in accordance with this methodology, resulting in the appropriate retail working capital utilizing the balance sheet approach. Each of these jurisdictions has numerous differences in required ratemaking calculations, but for retail ratemaking, all calculations are done in accordance with Florida requirements. To pick and choose different calculations and amounts when and if it is advantageous is inconsistent and inappropriate. Furthermore, the UPS comparisons made in this audit report are inappropriate since the comparisons were made to the UPS working capital reported in the 1987, 1988, and 1989 surveillance reports which were calculated in accordance with the 1984 rate order (Order #14030, Docket # 840086-EI, page 8).

Although the UPS calculations are not addressed in the 1984 rate order, the details were provided in Mr. Scarbrough's Exhibit No. 2a of the Deposition of Mr. Scarbrough in the 1984 rate case taken by the Commission, which was entered into the record of Docket No. 840086-EI as Exhibit 6a, and the monthly calculations were provided to the Commission audit staff in Audit Request No. 41. Use of a formulary (1/8 of O & M) approach to working capital for retail ratemaking would result in higher working capital requirements for the retail, wholesale, and UPS jurisdictions.

AUDIT DISCLOSURE NO. 23

SUBJECT: Working Capital Prepaid Pension Cost

COMPANY COMMENT:

In 1988 the Company recorded $1,385,000 of pension costs on its books. This amount was calculated using the "projected unit credit" actuarial method that is required by FASB Statement No. 87. However, the Company is allowed under section 404 (a) (6) of the Internal Revenue Code to claim a larger tax deduction for the 1987 tax year if the actuarily determined maximum tax deduction for the 1987 year is funded to the plan prior to September 15, 1988. The Company decided to take advantage of this provision and therefore, funded an amount in excess of the expense determined for book purposes in order to secure the increased tax deduction. The customer received the benefit of the related deferred taxes in the cost of capital. The correct amount of prepaid pension cost for 13-month average ending December 31, 1988 is $630,803.

AUDIT DISCLOSURE NO. 24

SUBJECT: Rate Base Reconciling Items

COMPANY COMMENT:

The following comments pertain to items 1 - 8, respectively, in this disclosure:

1. No adjustment is necessary since the Daniel Coal cars were retired in the month of March 1990.

2. No adjustment is necessary since these facilities are used and useful and will remain so.

3. The Non-utility deferred debit accounts were budgeted as zero.

4. All rate case expenses associated with Docket No. 881167-EI were expensed in 1989, and, therefore, no costs are included in the projections. The unamortized rate case expenses for Docket No. 891345-EI have been included in rate base.

5. The deferred debits for acid rain and the corporate investigation account were budgeted to clear by December 1989, and nothing was budgeted for 1990.

6. The December 1989 and 1990 balance in account 186-997 for Heating and Air loans was budgeted as zero.

7. The Deferred Debits and Credits related to over and underrecoveries of fuel and conservation revenues should not be included in working capital since interest expense or income related to the over or underrecoveries are accounted for through the fuel Cost Recovery Calculation. However, the Deferred Debits and Credits related to Fuel and Conservation are budgeted to zero out each month in the forecast.

8. The Non-Utility Sales & Use Tax amount is not a Rate Base reconciling item in 1990, because these taxes were not specifically identified in the calculation of Tax Collections Payable in the financial model.

AUDIT DISCLOSURE NO. 25

SUBJECT: Fuel and Conservation Over Recovery

COMPANY COMMENT:

Gulf Power Company is required to return any overrecoveries to the rate payers with interest, and conversely, the Company is allowed to recover any underrecovery from the ratepayers with interest. Therefore, following the Commission's guidelines that working capital excludes all accounts or items on which a return is earned or paid, both the over and underrecoveries should be excluded from working capital.

The Commission staff has justified this policy on the basis that the inclusion of any net overrecoveries of fuel and conservation expense in the working capital allowance has the effect of requiring the stockholders to pay the interest on these overrecoveries. It is further contended that if the net overrecoveries are excluded from the working capital allowance calculations, the ratepayers must pay interest to themselves. This is not correct.

Including overrecoveries in working capital not only requires the stockholders to pay the interest through a reduction in the fuel component of the customers bill, but also compensates the customer at the overall rate of return, which includes equity returns. Not only is the stockholder paying twice, but a short-term interest rate is not comparable to our overall rate of return. In Order No. 9273 (Docket No. 74680-EI), the Commission established the interest provision to counter any incentive to bias the projections in either direction. The Company agrees with the intent and purpose of this provision. Both the Company and the ratepayer are properly compensated for over and underrecoveries in the fuel and conservation dockets through the interest provisions. Therefore, both over and under recoveries should be excluded from working capital.

AUDIT DISCLOSURE NO. 26

SUBJECT: Working Capital - Acid Rain and Other Deferred Debits

COMPANY COMMENT:

The Company agrees with the information.

AUDIT DISCLOSURE NUMBER 27

SUBJECT: Peabody Buy Out

COMPANY COMMENT:

Gulf would accept an unadjusted Return on Equity rate which equals the allowed rate in our current Rate Case.

This unadjusted Return on Equity % would be used to calculate the Peabody Buy-Out costs and Adder Rate which would subsequently flow through the fuel clause calculation.

AUDIT DISCLOSURE NO. 28

SUBJECT: Insurance Deposits

COMPANY COMMENT:

The audit opinion states that the Energy Insurance Mutual (EIM) Reserve, which is recorded in Account 128-020 (Energy Insurance Mutual Reserve Premium), should be excluded from working capital because it provides for dividends to mutual policyholders. The Company does receive a distribution of policyholders' surplus. This is not a dividend, however, but a return of our capital or investment. If the Company were to get out of EIM any reserve premium returned to the Company would be reduced by the amount of any prior policyholder distributions. (See Section VI.(T)(6) of policy attached.)

When EIM originated, it was not set up as a vehicle to make a profit. As a joint participant in the entity, the Company made an investment at its inception, and at that time set up a reserve account (128-020). When the Company receives a payment, the reserve is reduced by the amount of the payment. For this reason the Company does not believe any of these amounts should be considered as revenues; therefore, the EIM reserve balance represented in Account 128-020 should not be excluded from working capital.

premium under the renewed policy would exceed the Premium under this Policy, any increase in premium due to an increase in the length of the policy period, an expansion of the scope of activities to be covered under the renewed policy or a reduction in the Attachment Point shall not be considered.

(4) This Policy may be cancelled by the Company upon ninety days prior written notice to the Insured in the event that the Insured breaches any provision of this Policy, violates any provision of the Company's Certificate of Incorporation or By-laws, or fails to meet the underwriting standards established by the Company. The insurance under this Policy shall end on the effective date and hour of cancellation stated in the notice.

(5) In the event that the Company does not elect to provide coverage for (a) any organization acquired by, formed by or merged with the Insured after the inception of the Policy Period, (b) any activities of the Insured which are materially different from the Insured's activities prior to the inception of the Policy Period, or (c) any activities which present a materially increased risk of loss to the Company, the Member Insured may terminate this Policy within thirty days of notice from the Company that the Company does not elect to provide such coverage. Such termination by the Member Insured shall be effective thirty days from the date the Member Insured notifies the Company of its election to terminate this Policy pursuant to this subsection (5).

(6) In the event the Member Insured terminates its membership with the Company and this Policy is not renewed pursuant to subsections (2) or (3) above, any reserve premium paid by the Member Insured to the Company, to the extent it has not been utilized to absorb losses and expenses (including any reserves therefor) and less the total amount of distributions previously paid to the Member Insured, shall be repaid to the Member Insured two years after the date this Policy is not renewed. In the event the Member Insured terminates its membership with the Company and this Policy is cancelled or terminated pursuant to subsection (4) or (5) above, any reserve premium paid by the Member Insured to the Company, to the extent it has not been utilized to absorb losses and expenses (including any reserves therefor) and less the total amount of distributions previously paid to the Member Insured, shall be repaid to the Member Insured thirty days after the date of such cancellation or termination.

(7) Termination of the Policy shall not, except as otherwise specified, relieve the Insured of any of its obligations hereunder.

(U) Governing Law and Interpretation

In view of the diverse locations of the parties purchasing insurance from the Company and the desirability of unified regulation, the parties agree that the Policy shall be construed and enforced in accordance with and governed by the internal law of the State of New York, except insofar as such law may prohibit payment in respect of punitive damages hereunder.

(V) Dispute Resolution

The Company and the Member Insured mutually acknowledge that the form, terms and conditions of the Policy have been formulated by representatives of the participating utilities in order to provide insurance coverage which is vital to all participants. It was desired to have the Company serve as a financially stable and reliable entity, responsive to the coverage needs of its participants, and providing coverage fairly and equitably as to each insured, but taking equally into account fairness and equity as to all insureds as a group.

While every effort has been made to define with clarity and precision the scope of coverage, the Company and the Member Insured mutually acknowledge that situations may arise where the availability of coverage for a Claim under the Policy is disputed.

In light of the foregoing, the Company and the Member Insured agree that:

(1) the following principles shall govern the interpretation of the Policy:

(a) Even-handedness and fairness to both parties;

(b) The intentions of the parties, including any extrinsic evidence of intent;

AUDIT DISCLOSURE NO. 29

SUBJECT: Reported Cost of Debt and Preferred Stock

COMPANY COMMENT:

The Company has properly calculated the jurisdictional cost of long term debt and preferred stock using the same method approved by the Commission in our previous rate cases. Both the principal and annual cost amounts are based on thirteen month averages to avoid distortions in the jurisdictional cost of capital whenever specific capital structure adjustments, such as the UPS adjustments, are made to the capital structure. The calculation proposed in the audit will generally result in the same answer for most companies and for Gulf on a system basis, but is not appropriate for Gulf's jurisdictional calculations due to the UPS capital structure adjustments. This method would inappropriately reflect different UPS adjustments in the numerator and denominator, and lead to erroneous results. This can be illustrated by comparing the jurisdictional cost of long-term debt using the auditor's method, for November, 1987 through January, 1988 of 8.34%, 8.20%, and 8.31%, respectively. As shown, this method would result in a significant decrease in December, and a subsequent increase in January. This erroneous discrepancy was caused by the significant difference in the UPS adjustments to the numerator and denominator. The Company's calculations more accurately reflect the actual cost of capital supporting jurisdictional rate base.

AUDIT DISCLOSURE NO. 30

SUBJECT: Non-Utility Capital

COMPANY COMMENT:

Gulf Power Company's non-utility activities have no effect on the Company's cost of capital, and to remove these investments directly from equity would unjustly penalize the Company's stockholders. Recognizing that some of the items in the capital structure, such as customer deposits, are not related to non-utility activities, the Company has adjusted the non-utility investments from the capital structure using long-term dept, preferred stock, and common equity sources of capital as a reasonable proxy for the cost of capital.

AUDIT DISCLOSURE NO. 31

SUBJECT: Preferred Stock Premium and Stock Issue Cost

COMPANY COMMENT:

Gulf agrees with the amounts reported with the following exceptions:

1. The 1987 and 1989 Preferred Issue Costs shown are for the "period ending" December 31, 1987 and 1989. The correct 13 month average amounts $1,136,807 and $1,061,197 respectfully.

2. The 1990 Preferred Issue Costs should be $1,036,000 and not $1,036,001.

The Company has properly calculated all previous surveillance reports and the 1990 test year capital structure cost rates consistent with prior Commission treatment. The Company has agreed in Docket No. 891345-EI to stipulate to the Staff's recommendation to report the preferred stock principal net of the premium and issuing expenses, with a corresponding increase in common equity.

AUDIT DISCLOSURE NO. 32

SUBJECT: Redeemed Preferred Stock

COMPANY COMMENT:

Gulf agrees with the information presented.

AUDIT DISCLOSURE NO. 33

SUBJECT: Cost of Customer Deposits

COMPANY COMMENT:

Gulf agrees with the information presented.

AUDIT DISCLOSURE NO. 34

SUBJECT: Gulf Power Plea Agreement in U.S. District Court

COMPANY COMMENT:

Gulf agrees that the information provided in the audit disclosure is factual.

AUDIT DISCLOSURE NO. 34-A

SUBJECT: West Florida Landscaping

COMPANY COMMENT:

As Mr. McCrary states in his rebuttal testimony, since initially learning of the existence and magnitude of the various schemes identified in the investigation, Gulf has evaluated the merits of continuing to do business with those vendors involved.

In each instance, to the best knowledge of the Company, the vendor had acted upon the express instruction of a former employee. While this does not justify the vendors' actions, it did, along with the total cooperation provided to the Company and authorities, make the Company reluctant to immediately terminate relations. Nevertheless, by December 31, 1988, the Company severed its ties with all but one of the vendors.

The one remaining vendor is Mr. Dave Cook of West Florida Landscaping. To the best knowledge of the Company, Mr. Cook never profited from the improper actions requested of him by the few former Company employees involved. He has been extremely cooperative with and helpful to the federal authorities and the Company. West Florida Landscaping continues to be the low bidder for some of the Company's grounds maintenance work. The work performed is of superior quality at an extremely reasonable price. The Company sees absolutely nothing to be gained by terminating the Company's relationship with Mr. Cook at this time.

AUDIT DISCLOSURE NO. 35

SUBJECT: Executive Salaries

COMPANY COMMENT:

The Company agrees that a small amount of Executive Salary should be budgeted below the line for such activities as oversight of Vision Design, Southern Sod, Merchandising, etc. This should not be an issue since the Company has budgeted $13,813 in executive non-utility salaries 'below the line' in 1990. As can be seen on the Company's response to Audit Request 156, the total executive salary amount is broken into the categories of O&M, Plant, ECCR, Clearing and Other. The Other category represents the non-utility amounts budgeted for 1990 Executive and Officers.

Audit Request No. 4, which consists of the Planning Unit Approval Letters shows the non-utility amount of $13,813 as a reduction to the Executive Planning Unit O&M Labor budget.

AUDIT DISCLOSURE NO. 36

SUBJECT: Management Salaries

COMPANY COMMENT:

The Company has agreed to stipulate to a reduction of the Performance Incentive Program because there has been a major change in the scope of the program and funding is now budgeted at half of the estimated maximum payout under the plan. (See Prehearing Issue 92.)

Had the company originally budgeted this amount, the PIP would be $464,177 less $358,209 or $105,968.

After adjusting for this adjustment the incremental analysis yields a percent increase of 3.4%.

	Management Compensation
1990 Budget	$14,756,362
Less PIP reduction:	(358,209)
1990 Adjusted	14,398,153
1989 Actual	13,920,095
Increase 1990 over 1989	478,058
1989 Actual	13,921,095
Percent Increase	3.4%

AUDIT DISCLOSURE NO. 37

SUBJECT: Incentive Compensation Plans

COMPANY COMMENT:

Both the Productivity Improvement Program and the Performance Pay Plan are a part of the employee's total compensation package, resulting from the shifting of a portion of the fixed-cost for base salaries to a variable-cost for annual incentive awards. Placing part of one's pay at risk has historically been proven to be a substantial management motivator. The variable compensation is tied to the achievement of individual goals which are linked to major organizational and corporate goals, which creates a sensitivity to goal accomplishment not found in base salary-only type programs. Any goal achievement that produces a cost savings or productivity improvement will positively impact the ratepayer, as well as continue to support Gulf's effort to attract and retain the highly motivated and well-qualified workforce essential to enable the Company to meet its obligation of providing adequate, reliable, low-cost electric service to our customers.

A small portion of the maximum funding opportunity in the Performance Pay Plan is tied to the Rate of Return on Common Equity. Increased efficiencies resulting in O & M reductions benefit the ratepayer by contributing to the cost of product goal. Employees' individual goals are developed with emphasis on improving customer service and satisfaction through quality, cost-savings, timeliness and accuracy.

The Productivity Improvement Program is a long-term incentive plan for fifteen top management employees. The Productivity Improvement Program is designed to reward productivity while forcing management to be conscious of the potential long-term economic impact of their day-to-day decisions. If the goal is not achieved, there is no payout under PIP.

A major change in the Productivity Improvement Program design, which was implemented after the 1990 budgeting process was completed, has resulted in an adjustment of the accrual for 1990 from $464,177 to $105,968.

Major emphasis in the incentive programs is placed on both the quality of service and maintaining low cost for the Company's product. Controlling costs benefits the customer through low rates and the shareholder through increased return. Thus the interests of both of the groups which Gulf's management and employees are obligated to serve are considered and addressed through the incentive payment compensation programs in place at the Company.

AUDIT DISCLOSURE NO. 38

SUBJECT: Executive Development

COMPANY COMMENT:

The Company responded to this issue in the FPSC Audit Report related to the cancelled rate case Docket No. 881167-EI, Audit Disclosure No. 23. In response to the Rate Case audit in this docket, Gulf reiterates its justification as stated below.

The Company has budgeted for Mr. Scarbrough to go to the Stanford Executive Program. The location of the course is Stanford, California. The length of the course is eight weeks. The tuition budgeted is $21,000.

This is a justified and prudent expense. The content of the programs include accounting, business, policy/strategic planning, economics, financial management, marketing, organizational behavior, quantitative analysis, and computers. The programs are designed to achieve several broad objectives including examining the impact of the national and international environment, and stimulating fresh thinking through exposure to new ideas. These programs are a good investment of Company resources because they are favorably priced compared to other programs such as the Harvard University Advanced Management course, which costs more than the Stanford course. Today's business environment demands diverse knowledge and skills rather than the traditional narrow, single-discipline focus of past executive training programs. These programs allow our executives to learn from executives in other industries which influence our business and our customers. Considering the scope of our executives' responsibilities and the magnitude of their financial responsibilities, $25,000 in training expense is a relatively small investment in maintaining and improving the quality of their decision-making capabilities. It is not possible to quantify or measure the benefits of improved leadership and decision making skills. However, because of the magnitude of the dollars under the responsibility of the executives of Gulf Power, the potential benefits of these training programs far outweigh the costs of the programs.

The conclusion of the audit staff is that because Mr. Scarbrough has yet to have the opportunity to go to this eight week training course, this expense should be made an issue in this case. The audit infers that this expense also may be non-recurring in the regulatory sense.

Mr. Scarbrough was not able to attend the course in 1989 due to the work requirements of Rate Docket Nos. 881167-EI, 890324-EI, and 891345-EI. It is still his intention to attend the course. Also, the Executive department has two new employees in 1989, who will also have the opportunity to attend this

AUDIT DISCLOSURE NO. 38

SUBJECT: Executive Development

COMPANY COMMENT: (Cont'd)

course or similar courses within the next few years. It is incumbent upon the Company to provide training for its executive employees on an ongoing basis.

Gulf has shown that this program is reasonable and that the benefits will far outweigh the costs, has explained why the cost has not yet been incurred, and has shown that the cost is expected to recur in order to provide appropriate training for executives.

AUDIT DISCLOSURE NO. 39

SUBJECT: Political Action Committee (PAC)

COMPANY COMMENT:

Gulf Power Company did not have a PAC II for the 1990 test year and PAC II is not an issue in the rate case. All activities associated with the loosely organized group of employees known as "PAC II" were discontinued in the last quarter of 1988. Voluntary contributions made by employees through PAC II had no impact upon the Company's 1989 or 1990 budget or actual expenses.

Gulf Power Company established its Political Action Committee which has been operating under the Federal Election Campaign Act since its formation in 1980.

Since the formation of the PAC there have been no violations or problems with the operations of this committee.

The PAC contributions are totally voluntary and are collected through payroll deduction once a month from the employees' paycheck if the employee elects to pay the contribution in this manner. The employees' salaries would be, and are, the same whether or not the particular employee contributes to the PAC or, in fact, whether or not the PAC existed. None of the activities of the PAC have any bearing on Gulf's request for rate relief.

AUDIT DISCLOSURE NO. 40

SUBJECT: Selected Non Operating Expenses

COMPANY COMMENT:

The following information will reconcile the 1989 amounts provided by the Company in its responses to the Audit Requests references in this disclosure with the Amounts compiled from the General Ledger on the Schedule entitled "Comparison of Expenses," Don Hartsfield contained in this item.

Request No. 39	Gulf	Auditor	Diff
Donations	146,290	121,540	24,750
Revised	142,263	121,540	20,723

Gulf submitted a revised response to Audit Request No. 39 in its response to Audit Request No. 90.

The difference between Gulf's revised amounts and the Auditor's is $20,723. This amount constitutes donations which Gulf set up in Account 923 in 1989 and subsequently reversed in 1990. This set up and reversal is necessary to reflect amounts incurred by SCS for Gulf but not billed during the year. The amount of $20,723 was a portion of the total set up and was not separately accounted for in Account 426, but included in Account 923.

Request No. 40	Gulf	Auditor	Diff
Acct. 926-200 A. Medical Insurance	0	2,149,692	(2,149,692)
Acct. 926-200 B. Business Travel	2,332	2,331	1
Acct. 926-201 C. Life Insurance	34,492	34,493	(1)
Acct. 926-209 D. Post Retire Life	102,254	855,107	(752,853)
Total	139,078	3,041,623	(2,902,545)

Description of differences:

A. The auditor included all medical insurance; the request was for Life Insurance.

B. The Business Travel Insurance was charged to the Medical Insurance account because it covers both loss of life and limb. The Company amount and the Auditor's amount are essentially the same.

AUDIT DISCLOSURE NO. 40

SUBJECT: Audit Manual Interim Change 3-90 Non-operating expenses, Issued 1/30/90.

COMPANY COMMENT: (Cont'd)

C. The Life Insurance amounts are essentially the same.

D. The amount shown by the Company was actually paid to retirees in 1989. The amount shown by the auditor was the amount the Company accrued for 1989.

Request No. 42	Gulf	Auditor	Diff
Acct. 426-4 Civic, Political or related	719,793	719,793	0

These amounts tie.

Request No. 46	Gulf	Auditor	Diff
Preliminary Survey & Investigation charges related to abandoned projects	264,307	1,591,083	(1,326,776)

The auditor shows the total amount for Account 506-610 Research and Development rather than the amount associated with the Crist Waste-to-Energy facility.

AUDIT DISCLOSURE NO. 41

SUBJECT: Reference Level

COMPANY COMMENT:

The audit disclosure, as written, does not represent the role that the Reference Level plays in documenting Gulf's Operations and Maintenance (O & M) Budget. The Reference Level is a point, determined by the Budget Committee during each year's budget process, which is only used to control the amount of documentation required to be submitted to the Budget Committee for review in the budget approval process. The audit disclosure indicates inaccuracies in several areas related to Gulf's Reference Level. The Company will address each area individually.

1. The audit report indicates that the Company builds its current year's O & M expense budget based on the Reference Level. That is not correct. Budget estimates are developed by each Planning Unit independent of the reference level by using appropriate budgeting methodologies (i.e., zero base, trending, etc.) Gulf's O & M budget is based on the goals and objectives of the Company and the individual planning units. The activities necessary to accomplish these goals and objectives are the basis for the development of Gulf's budget.

2. Contrary to the audit opinion and conclusion, the "reference level" method is not used over other methods but is used in conjunction with zero-based and trending methods. As indicated by the Company, the Reference Level is the level from which Planning Units must explain and justify to the O & M Review and Budget Committees the increases and decreases resulting in their 1990 Budget requests. As mentioned above, the Reference Level is a point, determined by the Budget Committee during each year's budget process, which is used to control the amount of documentation required to be submitted to review committees in the budget approval process. It is not the basis for the current year's budget. The budget must be based on the Company's actual needs, goals and objectives, and supported by detailed calculations maintained by the Planning Units, regardless of the Reference Level. Management personnel within each Planning Unit review and approve the detailed work papers.

3. The audit report erroneously states that in order to effectively audit the 1990 budget for reasonableness, it is necessary to audit the budgets of every preceding year as the Reference Level is built on the prior year's budget. That is not correct. The Planning Units develop their budgets to accomplish the activities to be performed during the budget year. The Reference Level is a point utilized

AUDIT DISCLOSURE NO. 42

SUBJECT: Budget Variances

COMPANY COMMENTS:

The Audit Staff states in this disclosure that it has not been able to verify that the Company takes budget variances into consideration when estimating their 1990 budgets.

The Company begins its budget process by issuing the Corporate Business Plan which outlines the Corporate Objectives, Goals and Strategies for the upcoming year. This plan is then translated by each planning unit into individual and departmental goals. The departments then budget in order to meet these goals and objectives. Management reviews the activities necessary to accomplish the goals and reviews the budget variances in their most current budget comparison reports and historical budget comparison reports. The budgeting methods used by Gulf personnel, zero-based and trending, automatically consider most budget variances when developing estimates for a future period. Since in the zero-based methodology one is making a totally new estimate from "scratch," one must include current estimates of volume and price which would include most changes reflected by budget deviations from a prior period. In trending, one utilizes a history of the expenditures being budgeted; therefore, when the history is updated the budget deviation is included in the new projections. To the extent the budget amounts are not indicative of the amounts needed in the future, they are adjusted.

The budgets prepared by the planning units are then reviewed by management within each planning unit to test for reasonableness and need. After this internal review, the increases and decreases are then compiled into Corporate Budget forms called B-3 and B-4 forms. These are reviewed by the O & M Review Committee and questions concerning amounts which may differ from historical actual amounts are raised and proposed to management of the planning units during the review meetings. Adjustments are made accordingly. The budget is then sent to the Budget Committee for its review and any further adjustments.

Philosophically, truing the budget up for variances may provide a disincentive for planning units to save money, since their budgets for future periods may be reduced if they are under budget during a particular period. Conversely, if a planning unit were over budget, it would not be prudent to simply true up the difference and, in effect, approve an amount of money without a review of the reasonableness of the overrun.

AUDIT DISCLOSURE NO. 42

SUBJECT: Budget Variances

COMPANY COMMENTS: (Cont'd)

Gulf's 1990 budget compared to its 1989 budget and 1989 actual is shown below:

1989 Budget	129,227,859	Actual	123,503,147
1990 Budget	129,712,291	Budget	129,712,291
Increase	484,432		6,209,144
Percent Increase	0.4%		5.0%

As can be seen Gulf has not allowed its budget to increase unreasonably from its prior budget and actual amounts.

Gulf did adjust the reference level to delete 1989 budgeted personnel additions not added to the complement and vacancies in the complement which had not been authorized to be filled since June 1988. This was stated in the budget message which was provided to the audit staff in response to their request.

AUDIT DISCLOSURE NO. 43

SUBJECT: Non-Recurring

COMPANY COMMENT:

The audit disclosure indicated that items listed by Gulf as non-recurring are not non-recurring in a regulatory sense. This is correct. Non-recurring in a regulatory sense indicates that these expenditures will never occur again. Gulf includes several items as non-recurring, such as Major Turbine and Boiler Inspection and Vehicle Rebuilds, in the Planning Unit's budgets for planning and control purposes. Turbine and Boiler Inspections will be performed periodically on different units and Vehicle Rebuilds will be performed on different vehicles in the forecast years.

The Company agrees with the removal of the $5,000 for non-recurring Grand Jury and IRS investigation related expenses and has stipulated to this in Issue No. 74, Prehearing Order, Docket No. 891345-EI.

AUDIT DISCLOSURE NO. 44

SUBJECT: Heat Pump Program

COMPANY COMMENT:

Documentation of the 1989 expenses and a description of the program were provided to the auditors as part of Document/Record Request 112. The auditors were told that the Heat Pump Program that existed in 1989 was cancelled and did not exist in 1990 and that <u>some</u> of the resources that were contained in the Heat Pump Program were included in the Technology Transfer Program. There were no expenses transferred between programs because marketing uses a "zero-based" budgeting methodology for all programs. Because the Marketing Department budget is zero-based, the statement in the disclosure that the monies are now "buried" in the reference level is incorrect. See Gulf's comment to Audit Disclosure No. 41.

The statement made by Mr. Davis "that the exact amount of the transfer of expenses from the Heat Pump Program to the Technology Transfer Program is unknown..." is taken out of context from the entire conversation. The auditors were advised that the budget documents submitted to Corporate Performance did not reflect details of the "transfer," but that working papers available in the Marketing Department would provide all detail necessary to support the 1990 budget.

The $717,000 for the Heat Pump Program could not be identified in the budget documents provided for the 1990 test year because the program does not exist in 1990.

AUDIT DISCLOSURE NO. 45

SUBJECT: WeatherGUARD Program

COMPANY COMMENT:

The WeatherGUARD program has been cancelled and there are no expenses for this program or any program of a similar nature contained in the 1990 test year budget. Mr. Davis stated that the B-3's and B-4's properly reflected the WeatherGUARD program in 1989 but would not reflect expenses associated with that program in 1990 because the program no longer exists. No statement was made that the removal was "buried in the Reference Level." Because the Marketing Department utilizes a zero-based budgeting methodology the reference level is irrelevant to the development of the current years budget. Marketing Department budget working papers fully supported the fact that WeatherGUARD expenses are not contained in the test year budget.

AUDIT DISCLOSURE NO. 46

SUBJECT: Good Cents Incentive Program

COMPANY COMMENT:

Gulf believes that the expenses for this program are more appropriately recovered through base rates.

AUDIT DISCLOSURE NO. 47

SUBJECT: ECCR Programs

COMPANY COMMENT:

Gulf and Staff reached an agreement concerning the Good ¢ents Home (New) program that Gulf would not seek approval of a similar new-home type program under the CCR unless instructed to do so by the Commission. The stipulation did not specifically allow base rate recovery of the Good ¢ents Home (New) program but did expressly provide that recovery of this program through base rates would be left open for the Commission to decide in Gulf's next rate case. Thus, Gulf is now requesting such recovery in this docket.

The other programs referenced in this disclosure were removed from conservation cost recovery because the Commission recognized that the services provided are a fundamental part of the Company's customer service responsibility, and the need for special treatment in the conservation cost recovery clause of such information services has long since passed (Order No. 21317, page 19). Gulf has presented evidence that all programs mentioned in this disclosure, are cost-effective, that the services are in great demand by our customers, that they are appropriate forms of customer service, and thus that the expenses associated with these programs should be recoverable in base rates.

AUDIT DISCLOSURE NO. 48

SUBJECT: Cancelled Rate Case Charges

COMPANY COMMENT:

Gulf Power Company has excluded all amounts related to the rate case expenses associated with Docket No. 881167-EI from Net Operating Income and rate base from its current rate case and in the 1989 Tax Rule filing.

AUDIT DISCLOSURE NO. 49

SUBJECT: Non Allocation of Postage Costs

COMPANY COMMENT:

Gulf appropriately allocates all non-utility expense. Gulf Power Company's non-utility appliance sales operations include sales promotion stuffers in monthly bill mailings. The various incremental costs of these bill inserts are calculated and reclassified via journal entry each month from customer billing expense (O&M) to the appropriate account, including non-utility operations accounts. The costs that are reclassified include transportation and storage of the bulk inserts to the Atlanta central billing location, machine set-up time for the inserting, programming costs, and mailroom handling costs. Because the Company is able to receive bulk mailer discounts from the Postal Service and maintains its piece weight within prescribed limits, the addition or exclusion of monthly inserts has no effect on total postage paid. If all bill inserts were eliminated immediately, there would be no decrease in Company postage costs; the entire cost is necessary for the Company to mail utility bills to the customer. Therefore, <u>no</u> customer billing postage costs should be removed from total O&M expense for purposes of this rate case.

The audit report references a calculated amount of postage costs for 1990 of $289,086 for mailings that include non-utility advertising. The schedule entitled "Finding Summary" at the front of the audit report shows this same amount ($289,000) under issue No. 49. Based on conversations with the audit staff at the exit conference, Gulf understands that this is the amount of expense that the audit staff has concluded should be allocated between the utility and non-utility businesses and is not the recommended adjustment for this issue.

AUDIT DISCLOSURE NO. 50

SUBJECT: Utility Transmission Rentals

COMPANY COMMENT:

The amounts resulting from the these agreements have secured the least expensive alternative available to provide transmission service from Plant Daniel and Plant Scherer. The Audit Conclusion spoke negatively about these agreements since they were not "based upon rate base regulation amounts." Gulf will continue to effect arrangements which may appear innovative to auditors, but which lower customer costs.

AUDIT DISCLOSURE NO. 51

SUBJECT: State Federal Jurisdictional Factors

COMPANY COMMENTS:

Gulf Power Company, in rate case filings as well as in the monthly surveillance reports, appropriately uses jurisdictional factors from the latest Cost-of-Service study.

AUDIT DISCLOSURE NO. 52

SUBJECT: Line Loss

COMPANY COMMENTS:

Gulf Power Company properly accounts for line losses in the monthly surveillance reports and rate case filings. The fuel related to line losses is included in the Company's total fuel expenses, and has been properly removed from Net Operating Income.

AUDIT DISCLOSURE NO. 53

SUBJECT: Changes in Adjustments to Net Operating Income

COMPANY COMMENT:

The Audit Staff states that Gulf has changed the amounts for Company Proposed 1989 Net Operating Income Adjustments since the filing of the Surveillance Report for the 12 months ended December 31, 1989. The Company has changed these amounts, reported them in Audit Request 87 and reflected the appropriate amounts in its current 1989 Tax Savings Report filed May 14, 1990 in order to most accurately reflect the best information the Company has available for the 1989 investigation, Market Support Activity and Area Development expenses. These adjustments do not necessarily tie directly to any particular FERC-Sub Account. The Company has details of these adjustments and has provided them to the Audit Staff.

AUDIT DISCLOSURE NO. 54

SUBJECT: Attorney Bonus

COMPANY COMMENT:

As stated by Mr. Scarbrough in the 1988 Tax Savings (Docket No. 890324-EI) hearings, Gulf had an agreement with the Levin firm to handle the appeal of the Kay pole hit case on an hourly basis with the representation to Mr. Levin that Gulf would explore the possibility of payment of a contingency fee which Mr. Levin was accustomed to receiving as a plantiff's lawyer.

The decision was reversed in Gulf's favor due to Mr. Levin's successful appeal to the District Court. The appellate decision also established significant precedent in pole hit cases which will continue to benefit Gulf, as well as other utilities, in similar cases in the future. Because the case was settled after the appellate courts' decision, the Company saved $5,700,000 which would eventually have been borne by the customer through the I & D Reserve.

In the $107,399.23 payment made to the Levin firm a contingency fee of $100,000 was included. (Gulf Power did not report that a bonus of $107,399.23 was paid.) The basis for this payment was a consultation the Company sought with a senior member of a law firm who said it was not unusual for a contingency fee to be paid and that his recommended range would be from $100,000 to $500,000. Gulf determined that $100,000 would be appropriate, reasonable and prudent for the benefits received by the Company as enumerated above.

Payment of this amount has no impact on the 1990 test year.

AUDIT DISCLOSURE NO. 55

SUBJECT: Out of Period UPS Charges

COMPANY COMMENTS:

The correct 1989 Out of Period UPS Charges as calculated by Gulf are as follows:

Transmission		Production	
1988 True-Up Recorded in 1989:	(188,616)	1988 VOM True-up Recorded in 1989	(25,558)
1989 True-Up Recorded 1990:	58,688	1989 VOM True-up Recorded70 in in 1990:	(19,595)
	(129,928)		(45,153)
Jurisdictional Factor	.9695245		.9688126
Jurisdictional Amt.	(125,968)		(43,745)
Less Income Taxes @.3763%	47,402		16,461
Income Effect	(78,566)		(27,284)

Total Adjustment (78,566) + (27,284) = (105,850)

(Reduces 1989 Income to Retail Customers)

AUDIT DISCLOSURE NO. 56

SUBJECT: Non-utility Activities

COMPANY COMMENT:

The Company agrees with the numbers represented in the disclosure; however, the service area was not addressed with regard to the appliance operations.

The comparable figures for the Appliance Service Operations are as follows:

Appliance Service	Year	Sales $	Profit/Loss (P)/(L)
	1986	771,449	91,862 (L)
	1987	743,755	109,065 (L)
	1988	895,546	55,460 (L)
	1989	922,910	25,113 (L)

The relevance of the information contained in this disclosure is unclear.

AUDIT DISCLOSURE NO. 57

SUBJECT: Tax Related Work

COMPANY COMMENT:

No response required.

AUDIT DISCLOSURE NO. 58

SUBJECT: Independent Quality Assurance Review

COMPANY COMMENT:

An important fact not mentioned by PSC audit staff was that the Quality Assurance Review by the Institute of Internal Auditors (IIA) in 1988 was voluntarily requested by Gulf's Director of Internal Auditing and Security. The request was made to gain an objective opinion of the department's overall compliance to the IIA Standards.

Under the report summary, the first paragraph indicates the effectiveness of the Internal Auditing Department could be improved by the Director reporting to the President. The IIA report states:

> "The independence of the Director of Internal Auditing is well recognized throughout the Company and is enhanced by his direct access to the President and Chairman of the Audit Committee."

The IIA felt that as long as the current Director remains in the position, the reporting relationship is sufficient. The current Director is retiring July 1, 1990 and the new Director will report directly to the President.

Two of the items in the summary report are in reference to the need for increased supervision. This is currently being addressed by management and additional technical supervision is scheduled to be in place by July 1, 1990. It should be noted that the IIA report also stated:

> "The Department's staff possess the knowledge and skills essential to practice the profession within Gulf Power" and "the IAD's commitment to training and continuing education is outstanding."

The item regarding broadening "the scope to include audits of economic and efficient use of resources and, whether company goals were accomplished," was agreed to by Gulf's Audit Management and the 1990 audit plan reflects increased attention in areas identified in this recommendation.

The item regarding "completing the good work to identify all auditable units" is a ongoing process. This is a project Gulf developed and the IIA recognized as very good and urged us to continue it.

AUDIT DISCLOSURE NO. 58

SUBJECT: Independent Quality Assurance Review

COMPANY COMMENT: (Cont'd)

The item relating to Gulf's audit staff's participation in "taking physical inventories" rather than "testing physical inventories," has been addressed by Audit Management. This occurred only on rare occasions when warehouse personnel had not been able to complete the count by the time the auditors arrived. This practice has been stopped.

The item concerning the issuance of audits on a timely basis is a situation being monitored by Gulf's Audit Management. The issuance of some audit reports during the time the IIA performed its review, were delayed due to an unusually high demand of special requests from management. These special assignments take priority and may delay the release of the final audit report. However, the Departments' main priority is to perform the audit work and determine if there are problems. If problems exist, they are reported to management even before a formal final report is released.

AUDIT DISCLOSURE NO. 59

SUBJECT: FERC Audit - 8 Compliance Exceptions

COMPANY COMMENT:

The FERC has not issued a final report. The current status of these issues is as follows:

Compliance Exceptions Affecting Tariff Billings

1. Coal Contract Buy-Out Cost

   FERC's recommendation is to amortize buy-out costs to Accounts 506 (Principal), 427 (Interest), and other appropriate Accounts not including 501 (Fuel). Also, refund to wholesale customers and UPS customers any buy-out amounts which have been flowed thru Account 501.

   The Company's position continues to be that the accounting for these transactions was correct as stated in the Company's response in the Audit Report. However, despite the Company's position on the issue, recent FERC rulings on similar issues have required the accounting indicated. The Company has a letter agreement from its UPS customers to allow recovery of the buy-out costs and is in the process of getting concurrence from Gulf's wholesale customers on amending the wholesale fuel clause tariff. These agreements will have to be filed with the FERC for approval.

2. Alabama By-Products Coal Purchase

   The FPSC determined that the prices paid by Gulf Power to ABC for coal from Maxine Mine during the period July, 1980 - September, 1982 were imprudent. FERC agrees with this determination and recommends making a memorandum entry to reclassify the fuel costs and recalculate the wholesale billings to refund these costs. Memorandum entry would be a debit to Account 426 and a credit to Account 501. Gulf has agreed to make this adjustment and refund but has not done so as of 4/30/90.

3. Maxine Mine Closing Costs

   FERC determined that the Maxine Mine closing costs paid by Gulf to ABC aren't recoverable fuel costs because these costs are not assignable to any coal on hand. FERC recommends that the mine closure costs be recorded in Account 186 and amortized to Account 506. Also, a refund should be made to the wholesale customers for any amounts which have flowed thru Account 501. The Company contends that all closing costs were recorded in Account 151 by October, 1983, which is the date which Gulf received the final coal delivery from Maxine Mine, thus all

AUDIT DISCLOSURE NO. 59

SUBJECT: FERC Audit - 8 Compliance Exceptions

COMPANY COMMENT: (Cont'd)

closing costs were recorded to Account 151 at the time Maxine Mine coal was still in inventory. In addition, closing costs charged to Account 501, Fuel Expense, and inclusion in the wholesale fuel clause billings satisfy the regulations covered in Section 35.14 of the CFR because the closing costs were related to fuel consumed. As of April 30, 1990 the Company's position had not changed and FERC was still reviewing it's position.

4. Black Lung Payments

FERC recommends that black lung reimbursements received in 1985 and 1986 which were credited to Account 253, be credited to Account 501 and that the wholesale customers be refunded for related amounts. Gulf recorded the reimbursement (due to an overfunding) amount in Account 253 based upon the findings of a report done by independent actuary, A Foster Huggins Company, which stated that Gulf has a possibility of a future liability associated with the Black Lung Trust. This liability will be paid with the funds recorded in Account 253. Gulf's customers will not incur fuel costs until the Black Lung Trust liability exceeds the 1985 and 1986 reimbursement amounts in Account 253. As of April 30, 1990 there was no change in Gulf's or FERC's positions.

5. Scherer Unit 3 Purchase

FERC's recommendation is to refund UPS customers for amounts overcollected due to excess utility investment included in the UPS billing calculation, which resulted when Gulf purchased a 25% interest in Scherer Unit 3 from Georgia Power.

The Company reached agreement with Georgia Power to reduce the "purchase price" of Plant Scherer Unit 3 by the related deferred taxes and the federal tax adder related to AFUDC-equity. The FERC has reviewed the Company's entries that were made in November and December of 1989 and has given verbal approval. UPS customers were refunded on the March, 1990 capacity invoice.

6. Scherer Acquisition Adjustment

FERC has recommended that Gulf revise accounting procedures to ensure that the amortization of the Plant Scherer Acquisition Adjustment be recorded in Account 425 and not 406. They also recommend that since Accounts 114, 406 and 425 are not included in the UPS billing agreement, that a refund be made to the UPS customers as a result of including the amounts in these accounts

AUDIT DISCLOSURE NO. 59

SUBJECT: FERC Audit - 8 Compliance Exceptions

COMPANY COMMENT: (Cont'd)

in the UPS calculation. The Company has a letter agreement from its UPS customers to allow recovery of amounts associated with the Acquisition Adjustment and is in the process of filing additional data with FERC to support the amortization being recorded in Account 406.

7. AFUDC Computed During Scherer Construction

FERC contends that the Company continued to accrue AFUDC (on the Monroe County Pollution Control Trust Fund) on the Plant Scherer Project beyond the in service date and that the Company failed to reduce the base for computing AFUDC on the Unit 3 project by the related interest income. Also, accrued post-retirement expenses recorded as construction costs by the Company were included in the base for computing AFUDC. Since there was no actual cash outlay these amounts should have not been included in the base for computing AFUDC. On the first issue FERC recommends that AFUDC be debited and plant in service and interest income be credited. On the 2nd issue FERC recommends a correcting entry to reverse AFUDC accrued on unfunded post retirement expenses. The Company's position is that the accounting procedure used to continue to accrue AFUDC was in accordance with AR-13. The final drawdown of the pollution control drawdown occurred in August 1988. The fund was dedicated fully to pollution control expenditures for Plant Scherer and remained in CWIP until the money was spent for same. The Company agrees with the post retirement adjusting entry recommended but feels that it is not necessary due to the materiality.

8. Railroad Coal Cars

FERC contends that the real economic impact of the Company's sale of Plant Daniel Railcars was a loss and that an amount should have been recorded in Account 421, loss on disposition of property. Also the Company's share of the loss should have been credited to Account 253 and not 108. The Company also included the entire lease payment as a component of cost of fuel for FAC billings which had the indirect effect of including the loss on the railcar sale in FAC billings without specific commission approval. FERC recommends that a correcting entry be made to recognize the loss and recognize financing of the loss thru the lease payments. Also, billings to the wholesale customers should be recomputed. The Company cites that the FPSC has allowed recovery from the retail customers. The Company also cites that per instruction 10F Account 108 was properly debited for the retirement book cost and credited with the salvage received (actual cash). Therefore, no gain or loss occurred.

AUDIT DISCLOSURE NO. 60

SUBJECT: FERC Audit - 13 Compliance Violations

COMPANY COMMENT:

The FERC has not issued a final report. The current status of these issues is as follows:

Other Compliance Exceptions

1. Generating Plant Spare Parts

   FERC maintained that after a review of the categories of spare equipment capitalized in Account 101 related to Plants Smith, Crist, and Scholz an estimated $170,000 of spare equipment did not meet the emergency spare parts criteria. These amounts should be reclassified in Account 154, Plant Materials and Operating supplies. After subsequent research by the Company, it was determined the accounting treatment for this amount is in accordance with FERC, FPSC, and IRS rules. The exception has been dropped by FERC.

2. Land Not Currently Being Used in Utility Operations

   In 1987, the Company transferred the cost of land and related improvements that was located adjacent to its corporate office from Account 105, Electric Plant Held for Future Use, to Account 101, Electric Plant in Service. The Company was not using the land for utility operations at the time of the reclassification. It did have future plans to construct a parking lot on this property to meet projected employee growth. FERC recommends that the Company should not have transferred the land and related improvements from Account 105 and should make a correcting entry debiting Account 105 and crediting 101 since this land is not currently used in Utility operations. The Company contends the property is in use mainly because of the development of a site specific zoning plan for the property which was approved by the city. The nature and development of the land became an integral part of the total Corporate Office Design. FERC has dropped the exception.

3. Recording Income Taxes

   FERC contends that the Company did not properly record income tax adjustments and as a result the current and deferred income tax expense accounts were misstated. FERC recommends the Company implement procedures to record income tax adjustments in conformance with the Uniform System of Accounts. The Company agrees with FERC on this issue. This has no effect on the Income Statement or Balance Sheet.

AUDIT DISCLOSURE NO. 60

SUBJECT: FERC Audit - 13 Compliance Violations

COMPANY COMMENT: (Cont'd)

4. <u>Accounting for Interest Income and Expense</u>

FERC recommends that the Company revise its procedures for classifying interest income and expense on the over/under recovery of fuel from Accounts 456 and 557 (Other Electric Revenues, Other Expenses) to Accounts 419 and 431 (interest income and interest expense). Also carrying charges on spare parts billed from Georgia Power should be debited to Account 431 and not Accounts 514 and 562 (misc. steam plant, station expenses). The Company agrees with FERC on this issue. Over/under recovery interest accounting was changed by year end 1989. Carrying charge accounting has not been changed.

5. <u>Discriminating Employment Practices Accounting</u>

Per FERC, from 1984 thru 1988 the Company recorded all settlements of employee discrimination charges in Account 930. Per FERC, settlements against the Company and compromises should be recorded in Account 426. The Company agrees with this recommendation and a correcting entry was made in June 1989.

6. <u>Non Utility Expenses</u>

FERC contends that the Company charged utility operating expenses with various expenditures related to non-utility operations. Accounts used were 908, 908, 912, 913, 930, 921, 923, 566, and 588. FERC recommends using accounts 426 and 417. The Company agreed that some items such as the "Clean and Green" program and Naval Aviation Foundation should be reclassified. However, other items such as the "School Appliance Change Out" program should not. FERC has dropped the items which the Company disagreed on.

7. <u>Accounting for Depreciation</u>

FERC found that the closings of several major construction projects to account 106, Completed Construction not Classified, were delayed due to clerical errors and depreciation was not adjusted for the delay. FERC recommends a correcting entry to record additional depreciation. The Company agrees and a correcting entry was made in December 1989.

8. <u>Cancelled SCS Building</u>

FERC contends that the Company improperly capitalized a portion of the costs allocated to it for the cancelled SCS building

AUDIT DISCLOSURE NO. 60

SUBJECT: FERC Audit - 13 Compliance Violations

COMPANY COMMENT: (Cont'd)

project. They recommend a correcting entry to correct utility plant, operating expense, and income taxes as of 12/31/88. The Company agreed and a correcting entry was made in May, 1989.

9. Marketing Department Expenses

FERC contends that expenses related to various marketing department entertainment activities should be classified in Account 426. The Company argues that the accounting undertaken for these activities is in accordance with the uniform system of accounts instructions for Accounts 908 and 912. FERC has dropped the issued.

10. Amortization of Loss on Reacquired Debt

FERC found that the Amortization of Loss on Reacquired Debt was improperly included with Amortization of Debt Discount in FERC Form 1 and should be corrected. Company agrees with this.

11. Billing Allocated A & G

FERC contends that the Company was being billed by Mississippi Power for A & G which they were also allocating to their UPS customers and in turn we were billing the UPS customers for their allocated portion of this "overbilling" to us. FERC recommends that Gulf refund its UPS customers for the result of these overbilled amounts. Gulf argues that these were legitimate A & G costs that Gulf paid Mississippi Power related to the operation of Plant Daniel in accordance with the Intercompany Agreement. FERC is still reviewing.

12. Accounting for Bank Commitment Fees

Company recorded commitment fees for bank loans committed but not borrowed in Account 921, Office Supplies and Expenses. FERC recommends that these amounts be recorded in Account 431, Other Interest Expense. The Company contends that these amounts are for an assurance fee and are not interest expense nor are they mentioned in the FERC description of Account 431. FERC is still reviewing.

13. Incomplete FERC Form 1

Company failed to disclose basis of allocation of the consolidated tax among group members. Company agrees with FERC.