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## -M-E-M-O-R-A-N-D-U-M-

**DATE:** September 24, 2009

**TO:** Kaley Thompson, Regulatory Analyst II, Division of Economic Regulation

**FROM:** Dale N. Mailhot, Assistant Director, Division of Regulatory Compliance DNM

**RE:** Docket No.: 090001-EI
Company Name: Progress Energy Florida, Inc.
Company Code: EI801
Audit Purpose: Hedging 2008 - 2009
Audit Control No: 09-189-2-2

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

DNM/ch
Attachment: Audit Report

cc: (With Attachment)
Division of Regulatory Compliance (Salak, Mailhot, File Folder)
Office of Commission Clerk
Office of the General Counsel

(Without Attachment)
Division of Regulatory Compliance (Harvey, Tampa District Office, Miami District Office, Tallahassee District Office)

DOCUMENT NUMBER-DATE
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**FLORIDA PUBLIC SERVICE COMMISSION**

***DIVISION OF REGULATORY COMPLIANCE***
***BUREAU OF AUDITING***

***Tampa District Office***

# PROGRESS ENERGY FLORIDA, INC.

## 2009 HEDGING ACTIVITIES

**12-Month Period Ended July 31, 2009**

**DOCKET NO. 090001-EI**
**AUDIT CONTROL NO. 09-189-2-2**

***Ron Mavrides, Audit Manager***

***Joseph W. Rohrbacher, District Audit Supervisor***

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**DIVISION OF REGULATORY COMPLIANCE**
**AUDITOR'S REPORT**

**September 11, 2009**

**TO: FLORIDA PUBLIC SERVICE COMMISSION**

We have performed the procedures described later in this report to meet the agreed upon objectives set forth by the Division of Economic Regulation in its audit service request dated June 23, 2009. We have applied these procedures to the Hedging Activities of Progress Energy Florida, Inc. (PEF) in Docket No. 090001-EI.

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

## OBJECTIVES AND PROCEDURES

**Objectives:** To verify that the hedging transactions for fuel purchases from August 1, 2008 to July 31, 2009, were prudent.

**Procedures:** We requested a listing of each futures, options, and swap contract executed by PEF for the 12-month period covered by the Hedging Information Report. We requested the volumes of each fuel the utility actually hedged using fixed price contract or instrument. In addition, we requested the types of hedging instrument the utility used and the average period of each hedge, options premiums, futures gains and losses and swap settlements. We tested 24 hedging transactions, choosing an array of transaction types for each hedged fuel type. We traced the transactions to the general ledger.

**Objectives:** To determine if there are any tolling arrangements, and if there are, review them and determine if the are prudent. A tolling arrangement involves providing natural gas to generators under purchased power agreements, and receiving back the generated power for a fee.

**Procedures:** We reviewed the existing tolling arrangements, and tested all tolling transactions for one month by tracing the invoices to the general ledger.

**Objectives**: Review and verify the information presented in PEF's Hedging Information Report filed on August 15, 2009.

**Procedures**: We reviewed PEF's Hedging Information Report as filed on August 15, 2009. We examined the report for reasonableness and used it as a basis for our testing and prudency reviews.

**Objectives:** Verify that the accounting treatment from futures, options, and swap contracts between PEF and its counterparties are consistent with Order No. PSC-02-1484-FOF-EI, in Docket No. 011605-EI, issued October 30, 2002, and as clarified by Order No. PSC-08-0316-PAA-EI.

**Procedures:** We recalculated and traced gains (losses) to the general ledger. We determined they flowed through the fuel and purchased power cost recovery clause as either a charge or a credit as required in Order No. PSC-02-1484-FOF-EI. When there was existing inventory, the inventory account was adjusted, and when there was no existing inventory, the gains (losses) flowed through the fuel expense account.

**Objectives**: Verify that the gains (losses) associated with each financial hedging instrument that PEF implemented is consistent with Order No. PSC-02-1484-FOF-EI.

**Procedures:** Using the trade tickets, we recalculated the gains (losses) by multiplying the volume by the difference between the fixed price and the settlement price, and compared them to the recorded gains (losses) per books.

**Objectives:** Verify that the quantities of gas, residual oil, and purchased power hedged are within the percentage range, as represented in the utility's Risk Management Plan.

**Procedures:** We compared the percentage limits of purchased power hedged in the Risk Management Plan with the actual volumes of hedged burns. There were discrepancies. See Audit Finding No.1.

**Objectives:** Review the utility's procedures for separation of duties related to hedging activities: front office, middle office, and back office.

**Procedures**: We reviewed the utility's written procedures for separation of duties related to hedging activities. We reviewed the internal and external auditor's workpapers addressing the separation of duties. The external auditor made no comment on this, but the internal audit staff reported one deficiency involving the appropriate approval for the Contract Approval Forms. See Audit Finding No.2.

**Objectives:** Review the new transportation fuel hedging program.

**Procedures:** We reviewed the "PEF Fuels & Power Optimization Risk Management Guidelines". The transportation fuel has been added as an "approved product", and volumetric limits have been set.

**AUDIT FINDING NO. 1**

**SUBJECT: PERCENTAGE RANGE OF PURCHASED FUEL HEDGED**

**AUDIT ANALYSIS:**

We compared the percentage of Natural Gas and Oil burned for the period August 1, 2008 to July 31, 2009 to the percentage range provided for in the Risk Management Plan. The percentages burned deviated from the Plan as shown below.

| | **Natural Gas** | **#6 Oil** | **#2 Oil** |
|---|---|---|---|
| **Per Risk Management Plan** | 50 %-80 % | 50 %-80 % | at least 25 % |
| **Actual Amount Burned 2008** | 83% (Note #1) | 96% (Note #1) | |
| **Actual Amount Burned 2009** | 87% (Note #1) | | 23% (Note #2) |

Note #1. The hedged percentage of natural gas and #6 oil burned exceeds the limits prescribed in the hedging plan due to less natural gas and #6 oil usage than was originally forecast. As the generation requirements have been reduced from prior forecasts, the percentage of hedged volume will increase when compared to actual burns.

Note #2. As the percentage range for #2 oil calls for a minimum hedged volume, a slight increase in burn activity for this commodity over prior estimates leads to the decrease in hedged volume as a percentage of total burns during this period.

**EFFECT UPON GENERAL LEDGER IF THE FINDING IS ACCEPTED:**

None

**EFFECT UPON THE FILING IF THE FINDING IS ACCEPTED:**

None, provided for information only.

## AUDIT FINDING NO. 2

## SUBJECT: SEPARATING DUTIES, HEDGING ACTIVITIES

## AUDIT ANALYSIS:

We reviewed the utility's written procedures for separating duties relating to hedging activities: front office, middle office, and back office. We reviewed the internal auditor and external auditor workpapers. The external auditors mentioned no deficiencies in their report. However, the internal auditors reported one "Ineffective Exception" to the contracting procedures. This involved a control activity that required contract negotiations, once completed and prior to final execution, to be internally routed for appropriate approval or comments with the Contract Review Form. Two out of five contracts tested did not have appropriate approval with the Contract Review Form.

## EFFECT UPON GENERAL LEDGER IF THE FINDING IS ACCEPTED:

None.

## EFFECT UPON THE FILING IF THE FINDING IS ACCEPTED:

None, provided for information only.