

June 17, 2003

**Internal Audit Report 2003-6
Bradley Lake Operation and Maintenance Costs
Municipal Light and Power**

Introduction. The Alaska State Legislature created the Alaska Energy Authority (AEA) in 1976. AEA is a public corporation and a component unit of the State of Alaska (State). AEA's purpose is to "... promote, develop, and advance the general prosperity and economic welfare of the people of the state by providing a means of financing and operating power projects and facilities that recover and use waste energy and by carrying out the powers and duties assigned to it"

AEA has entered into several agreements to provide for the operation and maintenance of the Bradley Lake Hydroelectric Project (Project).

- The Power Sales Agreement, December 1987: The Power Sales Agreement established the Bradley Lake Project Management Committee (BPMC). One of BPMC's purposes is to arrange for the operation and maintenance of the Project, which became operational in September 1991, and the scheduling, production and dispatch of power. In addition, the BPMC is responsible for budgeting annual Project costs and calculating each party's required contribution to fund annual Project costs. BPMC members include the AEA and the five purchasers under the Power Sales Agreement - Chugach Electric Association (CEA), Golden Valley Electric Association, the Municipality of Anchorage (Municipal Light & Power [ML&P]), the City of Seward (Seward Electric System), and the Alaska Electric Generation & Transmission Cooperative (AEG&T).

- **Master Maintenance and Operating Agreement, May 1994:** The Master Maintenance and Operating agreement with the BPMC established contract administration and budgeting procedures for Project maintenance and operation contracts. It also provides for the lease or other use of facilities and equipment in a manner consistent with the requirements of the Power Sales Agreement. This agreement authorizes the AEA to enter into any contracts necessary to perform operating or maintenance-type services to the Project, subject to the approval of the BPMC.
- **Bradley Lake Dispatch Agreement, August 1996:** AEA entered into an agreement with CEA to provide all services necessary to dispatch the Project's electric power output.
- **Static Var Compensation System (SVS) Agreement, August 1996:** AEA entered into an agreement with CEA to operate and maintain the SVS facilities at the Soldotna Substation and Daves Creek facility.
- **Operation and Maintenance Agreement, June 1999:** An operation and maintenance agreement for the Project was originally executed between the Homer Electric Association (HEA) and the AEA in February 1994 and amended in 1996 and 1999. The agreement provides for the operation and maintenance of the Project by the HEA. HEA is to be reimbursed for costs associated with the operation, maintenance and repair of the Project as determined in advance through the submission of an annual budget based upon estimates and anticipated operation and maintenance costs. In August 1996, the agreement was amended to separate the operation and maintenance of the electric transmission line facilities from the Project. In June 1999, the agreement was again amended to require the HEA to provide communication services in addition to the other services.

The Project has installed capability, under optimal conditions, of 126 megawatts and transmits its power to the State's main power grid via two parallel 20-mile transmission lines. The Project, which cost over \$300 million, went into commercial operation in 1991. The Project is now operated by

the HEA under contract with the AEA and serves Alaska's Railbelt from Homer to Fairbanks as well as the Delta Junction Area.

Objective and Scope. The objective of this audit was to determine whether the charges during 2002 to ML&P for the operation and maintenance of the Bradley Lake Hydroelectric Project were in compliance with the operating agreements. The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of April through May 2003. The audit was requested by the Administration.

Overall Evaluation. Generally, the expenditures allocated by AEA in 2002 to the Bradley Lake Hydroelectric Project were in compliance with the operating agreements. However, we found that AEA was not properly allocating the year-end surplus as required by the Power Sales Agreement, resulting in \$614,001 that should have been returned to the participating utilities. ML&P's share is \$159,026.26. We also found that AEA was not always enforcing the time limit on billing for services. In addition, we noted several instances where resources charged to the Project could have been used more efficiently by HEA.

FINDINGS AND RECOMMENDATIONS

1. Year-End Surplus Not Allocated.

- a. Finding.** AEA did not return the year-end surplus to the power purchasers as required by Section 13c(ii.E) of the Power Sales Agreement. The agreement states that after the conclusion of each fiscal year, the actual Annual Project Costs for that fiscal year should equal the total of all payments received from each Purchaser, and any additional or excess payments will be billed or refunded to the purchasers. According to AEA, they were not aware of this allocation provision in the Agreement, and carried over the estimated surplus to the next budget year. For

example, the 2002 surplus amount that should have been returned to the purchasers was \$838,889. However, AEA only credited the purchasers for \$224,888 of the \$838,889 in the 2003 budget. The remaining \$614,001 has yet to be returned to the purchasers. ML&P's share is \$159,026.26.

- b. **Recommendation.** ML&P should request that AEA comply with the Power Sales Agreement and allocate the year-end surplus to the power purchasers on an annual basis.
- c. **Management Comments.** Management concurred and stated, "ML&P's representative on the Bradley Lake Project Management Committee (PMC) will bring this to the attention of the members and ask that they request that the Alaska Energy Authority (AEA) which oversees the Project comply with the Power Sales Agreement and allocate the year-end surplus to the power purchasers on an annual basis."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **AEA Not Enforcing Time Limit.**

- a. **Finding.** AEA did not enforce the time limit for billing of services as required by Section 6(B) of the Static Var Compensation System Agreement. The agreement states that invoices will be furnished to AEA by the fifteenth of the month following the month in which the costs were incurred. For example, we found invoices from CEA dated from October and November 2000 that were not billed to AEA until December 2001. CEA staff stated that they were delinquent in billing the Project due to a staffing shortage. Although we understand that a staffing shortage may cause delays, significant delays, such as those previously noted, are unacceptable. In order

to prepare timely accounts and reliable financial reports, transactions should be promptly and properly recorded, classified and accounted for.

- b. **Recommendation.** ML&P should request that AEA enforce contract requirements for prompt billing.
- c. **Management Comments.** Management concurred and stated, “ML&P’s representative on the PMC will refer this issue to the members and ask that they request that AEA enforce contract requirements for prompt billing.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Inappropriate Expenditure.**

- a. **Finding.** Our review of expenditures found one inappropriate expenditure. Specifically, HEA inappropriately billed the Project \$153.50 for an Intertie Operating Committee meeting. This expense should have been paid by HEA as HEA was representing itself, not the Project, at the Intertie Operating Committee meeting. This expense was reversed when we brought it to HEA’s attention.
- b. **Recommendation.** ML&P should request that AEA review all invoices more closely to ensure all expenditures charged to the Project are Project-related expenditures.
- c. **Management Comments.** Management concurred and stated, “ML&P concurs with this finding, but finds it immaterial to pursue. ML&P will point out to the PMC that all invoices should be closely monitored by AEA for appropriateness in being charged to the Project.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

OTHER PERTINENT INFORMATION

Questionable Use of Resources.

We found a number of questionable, although allowable, expenditures that may not have been the most effective or efficient use of Project resources. For example, we found several instances where Homer Air made up to four flights a day in and out of the Bradley Lake facility. HEA was not able to explain the number of daily flights to the Bradley Lake facility. Further, we noted the use of a more expensive air carrier, Smokey Bay Air, for some flights to the Bradley Lake facility. According to HEA staff, their contract with Homer Air was not an exclusive contract and they could use any carrier available. Finally, we found HEA rented a U-Haul truck for 46 days to move materials to renovate a duplex at the Bradley Lake facility. We asked HEA staff why they rented the truck for such an extended period of time. They stated that they barged the truck to the facility and stored the materials in the truck while the renovations took place. The truck was then filled with employee goods for the return trip to Homer. While the renovation of the duplex was an approved expense, we question the need to keep the truck rented for 46 days when there was storage at the facility.

Management Comments. Management stated, “ML&P will also discuss issues noted in the Questionable Use of Resources with the PMC. Each participant that holds responsibility for performing tasks for the Project should do so in the most efficient and economical manner.”

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on May 29, 2003.

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