

April 22, 2008

**Internal Audit Report 2008-5
Bradley Lake Hydroelectric Project
Municipal Light and Power**

Introduction. According to information provided by the Alaska Energy Authority (AEA), the Bradley Lake Hydroelectric Project (Project) is located in South Central Alaska at the southern end of the Kenai Peninsula. The Project includes a 610-foot long, 125-foot high, concrete-faced, rock-filled gravity dam, and a 3.5-mile long power tunnel. The 126-megawatt Project transmits its power to the State's main power grid via two parallel 20-mile transmission lines. The Project, which cost approximately \$328 million (including reserve fund balances), went into commercial operation in 1991. Homer Electric Association (HEA) under contract with AEA now operates the Project. The Project serves Alaska's Railbelt from Homer to Fairbanks as well as the Delta Junction area. According to data provided by AEA, in fiscal year 2007, about \$1.4 million was paid to HEA for Project operation and maintenance expenditures.

AEA has entered into several agreements to provide for the operation and maintenance of the 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 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, Golden Valley Electric Association, the Municipality of Anchorage (Municipal Light and Power [ML&P]), the City of Seward (Seward Electric System), and the Alaska Electric Generation & Transmission Cooperative.

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 Chugach Electric Association to provide all services necessary to dispatch the Project's electric power output.

Static Var Compensation System Agreement, August 1996 - AEA entered into an agreement with Chugach Electric Association to operate and maintain the Static Var Compensation System facilities at the Soldotna Substation and Daves Creek facility.

Operation and Maintenance Agreement, June 1999 - The Operation and Maintenance Agreement for the Project was originally executed between 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.

Objective and Scope. The objective of this audit was to determine whether the charges during fiscal year 2007 for the operation and maintenance of the Project by HEA were in compliance with the applicable agreements. Our review included a review of charges made by HEA from July 1, 2006, to June 30, 2007.

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 November through December 2007. The audit was requested by the Administration.

Overall Evaluation. Generally, the operation and maintenance expenditures made by HEA in fiscal year 2007 to the Project were in compliance with the applicable agreements. However, our review of selected Project operation and maintenance expenditures revealed over \$30,000 in questionable expenditures. Also, HEA did not always segregate Project expenditures, and HEA staff did not code helicopter usage to the correct budget account.

FINDINGS AND RECOMMENDATIONS

1. Questionable Expenditures.

- a. Finding.** Our review of judgmentally selected Project expenditures revealed over \$30,000 of questionable operation and maintenance expenditures. Some examples of questionable expenditures are found below.

Training - The entire cost for “Tower Training” was charged to the Project. However, the two HEA employees who received the training were not full-time Project employees. In addition, HEA management stated that HEA also owns towers in addition to the Project’s towers.

Telecommunications - From July 2006 to February 2007, the Project was charged for Dish Network service in Haines, Alaska.

Legal Fees - Legal fees were charged to the Project for the renewal of the Operation and Maintenance Bradley Lake Agreement. The attorney was not representing the Project, but was representing HEA.

Air Transportation - Charges for seventeen airplane flights appeared questionable. Many of these flights appeared to be for family members. These airplane flights were made for transporting individuals to the Project who were not HEA employees, and none of the seventeen flights had a Project employee as a passenger.

Vehicle Usage Charges - Vehicle charges to the Project appeared questionable. According to time records, in most months for each work hour supervisors charged to the Project, they also charged one hour of vehicle usage. However, in some months, each work hour charged to the Project did not match vehicle hours charged to the Project. For example, from July 2006 to December 2006, one supervisor had 295 vehicle hours and 295 work hours charged to the Project. However, from January 2007 to June 2007, this same supervisor had only 48 vehicle hours and 242 work hours charged to the Project. In another case, from July 2006 to June 2007, another supervisor had 887 vehicle hours and 887 work hours charged to the Project.

Miscellaneous Charges - Our review identified other miscellaneous charges that appeared to be questionable. These charges included items such as a get well card, various meals, a dish network subscription, a transcription machine, software support, standby charges for a helicopter, and expenditures lacking supporting documentation.

- b. **Recommendation.** ML&P should bring the questioned costs to the BPMC for evaluation.

- c. **Management Comments.** Management stated, “ML&P sent the draft audit report to AEA and HEA for their review and response. Finance staff from AEA and HEA did respond to this audit report. This audit report along with the combined response from AEA and HEA will be given to the BPMC along with the Budget and Finance Subcommittee of the BPMC this year.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Air Transportation Costs Not Always Segregated.**

- a. **Finding.** HEA did not always segregate Project expenditures for air transportation costs between operation and maintenance and capital projects. Since October 2006, HEA discontinued segregating air transportation expenditures between operation and maintenance and the capital projects and started to bill all air transportation expenditures as operation and maintenance expenditures. As a result, operation and maintenance expenses for air transportation may be misleading.
- b. **Recommendation.** ML&P should request AEA to require HEA to segregate the expenditures between Project operation and maintenance and capital projects, and bill AEA accordingly.
- c. **Management Comments.** Management stated, “ML&P agrees with the response from AEA and HEA that HEA segregates costs for air transportation to capital projects when there is a clear distinction in the purpose of the flight. It appears that flights for the large capital projects were charged to those projects. Some flights carrying both workers and materials can be for both operations and maintenance and capital projects and the effort to spread those costs (based on weight, size, value or

some other factor) does not appear to be worth the effort since it doesn't change the amount the Utilities pay."

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

3. **Correct Budget Account Not Used.**

- a. **Finding.** HEA staff did not code \$20,303 of helicopter usage to the correct budget account. The helicopter, used for snow surveys, was coded to account 539.42, Helicopter Transportation for Hydraulic Power Generation Operations. According to AEA staff, the helicopter usage should have been coded to account 556.02, Snow Measurement.
- b. **Recommendation.** ML&P should request that AEA review all invoices more closely to ensure the correct budget account is used.
- c. **Management Comments.** Management stated, "ML&P did request that AEA review all invoices more closely to ensure the correct account is used. During this discussion AEA finance staff was requested to use the proper FERC account regardless of where the activity was budgeted. They confirmed they would do as requested."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

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Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials.

Audit Staff:
Scott Lee
Michael Chadwick, CICA