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

**DATE:** October 13, 2008

**TO:** Peter H. Lester, Economic Analyst, Division of Economic Regulation

**FROM:** Denise N. Vandiver, Chief of Auditing, Division of Regulatory Compliance *W*

**RE:** Docket No: 080001-EI; Company Name: Tampa Electric Company;  
 Audit Purpose: Hedging Transactions for January - July 2008;  
 Company Code: EI806; Audit Control No: 08-221-2-2;

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.

DNV/tbm  
 Attachment: Audit Report

CC: Division of Regulatory Compliance (Salak, Mailhot, Harvey,  
 District Offices, File Folder)  
 Office of Commission Clerk (2)  
 General Counsel  
 Office of Public Counsel

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 Tampa Electric Company  
 Regulatory Affairs  
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**FLORIDA PUBLIC SERVICE COMMISSION**

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

*Tampa District Office*

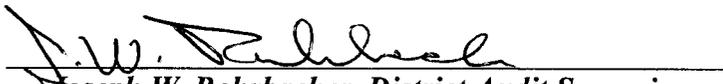
**TAMPA ELECTRIC COMPANY**

**2008 HEDGING ACTIVITIES**

**PERIOD JANUARY 1, 2008 THROUGH JULY 31, 2008**

**DOCKET NO. 080001-EI  
AUDIT CONTROL NO. 08-221-2-2**

  
\_\_\_\_\_  
*Daniel Acheampong, Audit Manager*

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

DOCUMENT NUMBER-DATE

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

**SEPTEMBER 22, 2008**

**TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES**

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 August 5, 2008. We have applied these procedures to the Hedging Activities in Docket No. 080001-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 which are only for internal Commission use.

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## **OBJECTIVES AND PROCEDURES**

**Objectives:** Review and verify the information presented in Tampa Electric Company's (TEC) Hedging Information Report filed on August 15, 2008.

**Procedures:** We reviewed the information presented in the utility's Hedging Information Report that was filed on August 15, 2008.

**Objectives:** To verify that the accounting treatment for futures, options, and swap contracts between Tampa Electric Company and counterparties are consistent with Order No. PSC-02-1484-FOF-EI.

**Procedures:** We reviewed a listing of all futures, options, and swap contracts executed by TEC for the period January 1, 2008 through July 31, 2008. Also, we reviewed the volumes of each fuel the utility actually hedged using a fixed price contract or instrument. In addition, we requested the types of hedging instruments the utility used and the period for all hedges, options premiums, futures gains and losses and swap settlements. We reviewed the listing, three International Swap Dealers Association Inc. (ISDA) contracts and twenty-nine confirmation contracts. We recalculated the gains and losses by multiplying volume by the differences between fixed price and settlement price.

**Objectives:** To reconcile the data included in the Hedging Information Report of August 15, 2008 with the books and records of the utility. This data includes the gains (losses), options premiums, swap settlements, as well as fees, commissions, and other transaction costs associated with each financial hedging instrument.

**Procedures:** We audited one hundred percent of gains and losses. We recalculated gains and losses from the general ledger amounts. We traced general ledger numbers to the Mark to Market Report and supporting invoices. We tested invoices for proper amount, proper approval procedures and proper periods. We reconciled the general ledger amounts and the Mark to Market Report to the utility's Expense Report.

**Objectives:** To verify that quantities of gas, residual oil, and purchased power hedged are within the limits of the percentage range specified in TEC Risk Management Plan.

**Procedures:** We reviewed the TEC hedging plan for 2007 and 2008. We compared actual percentage hedged to allowable minimum and maximum limits prescribed by the Risk Management Plan on a monthly basis. Audit Finding No.1 addresses this issue.

**Objectives:** To verify that the individual and group limits and authorization set forth in the TEC Risk Management Plan have been followed.

**Procedures:** We reviewed the TEC Risk Management Plan regarding transaction limits. We selected samples from the Mark to Market Report and compared it to the established credit limits for counterparties. We compared selected samples to the individual transactional limit and found the company followed its plan. We also compared selected projected burn samples from the Filing to the revised forecasted burn and recalculated the minimum and maximum hedge limits and found that utility hedged volume was within the revised limits.

**Objectives:** To verify that TEC has followed utility procedures for separating duties related to hedging activities ( Front office, Middle office, and Back office) per its Hedging Plan.

**Procedures:** We reviewed the Risk Management Plan and requested key personnel from each office to answer a series of questions. We followed up with observation and interviews. We determined that there are separations between the Front office, Middle office, and Back office.

**Objectives:** To verify that the hedging operating and maintenance expenses associated with maintaining a non-speculative financial and/or physical hedging program are incremental in nature as set forth in Order No. PSC-02-1484-FOF-EI.

**Procedures:** We requested if there are operating and maintenance expenses associated with non-speculative financial and/or physical hedging activities. The utility representative stated there are no operating and maintenance expenses associated with maintaining non-speculative hedging activities and our audit work did not find any evidence to the contrary.

**Objectives:** To verify that the hedging relationship between Tampa Electric and its affiliates, Peoples Gas System (PGS), does not result in any cross subsidy between the two entities.

**Procedures:** We reconciled the Position Summary Detail Report of PGS to the Swaps Invoice Summary Report. We reconciled the total Position Summary Detail Report (PGS & TEC) to the Swaps Invoice Summary Report. We recalculated the gains and losses of TEC and PGS. We traced PGS Position Summary Detail Report to supporting invoices. We determined there is no cross subsidy between TEC and its affiliate, PGS.

**Objectives:** To check that swap transaction price can be checked against the market futures price as of the date the utility entered the swap.

**Procedures:** We checked the swap transactions against the market future price as of the date the utility entered the swap and found that the prices were generally the same.

## **AUDIT FINDING NO. 1**

### **SUBJECT: ACTUAL HEDGED PERCENTAGE COMPARED TO RISK MANAGEMENT PLAN**

**AUDIT ANALYSIS:** Tampa Electric Company (TEC) implements a financial hedging strategy to mitigate its natural gas requirements. The company uses financial swap agreements to hedge its natural gas purchases.

TEC uses the forward pricing information of the New York Mercantile Exchange (NYMEX) natural gas price curve in developing natural gas hedging strategy. The purpose of TEC's natural gas plan is to reduce natural gas price volatility by utilizing financial instruments relying on three key variables: price, volume and time.

The objectives of our audit and the audit procedures performed are described on the preceding pages of this report. Our finding is detailed below.

#### **Hedge Limits**

Our objective was to verify that quantities of gas and residual oil hedged are within the limits of the percentage range specified in TEC's Risk Management Plan.

We determined that TEC hedged below the percentage limit in January, 2008 by six percentage points. We also determined that TEC exceeded the percentage limit for February 2008 by fifteen percentage points, for March 2008 by seventeen percentage points and July 2008 by forty-seven percentage points. We requested an explanation of the deviations from the hedging plan. The utility representative stated that weather and unit outages drive the amount of natural gas consumed, so in low load shoulder months, such as February through May, the actual consumption of natural gas may vary significantly from year to year. January had lower temperatures than expected, so more natural gas-fired units were used than projected. February and March had unexpectedly warmer temperatures than usual and less natural gas-fired units were used. Exhibit 1 on Page 5 indicates these differences.

We also determined that TEC revises its monthly forecasted burns. TEC does not file these monthly revisions with the Public Service Commission. However, these amounts were not material and did not appear to make a difference in the amounts hedged. TEC's January-July Filing states that "In July, 2008 coal-fired generation was greater than expected, and load was less than expected. Therefore, the natural gas units were less than projected, and the resulting percent hedged was higher than expected".

**EFFECT ON GENERAL LEDGER:** None.

**EFFECT ON FILING:** Informational