



Florida Municipal Power Agency

VIA: Email

January 22, 2016

Ms. Sherrill F. Norman, CPA  
Auditor General, State of Florida  
G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, FL 32399-1450

Re: Auditor General Report No. 2015-165

Dear Ms. Norman:

On May 28, 2015, the Florida Municipal Power Agency (FMPA) filed with the Auditor General a 60-day written corrective action plan detailing FMPA's plans and timetable for addressing findings in the Auditor General's operational audit of FMPA. That filing was made as directed by the Florida Joint Legislative Auditing Committee in a meeting held March 30, 2015.

FMPA's governing boards and member utilities take very seriously the findings of the Auditor General. As evidence of this commitment, FMPA voluntarily committed to file progress reports every 60 days until all recommendations were addressed. The attached report is FMPA's fifth and final report. This report documents that FMPA has completed action on all 15 audit findings.

If you require additional information, please contact Nicholas P. Guarriello, FMPA's General Manager and CEO, at 407-355-7767 or [nick.guarriello@fmpa.com](mailto:nick.guarriello@fmpa.com).

Sincerely,

A handwritten signature in black ink, appearing to read "Bill Conrad", written over a light blue horizontal line.

Bill Conrad  
Chairman  
FMPA Board of Directors

A handwritten signature in black ink, appearing to read "Howard McKinnon", written over a light blue horizontal line.

Howard McKinnon  
Chairman  
FMPA Executive Committee

Enclosure

cc: FMPA Board of Directors  
FMPA Executive Committee  
Nicholas P. Guarriello, FMPA  
Frederick M. Bryant, FMPA



Florida Municipal Power Agency

Re: Auditor General Report No. 2015-165

## FMPA Audit Response Report

+ + + + + + + + + + + + +

SUBMITTED TO

State of Florida  
Auditor General  
Sherrill F. Norman, CPA

January 22, 2016

Community Power + Statewide Strength

## Introduction

The Florida Joint Legislative Auditing Committee (JLAC) met March 30, 2015, and heard a presentation from the Auditor General regarding its operational audit of the Florida Municipal Power Agency (FMPA or the Agency). At the conclusion of that meeting, the JLAC directed FMPA to provide to the Auditor General within 60 days a written corrective action plan detailing FMPA's plans and timetable for addressing each of the 15 audit findings. FMPA filed a report with the Auditor General on May 28, 2015, that responded to the JLAC's directive.

FMPA's governing boards and member utilities take very seriously the findings of the Auditor General. As evidence of FMPA's commitment to addressing each finding in a prompt and thorough manner, FMPA voluntarily committed to submit progress reports every 60 days until all recommendations were addressed. As documented in this fifth progress report, FMPA has completed action on all 15 audit findings. Therefore, this is FMPA's final report.

FMPA has two governing boards: the Board of Directors and the Executive Committee. The Board of Directors is made up of one representative from each of the Agency's 31 member municipal electric utilities. The Board of Directors governs general activities of the Agency and all of its power supply projects except FMPA's All-Requirements Power Supply Project (the All-Requirements Project). The All-Requirements Project is independently governed by the Executive Committee. Each of the 13 municipal electric utilities that are participants and purchase power through the All-Requirements Project appoints a representative to the Executive Committee. Depending on the nature of each audit finding, some recommendations were within the exclusive authority of FMPA's Executive Committee and some findings have been addressed by both governing boards.

To address each of the Auditor General's recommendations, FMPA's Board of Directors or Executive Committee, or both, conducted a public discussion and a vote. Action on the Auditor General's findings were scheduled as agenda items for governing board meetings. FMPA's governing boards followed their practice of hearing a matter first as an information item and then a second time at a subsequent meeting for action. FMPA's governing boards generally meet once per month.

The following report documents FMPA's actions through January 22, 2016.

## Executive Summary

FMPA's governing boards have completed work on all 15 audit recommendations, as described in the following report. Therefore, this is the final FMPA Audit Response Report.

# Florida Municipal Power Agency

## FMPA Audit Response Report

January 22, 2016

### FINDING 1: Fuel Hedging

**Finding:** Fuel hedging practices were not consistent with industry practices utilized by other joint action agencies.

**Recommendation:** The FMPA should consider amending its fuel hedging policies to focus on offsetting changes in the cost of natural gas rather than the benefit from upward and downward price volatility. In doing so, the policy should provide for hedging using only derivative instruments necessary to achieve a simple effective fuel hedge at current natural gas prices rather than at present trigger amounts.

**FMPA Status Report:** Action on this recommendation is complete. On May 21, 2015, FMPA's Executive Committee voted to cease its fuel hedging program known as FST (FMPA Short-term) Program. On May 21, 2015, FMPA's Executive Committee also approved issuing a Request for Qualifications (RFQ) to retain an independent management consulting firm to provide analysis and recommendations on this finding. Responses to the RFQ were received on June 26. Interviews with respondents were held July 30. FMPA executed a contract with a consultant, Baker Tilly, on September 17. The consultant presented its preliminary report to FMPA's Executive Committee on November 19, 2015, and the final report was presented on December 17, 2015. Baker Tilly analyzed 17 utilities it considered part of a peer group for FMPA, and that comparison showed FMPA's hedging objectives were similar to the peer group, followed common industry practices, and had similar results. FMPA has not purchased a fuel hedge since May 2013, and as of May 21, 2015, FMPA's Executive Committee has made an affirmative decision not to engage in further fuel hedging.

### FINDING 2: Natural Gas Supply Agency Participation

**Finding:** Investment in natural gas exploration and drilling were not consistent with industry practices utilized by other joint action agencies and were more complex and involved more risk than alternative forms of hedging commonly practiced.

**Recommendation:** The FMPA should establish written policies regarding future gas production investments. These policies should state the circumstances under which the FMPA may consider participation in further PGP projects or other gas production investments, and the circumstances under which the FMPA may consider exiting its PGP participation. Additionally, these policies should identify the categories of risk that must be considered by the FMPA when deciding on new or increased gas production investments and place an appropriate value on risk.

**FMPA Status Report:** Action on this recommendation is complete. On September 17, 2015, FMPA's Executive Committee approved a policy regarding future gas production investments, including the criteria that must be considered if FMPA were to decide on

new or increased gas production as well as the categories of risk that must be considered by FMPA when deciding on new or increased gas production investments and place an appropriate value on risk; however, the Executive Committee has decided not to participate in any additional reserve acquisition activities at this time. Prior to the audit, FMPA's legal staff produced a report on the exit provisions of the PGP contracts.

### **FINDING 3: Interest Rate Swaps**

**Finding:** Certain interest rate swaps were not employed consistent with industry practices utilized by other joint action agencies, which resulted in significant termination fees likely to be incurred.

**Recommendation:** The FMPA should refrain from employing interest rate swaps in the future without concurrently issuing debt to bring its interest rate hedging practices more in line with industry standard risk tolerance. Further, such activities should not be undertaken before required approvals for projects are obtained from regulatory bodies. In addition, the Executive Committee should consider, without regard to prior unrealized losses incurred, developing and executing an exit strategy for the Taylor swaps that removes the ongoing risk to the ARP members.

**FMPA Status Report:** Action on this recommendation is complete. On May 21, 2015, FMPA's Executive Committee approved amendments to its Debt Risk Management Policy that implemented two of the three Auditor General's recommendations: 1) prohibiting the employment of interest rate swaps without concurrently issuing debt, and 2) prohibiting interest rate swaps before required approvals for projects are obtained from regulatory bodies. The Auditor General's third recommendation about developing an exit strategy for Taylor swaps also has been addressed. FMPA's Executive Committee approved actions on April 16, 2015, and May 6, 2015, providing policy direction on when and how to exit the Taylor swaps, and then on May 21, 2015, the Executive Committee approved resolutions authorizing the permanent financing structure for the Taylor swap termination costs. All nine swaps contracts were terminated as of June 16, 2015, removing the ongoing risk to ARP members, and FMPA closed June 30, 2015, on the permanent financing for the Taylor swap termination costs.

### **FINDING 4: Investment Policy**

**Finding:** The FMPA's investment policy needed to be enhanced to clarify requirements regarding allowable investment credit ratings and to establish geographic diversification requirements for investments.

**Recommendation:** The FMPA should enhance its investment policy to clarify the application of credit ratings. Additionally, the FMPA should enhance its investment policy to clarify that the investment diversification requirements are to be applied at the individual project level and to establish requirements for geographical diversification.

**FMPA Status Report:** Action on this recommendation is complete. On May 21, 2015, FMPA's Board of Directors and Executive Committee approved amendments to the Agency's Investment Policy that fully address all three of the Auditor General's

recommendations: 1) clarifying the meaning of the “two highest credit rating categories,” 2) clarifying that the Investment Policy applies individually to each Project, not in any combination of Projects, and 3) establishing an investment limit based on geographic concentration.

## **FINDING 5: Employee Benefits**

**Finding:** Compensated absences increased by 75 percent in four years, and the cost of future postretirement benefits for certain employees may result in payouts that negatively impact future rates.

**Recommendation:** The FMPA should periodically evaluate the impact of projected increases in benefit package costs provided to employees.

**FMPA Status Report:** Action on this recommendation is complete. On September 17, 2015, FMPA’s Board of Directors and Executive Committee directed FMPA staff to prepare a special report on Other Post-Employment Benefits (OPEB) and compensated absences as of September 30, 2015, for the purpose of evaluating the impact of these employee benefits on electricity rates. In addition, the Board of Directors and Executive Committee directed that the report be reviewed by FMPA’s independent auditors. FMPA staff prepared the report and submitted it to the independent auditors for review. The auditors did not propose any changes to the report. On January 21, 2016, the report on OPEB and compensated absences was presented to FMPA’s Board of Directors and Executive Committee. The report showed that the OPEB obligation at September 30, 2015, was \$2.3 million, which, conservatively, if funded in one year solely by FMPA’s All-Requirements Project, would have an electric rate impact of 0.6 percent. The report showed that the compensated absence liability at September 30, 2015, was \$1.3 million, which, conservatively, if paid in one year solely by FMPA’s All-Requirements Project, would have an electric rate impact of 0.3 percent. On January 21, 2016, the Board of Directors and Executive Committee approved acceptance of the report.

## **FINDING 6: General Counsel Contract**

**Finding:** The Board of Directors (Board) set the compensation package for the General Counsel through a series of actions over several years rather than through the use of a written employment agreement and FMPA was unable to provide documentation for all of the benefits provided by Board action.

**Recommendation:** The FMPA should enter into a contract with the General Counsel encompassing all Board-approved compensation arrangements cumulatively provided to the General Counsel and implement any further compensation changes as contract amendments.

**FMPA Status Report:** Action on this recommendation is complete. FMPA’s Board of Directors met October 22, 2015, to consider entering into an employment contract with the General Counsel. The Board of Directors’ inclination was not to enter into an employment contract but to have the General Counsel remain an at-will employee. The Board of Directors agreed to seek advice from its labor attorney whether it is advantageous to FMPA for its General Counsel to be an at-will employee, as opposed to

FMPA entering into a contract for employment for a specified term of duration. Based on the relevant facts and circumstances, the labor attorney recommended that continued at-will employment would give FMPA greater flexibility regarding its General Counsel and would provide FMPA with the ability to make decisions about the terms and conditions of the General Counsel's employment without being encumbered by an agreement for a specified term. The labor attorney concluded that continued at-will employment of the General Counsel appears to be in FMPA's best interest. To address the other aspect of the Auditor General's finding, FMPA's Board of Directors agreed to document all current compensation arrangements for the General Counsel, which has been completed, and incorporate them into the General Counsel's annual performance evaluation approval process. These revisions to the existing General Counsel Evaluation Process, which require this annual compensation documentation, addresses the essence of the Auditor General's finding.

#### **FINDING 7: Severance Pay and Benefits**

**Finding:** The Chief Executive Officer's employment contract provides for severance pay and postretirement benefits for life if he is terminated for cause.

**Recommendation:** The FMPA should consider amending the CEO's contract to remove any severance compensation and postretirement benefits associated with termination for cause.

**FMPA Status Report:** Action on this recommendation is complete. FMPA's General Manager and CEO submitted on October 21, 2015, his notice to retire and terminate his executive employment contract with FMPA in 2016, in accordance with his contractual requirement to provide at least 180 days prior notice of his retirement. On October 22, 2015, the Board of Directors agreed that the Auditor General's recommendation had been overcome by events rendering it moot but that the Board will take the Auditor General's comments in mind as it negotiates a contract with a new General Manager.

#### **FINDING 8: Questioned Expenditures**

**Findings:** FMPA records did not always evidence the public purpose served for purchases of goods and services.

**Recommendation:** The FMPA should strengthen its procedures to require documentation that expenditures serve an authorized public purpose and retain such documentation in its records prior to payment.

**FMPA Status Report:** Action on this recommendation is complete. On June 18, 2015, FMPA's Board of Directors and Executive Committee approved a new Public Purpose Policy and a new Public Purpose Determination Procedure. The new policy and procedure provide that FMPA's governing bodies will specifically provide a public purpose finding for certain expenditures and retain such documentation in FMPA's records before and after payment. In addition, FMPA's budgets will include language stating that all expenditures have been authorized and approved for a public purpose.

This follows FMPA's immediate action, after the preliminary and tentative audit report was issued in January, to discontinue several expenditures questioned by the Auditor General, including Orlando Magic tickets, an indoor plant service, Christmas tree rental and an annual conference dinner for members in Washington, D.C.

#### **FINDING 9: Competitive Selection**

**Finding:** The FMPA did not always follow its purchasing policies regarding competitive selection.

**Recommendation:** The FMPA should ensure that goods and services purchased through contractors are competitively procured in accordance with established policies and procedures.

**FMPA Status Report:** Action on this recommendation is complete. On July 24, 2015, FMPA's Board of Directors and Executive Committee approved revisions to FMPA's Procurement Policy and FMPA's Accounting and Internal Controls Policy. In addition, FMPA staff committed to perform an annual training session on the Procurement Policy to ensure that appropriate FMPA staff are familiar with the policy requirements. Finally, FMPA's governing boards approved on July 24, 2015, an amendment to FMPA's Accounting and Internal Controls Policy that provides for FMPA's Contract Compliance Audit Department to conduct an annual review of compliance with FMPA's Procurement Policy and report the results to FMPA's General Manager and CEO or FMPA's Audit and Risk Oversight Committee. Taken together, these policy updates, annual training, and annual testing are expected to fully address the Auditor General's recommendation to ensure that goods and services are competitively procured in accordance with policies.

#### **FINDING 10: Selection of Bond Professionals**

**Finding:** The FMPA had not recently used a competitive selection process when selecting financial advisors and bond counsel for bond issues, potentially increasing costs associated with bond issues.

**Recommendation:** To ensure that qualified financial and professional services are acquired at the lowest possible cost consistent with the size, nature, and complexity of the bond issue, the FMPA should select financial advisors and bond counsel using a competitive selection process whereby RFPs or RFQs are solicited from a reasonable number of professionals.

**FMPA Status Report:** Action on this recommendation is complete. On May 21, 2015, FMPA's governing boards approved amendments to the Agency's Debt Risk Management Policy that added requirements for a competitive selection process for all professionals associated with FMPA's debt. FMPA issued its initial competitive selection request for trustee, registrar and paying agent in October 2015 and awarded the contract on January 21, 2016. Additional competitive selection processes will be undertaken by FMPA for other bond professionals until all bond professionals have been engaged under the amended Debt Risk Management Policy.

## **FINDING 11: Credit Cards**

**Finding:** The FMPA did not always follow its policies regarding credit card issuance and purchases, and did not employ procedures for monitoring credit limits for reasonableness.

**Recommendation:** The FMPA should enhance its procedures to ensure compliance with its policies regarding credit card user agreements. The FMPA should also enhance its existing policies to clarify responsibilities regarding notification of credit card user termination and associated card cancelation, including notification requirements of member municipalities; require all credit card users to sign the monthly credit card activity reports; and require periodic reviews of credit card user credit limits for reasonableness.

**FMPA Status Report:** Action on this recommendation is complete. On June 18, 2015, FMPA's Board of Directors and Executive Committee approved revisions to FMPA's Credit Card Policy, new Credit Card Procedures, and revised Credit Card Use Agreements for employees and employees of FMPA members that work at power generation facilities contractually under FMPA's operational control. The policy and the procedures fully address all of the Auditor General's recommendations, including: 1) providing for regular checks of credit card user agreements on file, 2) providing notification requirements for credit card user terminations and associated card cancellation, including notification requirements of member municipalities, 3) requiring signatures on monthly activity reports, and 4) requiring periodic review of credit card user credit limits for reasonableness.

## **FINDING 12: Travel Expenditures**

**Finding:** The FMPA did not always follow its travel policies or ensure that travel-related receipts were submitted by contractors. Additionally, the FMPA's travel policies could be enhanced.

**Recommendation:** The FMPA should consider amending its Travel Policy to include a cap on per-meal costs. The FMPA should also enhance its procedures to ensure compliance with its policies regarding family member travel expenses and most economical cost of air travel, and to require supporting receipts for out-of-pocket expenses incurred by contractors. In addition, the FMPA should discontinue providing mileage reimbursements to employees who also receive vehicle allowances.

**FMPA Status Report:** Action on this recommendation is complete. On October 22, 2015, FMPA's Board of Directors and Executive Committee discussed the Auditor General's five recommendations and took the following actions: 1) amended FMPA's travel policy to include a cap on per-meal costs, 2) reviewed changes in FMPA's procedures to ensure compliance with restrictions on family travel expenses, 3) amended FMPA's travel policy to better define the most economical cost of air travel, 4) agreed to change FMPA's standard contract for contractors to provide the right for FMPA to audit contractor travel expenses, and 5) agreed not to change the mileage reimbursement, pending further possible consideration during the annual budget process, but amended the vehicle allowance policy language to better evidence in FMPA's records the basis for the

existing policy, in response to a statement in this regard in the Auditor General's narrative on this finding.

### **FINDING 13: Peak Shaving**

**Finding:** The ARP power supply project contracts did not address peak shaving and, although the Executive Committee agreed to curtail peak-shaving activities, the agreement appears primarily voluntary in nature, relies on self-reporting, and contains no consequences for noncompliance.

**Recommendation:** If the FMPA desires to affirmatively eliminate peak shaving activities of its members, the FMPA should consider amending the power supply project contracts to prohibit such activities and establish consequences for noncompliance.

**FMPA Status Report:** Action on this recommendation is complete. On September 17, 2015, the Executive Committee approved a Peak Shaving Monitoring and Corrective Action Policy. The All-Requirements Project (ARP) participants decided they did not want to affirmatively eliminate peak shaving because an FMPA-coordinated peak shaving program could be beneficial in the future. Therefore, the Executive Committee decided that adopting a policy, rather than amending the ARP contract, was the most prudent course of action to ensure peak shaving is conducted for the benefit of all ARP participants. The new policy provides for monitoring and enforcement.

### **FINDING 14: ARP Termination Provisions**

**Finding:** Certain ARP power supply project contract provisions relating to withdrawing members are ambiguous, used a fixed discount rate rather than one associated with current capital costs, and did not provide for independent verification by the withdrawing member.

**Recommendation:** Since ARP revenue requirements are calculated using monthly coincident peak demands, the FMPA should consider using a 12-month average of coincident peak to more accurately estimate the withdrawing member's share of fixed costs. Also, the FMPA should consider amending the power supply project contracts to clarify how withdrawal payments are to be calculated, define "additional benefits" and "excess amounts," establish a variable withdrawal payment discount rate that fluctuates with the actual cost of debt, and remove the 90 percent cap of an ARP member's withdrawal payment. Additionally, since the withdrawal payment can be used to temporarily correct deficiencies in other operating funds and for "excess amounts" to be deposited in the "General Reserve Fund," it should be determined how this ability to use these funds is recognized in the monthly revenue requirement calculation for remaining ARP participants.

**FMPA Status Report:** Action on this recommendation is complete. On May 21, 2015, FMPA's Executive Committee issued a Request for Qualifications to retain an independent management consulting firm to provide additional analysis and recommendations on this finding. The consultant submitted its final report in December 2015, observing and recommending the following: 1) FMPA's use of the highest coincident peak is proper to estimate the withdrawing member's share of fixed costs because the use of a 12-month average coincident peak would expose remaining

members to the risk of higher payments in that FMPA must provide resources plus reserve power that matches its highest coincident peak, 2) FMPA's calculation of a withdrawing participant's exit payment follows industry ratemaking practices and, consistent with the Auditor General's determination, FMPA's calculated withdrawal payment for Vero Beach and another project participant followed the ARP contracts' withdrawal provisions, 3) if FMPA were to consider amending the contract to define "additional benefits" and "excess amounts," then FMPA should be more conservative because at present a withdrawing participant is advantaged in that there is no provision in the contract for FMPA to recalculate the termination payment at regular intervals to account for changes in forecasted costs; therefore, additional costs should be incorporated into the withdrawal payment calculation to protect the remaining project participants, 4) FMPA's use of a fixed discount rate applied to the participant's withdrawal payment and the 90 percent cap on payment of additional benefits appear appropriate and have been agreed to by all ARP contract participants, and 5) as the calculation of the withdrawal payment is based on FMPA's ARP revenue requirements, it is assumed that the payment received is used in meeting monthly revenue requirements so that remaining ARP members are not negatively impacted by the withdrawing member. The consultant's report states, "Altering or amending the contract will require votes by the governing bodies of all participants and bond issuers. This process would be quite lengthy (as indicated in FMPA's management response) and not always at FMPA's discretion."

#### **FINDING 15: Disaster Recovery Plan**

**Finding:** The FMPA's disaster recovery plan could be enhanced.

**Recommendation:** The FMPA should enter into a written agreement to procure an alternate processing site that is sufficiently geographically distant to minimize the risk of being unable to continue critical operations in the event of a hurricane or other geographically large disaster.

**FMPA Status Report:** Action on this recommendation is complete. On September 17, 2015, FMPA's Board of Directors and Executive Committee reviewed FMPA's existing disaster recovery (DR) arrangements, discussed the potential disaster risks and FMPA's disaster experience, reviewed the cost of additional DR redundancies, and decided to maintain the existing DR arrangements.