

INTERNAL AUDIT REPORT

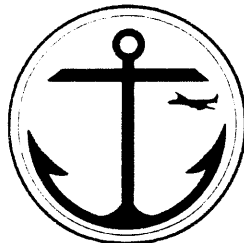
2012-05

Bradley Lake Hydroelectric Project

Municipal Light and Power

May 10, 2012

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Mayor Dan Sullivan

May 10, 2012

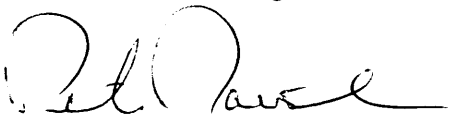
Honorable Mayor and Members of the Assembly:

I am pleased to present **Internal Audit Report 2012-05, Bradley Lake Hydroelectric Project, Municipal Light and Power** for your review. A brief summary of the report is presented below.

In accordance with the 2012 Audit Plan, we have completed an audit of the Bradley Lake Hydroelectric Project. The objective of this audit was to determine whether the charges by Homer Electric Association during calendar year 2011 for the operation and maintenance of the Project were in compliance with the applicable agreements. Specifically, we reviewed all charges to Alaska Energy Authority by Homer Electric Association from January 1, 2011, to December 31, 2011.

Based on our review, the operation and maintenance expenditures made by Homer Electric Association in calendar year 2011 to the Project were in compliance with the applicable agreements.

There were no findings in connection with this audit.



Peter Raiskums, CIA, CFE, CGFM
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**Internal Audit Report 2012-05
Bradley Lake Hydroelectric Project
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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 AEA staff, in calendar year 2011, about \$2.3 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 Project power. In addition, the BPMC is responsible for budgeting annual Project costs and calculating each party's required contribution to fund annual Project costs.

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 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 AEA in February 1994 and amended in 1996, 1999, and 2008. The agreement provides for the operation and maintenance of the Project by 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 amended to require HEA to provide communication services in addition to the other services. In July 2008, the agreement was amended again thru June 2013 and automatically continues in successive five year terms thereafter unless terminated by either party.

Objective and Scope. The objective of this audit was to determine whether the charges by HEA during calendar year 2011 for the operation and maintenance of the Project were in compliance with the applicable agreements. Specifically, we reviewed all charges to AEA by HEA from January 1, 2011, to December 31, 2011.

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

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accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of April 2012. The audit was requested by the Administration.

Overall Evaluation. Based on our review, the operation and maintenance expenditures made by HEA in calendar year 2011 to the Project were in compliance with the applicable agreements.

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

Audit Staff:
Scott Lee