

City of Austin



**A Report to the
Austin City Council**

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**Office of the
City Auditor**

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AUDIT REPORT

**South Texas Project Nuclear
Operating Company (STPNOC)
Management Oversight Audit**

October 2012



REPORT SUMMARY

In general, the STPNOC Board of Directors operates consistently with governance best practices. However, Austin Energy has some weaknesses in its governance structure related to STPNOC oversight, which may limit its ability to manage the ownership risks.

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GOVERNMENT AUDITING STANDARDS COMPLIANCE

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT TEAM

Rachel Snell, CIA, CFE, CICA, Assistant City Auditor
Olga Ovcharenko, CGAP, CRMA, CICA, Auditor-in-Charge
Naomi Marmell, CGAP, CICA, Auditor
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October 2012



Audit Report Highlights

Why We Did This Audit

This audit was conducted as part of the Office of the City Auditor's (OCA) Fiscal Year (FY) 2012 Strategic Audit Plan.

What We Recommend

Austin Energy should strengthen controls over STPNOC oversight related to: documenting and implementing staff roles and responsibilities; communicating expectations and relevant information; and monitoring issues and risks identified, as well as their resolution.



For more information on this or any of our reports, email oca_auditor@austintexas.gov

SOUTH TEXAS PROJECT NUCLEAR OPERATING COMPANY MANAGEMENT OVERSIGHT AUDIT

Mayor and Council,

I am pleased to present this audit on STPNOC Management Oversight.

BACKGROUND

Austin Energy (AE) owns 16% of the South Texas Project Nuclear Operating Company (STPNOC). CPS Energy (40%) and NRG Energy (44%) own the remainder. The STPNOC is a nonprofit management company for the South Texas Project (STP). The STPNOC is overseen by a Board of Directors (Board) that is responsible for hiring a Chief Executive Officer (CEO) to operate the daily activities of the STPNOC. The Board consists of the representatives of the three owners and the CEO. Additional staff are made available by the owners to serve on various committees overseeing the STPNOC operations for each owner.

OBJECTIVES AND SCOPE

The objectives of the audit were to:

- To determine whether the STPNOC Board of Directors operations are consistent with governance best practices.
- To evaluate whether management controls and quality assurance processes are in place in order to provide reasonable assurance that Austin Energy is providing oversight of the STPNOC.

The audit scope included the Board's governance and oversight operations for Calendar Years (CY) 2011 and 2012.

WHAT WE FOUND

In general, the STPNOC Board of Directors operates consistently with best practices; however, AE has some weaknesses in its governance structure for STPNOC oversight, which may limit its ability to manage the ownership risks.

- The Board routinely receives independent reports from various oversight groups and is informed about safety and reliability risks at a high level.
- AE governance structure could be further improved.
 - AE participates less in the oversight of the STPNOC than other owners.
 - Succession plans are not documented and the list of names serving as STPNOC points of contact for AE is not always current.
 - AE staff reported informal communication processes and in some instances, information was not always communicated to the relevant staff.

We appreciate the cooperation and assistance we received from Austin Energy staff and the members of the STPNOC Board of Directors during this audit.


Kenneth J. Mory, City Auditor

BACKGROUND

Austin Energy (AE) owns 16% of the South Texas Project Nuclear Operating Company (STPNOC), a nonprofit management company for the South Texas Project (STP). The remainder is owned by CPS Energy (40%) and NRG Energy (44%). Collectively, AE, CPS, and NRG are known as “owners.” As of September 30, 2011, AE’s investment in the STP was approximately \$446 million, net of accumulated depreciation. The STPNOC is overseen by a Board of Directors (Board) that is responsible for hiring a Chief Executive Officer (CEO) to operate the daily activities of the STPNOC. The Board consists of representatives of the three owners and the CEO. Owner alternates, assigned by each owner organization, assist the Board members by discussing the subjects of interest in greater detail and communicating the results to the Board members. The owners also make additional staff available to serve as points of contact on various committees that assist with the monitoring of the STPNOC operations (i.e. legal, insurance, finance, or benefits).

OBJECTIVES, SCOPE, AND METHODOLOGY

The South Texas project Management Oversight Audit was conducted as part of the Office of the City Auditor’s (OCA) FY 2012 Strategic Audit Plan, as presented to the City Council Audit and Finance Committee.

Objectives

The objectives of the audit were:

- To determine whether the STPNOC Board of Directors operations are consistent with governance best practices.
- To evaluate whether management controls and quality assurance processes are in place in order to provide reasonable assurance that Austin Energy is providing oversight of the STPNOC.

Scope

The audit scope included STPNOC Board of Directors governance and oversight operations for CY 2011 and 2012.

Methodology

To accomplish our audit objectives, we performed the following steps:

- Reviewed and analyzed applicable contractual agreements, guidelines, and best practices.
- Conducted interviews of STPNOC Board of Directors and key staff at AE.
- Analyzed reports and documentation related to governance and risk mitigation at STPNOC.
- Considered risks related to fraud, waste, and abuse and key information systems.

AUDIT RESULTS

We found that in general, the STPNOC Board of Directors operates consistently with governance best practices. However, AE has some weaknesses in its governance structure related to STPNOC oversight, which may limit its ability to manage the ownership risks.

Finding 1: In general, the STPNOC Board of Directors operates consistently with governance best practices.

According to the Institute of Nuclear Power Operators (INPO), the Board of Directors (Board) of STPNOC is required to receive routine safety and reliability reports about the nuclear station produced by an independent oversight process. Further, according to the Organization of Economic Co-operations and Development (OECD) best practices, a Board of Directors should also:

- act on a fully informed basis, in good faith, with due diligence and care;
- conduct an annual evaluation to appraise their performance and monitor the effectiveness of the company's governance practices and make changes as needed; and
- have a board chair that is separate from the CEO.

In general, the Board operates consistently with best practices. The Board routinely receives independent reports from various oversight groups and is informed about safety and reliability risks at a high level. The STPNOC CEO is responsible for addressing known issues and risks that are reported by various oversight groups. We identified two best practices that the Board may consider beneficial for adoption. The former CEO acted as the Chair of the Board, but as of August 2012, the NRG Energy representative serves as the Board's Chair, which is consistent with best practices. While the Board does not conduct annual self-evaluations, as suggested by best practices, it is not required by STPNOC participation agreement, operating agreement, bylaws, or articles of incorporation.

Finding 2: AE has some weaknesses in its governance structure related to STPNOC oversight, which may limit its ability to manage the ownership risks.

According to Committee of Sponsoring Organizations (COSO) internal control framework, management controls include:

- A clear definition of staff roles and responsibilities, which is understood by staff;
- Creation and implementation of policies and procedures;
- Clear organizational structure and lines of communication;
- Regular monitoring of entity operations.

AE owns 16% of STP, while NRG Energy and CPS Energy own 44% and 40%, respectively (see Exhibit 1). We found that AE participates less in the oversight of the STPNOC than other owners, and filled some committee positions on a temporary basis. In some cases the interim staff were not knowledgeable about the committees' operation and did not monitor the progress toward addressing issues identified. Responsibilities of AE staff assigned to the STPNOC committees and succession plans are not documented, and an informal communication process is used to assign staff to represent AE on STPNOC committees. In addition, the list of names serving as STPNOC points of contact for AE is not always current.

EXHIBIT 1
Comparison of the Staff Allocated by STP Owner to the Oversight Roles

STPNOC Owner	NRG Energy	CPS Energy	Austin Energy
% ownership as of September 2011	44%	40%	16%
% of time allocated to STP by owner representatives	20-25%	25%	5-15%
% of time allocated to STP by owner alternates	100%	100%	50%
# of STP committees	12	12	12
# of primary representatives	10	12	10
# of alternate representatives	9	6	3
# of committees with no alternate identified	1	5	9

SOURCE: OCA summary of information as self-reported by the Board of Directors'/Owners' representatives as of August 2012.

We reviewed several issues and risks identified by oversight groups, and while the issues were discussed by the Board at high level, information was not always communicated to the relevant AE staff, and issues and risks were not always monitored for resolution. For example, we noted that the issues identified in the control review under the Sarbanes Oxley Act and issues identified by the STPNOC internal audit group were not monitored by AE staff representing AE on the relevant committees. According to AE management, monitoring of the STP operations is limited due to CEO operational responsibilities outlined in the participation agreement and favorable reports from the federal Nuclear Regulatory Commission (NRC), INPO, the STPNOC's external auditor - KPMG, and other oversight agencies. Overall, the AE governance structure has some internal control weaknesses that may limit its ability to exercise the due diligence needed to manage the ownership risks.

RECOMMENDATION

The recommendations listed below are a result of our audit effort and subject to the limitation of our scope of work. We believe that these recommendations provide reasonable approaches to help resolve the issues identified. We also believe that operational management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches and we encourage them to do so when providing their response to our recommendations. As such, we strongly recommend the following:


- 1. Austin Energy should strengthen controls over STPNOC oversight related to: documenting and implementing staff roles and responsibilities, communicating expectations and relevant information, and monitoring issues and risks identified and their resolution.**

MANAGEMENT RESPONSE: **Concur.** Refer to Appendix A for management response and action plan.

MANAGEMENT RESPONSE



TO: Kenneth J. Mory, City Auditor

FROM: Larry Weis, General Manager, Austin Energy 

CC: Marc A. Ott, City Manager

DATE: October 11, 2012

SUBJECT: South Texas Project Nuclear Oversight Company (STPNOC)
Management Oversight Audit Management Response

Austin Energy has reviewed the report issued for the audit conducted by your staff on the STPNOC Management Oversight processes. Management concurs with the recommendation provided and has identified several tasks, as shown on the attached action plan, which will be implemented to improve our management oversight position. All items will be complete before the end of October 2012.

Austin Energy appreciates the support you provide to our organization to identify opportunities to continually improve and we certainly appreciate the efforts of the staff involved with us on this audit. Thank you.

cc: Cheryl Mcle
David Wood
Clyde Canady

ACTION PLAN

South Texas Project Nuclear Operating Company Management Oversight Audit

Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
<p>1. Austin Energy should strengthen controls over STPNOC oversight related to: documenting and implementing staff roles and responsibilities, communicating expectations and relevant information, and monitoring issues and risks identified and their resolution.</p>	<p>Austin Energy (AE) concurs.</p> <ul style="list-style-type: none"> ▪ AE Owners Alternate will establish internal process to identify and maintain a listing of all points of contact (POC) and subcommittee members and alternates. ▪ AE Owners Alternate will develop a POC and Committee member packet to be used to provide each new designee with role and expectations. Will include charter where applicable, STPNOC management org chart, list of all AE STPNOC POC and subcommittee, members and STPNOC contact names. ▪ AE STPNOC Board member will establish a pre-board review meeting for all POCs and subcommittee members to review board agenda, and for members and POCs to provide regular status updates, highlights and discuss any issues or concerns. 	<p>Underway</p> <p>Underway</p> <p>Underway</p>	<p>October 31, 2012</p> <p>October 31, 2012</p> <p>October 31, 2012</p>

