BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Florida Power Corporation's Earnings, Including Effects of Proposed Acquisition of Florida Power Corporation by Carolina Power & Light

DOCKET NO. 000824-EI

Submitted for Filing:
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DIRECT TESTIMONY
OF
JAN A. UMBAUGH

ON BEHALF OF
FLORIDA POWER CORPORATION

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DIRECT TESTIMONY OF JAN A. UMBAUGH
ON BEHALF OF FLORIDA POWER CORPORATION

I. POSITION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jan A. Umbaugh, and my address is Suite 1800, 150 Fayetteville Street Mall, Raleigh, North Carolina 27601.

Q. WHAT IS YOUR OCCUPATION AND WITH WHOM ARE YOU ASSOCIATED?

A. I am a Certified Public Accountant and a partner with the firm of Deloitte & Touche LLP ("D&T" or the "Firm"), an international public accounting firm.

Q. PLEASE DESCRIBE YOUR BACKGROUND AND PRESENT WORK RESPONSIBILITIES.

A. I graduated from Ball State University in Muncie, Indiana, in 1969 with a Bachelor of Science degree, majoring in accounting. Since 1969, I have been employed by Deloitte & Touche or its predecessors in St. Louis, Washington, D.C.` (National Office-Public Utilities), Detroit, New Orleans, West Palm Beach, and Raleigh. My responsibilities have been concentrated in public utilities throughout my career.

I currently serve as the Firm's National Audit Partner for the public utility industry. In this role, my responsibilities center on providing assistance to the Firm's personnel and our public utility clients concerning a variety of public utility accounting, tax, and regulatory matters. These responsibilities include accounting research and consultation, preparation and presentation of training programs, consideration of specific accounting and regulatory questions, concurring review of audit reports on utility clients' financial statements, and participation in a variety of engagements, including the preparation of testimony and supporting data on utility rate and accounting matters. I have served as lead client service partner on such audit clients as Entergy Corporation, Florida Public Utilities, FPL Group, IPALCO Enterprises, MCN Energy, Progress Energy, Tucson Electric Power, and Wabash Valley Power Association.

I have presented testimony as an expert witness before the Federal Energy Regulatory Commission ("FERC") and before courts or regulatory agencies in Alabama, Arizona, California, Florida, Georgia, Indiana, Mississippi, New Jersey, New Mexico, Ohio, Rhode Island, South Carolina, South Dakota, Texas, West Virginia, and Ontario, Canada.

My professional affiliations include the American Institute of Certified Public Accountants ("AICPA") and the North Carolina and Missouri state societies of Certified Public Accountants. I am a licensed CPA in the states of Florida, Missouri, and North Carolina. I served two terms as a member of the AICPA's Public Utility Committee and am a contributing author of <u>Accounting for Public Utilities</u> published by Matthew Bender.

II. <u>PURPOSE OF TESTIMONY</u>

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to present the results of an examination, made under my supervision and direction, of the financial forecast prepared by Florida

Power Corporation (the "Company") for calendar year 2002 as set forth in the Company's forecasted financial statements. This forecast provides the basis for the "per book" amounts for the forecasted test year in several of the Company's minimum filing requirements schedules (MFRs).

Q. HAVE YOU PREPARED ANY EXHIBITS TO YOUR TESTIMONY?

A. Yes. My exhibits, consisting of JAU-1, JAU-2 and JAU-3 are attached to my prepared testimony.

Q. PLEASE DESCRIBE EACH OF YOUR EXHIBITS.

A. Exhibit JAU-1 is D&T's report on an examination of the financial forecast and the Company's related forecasted financial statements, including footnotes. This report presents our opinion on whether the financial forecast is presented in conformity with AICPA guidelines and whether the assumptions provide a reasonable basis for the Company's presentation.

Exhibit JAU-2 is a summary of D&T's examination procedures. This summarizes the significant steps followed in performing our examination of the forecast.

Exhibit JAU-3 is a summary of the Company's compliance with the AICPA Guide for Prospective Financial Information (the "AICPA Guide"). This includes our comments on the Company's compliance with the AICPA Guide in preparation of the financial forecast and related forecasted financial statements.

Q. WHAT WAS THE OBJECTIVE OF D&T'S ENGAGEMENT?

A. The objective of our engagement was to examine, in accordance with standards established by the AICPA, Florida Power's forecasted December 31, 2002 balance sheet, the related statements of income and retained earnings and of cash flows for the year then ended, and the summaries of significant assumptions and accounting policies for the purpose of issuing a report stating whether, in our opinion, (a) the financial forecast is presented in conformity with applicable guidelines established by the AICPA Guide, and (b) the underlying assumptions provide a reasonable basis for management's forecasts. An examination is the highest level of service, and thus, assurance, that we can provide under the standards established by the AICPA.

III. DESCRIPTION OF PROCEDURES

Q. PLEASE DESCRIBE THE SCOPE OF YOUR EXAMINATION.

A. Our examination was performed in compliance with the requirements of the AICPA's Statement on Standards for Attestation Engagements No. 10, "Attestation Standards: Revision and Recodification" (the "AICPA Attestation Standards"). The AICPA Attestation Standards state, "an examination of prospective financial statements is a professional service that involves –

a. Evaluating the preparation of the prospective financial statements.

b. Evaluating the support underlying the assumptions.

c. Evaluating the presentation of the prospective financial statements for conformity with AICPA presentation guidelines.

d. Issuing an examination report."

Q. WOULD YOU PLEASE DEFINE A FINANCIAL FORECAST?

A. Financial forecasts are prospective financial statements that present, to the best of management's knowledge and belief at the point in time it is prepared, a company's expected financial position, results of operations, and cash flows, based on management's assumptions which reflect conditions it expects to exist and the course of action it expects to take.

Q. WHAT WERE THE RESULTS OF YOUR EXAMINATION?

A. Our opinion, as reflected in Exhibit JAU-1, states that the Company's forecasted statements as of and for the year ending December 31, 2002, are presented in conformity with the guidelines for presentation of a forecast established by the AICPA, and the underlying assumptions provide a reasonable basis for management's forecast.

We noted that there will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected and those differences may be material. This is required wording under the AICPA reporting standards to which we must properly adhere. It is not reflective of any specific deficiency in the Company's financial forecast but is reflective of the nature of all prospective financial statements.

Exhibit JAU-3 sets forth our evaluation of the Company's compliance with the preparation guidelines of the AICPA Guide. We believe the Company has complied with those guidelines.

Q. WERE THERE ANY SUBSEQUENT CHANGES IN ANY OF THE ASSUMPTIONS USED TO PREPARE THE FORECASTED FINANCIAL STATEMENTS?

A. Yes, subsequent to the Company's preparation of the forecasted financial statements, management received updated information from its actuary regarding the estimated pension credit for 2002. This updated information was received after the forecasted financial statements were prepared, and was not reflected in the 2002 forecasted financial statements included in Exhibit JAU-1. I understand that the Company intends to reflect this updated information as a proforma adjustment in its rate filing.

On September 20, 2001, the Company also filed a request with the Florida Public Service Commission to reduce its fuel clause adjustment factors because of anticipated lower fuel costs. Because recovery of fuel costs is addressed in separate proceedings, this change should not impact the review of the Company's base rates in this proceeding. This will, however, result in a difference between the forecasted financial statements included in Exhibit JAU-1 and the Company's expected results if that rate reduction is approved.

Finally, the terrorist attacks in the United States on September 11, 2001 have resulted in a continued weakening of the United States and Florida economies and are likely to delay economic recovery. These potentially significant negative economic impacts have not been reflected in the Company's forecasted financial statements included in Exhibit JAU-1.

IV. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

Florida Power Corporation:

We have examined the accompanying forecasted balance sheet-regulatory basis of Florida Power Corporation as of December 31, 2002 and the related statements of income and retained earnings-regulatory basis and of cash flows-regulatory basis for the year then ended. These forecasted financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the forecasted financial statements based on our examination.

Our examination was made in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We believe that our examination provides a reasonable basis for our opinion.

As discussed in footnote 1, these forecasted financial statements were prepared in accordance with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the accompanying forecast is presented in conformity with guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants and the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases, and the underlying assumptions provide a reasonable basis for management's forecast. However, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The historical financial statements as of December 31, 2000, and for the year then ending from which the historical data are derived, were not examined by us, and we express no opinion thereon.

This report is intended solely for the information and use of Florida Power Corporation and for filing with the Florida Public Service Commission in Docket No. 000824-EI and is not intended and should not be used by anyone other than these specified parties or parties to such FPSC proceeding.

Deloitte & Touche LLP
Raleigh, North Carolina
August 31, 2001 (except note 3 as to which the date is September 20, 2001)

FLORIDA POWER CORPORATION
STATEMENTS OF INCOME AND RETAINED EARNINGS - REGULATORY BASIS
FOR THE YEAR ENDING
(Thousands)

Line No.		FORECASTED DECEMBER 31, 2002	ACTUAL DECEMBER 31, 2000
1	**OPERATING REVENUES**		
2	Sales of Electric Energy	$ 3,128,494	$ 2,777,746
3	Other Operating Revenues	90,194	113,439
4	**Total Operating Revenues**	3,218,688	2,891,185
5			
6	**OPERATING EXPENSES**		
7	Fuel and Net Interchange	1,423,259	1,196,614
8	Other Operation and Maintenance Expense	474,326	527,425
9	Environmental Conservation Cost Recovery Costs	69,212	65,041
10	Depreciation and Amortization	376,304	402,625
11	Taxes Other than Income	239,753	213,280
12	Current Income Taxes - Federal and State	241,935	206,954
13	Deferred Income Taxes - Net	(40,538)	(51,693)
14	Investment Tax Credit	(7,752)	(7,857)
15	**Total Operating Expenses**	2,776,499	2,552,389
16			
17	**Net Utility Operating Income**	**442,189**	**338,796**
18			
19	**OTHER INCOME AND DEDUCTIONS**		
20	AFUDC Equity	2,834	1,254
21	Other Income & Deductions-Net	(3,375)	(2,878)
22	**Net Other Income (Deductions)**	**(541)**	**(1,624)**
23			
24	**INTEREST EXPENSE**		
25	Long Term Interest Expense (Excluding Commercial Paper)	100,363	102,218
26	Other Interest Expense	11,790	23,372
27	Debt Amortization-Net	3,007	2,889
28	AFUDC Debt	(2,350)	(3,117)
29	**Total Interest Expense**	112,810	125,362
30			
31	**Net Income**	**328,838**	**211,810**
32	Preferred Dividends	1,512	1,512
33			
34	**Earnings Available for Common**	**327,326**	**210,298**
35			
36	**Beginning Retained Earnings**	**965,374**	**880,593**
37	Common Stock Dividends	(253,204)	(201,276)
38			
39	**Ending Retained Earnings**	**$ 1,039,496**	**$ 889,615**

See accompanying summary of significant forecast assumptions and accounting policies

FLORIDA POWER CORPORATION
BALANCE SHEETS - REGULATORY BASIS
(Thousands)

Line No.	ASSETS	FORECASTED DECEMBER 31, 2002	ACTUAL DECEMBER 31, 2000
1	**UTILITY PLANT**		
2	Electric Plant in Service	$ 7,628,193	$ 6,995,489
3	Construction Work in Progress	217,777	124,988
4	Electric Plant Held For Future Use	8,274	8,274
5	Other Utility Plant	2,646	2,646
6	**Total Electric Plant**	**7,856,890**	**7,131,397**
7	Accumulated Provision for Depreciation	(4,181,353)	(3,600,441)
8	Nuclear Fuel-Net	42,789	39,879
9	**Net Utility Plant**	**3,718,326**	**3,570,835**
10			
11	**OTHER PROPERTY AND INVESTMENTS**		
12	Non-Utility Property-Net	8,087	6,414
13	Other Special Funds	386,855	344,601
14	**Total Other Property and Investments**	**394,942**	**351,015**
15			
16	**CURRENT ASSETS**		
17	Cash and Cash Equivalents	2,871	3,380
18	Customer Accounts Receivable	152,451	165,383
19	Accrued Utility Revenues	74,916	85,096
20	Other Accounts Receivable	22,078	43,978
21	Accumulated Provision for Uncollectibles	(4,939)	(5,220)
22	Account Receivable from Associated Companies	14,485	38,729
23	Fuel Stock	87,586	51,763
24	Plant Materials and Operating Supplies	92,115	86,734
25	Other Inventory	501	620
26	Prepayments and Miscellaneous	247,356	146,646
27	**Total Current Assets**	**689,420**	**617,108**
28			
29	**DEFERRED DEBITS**		
30	Unamortized Debt Expense	9,184	9,526
31	Unamortized Loss on Reacquired Bonds	20,851	21,568
32	Regulatory Assets-FAS 109	114,187	132,693
33	Other Regulatory Assets	83,467	244,495
34	Miscellaneous Deferred Debits	22,918	108,929
35	Accumulated Deferred Income Taxes	158,806	187,981
36	**Total Deferred Debits**	**409,413**	**705,192**
37			
38			
39			
40	**Total Assets**	**$ 5,212,101**	**$ 5,244,150**

See accompanying summary of significant forecast assumptions and accounting policies

FLORIDA POWER CORPORATION
BALANCE SHEETS - REGULATORY BASIS
(Thousands)

Line No.	LIABILITIES AND OTHER CREDITS	FORECASTED DECEMBER 31, 2002	ACTUAL DECEMBER 31, 2000
1	**PROPRIETARY CAPITAL**		
2	Common Stock (Without Par)	$ 354,405	$ 354,405
3	Premium on Capital Stock	31	31
4	Donations from Stockholders	419	419
5	Reduction in Par Value-Common Stock	326	326
6	Miscellaneous Paid in Capital	720,232	720,232
7	Unappropriated Retained Earnings	1,039,496	889,615
8	**Total Common Stock Equity**	**2,114,910**	**1,965,028**
9	Preferred Stock ($100 Par)	33,497	33,497
10	**Total Proprietary Capital**	**2,148,406**	**1,998,525**
11			
12	**LONG-TERM DEBT:**		
13	Bonds Payable	1,050,865	750,865
14	Other Long-Term Debt	616,900	731,100
15	Unamortized Discount on Long-Term Debt	(2,137)	(2,849)
16	**Total Long-Term Debt**	**1,665,628**	**1,479,116**
17	**Total Capitalization**	**3,814,034**	**3,477,641**
18			
19	**CURRENT LIABILITIES:**		
20	Notes Payable	60,296	192,530
21	Accounts Payable	137,521	153,880
22	Notes Payable to Associated Companies	20,180	20,180
23	Accounts Payable to Associated Companies	36,823	39,526
24	Customer Deposits	119,742	108,169
25	Taxes Accrued	280	13,352
26	Interest Accrued	53,304	47,117
27	Tax Collections Payable	11,028	10,177
28	Miscellaneous Current Liabilities	70,650	105,067
29	**Total Current Liabilities**	**509,824**	**689,998**
30			
31	**DEFERRED CREDITS:**		
32	Other Deferred Credits	33,571	44,921
33	Deferred Revenues		63,000
34	Regulatory Liability-FAS 109	81,755	113,004
35	Accumulated Deferred Investment Tax Credit	46,123	61,627
36	Accumulated Deferred Income Tax	498,273	575,882
37	Other Non-current Liabilities	228,520	218,076
38	**Total Deferred Credits**	**888,242**	**1,076,510**
39			
40	**Total Liabilities and Proprietary Capital**	**$ 5,212,101**	**$ 5,244,150**

See accompanying summary of significant forecast assumptions and accounting policies

FLORIDA POWER CORPORATION
STATEMENTS OF CASH FLOW - REGULATORY BASIS
FOR THE YEAR ENDING
(Thousands)

Line No.		FORECASTED DECEMBER 31, 2002	ACTUAL DECEMBER 31, 2000
1	**OPERATING ACTIVITIES**		
2	Net Income	$ 328,838	$ 211,810
3	Noncash charges (credits) to income:		
4	Depreciation and Amortization	402,566	453,300
5	Deferred Income Taxes and ITC-net	(49,293)	(59,518)
6	AFUDC-Equity	(2,834)	(1,254)
7	Change in OPEB Reserve	7,476	5,888
8	Net Change in Working Capital	(34,791)	(154,634)
9	**Net Cash Provided by Operating Activities**	**651,961**	**455,592**
10	**FINANCING ACTIVITIES**		
11	Redemption of Long-term Debt	(32,200)	(76,800)
12	Advances from Parent		20,200
13	Equity Contributions from Parent		71,000
14	Increase in Commercial Paper	85,585	
15	Change in Short-term Debt	63,044	39,400
16	Dividends on Preferred Stock	(1,512)	(1,512)
17	Dividends on Common Stock	(253,204)	(201,300)
18	**Net Cash Used in Financing Activities**	**(138,287)**	**(149,012)**
19	**INVESTING ACTIVITIES**		
20	Construction Expenditures	(505,153)	(283,700)
21	Other Property Additions		(3,100)
22	Other Investing Activities	(8,522)	(16,400)
23	**Net Cash Used in Investing Activities**	**(513,675)**	**(303,200)**
24	**Net Increase in Cash and Cash Equivalents**	**0**	**3,380**
25	**Cash and Cash Equivalents at Beginning of Year**	**2,871**	**-**
26	**Cash and Cash Equivalents at End of Year**	**$ 2,871**	**$ 3,380**

See accompanying summary of significant forecast assumptions and accounting policies

FLORIDA POWER CORPORATION
SUMMARY OF SIGNIFICANT FORECAST ASSUMPTIONS
AND ACCOUNTING POLICIES
FOR THE YEAR ENDING DECEMBER 31, 2002

The financial forecast presents, to the best of management's knowledge and belief, Florida Power Corporation's (Florida Power's or the Company's) expected financial position as of December 31, 2002 and its results of operations and cash flows for the forecast year then ending, in accordance with the accounting requirements of the Federal Energy Regulatory Commission (FERC) uniform system of accounts approved by the Florida Public Service Commission (FPSC). Accordingly, the forecast reflects management's judgment as of August 31, 2001, the date of this forecast, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecast. There will usually be differences between forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. The comparative historical financial information for 2000 is extracted from the Company's financial statements, included in its annual report on FERC Form 1 for that year, which should be read for additional information. The financial forecast is designed to provide information for the FPSC in the Company's rate filing (Docket 000824-EI). Accordingly, this forecast may not be useful for other purposes.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting – The Company is an electric utility subject to regulation by the FPSC and the FERC. The regulatory basis financial statements differ in certain respects from accounting principles generally accepted in the United States of America (GAAP). These differences relate to (1) unrealized gains on nuclear trust funds in trust fund assets and the related decommissioning liability are not recognized until realized, (2) the current portion of long-term debt and preferred stock is not included in current liabilities, (3) the current portions of deferred income taxes and SFAS No. 109 regulatory assets and liabilities are not recognized in current assets or current liabilities, and (4) the classification of prepaid pension costs, deferred recovery clause costs, and certain other regulatory assets and liabilities is different than their classification under GAAP. FERC accounting requirements allow utilities to capitalize or defer certain costs or reduce revenues based on regulatory approval and management's ongoing assessment that it is probable these items will be recovered or refunded through the ratemaking process. The accompanying forecasted financial statements have been prepared using the accounting principles that the Company expects to use when preparing its regulatory basis historical financial statements, and they comply with the accounting and reporting requirements of the American Institute of Certified Public Accountants' Guide for Prospective Financial Information.

On November 30, 2000, Progress Energy, Inc. (Progress Energy) acquired all of the outstanding common shares of the Company's parent, Florida Progress Corporation (Florida Progress). As a result of the acquisition, Progress Energy and Florida Progress are holding companies under the Public Utility Holding Company Act of 1935 (PUHCA), and the Company, as a wholly-owned subsidiary of Florida Progress, also became subject to the regulations of PUHCA. Progress Energy used the purchase method of accounting for the acquisition; however, due to the significance of the public debt and preferred securities of Florida Progress and the Company, the acquisition cost was not pushed down to the Company's separate financial statements. As a result, no new basis of accounting and reporting for the Company's assets or liabilities was established, and none of the acquisition premium or goodwill incurred by Progress Energy in connection with the acquisition has been recorded in the Company's financial statements. However, in connection with the acquisition, the Company began the implementation of a plan to combine operations with Progress Energy in the fourth quarter of 2000, and significant merger-related costs were incurred, which have been reflected in the Company's historical financial statements.

Property, Plant and Equipment - Electric utility plant is stated at the original cost of construction, which includes payroll and related costs such as taxes, pensions and other fringe benefits, general and administrative costs, and an allowance for funds used during construction. Substantially all of the utility plant is pledged as collateral for Florida Power's first mortgage bonds.

The allowance for funds used during construction (AFUDC) represents the estimated cost of equity and debt for utility plant under construction. Florida Power is permitted to earn a return on these costs and recover them in the rates charged for utility services while the plant is in service. The average rate used in computing the allowance for funds was 7.81% for 2002.

The cost of nuclear fuel is amortized to expense based on the quantity of heat produced for the generation of electric energy in relation to the quantity of heat expected to be produced over the life of the nuclear fuel core.

Florida Power's annual provision for depreciation, including provisions for nuclear plant decommissioning costs and fossil plant dismantlement costs, expressed as a percentage of the average balances of depreciable utility plant, is 4.6% for 2002.

Florida Power charges maintenance expense with the cost of repairs and minor renewals of property. The plant accounts are charged with the cost of renewals and replacements of property units. Accumulated depreciation is charged with the cost, less the net salvage, of property units retired.

In compliance with a regulatory order, Florida Power accrues a reserve for maintenance and refueling expenses anticipated to be incurred during scheduled nuclear plant outages. The accrual for 2002 is estimated to be $7.8 million.

Jointly-owned Plant – The Company owns a 91.78% interest in the Crystal River Nuclear Plant Unit 3 (CR3). Each co-owner provides for its own financing of its investment. The Company's share of the asset balances and operating costs is included in the forecast financial statements.

Nuclear Plant Decommissioning — The Company's nuclear plant depreciation expenses include a provision for future decommissioning costs, which is recoverable through rates charged to customers. The Company is placing its collection in an externally managed trust fund. The recovery from customers, plus income earned on the trust fund, is intended to be sufficient to cover the Company's share of the future dismantling, removal and land restoration costs. The Company has a license to operate the nuclear unit through December 3, 2016, and the forecast contemplates decommissioning beginning at that time.

Fossil Plant Dismantlement — The Company accrues for fossil plant dismantlement expense based on studies approved by the FPSC.

Utility Revenues, Fuel and Purchased Power Expenses - Florida Power accrues the non-fuel portion of base revenues for services rendered but unbilled.

Revenues include amounts resulting from fuel, purchased power and energy conservation cost recovery clauses, which generally are designed to permit full recovery of these costs. The FPSC and FERC allow electric utilities to recover these costs, referred to as "pass-through" costs, through various cost recovery clauses to the extent those costs are prudent. Pass-through costs, including related taxes, represent about 52% of the Company's annual electric revenues and about 58% of its operating expenses for 2002. Due to the regulatory treatment of these expenses and the method allowed for recovery, changes from year to year have no material impact on net operating results. The FPSC adjustment factors are based on forecasted costs for a 12-month period. The cumulative differences between actual and billed costs are included on the balance sheets as miscellaneous deferred debit or credits. Any difference is billed or refunded to customers during the subsequent period.

Fuel Disposal Costs — The Company has entered into a contract with the Department of Energy (DOE) for the transportation and disposal of spent nuclear fuel. Disposal costs for nuclear fuel consumed are being collected from customers through the fuel adjustment clause at a rate of $.001 per net nuclear kilowatt-hour sold and are paid to the DOE quarterly. The Company currently is storing spent nuclear fuel on-site and has sufficient storage capacity in place for fuel consumed through the year 2011.

Income Taxes — Deferred income taxes are provided on all significant temporary differences between the financial and tax basis of assets and liabilities using current tax rates. A regulatory asset or liability has been recognized for the impact of tax expenses or benefits that are recovered or refunded in different periods by the Company pursuant to rate orders. These SFAS 109 regulatory assets and liabilities are amortized as additions to or reductions of income tax expense as the temporary differences reverse.

Deferred investment tax credits, subject to regulatory accounting practices, are amortized to income over the lives of the related properties.

Pension Benefits — The Company participates in two noncontributory defined benefit pension plans covering most employees. The estimated pension benefit for 2002 is $54.5 million including the increased benefit of converting the plans to a cash balance pension plan. This includes the assumption of a 9.25% expected long-term rate of return on plan assets for 2002. See Note 3.

Other Postretirement Benefits (OPEB) — The Company also provides certain health care and life insurance benefits for retired employees that reach retirement age while working for the Company. The estimated OPEB costs, including amounts capitalized, for 2002 are $20 million. The assumed pre-medicare and post-medicare health care cost trend rates for 2002 are 6.7% and 6.0%, respectively. Both rates ultimately decrease to 5.25% in 2005 and thereafter. A one-percentage point increase or decrease in the assumed health care cost trend rate would change the total service and interest cost by approximately $1 million.

Related Party Transactions — In connection with the acquisition by Progress Energy and PUHCA requirements, Progress Energy Service Company (Service Company) was created to perform certain common general and administrative functions formerly performed by the Company or Florida Progress. Service Company costs are allocated to affiliates and others receiving benefits based on formulas filed with and approved by the Securities and Exchange Commission (SEC) in accordance with PUHCA regulations. Other Operation and maintenance and ECCR expenses for 2002 include approximately $97 million and $1 million, respectively, of costs allocated to the Company from the Service Company and 2002 capital additions include approximately $62 million of capitalized Service Company costs.

The Company has coal supply contracts with Electric Fuels Corporation, an affiliated company, which require the Company to buy substantially all of the coal requirements for four of the Company's power plants, two through 2002 and two through 2004. Affiliated companies have also provided rail and water-borne transportation for such coal. Approximately $370 million of such costs are included in fuel purchases for 2002. The price the affiliate charges Florida Power is based on market rates for coal procurement and for water-borne transportation under a methodology approved by the FPSC. Rail transportation is also based on market rates plus a return allowed by the FPSC (currently 12%) on equity in transportation equipment utilized in transporting coal to Florida Power. In July 2001, Progress Energy announced it had agreed to sell the affiliate that provided the water-borne transportation to an unaffiliated company. The forecast assumes that the Company will continue to incur water-borne transportation costs from unaffiliated entities at costs comparable to those of the former affiliate.

Insurance — Florida Power utilizes various risk management techniques to protect certain assets from risk of loss, including the purchase of insurance. Risk avoidance, risk transfer and self-insurance techniques are utilized depending on the Company's ability to assume risk, the relative cost and availability of methods for transferring risk to third parties, and the requirements of applicable regulatory bodies.

Florida Power self-insures its transmission and distribution lines against loss due to storm damage and other natural disasters. Pursuant to a regulatory order, Florida Power is accruing $6 million annually to a storm damage reserve and may defer any losses in excess of the reserve. The reserve balance at December 31, 2002 of approximately $32 million is included in Other Non-current Liabilities.

Under the provisions of the Price Anderson Act, which limits liability for accidents at nuclear power plants, Florida Power, as an owner of a nuclear plant, can be assessed for a portion of any third-party liability claims arising from an accident at any commercial nuclear power plant in the United States. If total third-party claims relating to a single nuclear incident exceed $200 million (the amount of currently available commercial liability insurance), Florida Power could be assessed up to $88 million per incident, with a maximum assessment of $10 million per year.

Florida Power also maintains nuclear property damage insurance and decontamination and decommissioning liability insurance totaling $1.6 billion. This insurance coverage is purchased from Nuclear Electric Insurance Ltd. (NEIL). Florida Power is self-insured for any losses that are in excess of this coverage. Under the terms of the NEIL policy, Florida Power could be assessed up to a maximum of $9 million in any policy year if losses in excess of NEIL's available surplus are incurred. NEIL premiums, net of any refunds received, are included in operating expense.

Florida Power has never been assessed under these nuclear indemnities or insurance policies.

New Accounting Standards — Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as assets or liabilities in the balance sheet and measure those instruments at fair value. Because of the effects of SFAS No. 71, there has not been and is not expected to be any significant impact on the Company's operations from application of SFAS No. 133. There are no impacts of SFAS No. 133 included in the forecast financial statements and any ongoing balance sheet impact will depend on future market conditions and the Company's positions in derivative instruments and hedging activities.

In August 2001, the Financial Accounting Standards Board (FASB) issued SFAS 143, "Accounting for Asset Retirement Obligations", that provides accounting guidance for the costs of retiring long-lived assets and is effective for fiscal years beginning after June 15, 2002. The Company is assessing the impact adoption of this statement will have on the financial statements, and has not reflected any such impact in the 2002 forecast.

(2) SIGNIFICANT ASSUMPTIONS

Revenues

The forecast assumes no change in base rates from 2001 levels and the following customer growth rates and kilowatt-hour sales (kWh) growth rates for 2002:

Customer Growth Rate	1.85%	Total Retail
Sales (kWh) Growth Rate	2.15%	Residential
	2.53%	Total Retail

The economic outlook for this forecast calls for a significant moderation of national and State economic growth compared to rates seen in the 1990's. Energy price escalation and the bursting of the stock market bubble have acted to deflate consumer confidence and effectively halt new capital investment in many industries nationwide. While no economic recession – two negative quarters of GDP growth -- is incorporated in this forecast, the growth rate of the U.S. national economy has ground to a halt in early 2001. The manufacturing and high tech sectors can be classified as in recession and are putting a serious drag on the economy as a whole. The current stretch of economic expansion – which has become the longest period of economic expansion in the history of our nation – is now in serious risk of stalling out.

The forecast reflects the Company's assumption that the national economy will skirt a full-blown recession based upon the belief that the U.S. Congress and the Federal Reserve Board (FRB) will enact an appropriate mixture of fiscal and monetary policy actions. Economic stimulus from a Federal tax cut, while marginal in the short term, has been enacted. Swift and significant reductions to government-controlled interest rates by the FRB during the first half of 2001 assure most economists that the economy will react (with a lag) and pick up by the end of 2001 and into 2002.

Over-riding this, however, is the fear that a "reverse wealth-effect" will take hold of the economy and depress consumer demand. The "wealth-effect", caused by the record run-up in the U.S. stock market in the later 1990's, created a sizeable increase in consumer demand these past few years. Today, after a loss of several trillion dollars of wealth in the stock market and rising unemployment, the fear is that the consumer will rein in spending and pay down their record levels of debt.

Personal income growth is expected to continue growing but not at the torrid pace experienced in recent years. Employment growth will moderate resulting in slower growth in total wages. Slower growth in hourly earnings as well as transfer payments should also hold down income growth in the years ahead. The low interest rate environment also means lower returns on bank deposits – a significant part of retiree income.

Weather conditions significantly affect revenues based on customer usage for heating and cooling. The forecast assumes normal weather conditions. Normal weather is based on a twenty-five year average of service area weighted degree-days for comparison with kWh sales. A twenty-five year average service area weighted temperature during the hour of system peak is used for comparison with kilowatt peak demand. The forecast also contains the effects of the Company's continuing energy conservation and marketing programs on kWh energy sales and kilowatt (kW) peak demand, which are designed to moderate growth in peak demand and usage.

On a Statewide basis, interest rates and energy prices will continue to influence the pace of economic growth in Florida through their impacts on the construction and tourism industries. The Florida construction industry is expected to feel the impact of corporate mergers and consolidations with respect to commercial and industrial floor space requirements. The State has seen its fair share of corporate mergers in the banking, telecommunications and utility industries, and has not been immune to the impact of "DOT-com" failures. Office vacancy rates are reported to have risen dramatically of late. The tourism industry is reported to have performed well during the winter 2000-2001 but by mid-year hotel vacancy rates and theme park attendance have dropped precipitously. Looking forward, high consumer debt levels in a weak economic environment place an added risk on this industry's ability to avoid some economic pain.

Within the State of Florida the phosphate mining industry accounts for 75% of the U.S. phosphate supply and 35% of the global need. This energy intensive industry, which in the Company's service area consists of six major producers with either national and/or international influence upon the supply of phosphate-based fertilizers, consumed 30.5% of industrial class kWh energy sales in 2000. Load and energy consumption at the Florida Power-served mining or chemical processing sites depend heavily on plant operations, which are heavily influenced by both micro- and macroeconomic conditions. There is presently excess mining capacity in the industry due to weak farm commodity prices worldwide. Weak farm commodity prices lead to lower crop production, which results in less demand for fertilizer products. In addition, the export market for fertilizer has dried up since the Asian/Russian financial crisis. Phosphate energy consumption - as a percentage of total of the Company's industrial class usage - is expected to fall to 27% in the 2001-2002 timeframe, the second lowest share ever seen. Going forward, energy consumption is expected to remain weak, and a return to even recent historical levels is not expected in the short term.

Another Florida industry sector increasing in importance, export-related industries, is expected to stall in 2001 as Central and South American economies flounder. Florida has developed significant trade relations with its neighbors to the south and continues to attract a significant number of tourists from this area. Areas of Latin America are reeling from drought conditions and a serious electricity shortage, which are not helping economic matters.

Expected energy and demand reductions from self-service co-generation are also included in this forecast. Florida Power will supply the supplemental load of self-service co-generation customers. While Florida Power offers "standby" service to all co-generation customers, the forecast does not assume an unplanned need for standby power.

This forecast assumes that the regulatory environment and the obligation to serve our retail customers will continue throughout the forecast horizon. It also assumes that there are no changes in the Company's retail base rates through the forecast period.

The ability of wholesale customers to switch suppliers has ended the Company's obligation to serve these customers beyond their contract life. As a result, the company does not plan for generation resources to serve wholesale customers unless a long-term contract is in place. Current "all requirements" customers are assumed to not renew their contracts with the Company. Current "partial requirements" contracts are forecasted to terminate as terms reach their expiration date. Deviation from this forecast can occur if new information is received that indicates a wholesale customer has limited options in the marketplace to replace Florida Power capacity more economically.

Fuel and Purchased Power

Residual Fuel Oil Assumptions – Crude Oil supply will remain relatively stable through the forecast period. U.S. Government policy is not expected to impact the residual or light oil market except that environmental restrictions will increase the relative demands and price of lower sulfur oils. Changes to refining product mix will tend to balance residual fuel supply with demand. Weather is assumed to be normal throughout the period.

Mismatches between the two above mentioned factors combined with uncertain weather would cause periodic mismatches in supply/demand balances and wider short-term fluctuations in prices than presented in this forecast.

Natural Gas Assumptions – Overall supply of natural gas will be adequate except during extreme weather and during pipeline outages. Interruptible supply from Florida Gas Transmission and South Georgia Natural Gas will be available in limited quantities as the pipeline capacity is utilized for firm supply contracts for Florida Power Corporation and others. The Gulfstream Pipeline will come into service in mid 2002.

Coal Assumptions – Coal price forecasts are provided by Electric Fuels Corporation, an affiliated company, and represent an estimate of EFC's price to Florida Power for coal delivered to the plant sites in accordance with the forecasted delivery schedules. It assumes environmental restrictions on coal quality remain in effect as per current plans: 2.1 lbs. per million BTU sulfur dioxide limit for Crystal River (CR) Units 1 and 2 (CR1&2) and 1.2 lbs. per million BTU sulfur dioxide limit for CR4&5. However, expected environmental restrictions do impact the market for low sulfur coals causing demand and prices to be higher than would otherwise be expected.

Nuclear Fuel Expense Assumptions – Nuclear Fuel amortization forecasts (nuclear fuel expense) are based on a combination of actual dollar expenditures, estimates of future cash expenditures for contractual commitments, forecasted allowance for funds used during construction (AFUDC) of each reload batch and the amount of energy (BTU's) extracted during a particular cycle from each batch utilized.

Purchased Power – Florida Power has long-term contracts for the purchase of about 460 MW of power with other utilities, including a contract with The Southern Company for approximately 400 MW annually through 2010. This represents less than 5% of Florida Power's total current system capacity. As of December 31, 2000, Florida Power had power purchase contracts with certain qualifying facilities for 871 MW of capacity with expiration dates ranging from 2002 to 2025. The power purchase contacts provide for capacity and energy payments.

Other Expense Assumptions

O&M Expense – The 2001 budget, which reflected approximately $59 million of synergy savings resulting from the Progress Energy acquisition as compared to pre-merger Company costs, was used as the starting point for the 2002 O&M expense forecast. The 2001 budgeted expenses were generally increased by 4%, which assumes 3.75% of wage and salary increases based upon an assessment of: (1) competition; (2) impact of inflation; (3) corporate bargaining union agreement; and (4) merit increase for all non bargaining unit employees beginning in April 2002. An additional .25% increase in O&M expense was added for Energy Delivery expenses for the impact of each 1% increase in customer growth. In addition to these adjustments, the Company also reflected known or likely changes expected to occur in 2002 compared to 2001 expenses. In addition to a pension credit adjustment, which was based upon an actuarial valuation, described above, performed on the forecasted demographic data for 2002, other large adjustments included expected projects for Energy Supply and Energy Delivery to enhance the Company's service reliability, increased benefit expenses caused by the change of Florida Power employees into Progress Energy benefit plans, and an expected increase in advertising costs as a result of the merger.

Depreciation, Decommissioning and Dismantlement Expense – Depreciation expense is determined using forecasted 2002 monthly Electric Plant in Service. Depreciation rates were approved by the Florida Public Service Commission in Docket No. 971570-EI, Order No. 98-1723-FOF-EI, December 18, 1998.

Decommissioning expense, net of estimated earnings on trust funds, are expected to decrease to approximately $9 million for 2002 based on the Company's study filed with the FPSC in December 2000 submitted as part of FPSC Docket No. 001835-EI Order No. 21928. The FPSC is expected to rule on this petition in the 4th quarter of 2001.

Fossil plant dismantlement expense was based on the Company's study filed with the FPSC in January 2001 in Docket No. 010031-EI. The study reflects an increase in annual fossil plant dismantlement expense to $7.5 million. The FPSC has scheduled an agenda conference on this docket for November 2001.

Amortization of Regulatory Assets -- The Tiger Bay regulatory asset, for contract termination costs, is being recovered pursuant to an agreement between Florida Power and several intervening parties, which was approved by the FPSC in June 1997. The amortization of the regulatory asset is calculated using revenues collected under the fuel adjustment clause as if the purchased power agreements related to the facility were still in effect, less the actual fuel costs and the related debt interest expense. This will continue until the regulatory asset is fully amortized. Florida Power has the option to accelerate the amortization at its discretion. No accelerated amortization was assumed in the 2002 forecast. Other regulatory assets and liabilities are amortized consistent with previously approved regulatory guidelines.

Taxes Other Than Income – The forecast expenses include property taxes, payroll taxes, and revenue-related taxes less a credit for those taxes capitalized and transferred to other accounts. The property taxes reflect an estimate of taxes for 2002 by the tax department based on assumed changes in property tax rates and assessments. Payroll taxes were estimated based on budgeted payroll and rates in current law. Revenue-related taxes are based on current law and franchise agreements and the forecasted revenues.

Interest Expense – Interest expense on long-term debt is determined by the interest rate applied to the amount of each series outstanding. There are no new long-term debt issues in the 2002 forecast. Interest expense on short-term debt is determined by applying the assumed rate of 4.92% on the average outstanding amount each month. Interest on customer deposits is calculated using a blended interest rate applied against the forecasted total customer deposit balance. The customer deposit balance is based on the historical relationship between total deposits and number of customers. Interest on tax deficiencies was predicted on a three-year amortization of the outstanding amount, which is a net reduction of interest expense as a result of interest earned on prior income tax refunds.

Facility Assumptions

Production Plant –The forecasted 2002 expenditures includes approximately $96 million for the construction of new combined cycle unit at the Hines Energy Complex. The planned in service date for this unit is in the fall of 2003. This unit will add capacity of approximately 567 MW. Additionally there are $29 million in expenditures for the upgrade/refurbishment of the fossil plants at the Crystal River site. In general all projects are justified on the basis of environmental, safety, regulatory requirements and/or discretion (where benefits exceed cost).

Transmission and Distribution Plant – Delivery plant expenditures for 2002 include those expenditures required to provide the infrastructure for the forecasted customer growth, maintain existing level of service, as well as $51 million to improve the quality of service and reliability to existing customer base. In October 2000, Florida Power, along with Florida Power & Light Company and Tampa Electric Company filed with the FERC an application for approval of a regional transmission organization, or RTO, for peninsular Florida, currently named GridFlorida. The FPSC has established a separate proceeding to determine the appropriate transmission organization to serve Florida. Because of uncertainties about the timing and costs of the formation of GridFlorida or another RTO, no costs related to the formation of an RTO are included in the 2002 forecast.

General Plant – General plant expenditures are used to provide proper equipment for new employees to perform their jobs or replace existing equipment that cannot be properly maintained or repaired.

Financing

Accounts Receivable –The monthly balances for Customer Accounts Receivable assume that 42% of a forecasted months revenue would be received as cash that month and 58% would be collected in the subsequent month. Forecasted bad debt expense for 2002 of approximately $4 million is based on a charge-off rate of .15% of retail revenues.

Debt Financing –No new issues of long-term debt are included in the 2002 forecast. 2002 financing needs are assumed to be met with additional borrowings under the Company's long-term commercial paper program and through short-term debt. $30 million of 6.54% medium term notes are to be redeemed in July 2002 and $1.1 million of sinking fund payments on the Sebring issue are scheduled for April and October of 2002.

Common Equity – Dividends are forecasted to be $63.3 million in each quarter of 2002. No additional parent company capital contributions are included in the 2002 forecast.

(3) SUBSEQUENT EVENTS

The Company's 2002 forecast does not include the impacts of any subsequent events that occurred or information obtained after August 31, 2001, including those discussed in the following paragraphs.

Subsequent to the preparation of the forecast, the Company filed a request with the FPSC to reduce its fuel cost recovery factors. If approved by the FPSC, such reduction is expected to reduce 2002 revenues by approximately $65 million. The reduction was requested because the Company anticipates a similar reduction in its fuel costs.

Subsequent to the preparation of the forecast, the Company received updated information from their actuary regarding 2002 pension costs that indicate that the pension credit for 2002 is now expected to be only $31.4 million rather than the $54.5 million included in the forecast.

Terrorist attacks in the United States on September 11, 2001 have resulted in a continued weakening of the United States and Florida economies and are likely to delay economic recovery. These potentially significant negative economic impacts have not been reflected in the 2002 forecast.

FLORIDA POWER CORPORATION

SUMMARY OF DELOITTE & TOUCHE EXAMINATION PROCEDURES

A. Procedures to Determine the Scope of the Examination

1. Obtained knowledge of the Company's business and industry, including resources, relevant markets, industry structure, competitive environment and historical financial information.

2. Obtained an understanding of the process by which the Company prepared the forecast financial statements.

3. Obtained an understanding of the Company's accounting principles and practices.

4. Determined the key factors on which the Company's future results are significantly dependent.

5. Obtained a copy of the financial forecast and a description of the assumptions and determined that they were developed by Company personnel based upon the key factors and reviewed by appropriate management.

6. Obtained an understanding of the Corporate Model and PROSYM processing procedures; including examination of input data files and output reports, interface processes, adjustments made to input and output data and consistency in application of assumptions.

7. Examined the Company's compliance with the preparation guidelines of the AICPA Guide.

8. Evaluated the competence of Company personnel involved in the forecast process, including their degree of authority, prior experience and understanding of both the Company's plans and the forecast process.

9. Examined documentation of both the financial projections and the process to develop them and tested significant elements of the process.

10. Performed an analytical review of the Company's documentation and analysis of historical results as compared to past projections.

B. Procedures to Evaluate the Assumptions

1. Evaluated key factors and underlying assumptions in comparison to Company plans and objectives, industry trends and historical information.

2. Examined documentation supporting assumptions, including analytical review,

verification to outside sources and inquiries of management personnel responsible for development or review of the assumptions.

3. Determined that the assumptions used are consistent with the information from which they were derived.

4. Determined that significant assumptions are suitably supported and appropriate in light of the expected set of conditions and course of action in the prospective period given the hypothetical assumption and in relation to the special purpose of the presentation.

5. Examined the Company's analysis of alternative assumptions on the prospective financial information.

6. Reviewed the minutes of the Board of Directors.

C. Procedures to Evaluate the Preparation and Presentation of the Financial Forecast.

1. Tested the mathematical accuracy of the computations made in translating the assumptions into prospective amounts.

2. Determined that the listed assumptions are those used in preparing the financial forecast.

3. Determined that the financial forecast reflects the effect of each assumption and there are internal consistencies between assumptions.

4. Determined that the presentation is in conformity with the presentation guidelines in the AICPA Guide.

5. Determined that the accounting principles used in the financial forecast are consistent with those used in historical financial statements, those the Company expects to use in historical financial statements covering the prospective period, and those typically used in the industry.

FLORIDA POWER CORPORATION

Compliance with the Preparation Guidelines of the
American Institute of Certified Public Accountants' (AICPA)
Guide for Prospective Financial Information

The results of our examination within the context of each of the guidelines included in the AICPA Guide are as follows:

Financial forecasts should be prepared in good faith.

Preparation of a financial forecast necessitates the use of judgment, and the responsible party should make a good-faith effort in preparing such statements. Good faith in this context includes making a diligent effort to develop appropriate assumptions. Good faith also includes exercising care not to mislead a third-party reader. Accordingly, a financial forecast should be presented in conformity with the presentation guidelines in the AICPA Guide, including appropriate disclosures. Because a financial forecast reflects the responsible party's estimate of financial results based on its plans, good faith precludes preparing it with either undue optimism or pessimism.

Although a financial forecast prepared in good faith is neither unduly optimistic nor pessimistic, the purpose of a financial forecast may require optimism or pessimism. Accordingly, the hypothetical assumptions used in a financial forecast should be consistent with the purpose of the forecast; the other assumptions, including assumed courses of action, should be consistent with events expected to occur given the hypothetical assumptions.

Based upon our examination of the forecast process, we believe that the financial forecast was prepared in good faith.

Financial forecasts should be prepared with appropriate care by qualified personnel.

Appropriate care means that diligence and proper attention should be excised in the preparation of the financial forecast. Procedures should be established to facilitate the prevention, detection, and correction of any errors in the processing of data and making calculations.

The use of qualified personnel ensures that appropriate knowledge and competence are present or are acquired while developing the financial forecasts. Personnel having competence in various technical disciplines should participate in the development of the financial forecast. Analytical capability and expertise may be needed to analyze and interpret relevant historical data. In some circumstances, expertise in technical forecasting techniques and methods may be required.

Our examination included an overall analysis of the forecast process and discussions with personnel who developed the assumptions and prepared the various elements of the financial forecast. From this, we obtained an understanding of their knowledge of the Company and the forecast process and determined the degree of the input into the process. We reviewed the control steps in the forecast development and review process to determine that appropriate controls were in place to check for clerical accuracy and consistency in the application of key assumptions. We tested the computation and compilation of significant elements of the 2002 forecast.

Based upon our examination, we found that the Company has qualified personnel involved in the forecast process. These personnel have the appropriate background and experience for their respective responsibilities in the process. The forecast process is designed so that each element is prepared by personnel with direct knowledge and competence in their respective area, with the review and approval by upper level management providing the overall control of the process. The Company has mechanized a portion of the data accumulation process in order to minimize the potential for clerical errors and has appropriate controls in place to check for clerical accuracy.

Financial forecasts should be prepared using appropriate accounting principles.

The accounting treatment applied to events and transactions contemplated in the financial forecast should be the same as the accounting treatment expected to be applied in recording the events when or if they occur. An accounting change should be reflected in the forecast only if the responsible party expects to make the change in the historical statements.

Our examination found that the Company's 2002 financial forecast includes the same accounting principles as those used in preparation of the 2000 regulatory basis historical financial statements and expected to be used in preparing the 2002 regulatory basis historical financial statements.

The process used to develop financial forecasts should provide for seeking out the best information that is reasonably available at the time.

An effective process to develop the financial forecast should provide for searching out the best information that is reasonably available relevant to developing assumptions that are appropriate in relation to the presentation. The information used would include any relevant historical information. Often, pertinent information becomes available only after the financial forecast has been completed or disclosed or after the prospective period has expired. The fact that information existed does not necessarily mean that it was available to the preparers of the financial forecast.

Our examination included discussions with management and an evaluation of the timeliness and appropriateness of data used in the forecast. In connection with our examination of the financial forecast, we noted the Company has relied on information from sources within the Company and outside the Company. We believe that the Company sought out the best information that was reasonably available at the time the forecast was prepared (August 31, 2001).

The information used in preparing financial forecasts should be consistent with the plans of the entity.

The financial forecast should be consistent with the expected economic effects of anticipated strategies, forecasts, and actions, including those being planned in response to expected future conditions. An indication of the responsible party's plans can often be found in its budgets, goals, and policies.

Our examination included interviews with management and examination of published goals and objectives, as well as documentation maintained supporting the decision-making process. Based upon our examination, we believe that management's plans, goals and assumptions were appropriately documented and conveyed to those engaged in the forecast process, and that the forecast reflects those assumptions and plans.

Key factors should be identified as basis for assumptions.

Key factors are those significant matters upon which an entity's future results are expected to depend. These factors are the basis to the entity's operations and service as the foundation for the prospective financial statements. All key factors should be identified in preparing financial forecasts. After such identification, assumptions should be developed for those key factors.

Our examination procedures included identification of key factors for the purpose of developing a program designed to examine the underlying assumptions for those key factors. Based upon our examination, we believe the Company identified the appropriate key factors for the financial forecast and utilized these key factors in the development of their assumptions.

Assumptions used in preparing financial forecasts should be appropriate.

Assumptions are the essence of developing a financial forecast and are the single most important determinant of such statements. The quality of the underlying assumptions largely determines the quality of a financial forecast. Since some assumptions have a much greater impact on the forecasted results than others, they should be evaluated in view of their relative importance. The assumptions should be reasonable and suitably supported. Care should be exercised to ensure that interrelated assumptions are consistent. Support of the assumptions should be corroborated by historical trends or other external or internal information available to the Company and the reliability of assumptions used in prior forecasts should be tested.

We discussed the development of the assumptions with appropriate personnel and reviewed the types of statistics and studies gathered and maintained by the Company to support their assumptions. Although it is not feasible to exhaustively list and otherwise document and support all the assumptions underlying a forecast, nevertheless it is necessary to seek out and explicitly list and support the most critical assumptions. The forecasted financial statements describe the significant assumptions underlying the financial forecast.

We related the major assumptions to historical trends in the major areas (Revenues, O & M, Construction) of the income statement and balance sheet as a check of reasonableness. Where we were aware of changes in current conditions, we examined the effect of the conditions on the assumptions to see if they had a material effect on the financial forecasts.

We also examined assumptions that should be treated consistently throughout the forecast process, such as growth in customers and usage, to verify that the same assumptions were consistently used in the construction and O & M forecasts. We also examined all other major assumptions to see that they were consistent in all areas of the forecast process.

Based upon our examination, we believe that procedures for the derivation of major assumptions and their application in the forecast process were reasonable.

The process used to develop financial forecasts should provide the means to determine the relative effect of variations in the major underlying assumptions.

In developing financial forecasts, an understanding of the relative sensitivity of the results to the assumed conditions permits the allocation of analysis and study, as well as review by persons of higher authority, to those areas with the most significant effect. Particular attention should be devoted to those assumptions (1) to which the attainment of forecasted results is particularly sensitive (that is, those in which a small variation in the assumption would have a large effect on forecasted results) and (2) for which the probability of variation is high.

We discussed the review and monitoring process with Company personnel and examined a sampling of the results of the analyses prepared. We found that the Company makes limited sensitivity analyses of applicable assumptions used in the forecast, but instead chose the single most probable result.

The process used to develop financial forecasts should provide adequate documentation of both the financial forecasts and the process used to develop them.

Documentation involves recording the underlying assumptions as well as summarizing the supporting evidence for the assumptions. Documentation provides the ability to trace forecasted results back to the support for the basis underlying assumptions. Documentation covers the process, as well as individual financial forecast, and provides an organized record of both that can be maintained and made available for subsequent use.

In the course of our examination of each of the components of the financial forecast, we examined the applicable documentation supporting that component. We examined the documentation supporting the various assumptions for the major components. Our examination also included discussions with management of the documentation procedures.

We found that the documentation process used by the Company includes the dissemination of written instructions during the preliminary forecast process, the preparation and retention of input and supporting documentation by the individual department and by Corporate Planning &

Budgeting. Input and output information from PROSYM and the Company's Corporate Model is also retained. The Company's maintenance of information to support its forecast makes it possible to trace the assumptions back through the calculations and to recreate the forecast.

The process used to develop financial forecasts should include, where appropriate, the regular comparison of the financial forecasts with attained results.

Comparison of prospective financial results with actual results for the prospective period and for prior periods for which financial forecasts were prepared provides a historical measure of success in developing financial forecasts and may also be useful as an indication of the likely reliability of future financial forecasts.

We discussed the review process with management and examined the Company's reports comparing previous forecasts to actual results. We discussed differences between previous forecasts and the actual results for those periods with Company personnel. Our examination found that the Company has in place a monitoring process that includes the comparisons of forecasts and actual results and procedures for reflecting those results in future forecasts.

The process used to prepare financial forecasts should include adequate review and approval by the responsible party at the appropriate levels of authority.

Adequate review means that the review is conducted in sufficient depth to assure the responsible party of the soundness of the process used to develop the financial forecast and that the financial forecast and subsequent revisions were prepared in accordance with the guidelines for the preparation of financial forecasts.

Our examination included discussions with management familiar with the various areas of the forecast process as to the review and approval of selected documentation supporting the major components of the financial forecast.

Our examination found that management of the Company is involved at all stages in the forecast process. Objectives and long-range plans are developed under the direction of senior management with the approval of the Board of Directors. The key assumptions used in the forecast process and the forecasted financial statements are reviewed and approved by senior management. Summaries of variations between the forecasted results and actual results are distributed to appropriate levels of management.