ORIGINAL

State of Florida

Public Service Commission

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

DATE: April 29, 2002
TO: Division of Economic Regulation (Slemkewicz)
FROM: Division of Auditing and Safety (Vandiver) DV
RE: Undocketed ; Florida Power & Light Company; Audit Purpose: Audit allocations of fiber cost charged to the utility for the use of the fiber network; Audit Control No. 01-067-4-1

Attached is a redacted copy of the audit report issued by memo dated September 21, 2001. Many of the pages in that report were confidential pending an official request. This redacted copy releases the remainder of the non-confidential information in the audit report.

DNV/jcp
Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)
Division of the Commission Clerk and Administrative Services
Division of Competitive Markets and Enforcement (Harvey)
General Counsel
Office of Public Counsel

AUS ____
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FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF REGULATORY OVERSIGHT
BUREAU OF AUDITING SERVICES

Miami District Office

FLORIDA POWER AND LIGHT COMPANY

ALLOCATION METHODOLOGY FOR COSTS
CHARGED FROM FIBERNET TO FPL

ESTIMATED YEAR ENDED DECEMBER 31, 2001

UNDOCKETED
AUDIT CONTROL NO. 01-067-4-1

Raymond Grant, Regulatory Analyst

Ruth K. Young, Audit Manager

Kathy Welch, Public Utilities Supervisor

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DIVISION OF REGULATORY OVERSIGHT
AUDITOR'S REPORT
September 10, 2001

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described in this report to audit the Allocation Methodology used by FiberNet to charge FPL utility for the use of the fiber network estimated for the year end December 31, 2001. The allocation methodology was submitted to the Commission in February 2001 in response to a PSC staff audit in August 2000.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this report should not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report:

Scanned- The documents or accounts were read quickly looking for obvious errors.

Compiled- The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Reviewed- The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers, and selective analytical review procedures were applied.

Examined- The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers. Selective analytical review procedures were applied, and account balances were tested to the extent further described.

Verified- The item was tested for accuracy, and substantiating documentation was examined.

FiberNet used a number of different methods to allocate charges to FPL for the use of the fiber network. These methods are described in the report. Each method was analyzed and recalculated. Engineering studies were reviewed where appropriate. Certain amounts used in the calculations were traced to the company books.

AUDIT DISCLOSURE 1

SUBJECT: FIBERNET ALLOCATION OF ASSETS AND EXPENSES TO FPL UTILITY

STATEMENT OF FACTS: An audit of FPL's transfer of fiber optic assets to FiberNet was performed by the PSC staff in August, 2000. In that audit it was recommended that a different allocation methodology be considered for the monthly charges from FiberNet to the utility. FPL responded on February 19, 2001 describing a revised methodology.

The components of the invoice to FPL from FiberNet are a percent of depreciation expense on assets, a percent of return on investment on assets, a percent of property taxes on assets and a portion of expenses. The total estimated to be allocated to FPL for the year end December 31, 2001 from FiberNet follows:

Depreciation Expense on Electronics used exclusively by FPL	$
Depreciation on Fiber for FPL use only	
Depreciation on Electronics shared	
Depreciation on Shared Fiber	
Return on Investment	
Property Taxes	
Expenses	
Total	

Added to the above amount are sales, municipal, gross receipts and regulatory assessment taxes estimated in the amount of ______ Therefore, the total estimated amount to bill FPL for 2001 is $8,984,701.92.

Billed to FPL the first quarter 2001
Billed to FPL the second quarter 2001

Disclosure 2 describes the methodology for allocating the assets. Audit Disclosure 3 discloses the methodology for calculating the return on investment, Audit Disclosure 4 describes the allocation of the property taxes on the assets and Audit Disclosure 5 addresses the expenses charged to FPL. Audit Disclosure 6 includes any staff revisions because of mathematical errors and/or methodology alternatives.

DISCLOSURE 2

SUBJECT: ALLOCATION OF DEPRECIATION ON FIBERNET ASSETS

STATEMENT OF FACTS: The cost of the assets of the FiberNet system to FPL comprises (1) depreciation expense on electronics and fiber used by FPL exclusively, and (2) a percent of depreciation expense on electronics and fiber shared by FPL and FiberNet commercial customers.

Definition of Electronics - There are buildings called huts and points of presence, which house the electronics that lights the fiber (makes the fiber operable).

Definition of Fiber - Fiber is cable that light travel through that carries the sound waves.

(1) Depreciation Expense on Electronics and Fiber used by FPL 100%:

a. Electronics: The electronics used by FPL exclusively were determined to be the pre 1996 electronics on the books. The company says that these electronics are dedicated to FPL and used only by FPL. The depreciation rate of 20 years is applied to this balance.

Depreciable Base for exclusive Electronics (per books)	
20 years rate	.05
Depreciation Expense to FPL	

b. Fiber: The fiber used by FPL-only was determined by a study which measured the fiber miles that are dedicated to FPL. The fiber used by FPL was mapped out by engineers and shows FPL connections only. From this a ratio of FPL exclusive fiber miles to the total fiber miles is determined. The ratio is applied to the book value of the total fiber backbone miles on the books as of December 31, 2000 (both exclusive and shared.) The depreciation rate of 20 years is applied to FPL's portion of the shared assets. The company stated that the study will be updated every year.

B

Fiber for FPL Use only per study	
Total FPL exclusive miles/ Total Fiber miles	6,140/28,000 =21.92857%
Total Book Value of Fiber on books 12/31/00	
Times FPL Use only	21.93%
Times 20 year rate	.05
Depreciation Expense Charged to FPL	

A mathematical error was made in adding up the FPL exclusive miles. The exclusive miles are 6,341 instead of 6,140. This changes the ratio and the depreciation expense charged to FPL. See Audit Disclosure 6 for changes.

(2) Depreciation Expense on Electronics and Fiber shared by FPL and FiberNet Commercial customers.

a. Electronics: Housed in the huts or points of presence, is equipment called DS3. Each DS3 consists of 672 lines. A study was performed to determine the number of DS3's dedicated solely to FPL and the total number of DS3's. The study determined the beginning and ending location for all circuits used solely at FPL locations. This was compared with utility records and commercial use records. From this a ratio of FPL DS3's to total DS3's is determined. The percent is applied to the total shared value of electronics on the books as of December 31, 2000. The company stated that the study will be updated every year.

Shared Electronics	
Shared Electronics book value at 12/31/00	
FPL DS3's to Total DS3's 608/3480=17.47	17.47%
Prorated depreciable assets	[redacted]
Times 20 year rate	.05%
Depreciation Exp Charged to FPL	[redacted]

A math error was made in adding up the number of FPL DS3's. The number of DS3's to total should be 614/3480 or 17.64%. This changes the depreciation expense charged to FPL. See Audit Disclosure 6 for changes.

b. Fiber: The book value of the fiber miles determined to be used solely by FPL above is subtracted from the book value of the total backbone fiber miles on the books. To this the ratio of DS3's used solely by FPL to the total DS3's is applied. The DS3 ratio is applied because FPL believes that usage should determine the rest of the shared lines rather than the miles. Even though FPL has dedicated lines, it also is provided protected circuits in case of a fiber cut. The PSC staff also recommended that usage be used in its prior audit. The depreciation rate of 20 years is applied to this book value.

Shared Fiber	
Total Backbone Fiber on Books at 12/31/00	
Less FPL Exclusive Fiber above	
Base for Shared Fiber	[redacted]
Shared based on FPL DS3's to Total DS3's above	17.47%
Prorated Depreciable Base	[redacted]
Times 20 year rate	.05%
Depreciation Exp Charged to FPL	[redacted]

There is a mathematical error in the above calculation for the shared fiber. Using the company's percent for shared DS3's, the depreciation expense should be [redacted] However, this 17.47% is also in error as discussed above. See Audit Disclosure 6 for recalculation.

OPINION: Except for the mathematical errors, the depreciation expense allocation method on both FPL exclusive assets and shared assets appears to be reasonable and follows the recommendations of the prior Commission staff audit.

AUDIT DISCLOSURE 3

SUBJECT: CALCULATION OF RETURN IN INVESTMENT

STATEMENT OF FACTS: A return on investment rate of [redacted] is applied to the assets described in Audit Disclosure 2.

The return on investment amount is an average of three cost rates for BellSouth Telephone which are rated AA-. These cost rates are prepared by the Finance and Tax Division of the Florida Public Service Commission quarterly. The three rates used for the average by FPL were (*1*) discounted cash flow (*2*) ExAnte Risk Premium and (*3*) Prospective CAPM. They were [redacted] and [redacted] respectively. This averages to [redacted].

This [redacted] is applied to:

a. Book value of exclusive FPL electronics as of December 31, 1995(100% FPL),
b. Book value of exclusive FPL fiber as of 1/2001 (engineering drawings),
c. Book value of shared electronics calculated used by FPL as of December 31, 2000, and
d. Book value of shared fiber calculated used by FPL as of December 31, 2000.

Less: Accumulated Depreciation
Asset Base subject to ROI
Return on Investment

The mathematical errors in the calculations described in audit disclosure 2 change the return on investment. See audit disclosure 6 for the corrected calculation.

OPINION: The return on investment calculation should be reviewed with the Division of Economic Regulation in Tallahassee.

AUDIT DISCLOSURE 4

SUBJECT: **ALLOCATION OF PROPERTY TAXES**

STATEMENT OF FACTS: FPL is charged for property taxes on the property used exclusively by it, and its portion of the shared property.

The total asset base for FPL use (exclusive and shared %) is compared to the total assets. This ratio is applied to the estimated property taxes for total assets for 2001. The actual property taxes for 2000 were reviewed and compared to the estimated 2001.

Total property taxes estimates for 2001	[redacted]
Total Base assets for FPL use	
Total all Assets	
Ratio assets for FPL use to total	28.0903%
Ratio times property tax estimates For 2001 =	
Allocated Property Taxes	

The mathematical errors in the prior audit disclosures change the above property tax calculation. These changes are included in Audit Disclosure 6.

OPINION: The method used for the allocation of property taxes appears to be reasonable.

AUDIT DISCLOSURE 5

SUBJECT: **EXPENSES ALLOCATED TO FPL FROM FIBERNET**

STATEMENT OF FACTS: FiberNet expenses billed to FPL comprise the average salary of 19 employees. To this an overhead rate is added for the 19 employees.

The only expenses allocated to FPL for the year 2001 are based on the average salaries of 19 employees plus overhead of [redacted] percent. The company stated that the headcount is the number of people that supported the fiber network for the utility prior to the FiberNet split off. The company also stated that this could be reviewed every year to determine a new number.

OPINION: The allocation of expenses appears to be reasonable.

AUDIT DISCLOSURE 6

SUBJECT: **PSC STAFF REVISED 2001 ESTIMATED CHARGES TO FPL FROM FIBERNET**

STATEMENT OF FACTS: The schedule following this disclosure recalculates the estimated charges to FPL for the Year End December 31, 2001. This schedule includes corrections to the mathematical errors noted in Audit Disclosures 2 through 5, and the staff revised overall return on investment.

Also included in the attached schedule is a reallocation of taxes.

OPINION: Based on the attached calculation by staff, FPL should be billed [redacted] from FiberNet for the second half of 2001; that is [redacted] more than the estimated amount calculated by the company as follows:

	Company	Staff
Estimated 2001 cost to FPL including taxes	[redacted]	[redacted]
Less: Amount billed to FPL for First half of 2001 including taxes	[redacted]	[redacted]
Estimated Amount to be billed to FPL for second half of 2001 **per Company**	[redacted]	
Estimate Amount to be billed to FPL for second half of 2001 **per Staff**		[redacted]

COMPANY: FPL
TITLE: RECALCULATION OF COMPANY ALLOCATION
PERIOD: YEAR END 12/31/2001
DATE: AUGUST 13, 2001

RECALCULATION OF ESTIMATE OF CHARGES TO FPL FOR FIBER OPTIC NETWORK
CALENDAR YEAR 2001

	COMPANY	STAFF RECALCULATION
1. Pre 1996 electronics depreciation - Base Depreciation Exp (20 years)	[redacted] (a)	[redacted] (a)
2. Fiber for FPL use only - per engineering drawings and spreadsheet		
Total FPL exclusive miles/total fiber miles - backbone only	6140/28000 21.9286%	6341/28000 22.6464%
Total Backbone Fiber on books	[redacted]	[redacted]
Prorated Depreciable base ($42M[redacted]	[redacted]	[redacted]
Depreciation Expense (20 years) staff recalculated	b)	(b)
3. Post 1995 electroincs-capacity calculated as follows:		
Total on books for all rings	[redacted]	[redacted]
Total FPL DS3's /Total DS3's	608/3480 17.4713%	614/3480 17.6437%
Prorated depreciable base ($57M[redacted]	[redacted]	[redacted]
Depreciation Expense (20 years)		(c)

	COMPANY	STAFF RECALCULATION
Shared Fiber- capacity		
Total Non-FPL Fiber shared/Total Fiber miles backbone only	21,860/28,000 78.0714%	21,659/28,000 77.3536%
Total Backbone Fiber on books less FPL Exclusive Fiber determined in #2 above Depreciable base for shared fiber	[redacted]	[redacted]
(FPL DS3's/Total DS3's)XTotal on books for each ring	608/3480 17.4713%	614/3480 17.6437%
Prorated depreciable base $32.9MX[redacted]	[redacted]	[redacted]
HOWEVER, company calculated as At 20 years	[redacted] 5.0000% [redacted]	
Depreciation Expense (20 years) -staff recalculated Company calculated as		[redacted] (d)

(Continued on Next Page)

COMPANY: FPL
TITLE: RECALCULATION OF COMPANY ALLOCATION
PERIOD: YEAR END 12/31/2001
DATE: AUGUST 13, 2001

RECALCULATION OF ESTIMATE OF CHARGES TO FPL FOR FIBER OPTIC NETWORK
CALENDAR YEAR 2001

	COMPANY	STAFF RECALCULATION
5. Return on Investment		
FPL exclusive electronics depreciation - 100%	[redacted]	[redacted]
Fiber for FPL use only		
Shared electronics		
Shared Fiber		
Total assets for FPL use		
Less: accumulated depreciation - recalculated below (A)		
Asset base subject to ROI		
Recalculated ROI	(e)	(e)
6. Property Taxes on the above		
Total property taxes estimate for 2001	[redacted]	[redacted]
Total base assets for FPL use - staff estimate		
Total all assets		
Ratio assets for FPL use to Total	28.0903%	28.8084%
Allocated Property Taxes Recalculated	[redacted] (f)	[redacted] (f)
7. Personnel expense as calculated by company	[redacted] (g)	[redacted] (g)
TOTAL (a) through (g)	[redacted] (a)thru(g)	[redacted] (a)thru(g)
Total per Company estimate for 2001		[redacted]
Difference	[redacted]	[redacted]
(A) Calculation on Accumulated Amortization		
Total Assets subject to ROI:	[redacted]	[redacted]
Total Fiber Assets at 12/31		
Percent of Assets	28.0903%	28.8084%
Total Accumulated Depreciation Balance at 12/31/00	[redacted]	[redacted]
Times FPL use % of assets	28.0903%	28.8084%
Accumulated Depreciation Recalculated	[redacted]	[redacted]

CONTINUED ON NEXT PAGE

COMPANY: FPL
TITLE: RECALCULATION OF COMPANY ALLOCATION
PERIOD: YEAR END 12/31/2001
DATE: AUGUST 13, 2001

RECALCULATION OF ESTIMATE OF CHARGES TO FPL FOR FIBER OPTIC NETWORK
CALENDAR YEAR 2001

		COMPANY	STAFF RECALCULATION
Total Estimated Bill to FPL before taxes		[redacted]	[redacted]
FPL Estimated Taxes (sales, municipal, GRT and RAF)			
		[redacted]	
per cent of total taxes	[redacted]		12.3613%
Staff Estimated Taxes			[redacted]
Amount billed to FPL for first half of 2001 (Audit Disclosure 1)		[redacted]	[redacted]
Staff estimated amount to be billed to FPL for second half of 2001			[redacted]
Amount to be billed to FPL for second half of 2001 per Company		[redacted]	
Difference between Company and Staff Estimate for 2nd half of 2001		[redacted]	