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DATE: July 27, 2004

TO: Jim Breman, Division of Economic Regulation

FROM: Denise N. Vandiver, Chief, Bureau of Auditing
Division of Regulatory Compliance and Consumer Assistance

RE: **Docket No.** 040007-EI ; **Company Name:** Progress Energy Florida, Inc. ; **Audit Purpose:** Environmental Cost Recovery Clause ;**Audit Control No.** 04-044-2-2

Attached is the final audit report for the utility stated above. I am sending the utility a copy of this memo and the audit report. If the utility desires to file a response to the audit report, it should send the response to the Division of the Commission Clerk and Administrative Services. There are confidential work papers associated with this audit.

DNV/jcp
Attachment

cc: Division of Regulatory Compliance and Consumer Assistance (Hoppe, District Offices, File Folder)
Division of the Commission Clerk and Administrative Services (2)
Division of Competitive Markets and Enforcement (Harvey)
General Counsel
Office of Public Counsel

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FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF REGULATORY COMPLIANCE AND CONSUMER ASSISTANCE
BUREAU OF AUDITING

Tampa District Office

PROGRESS ENERGY FLORIDA, INC.

ENVIRONMENTAL COST RECOVERY CLAUSE AUDIT

TWELVE MONTHS ENDED DECEMBER 31, 2003

DOCKET 040007-EI
AUDIT CONTROL NO. 04-044-2-2

Jocelyn Y. Stephens, Audit Manager

Joseph W. Rohrbacher
Tampa District Supervisor

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DIVISION OF REGULATORY COMPLIANCE AND CONSUMER ASSISTANCE
AUDITOR'S REPORT

JULY 9, 2004

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the Environmental Cost Recovery Clause (ECRC) schedules for the historical twelve month period ending December 31, 2003 for Progress Energy Florida, Inc. These schedules were prepared by the utility in support of Docket 040007-EI. This report is based on confidential information which is separately filed with the Division of the Commission Clerk and Administrative Services.

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 FINDINGS

1) Company overstated its ECRC revenues by $335,200.
2) QORE Inc has charged PEF $3,829,466 for services that are being recommended for further review by PSC technical staff.
3) Costs for Emergency response to transformer failures were charged to ECRC.
4) Company charged Electrician delay charges to ECRC
5) Rental charges by a vendor to PEF need further review by PSC technical staff.
6) Water main break charged to ECRC

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 the report:

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

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

REVENUES: Compiled ECRC revenues. Traced rates used by the company to the rates authorized by FPSC. Recalculated ECRC revenues using FPSC authorized rates and company provided KWH sales.

EXPENSES: Compiled ECRC expenses and agreed to the filing. Performed judgmental testing of invoices and other supporting documentation. Verified that costs complied with requirements of ECRC approved programs. Reviewed direct testimony of company personnel. Determined that no legal expenses or R&D expenses are recovered through the ECRC clause.

TRUE-UP: Compiled ECRC True-Up. Verified interest rates used by the utility.

CAPITAL INVESTMENT: Scheduled capital investment for ECRC projects. Determined that no ECRC projects involve the replacement of existing plant assets. Obtained and verified cost rates and capital structure components used to calculate the weighted average cost of capital.

AUDIT DISCLOSURE NO. 1

SUBJECT: ECRC REVENUES

STATEMENT OF FACT:

In preparing the filing, the company included the wrong environmental cost recovery rate for rate codes 53 (general service demand - secondary); and 54 (general service demand - primary) in its calculation of ECRC Revenues. The company used .012 cents per KWH. The Commission approved rate for these rates codes is .008 cents per KWH. The impact of using the wrong recovery rates resulted in a difference of $335,200.

Company has stated that it will correct this error in its ECRC filing for 2003 in the month of July 2004. No adjustment had been made at end of fieldwork.

AUDITOR OPINION/RECOMMENDATION:

In the True-Up computation, staff has included the correct ECRC revenue calculation. The use of the incorrect rate, by the company, results in a variance from the staff prepared Revenues computation of $335,200.

Interest associated with the $335,200 is computed to be $ 1,732.

The company should be required to make this correction to its true-up amount for the period January-December, 2003, with applicable interest from January 2003 to July 2004.

AUDIT DISCLOSURE NO. 2

SUBJECT: QORE INC.

STATEMENT OF FACT:

Progress Energy Florida (PEF) entered in an agreement on June 18, 2003 with QORE Inc. The company stated that QORE provides the following services to PEF as they relate to the ECRC program:

1) Coordination and scheduling of the Transformer Reliability and Inspection Program (TRIP) remediation activities;
2) On-site project management performing site coordination of PEF personnel and remediation contractors in accordance with the TRIP Environmental Remediation Strategy (ERS);
3) Conduct TRIP site pre-assessments/inspections in accordance with the TRIP ERS;
4) Identify tasks, equipment, contractors and/or unique site conditions for proper coordination of remediation activities;
5) Prepare site specific documentation required by the TRIP ERS and the FDEP;
6) Working with Supervisor of Environmental Services, by providing guidance and direction for site specific remediation issues that modify or deviate from standard remediation activies as allowed by the TRIP ERS and the FDEP; and,
7) Participate in FDEP meetings concerning the development and implementation of the TRIP ERS.

Even though the contract between PEF and QORE was entered into June, 2003, PEF states that services were provided by QORE beginning in April 2003. Total Cost to PEF for the services provided by QORE, for the period January - December 2003 equals $3,829,466. No other contractor or PEF personnel provided this service prior to these dates. The contract between QORE and PEF has been extended for the 12-month period ended 12/31/04.

In April 2003, PEF paid QORE for Professional Geologist Certification services for PEF's Substation Assessment and Remedial Action Plan.

In October 2002, a position was created at PEF for Supervisor - Environmental Services. At that time the responsibilities of the supervisor were described as: "Responsible for managing a staff of three environmental specialists. Provides environmental compliance support to Florida energy delivery facilities. Functional areas include remediation activities, waste management, emergency response, compliance reporting, construction compliance oversight, environmental assessments and environmental agencies.....".

In July 2004, Company was asked for a complete and accurate description of all the responsibilities being performed by the supervisor with regard to ECRC, for the current audit period. In its response, the company stated that the job responsibilities for the 12 months ending 12/31/03 were:

1) Lead the negotiations with and obtained the approval from the Florida Department of Environmental Protection (FDEP) for the TRIP Environmental Remediation Strategy (ERS);
2) Worked with field operations and contractors to establish the work process necessary to achieve compliance with the TRIP ERS;
3) Monitored day-to-day remediation activities throughout the year to ensure continued compliance with the ERS
4) Provided direction to field crews and contractors on issues arising from carrying out the TRIP ERS;
5) Performed periodic review of remediation contractor invoicing to ensure accuracy and appropriateness of charges to the ECRC;
6) Served as the Progress Energy Liaison for the FDEP and customers inquiring about specific TRIP remediation activities;
7) Provided periodic updates to the FDEP on TRIP performance;
8) Managed the FDEP required documentation of TRIP remediation activity including all required data collection, sample analysis and reporting criteria;
9) Developed and provided TRIP ECRC budget forecasts as needed for PSC ECRC filings; and
10) Prepared testimony relating to TRIP ECRC activities as part of PSC ECRC true-up submittals

With regard to contractors, including those involved in the TRIP Program, who perform remediation for PEF, the supervisor's responsibilities include establishing work processes for site specific and programmatic work efforts, monitoring contractor performance to ensure compliance with all applicable environmental criteria, assist in the development of work scopes and RFPs and provide periodic review of contractor invoicing.

AUDITOR OPINION:

After reviewing the services provided by QORE and the responsibilities of the supervisor of Environmental Services, it appears that there is an overlap of services/responsibilities being performed by QORE and the Supervisor. This overlap includes but it not limited to:
coordination and scheduling activities vs. working with field operations and contractors to establish the work process; identifying task.....for remediation activities vs. providing direction providing guidance on issues; prepare site specific documents required...by FDEP vs managed the FDEP required document.

Additionally, PEF has entered into binding and detailed agreements with contractors, which outline the criteria required by PEF for compliance with TRIP ERS and FDEP requirements. It would be justified to say that PEF entered into these contracts because the companies have or have access to trained and experienced professionals and have been identified by the company as qualified suppliers of the necessary services; can perform their duties in compliance with agreements which comply with FDEP requirements; can efficiently coordinate their activities as per agreement; and can document their remediation process. It would therefore appear logical to assume that the contractors are able to determine the scope and logistics, with just the oversight of the supervisor, of their respective jobs without additional input from a third party.

Also, during the period January - April, 2003, nothing in the way of problems or concerns, came to the attention of the auditor that would indicate a need for oversight of the professional contractors in performing their responsibilities regarding ECRC remediation.

An additional level of review by the technical staff of the FPSC should be performed to determine the prudence and efficiency of retaining QORE in order to comply with the TRIP ERS as it relates to ECRC.

AUDIT DISCLOSURE NO. 3

SUBJECT: EMERGENCY RESPONSE TO TRANSFORMERS

STATEMENT OF FACT:

During the period January 1 - December 31, 2003 several instances were noted where the costs associated with the Emergency response to a transformer malfunction were expensed to ECRC. Total costs noted by the auditor equals $41,355

In response to a Document Request, it was stated that "Cost incurred when responding to emergency oil spills are not currently passed through ECRC".

AUDITOR OPINION:

For the 12-month period ended 12/31/03, it cannot be determined if the items noted by staff consists of all instances of emergency response or whether the company has made an adjustment to remove these costs.

The Company should therefore be required to schedule all instances of emergency responses and remove all associated costs over and above that amount noted by staff for the audit period, if applicable.

AUDIT DISCLOSURE NO. 4

SUBJECT: DELAY CHARGES

STATEMENT OF FACT:

Staff noted that on numerous invoices from Pike Electric, an amount was recorded for "Delay Charge".

The company explained that "The delay charge is generally the time incurred by the electrical contractor while waiting for the soil remediation to be completed by an environmental contractor. This time is necessary because the electrical contractor cannot be dispatched elsewhere during this time - they must be available to put the transformer back into service immediately following the remediation. This scenario permits the least amount of time possible that the customer has to be without power. These costs are not being capitalized by the Company because the soil remediation costs are incremental to the Company and **do not add value** to the transformer. The new criterion requires significantly more clean-up than the company performed prior to the DEP memo of November 2001. **If no soil remediation occurred when replacing a transformer, then the delay time would not be incurred, thus it is incremental to this process."**

Additionally, company responded that PEF worked closely with Pike on their invoicing to show the actual time spent performing electrical work. Only the invoiced time shown associated with the remediation is charged to the ECRC. In addition, Progress Energy worked with Pike to find ways for them to assist the remediation contractor so the total amount of time was not just spent waiting on the remediation to be completed.

AUDITOR OPINION:

Once the electrical contractor removes a transformer, he must wait for the soil remediation to be completed before replacing the transformer. The transformer could have been previously repaired/replaced but no soil remediation occurred at the time of repair/replacement. Or the transformer could be defective and is being currently repaired or replaced. Both would result in a delay charge.

The delay charge from Pike Electric should not be expensed to ECRC. This delay charge is not an expense for soil remediation. Soil remediation refers to the job of cleaning contaminants that cause pollution, which may be detrimental to human.....life, or to property; or unreasonably interfere with the comfortable enjoyment of life. As such, wait time by the electrician does not contribute to this process. Neither does the delay play a role in identification of a leak, excavation of the soil, testing of the soil, hauling away the soil, nor replacing the soil. Additionally, it is not a reportable item for FDEP compliance .

Company implies that only those costs that add value are capitalizable costs. If this is the case, installation must be completed before the transformer has value for its intended purpose. The cost of remediation does not add value to the transformer, but the cost of installation does. Without installation, the transformer has no value for its intended purpose. Thus costs associated with installation add value and are therefore capitalizable.

From Company prepared/supplied documents, staff noted that FERC Account 367 states that Underground conductors and devices, includes the cost installed of underground conductors and devices used for distribution purposes. (The cost of installation, in FERC Account 367, does not refer to first installation only). In a PEF Plant Accounting Manual- Distribution Accounting Interpretations section, for questionable items, (dated 6/93) it reads that "Underground and Pad Mounted Transformer purchases are charged to Undergrond Work Order 709.20-13660. Charge actual installation expenses to Account 584.00 Underground Line Expense.......".

In a memo dated 5/08/2003, regarding the Capitalization of Transformers, it is stated that ".....all other charges associated with the install are also charged to capital....."

If the company chooses not to capitalize the delay charge from the electrician, by it own documents, an alternative exists. The charge should be recorded in Account 584.

AUDIT DISCLOSURE NO. 5

SUBJECT: INVOICES FROM VENDOR FOR RENTAL CHARGES ONLY

STATEMENT OF FACT:

Staff noted invoices from Viasys Utility Services, Inc. (Viasys) that included only a rental charge for equipment or a materials fee, and the associated handling fee at a designated address. Due to the volume of charges to Progress Energy Florida (PEF) during the audit period, staff was not able to determine if the particular item that was rented was also charged an as equipment charge, on the invoice for work that was performed at the same location.

AUDITOR OPINION:

An additional level of review should be performed of all Viasys invoices and other applicable vendors, by location, to allay unanswered concerns of possible double billing of equipment - once as a rental or material charge and again as equipment or material charge for the same item at the same address.

AUDIT DISCLOSURE NO. 6

SUBJECT: WATER MAIN BREAK

STATEMENT OF FACT:

Staff noted an invoice for a water main break charged to the ECRC for $8,748.00

The Company explained that "Before soil clean up is done, a third-party performs "locates" for subsurface obstructions. A waterline was not identified during this task so PEF had no knowledge of its presence. During the remediation, the waterline burst. It was unavoidable and only occurred because of remediation.

AUDITOR OPINION:

Staff was not able to determine if a budgeted or contingency item exists for this type of incident. However, because of the extensive nature of underground projects that Company performs during the year, staff believes that a line item or contingency may exist. If so, the company should charge the costs of repairing the water line break against that budgeted item.

It is recommended that staff further investigate this issue to determine whether or not this charge is correctly charged to ECRC.

Form 42-2A

PROGRESS ENERGY FLORIDA, INC.
Environmental Cost Recovery Clause (ECRC)
Calculation of the Final True-up Amount
January 2003 through December 2003

End-of-Period True-Up Amount
(in Dollars)

Line	Description	Actual January 03	Actual February 03	Actual March 03	Actual April 03	Actual May 03	Actual June 03	Actual July 03	Actual August 03	Actual September 03	Actual October 03	Actual November 03	Actual December 03	End of Period Total
1	ECRC Revenues (net of Revenue Taxes)	$378,105	$356,537	$302,100	$325,794	$373,149	$428,997	$438,788	$426,601	$457,010	$389,149	$354,880	$340,796	$4,569,907
2	True-Up Provision	0	0	0	0	0	0	0	0	0	0	0	0	0
3	ECRC Revenues Applicable to Period (Lines 1 + 2)	378,105	356,537	302,100	325,794	373,149	428,997	438,788	426,601	457,010	389,149	354,880	340,796	4,569,907
4	Jurisdictional ECRC Costs													
	a. O & M Activities (Form 42-5A, Line 9)	7,100	93,932	89,177	400,755	520,349	1,830,170	1,254,431	1,524,721	2,009,561	3,571,613	2,106,638	997,621	14,406,068
	b. Capital Investment Projects (Form 42-7A, Line 9)	0	0	0	0	0	0	0	387	1,067	1,861	2,732	5,420	11,466
	c. Total Jurisdictional ECRC Costs	7,100	93,932	89,177	400,755	520,349	1,830,170	1,254,431	1,525,108	2,010,628	3,573,474	2,109,370	1,003,041	14,417,534
5	Over/(Under) Recovery (Line 3 - Line 4c)	371,005	262,605	212,923	(74,961)	(147,200)	(1,401,173)	(817,643)	(1,098,507)	(1,553,617)	(3,184,325)	(1,754,490)	(662,245)	(9,847,628)
6	Interest Provision (Form 42-3A, Line 10)	157	487	709	764	661	(103)	(1,039)	(1,919)	(3,088)	(5,175)	(7,102)	(8,231)	(23,879)
7	Beginning Balance True-Up & Interest Provision	0	371,162	634,254	847,886	773,689	627,150	(774,126)	(1,592,808)	(2,693,234)	(4,248,939)	(7,439,439)	(9,201,031)	0
	a. Deferred True-Up from October 2002 to December 2002 (Order No PSC-02-1735-FOF-E1)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)	(38,833)
8	True-Up Collected/(Refunded) (see Line 2)	0	0	0	0	0	0	0	0	0	0	0	0	0
9	End of Period Total True-Up (Lines 5+6+7+7a+8)	332,329	595,421	809,053	734,856	588,317	(812,959)	(1,631,641)	(2,732,067)	(4,288,772)	(7,478,272)	(9,239,864)	(9,910,340)	(9,910,340)
10	Adjustments to Period Total True-Up Including Interest	0	0	0	0	0	0	0	0	0	0	0	0	0
11	End of Period Total True-Up (Lines 9 + 10)	$332,329	$595,421	$809,053	$734,856	$588,317	($812,959)	($1,831,641)	($2,732,067)	($4,288,772)	($7,478,272)	($9,239,864)	($9,910,340)	($9,910,340)

-12-