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September 3, 2004

BY HAND DELIVERY
Ms. Blanca Bayó
Commission Clerk and Administrative Services
Room 110, Easley Building
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

Re: Docket 040216-GU - *Application for rate increase by Florida Public Utilities Company*

Dear Ms. Bayó:

Enclosed for filing in the captioned docket are an original and four copies of the responses of Florida Public Utilities to the Rate Case Audit, Control No. 04-168-4-1, conducted by Staff.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the same to me.

Thank you for your assistance with this filing.

Sincerely,

Norman H. Horton, Jr.

NHH/amb
Enclosures
cc: Ralph Yeager, Esq.

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DOCUMENT NUMBER-DATE
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ORIGINAL

Florida Public Utilities Company
Natural Gas Rate Proceeding
Docket 040216-GU

Responses to the Audit Report- Control No. 04-168-4-1

9-1-04

AUDIT EXCEPTION 1

SUBJECT: PLANT ALLOCATIONS

Company Response: This Audit Exception Addresses issues of Rate Base and NOI.

Concerning rate base items, a statement is made in the Audit Exception that the combined 2004 allocation factor for common plant to regulated natural gas was 55%: this statement is somewhat incomplete. Common plant is allocated in two parts: The first part, EDP Equipment (Accounts 3913) is allocated based on customers. For 2004, the allocation for EDP was 35% for South Florida and 20% for Central Florida for a total combined allocation of 55%.

The second part is all of the remaining common plant accounts. This allocation is based on the individual operating divisions' Plant-In-Service (including CWIP), as a percentage of the combined total Plant-In-Service (including CWIP) of all operating divisions. For 2004, the natural gas allocation for EDP was 41% for South Florida and 14% for Central Florida for a total combined allocation of 55%.

The fact that the combined natural gas allocations are 55% for both EDP and Remaining Common accounts is only a coincidence. The derivation of the allocation percentages are unrelated and are typically not the same value.

It is not appropriate to remove the Sanford facility from natural gas rate base. See Disclosure 1 for reasons; however, even if the Commission felt that was appropriate it would not affect the allocations. The removal of the Sanford facility from the computation would have no affect on the allocation of Common EDP plant. Additionally, for remaining Common plant, due to the relative small value the removal of the Sanford facility from the computation has no effect on the allocation percentage of Common Plant; and since the amount would be removed from both the natural gas Plant-In-Service amount, and from the combined total Plant-In-Service accounts of all operating divisions. Total Plant-In-Service relating to the Sanford facility is $127,028. Attached is Exhibit EA1.1, indicating the natural gas allocation percentages with the Sanford facility amount excluded: the allocation percentages do not change.

The acquisition adjustment rightfully is includable in rate base. Due to the character of the acquisition adjustment, it should remain a component of the allocation percentage computations.

FPUC agrees with the statement of the facts relating to the clearing accounts.

(Mesite, Khojasteh)

DOCUMENT NUMBER-DATE
09722 SEP-3 8
FPSC-COMMISSION CLERK

AUDIT EXCEPTION 2

SUBJECT: WORKING CAPITAL

Company Response: It is inappropriate to adjust working capital for the issues discussed in this audit exception. The Company does concur with the opinion that zero working capital should be used if the computed working capital balance is negative.

Based on the explanations that follow, the Statement of Fact and the Opinions reached with respect to the Company's allocation factors, and treatment of Under-recoveries of PGA and conservation are not correct. The Company's computation and application of the allocation percentages was correct and is consistent with past Commission accepted methodologies.

Reference was made to Audit Exception Number 3 as the basis for various working capital adjustments in this audit exception. Those issues are addressed in FPUC's response to Audit Exception 3. Net over-recoveries are includable in working capital: the Company's various Schedules B-13 and G-1(B-13), in fact, do indicate net over-recoveries.

The 2003 monthly information as contained in the MFR is based on actual general ledger data. The various allocation percentages used in the MFR to allocate the 2003 13-month average balances were based on actual data for the 12 months ended June 2002. The 12 months ended June 2002 data was adjusted to reflect the exclusion of the Water division that had been sold in March 2003. These same allocation percentages were used when filing various FPUC December 2003 quarterly surveillance reports.

Again, the same allocation methods were used in the MFR for the 2004 and 2005 projections: they were the 12 months ended June 2003. The use of allocation percentages based on 12-month ended June data as the means of allocating data for the subsequent calendar year has historically been the allocation method approved by the Commission. Since the 12-month ended June 2003 is the most current data available, using this data for 2004 and 2005 allocations is appropriate.

When accounts were projected from 2003 to 2004 and from 2004 to 2005, the base account balance was first projected and then the appropriate allocation factor was applied. In this way the allocation factor that was used in one year did not affect the account balance that was allocated in the subsequent year.

The allocation of working capital accounts between only the regulated utilities is the methodology that has historically been approved by the Commission. The Commission has approved this method in numerous rate case filings for all FPUC regulated utilities, and for surveillance reporting for the various regulated utilities: including reviews and audits of the various filings. In order to determine equitable working capital for the regulated utilities, the allocation of working capital should be amongst the regulated utilities only since common working capital components create an intercompany receivable when the nonregulated companies use those components in their operations. Removing the nonregulated equity from the consolidated capital structure in theory

accounts for their share of the working capital components and the remaining working capital components should all be regulated.

The Commission has historically referred to net under-recoveries as being excludable from working capital. In the Statement of Fact, it is stated that FPUC included accounts 186.21 and 186.61, under-recoveries of PGA and Conservation, respectively. However, in fact the Company does have a net over-recovery in both of these areas since the related liability accounts, 253.21 and 2536.61, respectively, indicate combined 13-month averages of ($550,897) for 2003, ($570,839), and ($594,243) for 2005; a net over-recovery for all three years. The associated asset and liability account must be viewed collectively when determining the inclusion or exclusion of over/under-recoveries. **(Mesite)**

AUDIT EXCEPTION 3

SUBJECT: ALLOCATION FACTORS

Company response: The amount of the staff's adjustment of $134,778.22 is incorrect. The adjustment should $117,988.82. The allocation factor that was flawed was the based on payroll and the staff is correct that the allocation needs to change from 51% to 47%, but this only effects the 926 accounts. Accounts 925 allocations were based on gross profit and are correct at 51%. The amount of the adjustment to accounts 926 should be a reduction of $128,661.44. The actual percentages used were coincidentally the same, but the basis was different and is consistent with our past methodologies.

The staff was correct in saying that the Workers Compensation allocation was incorrect, but the adjusted allocation factor should be 58%. It is not prudent to allocate Workers Compensation rates based on solely payroll. The allocation should be based on a combination of payroll, claims, and rates. In the original projection an allocation of 59.77% was used, but this included claims from all corporate employees being allocated to natural gas because they are located in West Palm Beach. To correct this problem we have reviewed all of the corporate claims and made an adjustment to allocate corporate employees claims based on their payroll. This adjustment brought the allocation down to 58%. The reason that the adjustment was so slight was because there are very few corporate claims; most claims are from operations personnel this is due to the nature of the job descriptions. The amount of this adjustment should be reduction of $9,676.38.

There is an additional adjustment to allocation factors in account 925. The allocation of the additional position needs to be changed to 85%. The allocation was originally 51% based on gross profit due to a belief that the position would be working in each division. During the hiring process the Company determined that the need for an additional safety position was only in the Natural Gas and Propane divisions. The allocation of 85% is based on number of customers and is split only between natural gas and propane. This position has been filled and will start in the beginning of October with an allocation of 85% to natural gas. The increase to account 925 should be $20,349.

The Company does agree with the adjustment of $74,438.67.

It is inappropriate to adjust working capital by $217,101 (as included in Audit Exception #2) for the issues relating to the allocation percentages as discussed in this Audit Exception and Audit Exception Number 2. As discussed in detail in Audit Exception number 2, FPUC's computation and application of the allocation percentages when preparing the MFR were according to historically approved Commission procedures and practices.

(R Smith/Mesite)

AUDIT EXCEPTION 4

SUBJECT: CONSERVATION AD

Company Response: Following an inquiry for an opinion from a PSC staff analyst specializing in conservation, it was determined that only 50% of the costs associated with this add qualifies for conservation and propane. Therefore, 50% of the costs qualify for natural gas and the appropriate adjustment should be a reduction of $1,335.26 in 2005 expenses. ($2,670.52 / 2 = $1,335.26)
(Khojasteh)

AUDIT EXCEPTION 5

SUBJECT: OUT OF PERIOD EXPENSES

Company Response: The Company agrees that these costs were out of period expenses. However, so far in 2004 the Company has made similar adjustments in 2004 to increase expenses relating to charges in 2003. As of June 30, 2004, these charges have amounted to $11,866.08 for natural gas with a possibility of an additional $70,000 pending the outcome of our most recent audit on conservation.
Therefore, an adjustment is not needed since 2003 adjustments in 2004 at the very least will cover this amount and will most probably exceed it.
(Khojasteh)

AUDIT EXCEPTION 6

SUBJECT: ACCOUNT 923.3 PROPERTY TAX AUDIT

Company Response: The Company agrees with the staff's opinion that the projected test year 2005 expense should be reduced by $10,200.
(Khojasteh)

AUDIT EXCEPTION 7

SUBJECT: Duplicate Increase in Brokers Fee Account 924

Company Response: The Company agrees with the staff's opinion that the broker's fee was overstated by $5,000, but the amount of the adjustment should be $2,600 because the allocation to the natural gas division is 52% not 51%.
(R Smith)

AUDIT EXCEPTION 8

SUBJECT: Employee Benefit Forecast Account 9262

Company Response: The Company agrees with the staff's opinion.
(R Smith)

AUDIT EXCEPTION 9

SUBJECT: Duplication of Costs in Test Year

Company Response: An adjustment is needed for the duplication of these costs, but the total adjustment for the annual report should be $6,854.63 and the adjustment for the legal fees should be $1,785.84. To support the $20,000 in legal fees we have done a comparison of the increase in cost from 2003 to 2004 thus far. In 2003 we paid $4,917 for review of the 10K and proxy while in 2004 we paid $14,748.50 for 10K and proxy review. This increase is due to additional regulations from Sarbanes Oxley and other SEC regulations and the $20,000 is conservative based on the increases that we have seen thus far. We expensed $29,947.56 in 2003 for the annual report, this included an accrual of $15,000 and the total cost for the 2003 annual report that was paid in 2004 was $17,199. So the amount over expensed was $12,748.56 ($29,947.56 - $17,199) and trended to $13,169.26. This was allocated 50% to Natural Gas, so the adjustment should be $6,584.63.
(R Smith)

AUDIT EXCEPTION 10

SUBJECT: TAXES OTHER THAN INCOME – REGULATORY ASSESSMENT FEES

Company Response: The Company agrees with the staff's opinion and the projected test year 2005 TOTI expense should be increased by $6,692 for regulatory assessment fees. **(Khojasteh)**

AUDIT EXCEPTION 11

SUBJECT: TAXES OTHER THAN INCOME – PROPERTY TAXES

Company Response: The Company agrees with the staff's opinion that the 2005 projected expenses for TOTI should be reduced by $42,448 for shared common utility plant property taxes.
(Khojasteh)

AUDIT DISCLOSURE 1

SUBJECT: Contaminated Land

Company Response: The property located at the Sanford location should remain in rate base and the associated expenses with this property should remain in NOI. The EPA has determined that at the location the soil is impacted, and that remediation is required.

The Central Florida operation was moved from the Sanford location to a new larger facility located in DeBary late in 2002. This move allowed the division to provide centralized and more efficient service to our customers in the area. The Sanford location is not marketable pending remediation. When the property is eventually sold, the ratepayers will receive benefits from the sale. Accordingly, FPUC feels that the property should continue to be included in rate base since the property has been included in rate base prior to being vacated, the eventual sale will be benefit the ratepayers, and the Commission has allowed recovery of environmental costs from the ratepayers.

As an alternative, if the Commission deems that it is not appropriate to include this property in rate base, all related expenses and a return on this property should be provided for through the environmental reserve. Any related expense to the environmentally damaged property that is removed from rate base such as property taxes should be paid from the environmental reserve along with a fair return on that same investment. **(Mesite)**

AUDIT DISCLOSURE 2

SUBJECT: COMPARISON OF ACTUAL VS. FORECASTED PLANT IN SERVICE AT JUNE 30, 2004

Company Response: The Company agrees with this disclosure as it relates to known facts and projections as of June 30, 2004. Many items included in the construction budgets used when preparing the MFR are subject to conditions imposed by third parties: municipalities, contractors, developers, etc. Several of the projects have been modified, delayed, put on hold, changed, or cancelled.

As the disclosure indicates, the net result of actual expenditures and budget changes as they apply to combined Plant-In-Service and CWIP balances as of December 2005 is anticipated to be a reduction of $890,364 below what was included in the MFR.

(Mesite)

AUDIT DISCLOSURE 3

SUBJECT: DEFERRED PIPING ALLOWANCE

Company Response: The methodology used for projecting deferred piping and conversion in accounts 1860.31 and 1860.32 is reasonable and produces conservative results.

A comparison of the actual expenses versus the projected expenses for the period January to June 2004 supports the view that the projections were conservatively derived. The actual amortizable expenses exceed the projected expenses by $44,935 for the first six months of 2004.

The most current year's level of activity is more reflective of future levels than the prior 5 years as the 5-year average does not take into consideration inflation and increased levels of activity. In addition, the prior five year methodology spans years that include non-typical events such as pre-conservation years (1999 and 2000) and acquisitions.

The projected results in amortized expenses are realistic and in a normal range, with a 2% reduction of amortized expense in 2004 and a 1% increase in 2005. The projections are reasonable, appropriate and if adjusted, should be increased rather than decreased as shown by the actual results for the first six months of 2004.
(Kitner / Cox)

AUDIT DISCLOSURE 4

SUBJECT: COST OF CAPITAL PRESENTATION

Company Response: The Company agrees with the disclosure but disagrees with the past methodology. The consolidated capital structure should be used to allocate certain common capital components including common equity, long term debt, short term debt and preferred stock to all areas of the company. It is not appropriate to arbitrarily remove propane equity 100% from common equity before making this allocation. Flo-Gas (our wholly owned subsidiary) is also financed with long-term and short-term debt of this consolidated company, and accordingly, they proportionately share in these components.

The fixed assets of the non-regulated utility are pledged as collateral for the debt. It is therefore appropriate to proportionately share all the components of capital. Without sharing capital, the results are encumbering assets for debt while giving another entity the related leverage.

In addition, assigning all equity to the non-regulated utility places it at a competitive disadvantage. Other competing propane companies use substantial leverage to maximize competitive pricing. If our propane operation must provide a reasonable return on 100% equity we are at a competitive disadvantage. This may force the company to divest its propane operations, thereby negatively affecting regulated customers who would lose the benefit of shared expenses.
(Bachman, Cox)

AUDIT DISCLOSURE 5

SUBJECT: COST OF CAPITAL PRESENTATION

Company Response: The Company agrees with the disclosure.
(Bachman, Cox)

AUDIT DISCLOSURE 6

SUBJECT: COST OF CAPITAL-2004 EQUITY OFFERING

Company Response: The Company's position remains as stated in the minutes and most recent 10Q. We feel we will have a need to issue equity within the next 1 to 3 years and that it is appropriate to reflect an equity issuance in the capital structure.
(Bachman, Cox)

AUDIT DISCLOSURE 7

SUBJECT: POSSIBLE NON-RECURRING EXPENSES

Company Response: Although these specific items may be non-recurring, similar types of charges occur periodically. For instance, we routinely have modifications to Orcom billing system in order to improve the functions of this software or other software enhancements and ongoing software maintenance work. Therefore, these costs should be included in the filing and not removed for projection purposes. The level of these types of expenses is normal and recurring even though the specific items change.
(Khojasteh)

AUDIT DISCLOSURE 8

SUBJECT: CO-OPERATIVE ADVERTISING

Company Response: The Company agrees with the facts as stated.
(Khojasteh)

AUDIT DISCLOSURE 9

SUBJECT: New Insurance Estimate

Company Response: The Company agrees with the staff's opinion that insurance estimates and the projection amount should be increased by $30,855.50.
(R Smith)

AUDIT DISCLOSURE 10

SUBJECT: ANNUALIZATION OF CURRENT 2004

Company Response: The Company experienced higher than usual, abnormal vacancies in 2003, especially, in the South Florida Division. A number of employees from South Florida requested to transfer to our Central Florida division as well as other factors affecting the division. The Company participated in a number of job fairs in order to find qualified candidates to fill these positions and has since focused on its recruiting efforts in order to avoid such high number of vacancies in the future.

See below for a list of positions that have been filled.

Position	Date Filled
I & M Mechanic	3/24/2003
I & M Mechanic	7/28/2003
I & M Mechanic	9/10/2003
I & M Mechanic	11/20/2003
I & M Clerical	1/23/2003
Service Tech	9/22/2003
Service Tech	1/5/2004
Service Tech	11/17/2003
Service Sr. Clerk	8/25/2003
Customer Service Rep	1/27/2003
Customer Service Rep	4/21/2003
Customer Service Rep	6/3/2003
Meter Reader	2/3/2003
Meter Reader	6/26/2003
Meter Reader	2/2/2004
Engineering Tech	4/1/2003
Engineering Tech	1/12/2004
Ops Manager	8/25/2003
I & M Manager	10/13/2003
Msmt Supervisor	3/8/2004
Marketing Position	8/25/2003
Distribution Line Locator	11/24/2003
Gas Utility Worker	6/03
Gas Utility Worker	7/03
Gas Utility Worker	11/03
Gas Utility Worker	3/04
Business Development	1/1/2004
Inside Marketing Rep	6/1/2004
Communications Assistant	6/7/2004
Customer Service Trainer	6/1/2003
Distribution Line Locator	7/6/2004
Serviceman	6/28/2004
Distribution Clerk	7/6/2004
I & M Mechanic	2/2/2004
I & M Mechanic	3/23/2004
Gas Utility Worker	6/21/2004
Lockbox Operator	Nov-03
Measurement Supervisor	3/8/2004
Gas Safety Position	9/4/2004

(Khojasteh)

AUDIT DISCLOSURE 11

SUBJECT: UNBUNDLING

Company Response: The Company has requested that the unbundling expenses currently recovered through a special clause be rolled into our base rates effective 1/1/2005 to coincide with our rate proceeding and projection period for the base rates. This will ease up the administrative costs of a separate factor and clause and allow us to roll these expenses and recover through base rates.
(Khojasteh)

AUDIT DISCLOSURE 12

SUBJECT: ACCOUNT 920 PAYROLL INCREASE

Company Response: The Company agrees that the expenses for 2005 for account 920 should be reduced by $10,400.
(Khojasteh)

AUDIT DISCLOSURE 13

SUBJECT: REQUESTED TRAINING

Company Response: In addition to the staff's comments relating to the volume of work performed by the corporate employees, changes in financial reporting requirements associated with the "Sarbanes Oxley Act", ongoing changes in accounting regulation, and technological advancements necessitate additional training above and beyond the 2003 trended amounts and to a level of expenses that would reflect a more historically normal level. The 2003 amounts reflect below average training due to our rate proceedings projects and time constraints and should not be used as a benchmark to project future typical expenditures related to ongoing training of company employees.

The following positions are scheduled for additional ongoing related training above the 2003 levels:

CFO – 2 Seminars
Controller – 2 Seminars
Corporate Accounting Supervisor – 2 Seminars
General Accounting Manager – 2 Seminars
Senior Tax Accountant – 1Seminar
Financial Analyst – 1 Seminar
Office Services Manager – 1 Seminar

Senior Project Accountant – 1 Seminar
Senior Financial Accountant – 2 Seminars
Senior Regulatory Accountant – 1 Seminar
Senior Financial Reporting Accountant – 2 Seminars
Cash Accountant – 1 Seminar
General Ledger Accountant - 1 Seminar
IT Department – 2-3 Training Seminars

Estimated cost associated with out of town seminars including travel and lodging is about $2,500.
(Khojasteh)

AUDIT DISCLOSURE 14

SUBJECT: NEW POSTIONS REQUESTED IN 2005 FILING OF EXPENSES

Company Response: The Company agrees with the staff that the position of the Inside Marketing Representative is an upgrade of an existing position. However after a thorough review of this item the amount of the adjustment should be changed. The new position was filled with an annual salary of $40,305 this would be trended to $41,514 and the replaced position was paid $25,804 in 2003 this would be trended to $27,375 in 2005. So the reduction from the $41,715 should be $27,576 ($41,514 - $41,715 - $27,375). This is noted in Data Request question 73 and 74.
(R Smith)

AUDIT DISCLOSURE 15

SUBJECT: INCREASED ADVERTISING EXPENSES

Company Response: The Company agrees with the facts as stated. However, the Company is forecasting an increase of $2,150 in 2005 associated with safety advertising in Spanish. Safety advertising in Hispanic media was a recommendation from the PSC staff during their field audits. Therefore, account 913.3 projections for 2005 should be increased by $2,150 over what was originally filed in the MFRs.
(Khojasteh)

AUDIT DISCLOSURE 16

SUBJECT: LINE LOCATION AND BARE STEEL REPLACEMENT REDUCTION

Company Response: After the application of the trend factors, Marc Schneidermann and Don Kitner, the Directors responsible for our natural gas operations, reviewed the preliminary projected amounts to make sure that the application of various projection factors produced amounts that were reasonable. Based on their expert opinions, the preliminary projected amounts in the accounts related to line location and bare steel replacement program were not reasonable and needed to be reduced by $80,000 and $100,000 respectively. These reductions in projected expenses are reflected in our original MFR filing. If there are other reductions made to these account numbers for other types of analysis, these reductions may not still be appropriate and would need to be reviewed to make sure the adjustments are not duplicated.
(Khojasteh)

Florida Public Utilities Company
Consolidated Natural Gas Division
Docket Number 040216-GU

Company Responses to Engineering Report

There does not appear to be a particular numbering scheme for the various audit findings so we have commented by subject and auditor's page number as appropriate.

GENERAL RESPONSE - "THREE FACTOR METHOD"

Throughout the Audit Report, the engineering auditors refer to the "three factor method" as being a preferred means of allocating plant accounts. This allocation method should not be used since it is not a more accurate method. It was also expressed by the Commission accounting audit staff that the three factor method would not be appropriate owing to FPUC's operating structure.

Historically, the Commission has allowed and approved the methods currently in use by FPUC: these same methods were used for all schedules presented in the MFR. Our allocation methods take into account the many variables that reflect the usage of the individual accounts. For many years, FPUC, with the approval of the Commission, has refined a methodology that fairly reflects plant utilization between the various regulated and non-regulated operating units of FPUC.

Our current methods of allocating have been approved by the Commission for use by all regulated divisions of FPUC and are applied consistently amongst all of our regulated and nonregulated divisions. To apply different allocation methods among divisions would not be fair to some customers. This would create inequities between the operating units and present an unfair burden on the Company. The resulting increased expenses required, due to the additional time and effort of maintaining and controlling dual allocation methods, would also be passed on to the ratepayers.

In Exhibit 2, the auditors stated that the three factor method should not be used to allocate accounts 389 and 390. The current methodology is appropriate for these two major common plant accounts. However, the currently used methods should continue to be applied on a consistent basis to the remaining non-EDP accounts.

As a final point in Exhibit 2, it was pointed out that South Florida Natural Gas had used the three factor method in several of their previous rate case proceedings. It would not be appropriate to compare the operations and techniques of SFNG and FPUC, for several reasons, and that allocations should be done in a manner consistent with FPUC's past practices. FPUC is not in the position to explain why certain methods were used or perhaps appropriate by SFNG. SFNG's operational structure was dissimilar to that of FPUC and should not be considered in determining what is appropriate for our operations and allocation basis.

The three factor method is not appropriate; and in addition, the factors were not computed correctly. In arriving at the three factor percentages, common was included in total gross plant and total gross payroll. Common values should not be included in the percentage computation. The percentages are intended to allocate common plant; therefore, only the non-common elements are includable in the computation of the percentages. When the common values are excluded from the computation, the Three Factor Percentage for Natural Gas would be 52%, instead of the indicated 49%. (Mesite)

GENERAL RESPONSE – CWIP REVIEW

FPUC does not agree with these recommendations contained in the Engineering Report. Resulting from the CWIP review, the auditors have included in the report recommendations for adjustments due to differences between budget and actual for several individual budgetary items. Adjustments to Test Year Rate Base should not be made on an item-by-item basis but rather by account based on a detailed and extensive comparison of budget to actual. Real world conditions in a dynamic industry such as a natural gas utility dictate that from time-to-time modifications be made concerning the allocation of budgeted funds for specific projects. Our levels of construction expenditures may stay at a certain level, but for various reasons it may be necessary from time to time to vary the actual projects that are worked on. It becomes necessary to reprioritize projects occasionally, requiring changes in the actual construction items. The level of construction remains appropriate as filed in our original MFR with the exception of those mentioned in the Audit Disclosure Number 2 and the additional $2,000,000 requested for the purchase of operation center land, as discussed in our response to Engineering Auditor's Page 17.

Subsequent to the work done by the Commission Engineering Department, the Miami Accounting Office conducted an extensive audit of combined Plant-In-Service and CWIP activity. This review was based on actual activity through June 30, 2004. The audit included a review of budgeted expenditures against actual expenditures, along with an evaluation of revised Company Budgets. The results of this review were contained in Audit Disclosure #2 and FPUC has responded to the Commission that it concurs with the findings contained in the Disclosure. Additionally, the Company is requesting an additional $2,000,000 for the purchase of operation center land, as discussed in our response to Engineering Auditor's Page 17. (Mesite)

GENERAL RESPONSE – PLANT-IN-SERVICE REVIEW

FPUC does not agree with these recommendations contained in the Engineering Report. Resulting from the Plant review, the auditors have included in the report recommendations for adjustments due to differences between budget and actual for several individual budgetary items. Adjustments to Test Year Rate Base should not be made on an item-by-item basis but rather by account based on a detailed and extensive comparison of budget to actual. Real world conditions in a dynamic industry such as a natural gas utility dictate that from time-to-time modifications be made concerning the allocation of budgeted funds. It would be shortsighted and unrealistic to assume that every budgeted dollar should be spent exactly as indicated on a specific project. Work sometimes has to be reprioritized based on conditions that face the company and the urgency of various projects.

Subsequent to the work done by the Commission Engineering Department, the Miami Accounting Office conducted an extensive audit of combined Plant-In-Service and CWIP activity. This review was based on actual activity through June 30, 2004. The audit included a review of budgeted expenditures against actual expenditures, along with an evaluation of revised Company Budgets. The results of this review were contained in Audit Disclosure #2 and FPUC has responded to the Commission that it concurs with the findings contained in the Disclosure. Additionally, the (Mesite)

GENERAL RESPONSE – RETIREMENTS

FPUC does not agree with these recommendations contained in the Engineering Report. Resulting from the Retirement review, the auditors have included in the report recommendations for adjustments due to differences between projected and actual retirements. Adjustments to Test Year Rate Base should not be made on an item-by-item basis but rather by account based on a detailed and extensive comparison of projected to actual retirements. Real world conditions in a dynamic industry such as a natural gas utility dictate that from time-to-time modifications be made concerning the timing and amount of projected retirements.

The actual accounting entries for the items indicated in the audit were booked prior to June 2004 and were included in the data presented to the Commission auditor for Audit Disclosure Number 2. (Mesite)

GENERAL RESPONSE - OBTAINING QUOTES AND DOCUMENTATION FOR BUDGETED ITEMS

Obtaining quotes for budgeting purposes from vendors on many items is viewed as a major annoyance by most vendors. FPUC followed this practice in the past and had vendors refusing to quote strictly for our budgeting purposes. If we do experience a situation that is unusual and for which we are not able estimate, we still request these types of quotes.

Most items are recurring in nature and FPUC has sufficient experience and expertise to reasonably estimate most projects; vehicle purchases and main line installations are examples where cost increases (percentage of increase on materials) are relatively predictable from one year to the next. This, coupled with having a multi-year contract with a pipeline contractor, provides FPU with known installations costs.

For items that are unusual, estimates are requested in advance for budgeting purposes; the Automated Mapping/Facilities Management System is an example; we obtained preliminary quotes in advance of budgeting. (Kitner)

Auditor's Page 8, – Transeastern Homes

The adjustments proposed by this recommendation were, in fact, made by the Company in June 2003. The amounts that had been charged to account 1070 were transferred to account 1860.31. The December 2003 account balances were correct. Since projected Test Year plant balances were based on December 2003 plant balances modified by projected activity for 2004 and 2005, the Test Year Plant projections are unaffected by this issue. (Mesite)

Auditor's Page 17 – Operations Center Land, South Florida

The cost of land associated with the operations center is now anticipated to be $4,200,000. Current local demand in Palm Beach County for the type of property required has increased substantially in recent months. The estimates that were used in the MFR and the subsequent Commission audit were based on the asking price of a particular piece of property. Subsequently, the landowner and their latest broker have revised the asking price to $4M+. The revised asking price is more inline with other similar properties that the Company has investigated or that is even available in Palm Beach County. These facts have come to light subsequent to the PSC Accounting and Engineering audit.

The Company now anticipates $4,500,000 to be the total cost of obtaining the needed land. This amount includes $300,000 to cover total additional necessary closing costs - attorney's fess, closing costs, obtaining variances, etc. The net increased cost of the land will be $2,000,000.

The Company is increasing by $1,109,636 the total projected capital expenditures through December 2005. This represents an increase in the total cost of land of $2,000,000, as discussed above, and a net reduction in plant expenditures as determined in Audit Disclosure Number 2 of $890,364. (Schneidermann/Mesite)

Auditor's Page 53 – Service Lines

This issue has been made an additional part of the Depreciation Study associated with this rate proceeding. Betty Gardner has requested a listing of all service lines that require abandonment and the Company is in the process of preparing the list. (Mesite)

Auditor's Page 54 – Bare Steel Replacement Program

The auditor is in effect proposing two options for the completion of the Bare Steel Replacement Program; 50 years or $1,000,000 per year. The Company feels that a 75-year program as proposed in the MFR would have the least impact on the ratepayer and the Company. We are, however, amicable to a 50-year program, but feel that $1,000,000 per year is unrealistic since it represents a 28-year completion date.

A 28-year program would place an unnecessarily large burden on the ratepayer. Additionally, the internal structure of the Company may need to be modified in order to manage the additional load imposed by such an accelerated time-line. Use of outside engineers and additional higher-priced contractors may also be required. The additional pressures would tend to increase the installation cost of the replacements. Accordingly, the total cost of the program to the ratepayers will be increased, in addition to the accelerated rates resulting from a shorter program period.

A 50-year program would allow for controlled replacements in coordination with municipal road projects, community redevelopment and other utilities that would be affected by main replacements. The affect on the Company infrastructure will be minimal and will not create additional requirements.

Auditor's Page 55, Item I – Sanford Property

The property located at the Sanford location should remain in rate base and any associated expenses should remain in NOI. The EPA has determined that at the location the soil is impacted, and that remediation is required.

The Central Florida operation was moved from the Sanford location to a new larger centralized facility located in DeBary late in 2002. The Sanford location is not marketable pending remediation. When the property is eventually sold, the ratepayers will receive benefits from the sale. Accordingly, the property should continue to be included in rate base since the property has been included in rate base prior to being vacated, the eventual sale will be benefit the ratepayers, and the Commission has allowed recovery of environmental costs from the ratepayers.

As an alternative, if the Commission deems that it is not appropriate to include this property in rate base, all related expenses and a return on this property should be provided for through the environmental reserve. Any related expense to the environmentally damaged property that is removed from rate base such as property taxes should be paid from the environmental reserve along with a fair return on that same investment. (Mesite)

Auditor's Page 55, Item II – Allocation to Merchandise & Jobbing

The Company does provide for Merchandise & Jobbing in the allocation of the various plant accounts of the operating divisions. Based on customers, allocations are made to non-regulated activity. These allocations are shown in the MFR as one of the Rate Base Adjustments on Schedules B-3 and G-1(B-3). (Mesite)

Auditor's Page 57 – Refunds Due To Meter Error

The audit findings indicate that a holding account for failed refunds did not exist. The auditor did not question any other aspect of this issue that would indicate that the position of the ratepayer is being adequately provided for. The time, effort, and additional costs of providing and maintaining an account for such an immaterial amount of money would be inappropriate and would not provide any additional benefit to the ratepayers. (Mesite)