
**BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION**

**DOCKET NO. 050045-EI
FLORIDA POWER & LIGHT COMPANY**

MARCH 22, 2005

**IN RE: PETITION FOR RATE INCREASE BY
FLORIDA POWER & LIGHT COMPANY**

TESTIMONY & EXHIBITS OF:

MICHAEL E. BARRETT

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

DIRECT TESTIMONY OF MICHAEL BARRETT

DOCKET NO. 050045-EI

MARCH 22, 2005

Q. Please state your name, current position and business address.

A. My name is Michael E. Barrett. I am a Partner with the accounting firm of Ernst & Young LLP. My business address is 600 Peachtree Street NE, Suite 2800, Atlanta, GA 30308.

Q. Please describe your qualifications.

A. I currently serve as Ernst & Young's National Director of the Electric & Gas Energy Industry, where I specialize in providing audit and advisory services to the electric, gas, water and wastewater industries. In the course of my career, I have served as either the audit partner or technical reviewer for hundreds of audits of companies in these industries, all across the United States. In addition, in my role as National Director, I am consulted on most substantive technical accounting issues on audits performed by Ernst & Young in the electric and gas energy industry. I am a Certified Public Accountant in Florida, Georgia, Pennsylvania, Oklahoma and Virginia and am a member of the American Institute of Certified Public Accountants (AICPA).

1 In 1976, I started my career with the Federal Power Commission, which later
2 became the Federal Energy Regulatory Commission (FERC), as an auditor
3 responsible for completing audits of electric and gas utilities for compliance with
4 the FERC's Uniform System of Accounts.

5
6 In 1981, I joined the accounting firm of Coopers & Lybrand in its National Utility
7 Advisory Group as a supervisor responsible for audits and consulting projects to
8 utilities. I was admitted into the partnership in 1988. I joined Ernst & Young in
9 my current position in 1998.

10
11 My experience includes financial audits of numerous electric and gas utilities as
12 well as several energy marketers and traders. I have previously testified as an
13 expert in over 20 regulatory proceedings and arbitrations.

14 **Q. What is your experience reviewing electric utility forecasts?**

15 A. I have hands-on experience with electric utility forecasts through rate case
16 assistance, litigation assistance and audits of financial statements. In a large
17 number of financial audits for which I have been responsible, forecasts were used
18 in the valuation of derivatives and asset impairment assessments. I have also been
19 responsible for quality control reviews over a number of valuations performed by
20 Ernst & Young as clients were adopting the new goodwill accounting standards.
21 Further, I have worked on a number of litigation projects that have involved
22 valuations of assets or companies, all of which rely on forecasted data. Finally, I
23 completed a feasibility study for a wastewater utility as part of a financing

1 package it was seeking, and performed an audit of a financial forecast required by
2 a client's bond indenture.

3 **Q. What is the purpose of your testimony?**

4 A. Florida Power & Light Company (FPL) has asked me to assess the financial
5 forecasting process used by FPL to forecast the years 2005, 2006 and 2007 in
6 connection with FPL's request to increase base rates, and to present the results of
7 my review. In particular, I will address the following topics:

- 8 • Comment on the preparation of the FPL financial forecast including the
9 robustness and comprehensiveness of the FPL financial forecasting process
- 10 • Address the overall reasonableness of the significant assumptions used to
11 develop the financial forecast
- 12 • Consider the consistency of the significant data used in applying those
13 assumptions throughout the forecast
- 14 • Assess the presentation of the FPL financial forecast, including the accuracy
15 with which the FPL financial forecast presents the test period financial results
16 should the significant assumptions prove true.

17 **Q. Are you sponsoring an exhibit in this proceeding?**

18 A. Yes. It consists of the following five documents:

19	<u>Document No.</u>	<u>Description</u>
20	MEB-1:	Curriculum Vitae of Michael E. Barrett
21	MEB-2:	AICPA Guidelines for Preparation of Financial Forecasts
22	MEB-3:	FPL Forecasting Process Overview
23	MEB-4:	Summary of Impact of Differences in Financial Forecast

1 MEB-5: Comparison of Prior Periods Forecast to Actual Performance

2 **Q. What standards did you follow in conducting your independent assessment**
3 **of FPL's financial forecasting process?**

4 A. I used the AICPA guidelines for prospective financial information as standards
5 for assessing FPL's financial forecasting process. The guidelines provide the
6 broad principles and requirements that govern the preparation of financial
7 forecasts, and thus can be used to determine that a forecast is prepared in a
8 reasonable and prudent manner. The eleven AICPA guidelines are presented in
9 Document No. MEB-2.

10 **Q. What procedures did you perform to develop your conclusions?**

11 A. I utilized a work program designed to evaluate FPL's financial forecasting
12 process in light of the AICPA standards. I considered both FPL's financial
13 forecasting process itself and the specific assumptions used in the forecasts for
14 2005, 2006 and 2007. The following summarizes the procedures I followed:

- 15 • **Develop an understanding of the overall financial forecast process, including**
16 **the flow of information from the business units through the forecasting**
17 **organization and financial model to the final preparation of the financial**
18 **forecast.**
- 19 • **Identify the inputs to the forecast from the business units and develop an**
20 **understanding of the specific forecasting processes used by the business units**
21 **providing the inputs.**
- 22 • **Develop an understanding of the operation of the financial forecasting model**
23 **used by FPL to take the various inputs and generate the financial forecast.**

- 1 • Trace selected portions of the 2005, 2006 and 2007 forecasts to the
2 Consolidated Financial Model (CFM) inputs, and trace selected CFM inputs
3 to their source documentation.
- 4 • Develop an understanding of FPL’s “FERC functionalization” of its operating
5 and maintenance (O&M) forecast, which is the translation of the O&M
6 forecast into FERC accounts.
- 7 • Develop an understanding of the processes for determining separation factors
8 and jurisdictional utility values, and for generating the minimum filing
9 requirements and the 2007 schedules (MFRs and 2007 Schedules) for the rate
10 case.
- 11 • Assess the reasonableness and comprehensiveness of assumptions from the
12 business units, and the consistency of assumptions across the inputs to the
13 financial forecast model.
- 14 • Perform tests to confirm that the significant elements of the financial
15 forecasting process operate as designed, and ensure the internal consistency of
16 data used in the 2005, 2006 and 2007 forecasts.
- 17 • Assess the historical performance of the financial forecasting process by
18 comparing forecast and actual results for 2002, 2003 and 2004.

19 **Q. What have you concluded?**

20 A. My major conclusions are:

- 21 • In all material respects, the financial forecast was prepared in conformity with
22 the AICPA guidelines.

- 1 • The material processes for developing the base revenue forecasts from the
2 Resource Assessment and Planning and Rate departments, and the material
3 processes for developing the base O&M and capital forecasts by the business
4 units, are comprehensive and well founded, with adequate oversight and
5 documentation of significant inputs.
- 6 • The significant inputs from the business units to the CFM can be traced to
7 source documentation.
- 8 • The significant assumptions used by the business units in developing their
9 inputs are reasonable.
- 10 • The components of the financial forecast are prepared by qualified and
11 knowledgeable personnel with appropriate management review and approval.
- 12 • The financial forecast was prepared using appropriate accounting principles,
13 consistent with historic practices used in reporting financial results.
- 14 • The basic CFM modules for revenue, O&M and capital (including calculation
15 of capital going into plant in service, depreciation and AFUDC) consistently
16 apply the source inputs and properly reflect business practices and accounting
17 guidelines.
- 18 • The CFM performs cash flow and cash requirements calculations as designed.
- 19 • The significant other inputs to the forecasted utility financial statements were
20 assessed and found to be reasonable. Further, FPL regularly and consistently
21 compares forecasts to actuals and makes adjustments to its recurring processes
22 to fine tune the future forecasts.

- 1 • The significant adjustment and allocation items were materially consistent
2 with business unit inputs and assumptions.
- 3 • The Regulatory Information System (RIS) process for applying FERC account
4 detail and cost of service identifiers to the per book values in the financial
5 forecast is reasonable and consistent with the recording of historical
6 information.
- 7 • The RIS process for taking the per book values in the financial forecast,
8 detailed by cost of service identifiers, and applying the jurisdictional
9 separation factors obtained from the Cost of Service System, to develop the
10 jurisdictional utility values preserves the integrity of the per book values, is
11 well founded and is the same process used in developing FPL's monthly
12 surveillance reports.
- 13 • The RIS model also generates the information for a significant portion of the
14 MFRs and 2007 Schedules, thus controlling the preparation of the MFRs and
15 2007 Schedules and ensuring that the MFRs and 2007 Schedules accurately
16 report the information generated in the forecast.
- 17 • The FPL financial forecast represents an accurate simulation of the test period
18 financial results, should the significant assumptions prove true.

19
20

THE FPL FINANCIAL FORECASTING PROCESS

- 21 **Q. Please provide an overview of the financial forecasting process at FPL.**
- 22 A. The financial forecast is the output of various inputs from the responsible business
23 units whose personnel are qualified in specific areas such as economics,

1 operations, engineering, finance and accounting. (See Document No. MEB-3 for a
2 schematic overview of the financial forecasting process; see the testimony of Mr.
3 Stamm for a more in-depth discussion.) In turn, the inputs to the CFM are the
4 result of processes within the responsible business units. The major processes
5 providing input to the financial forecast include:

- 6 • The Resource Assessment and Planning Department (RAP) develops forecasts
7 of customers, sales, peak load and other parameters that drive operations.
- 8 • The Rate Department converts the RAP customer and sales forecasts into
9 forecasts by rate classes and calculates forecasted revenues from existing
10 rates.
- 11 • O&M expense and capital expenditure forecasts are developed by each of the
12 operating and staff business units.
- 13 • The CFM applies these inputs and performs certain calculations. The CFM
14 applies capital spending to the appropriate time period and calculates
15 construction work in process (CWIP). When capital investments go into
16 service, the CFM closes the spending to electric plant, transferring CWIP to
17 electric plant in service, and calculates and applies depreciation. If allowance
18 for funds used during construction (AFUDC) applies to an investment, the
19 CFM also calculates AFUDC. With respect to cash and financing, the CFM
20 calculates receipts and disbursements, changes in cash and changes in short
21 term debt or temporary cash investment. The information developed in the
22 CFM is used in calculating rate base and cost of service. The CFM produces
23 summary level financial statements for FPL for management's use. The

1 financial forecast is FPL's plan for the future of the Company and is used by
2 management in making decisions and assessing performance.

- 3 • The RIS applies FERC account detail and cost of service identifiers to the per
4 book values in the financial forecast, then applies the jurisdictional separation
5 of factors obtained from the Cost of Service System, and calculates
6 jurisdictional utility values and MFR and 2007 Schedule data for the rate case.
- 7 • The Responsibility Reporting System (RRS) provides monthly comparisons of
8 forecast to actual for variance analysis as part of FPL's management control.

9
10 In addition to these major processes, there are numerous other processes that
11 provide inputs to the financial forecast model, such as tax considerations from the
12 Tax Department, benefit costs from the Human Resources Department,
13 allocations such as the allocation of management costs between regulated and
14 non-regulated affiliates from the Accounting Department and financing costs
15 from the Treasury Department. There are also various other income statement and
16 balance sheet accounts besides the base revenue, base O&M and base capital
17 driven accounts, all of which are prepared in order to present full forecasted
18 financials for FPL.

19
20 The Forecasting, Budgeting and Analysis (FBA) Department has primary
21 responsibility for collecting common assumptions to be used in the financial
22 forecast from the appropriate sources (this would include items such as planned
23 salary increases and forecasted sales), communicating the assumptions and

1 forecast guidelines to the business units, validating the internal consistency of the
2 data, producing the financial forecast by consistently applying the inputs and
3 operating the CFM, and obtaining appropriate management review and approval.

4 **Q. Please briefly describe the inputs from the RAP and Rate Departments that**
5 **lead to the revenue forecast.**

6 A. RAP uses econometric models to provide forecasts of economic assumptions,
7 customers, sales and peak demand.

8

9 Economic assumptions are taken from DRI's Global Insight Model, the same
10 source used by the Florida Public Service Commission (FPSC) and the Florida
11 state government.

12

13 Regarding customers, the University of Florida Bureau of Economics and
14 Business Research provides projections of population by county that drive the
15 Company's projections. RAP applies judgment and experience in incorporating
16 the effects of specific events such as hurricanes.

17

18 Regarding sales, RAP forecasts net energy for load, then adjusts for line losses
19 and company use to arrive at delivered sales, which are then adjusted for unbilled
20 sales to arrive at billed sales by revenue class. The key drivers of forecasted sales
21 are weather data, the price of electricity and real Florida income. Weather is also
22 the key driver of peak demand.

23

1 RAP provides its forecast methods and models, including statistical validity, to
2 the FPSC for review. RAP forwards its forecasted information to the Rate
3 Department, which translates it into rate classes based primarily on historic and
4 known information about specific rate classes, applies the billing determinants for
5 the current tariff schedules, analyzes the individual tariffs by tariff component,
6 and calculates the forecasted revenue from current rates. The revenue forecast is
7 forwarded to FBA for management review and approval before it is incorporated
8 into the CFM.

9 **Q. Please briefly describe the O&M and Capital Expenditure forecast processes.**

10 A. Each business unit has its own internal process for forecasting O&M and capital
11 spending. All of the processes have certain elements in common, including:

- 12 • A dedicated planning and budgeting organization with experience in
13 developing budgets, which develops a bottom up budget from section or
14 location to department to business unit.
- 15 • Utilization of common assumptions provided by the FBA.
- 16 • Top down direction from business unit management as well as detailed review
17 and approval procedures from business unit management.
- 18 • Development of recurring base O&M and capital expenditures on a
19 combination of “key driver” based methods and specific knowledge, and
20 development of project O&M and capital expenditures based on specific
21 analysis (zero based) methods and specific assumptions.
- 22 • An annual O&M budgeting process that starts with development of key
23 drivers, key operational issues and key performance measures; proceeds to

1 development of a business plan; and then to detailed submissions and review
2 and development of a three-year forecast with the first year of the forecast
3 being the annual budget.

- 4 • An annual capital budget process that follows a similar approach over a five-
5 year forecast period. Capital spending projects require extensive
6 documentation of project justification. Various alternatives are evaluated. The
7 end result is a specific plan for construction of facilities. The essential
8 construction requirements are transmitted to the specific groups that develop
9 the detailed capital budgets.
- 10 • Controls driven by key performance measures and monthly comparisons of
11 historic actuals to forecast.

12
13 As noted above, FPL's O&M budgeting process regularly generates forecasted
14 results for the upcoming year and two subsequent years. Typically this process
15 results in preparation of a budget for the upcoming year that contains substantial
16 detail, while the forecasts for the subsequent two years are at a summary level.
17 For this budget cycle, due to the rate case, the FPL business units prepared
18 forecasts for 2006 and 2007 that contain considerably more detail than they would
19 in non-rate case years.

20 **Q. Please discuss the process, tools and methodology used in the preparation of**
21 **the financial forecast, including the CFM.**

22 A. The FBA manages the compilation of common assumptions to be used in the
23 financial forecast from the appropriate sources, communicating the assumptions

1 and detailed forecast guidelines and instructions to the business units, and
2 validating the internal consistency of the data. The FBA produces the financial
3 forecast for management review and approval by consistently applying the
4 business unit inputs, and maintaining and operating the CFM. The CFM contains
5 eight primary modules. These are plant and construction, financing, fuel and other
6 clauses, revenue, O&M and amortization, non-regulatory inputs, actuals, and
7 miscellaneous inputs. The CFM takes the inputs previously described and
8 processes them through the modules. It performs certain calculations such as the
9 timing of capital spending going into plant in service, the application of
10 depreciation and AFUDC, the development of balance sheet accounts and cash
11 flow, and the calculation of financing needs. The CFM produces a wide range of
12 management reports at various levels of detail, as well as various control reports.
13 The ultimate output is summary level financial statements for use by management
14 in making decisions and assessing performance. The model also has the capability
15 to create various scenario analyses.

16 **Q. Please describe the process of converting the financial forecast into the rate**
17 **case MFRs and 2007 Schedules.**

18 A. FPL has undertaken a structured process to convert information at the budget
19 activity level (the level at which information is developed by the originating
20 business units and applied in the CFM) into FERC accounts. The CFM includes
21 cost of service identification tags for use by regulatory accounting in creating and
22 reporting retail cost of service and jurisdictional results. Once the final financial
23 forecast is approved, the CFM information by cost of service identifier is

1 electronically forwarded to RIS, which tests the translation to ensure the integrity
2 of the CFM per book forecast information. RIS prepares the Commission
3 adjustments per book, checking the adjustments to history, and incorporates any
4 Company-proposed per book adjustments. The Rate Department provides the
5 jurisdictional separation factors based on detailed allocation factors and a time-
6 tested allocation methodology. The separation factors are updated regularly, most
7 recently in December 2004 for the current forecast. The process used for the
8 forecast is the same process used for the monthly surveillance reporting to the
9 Commission, which is audited periodically. The RIS model also generates the
10 information for a significant portion of the MFRs and 2007 Schedules, thus
11 controlling the preparation of the MFRs and 2007 Schedules and ensuring that the
12 MFRs and 2007 Schedules accurately report the information generated in the
13 forecast.

14 **Q. Please briefly describe the significant other processes that provide inputs to**
15 **the financial forecast model.**

16 A. Significant other processes that provide inputs to the financial forecast model
17 include preparation of income tax expense by the Tax Department, preparation of
18 benefit costs by the HR Department, allocations of costs between regulated and
19 non-regulated affiliates by the Accounting Department, and development of
20 financing costs by the Finance Department.

21
22 The Tax Department starts with per book income and income taxes at regular
23 rates, calculates above the line and below the line permanent differences,

1 calculates timing differences, computes current tax expense, computes deferred
2 tax expense, calculates any true up and calculates quarterly tax payments. The
3 process used by the Tax Department assessed the application of both current and
4 new tax treatments, including tax treatment under the Job Creation Act of 2004.

5

6 The HR Department calculates benefit costs for pension, welfare, taxes and
7 insurance based on detailed program costs driven by corporate objectives,
8 approved strategies, performance measures, known changes and events, and
9 financial accounting requirements applied to projected headcount.

10

11 There are three types of fees applicable to services provided by FPL to non-
12 regulated affiliates: affiliate management fees, service fees and direct charges.

- 13 • The Accounting Department calculates the affiliate management fees, which
14 are the allocations of costs between regulated and non-regulated affiliates for
15 corporate staff services that benefit both FPL and its affiliates. The staff
16 business units identify pools of costs for services that provide benefit to
17 affiliates, which the Accounting Department allocates. These pools of costs
18 are allocated to FPL and the affiliates based on widely used allocation
19 formulas such as the Massachusetts Formula; or based on various specific
20 drivers, where more specific driver based allocations are more appropriate.
21 The Massachusetts Formula is based on a simple average of the percentages
22 attributable to the utility and the affiliates of three factors - revenues; gross
23 property, plant and equipment; and total payroll.

1 • The Accounting Department also calculates the benefit costs that apply to
2 service fees and direct charges that the business units charge to non-regulated
3 affiliates. Power Generation, Energy Marketing and Trading, Integrated
4 Supply Chain, and Nuclear charge service fees to non-regulated affiliates
5 based on the concept of shared services allocations reflecting the level of
6 service with the affiliates. There are also direct charges from FPL business
7 units to non-regulated affiliates based on specific work orders.

8

9 The Treasury Department develops financing costs based on confirming financing
10 requirements calculated by parameters in the CFM. These parameters include
11 items such as maintaining a book debt to capital ratio in the upper 30 percent
12 range, and generally keeping commercial paper levels of \$200 million or less.
13 Forecasted interest costs on the financing are taken from the December Blue Chip
14 Forecast, a widely used forecast of interest costs.

15

16 In all instances the processes appear to be appropriate and the assumptions are
17 reasonable and consistently applied.

18 **Q. Please describe your review of the other income statement and balance sheet**
19 **accounts prepared in order to present full forecasted financials.**

20 A. For the various other material income statement and balance sheet accounts, I
21 looked at historical values and trends and considered any accounts with
22 significant changes to determine the reasonableness of assumptions. In all

1 instances the processes used appear to be appropriate and the assumptions
2 reasonable.

3
4 **REVIEW OF THE 2005-2007 FORECAST ASSUMPTIONS**

5 **Q. What is the starting point for the forecast assumptions?**

6 A. In this forecasting cycle, FPL has started with year 2004 results based on eight
7 months of actual and four months of estimated data.

8 **Q. Is the level of detail in the forecast assumptions appropriate?**

9 A. Yes. The 2005 budget year inputs were developed in detail at the budget activity
10 and sub activity level. The 2005 forecast is the basis for FPL's actual plans for
11 that year. For this forecasting cycle, because of the rate case, the years 2006 and
12 2007 were also forecast in considerable detail, though at a somewhat more
13 summary level than for 2005. This is consistent with AICPA guidance for
14 prospective financial information, which recognizes the need for increased
15 summarization of information going farther out in time.

16 **Q. Are the assumptions consistent with FPL's plans?**

17 A. Yes. The assumptions in the three year forecast are consistent with the
18 Company's plans for its business as stated in previous financial filings and public
19 statements including the 2003 Form 10-K filing, analyst presentations, news
20 releases and specific events approved by the FPSC and the State of Florida, such
21 as the FPSC's approval of new generation construction by FPL and the siting
22 approval by the Governor and the Cabinet of the Martin, Manatee, and Turkey
23 Point power plant expansions.

1 **Q. What does your review of the 2005-2007 forecast inputs indicate?**

2 A. My review of the specific forecast inputs for the years 2005 through 2007
3 indicates that the business unit inputs are subject to tracing and verification to
4 source documentation. The fundamental assumptions that are the basis for the
5 inputs appear to be reasonable, based on widely used parameters from well
6 accepted sources. The significant assumptions appear to be consistently applied
7 across the business units. The calculation of adjustments and allocations appear to
8 be materially consistent with the significant assumptions. Inputs are based on
9 relevant information. Recurring base O&M and capital expenditures are based on
10 a combination of specific knowledge and key driver based methods. Project O&M
11 and capital expenditures are based on specific analysis (zero based) methods and
12 specified assumptions. Significant other inputs to the CFM appear to be
13 reasonable. Finally, the CFM accurately incorporates and applies the business
14 inputs. The CFM appears to have the appropriate interrelationships of the data
15 and consistently performs the calculations to generate the summary level financial
16 statements.

17 **Q. Has FPL made any significant new assumptions for the 2005-2007 forecast?**

18 A. Yes. FPL has made two significant new assumptions. For the forecast years 2006
19 and 2007 FPL has increased the assumed base O&M expense for the storm
20 restoration fund contribution to \$120 million from \$20.3 million in 2005. FPL has
21 also assumed a base O&M expense for incremental startup and operating costs for
22 a regional transmission organization (RTO) of \$59 million in the 2006 forecast

1 and \$82 million in the year 2007 forecast. These assumptions are discussed in
2 detail in the testimonies of Messrs. Davis and Stamm.

3 **Q. Has FPL changed its accounting treatment of any items?**

4 A. No. FPL has applied its accounting principles consistent with historic reporting
5 practices. There are two new items in the current forecast, but they do not reflect
6 new accounting principles. FPL's NE division was started in 2004 and so was not
7 previously forecast. FPL has applied a zero separation factor to its NE division
8 costs in calculating jurisdictional revenue requirements. Also, in previous
9 forecasts revenue enhancement revenue less revenue enhancement expense was
10 presented as a net number in non-electric revenues for FPSC purposes. The
11 current forecasts for the years 2006 and 2007 change that treatment and present
12 revenue enhancement revenue and expense separately. This is the way it is
13 reported for financial statement purposes, and FPL has assumed that the FPSC
14 will allow similar regulatory reporting following this rate proceeding. Both of
15 these items are immaterial relative to FPL's overall financial forecast.

16 **Q. During your review did you identify any inconsistencies or potential**
17 **inconsistencies?**

18 A. Yes. I identified certain differences or inconsistencies and potential
19 inconsistencies, which I describe and estimate the impact of below.

- 20 • The HR business unit forecast includes the forecasted benefits cost for all of
21 FPL. The benefits cost was initially developed based on an estimated
22 headcount. The final projected headcount used in the CFM is the sum of the
23 individual business unit forecasts. The forecast benefits cost in the CFM was

1 not updated for the final business unit headcount forecasts. The impact of this
2 difference appears to understate year 2006 forecasted base O&M by
3 approximately \$1.74 million and to understate year 2007 forecasted base
4 O&M by approximately \$0.57 million.

5 • The Finance business unit calculates a credit to O&M for the benefits cost to
6 labor that is capitalized. It also calculates an addition to capital costs for the
7 benefits cost of that capitalized labor. Similarly, in calculating the affiliate
8 management fees paid by non-regulated affiliates to FPL, the Finance
9 business unit calculates the charge to the non-regulated affiliates for the
10 benefits cost to labor that is charged to the non-regulated affiliates. These
11 calculations were based on initial assumptions for benefits cost and capitalized
12 labor that changed with the development of the forecasts from the individual
13 business units used in the CFM. The impact of these different assumptions
14 appears to understate year 2006 forecasted base O&M by approximately \$2.68
15 million and to understate year 2007 forecasted base O&M by approximately
16 \$3.72 million. Conversely, the impact of these different assumptions appears
17 to overstate year 2006 forecasted capital cost by approximately \$2.75 million
18 and to overstate year 2007 forecasted capital cost by approximately \$3.44
19 million.

20 • The initial calculation of the St. Lucie 2 participation credit was based on
21 applying the ownership percentages of the minority owners to preliminary
22 computations of O&M and capital spending at the plant. Subsequently the
23 Nuclear business unit forecasted O&M and capital spending for the CFM. The

1 subsequent forecast of O&M and capital spending for the CFM differs from
2 the earlier forecast of the participation credit. The impact of the difference
3 appears to understate year 2006 forecasted O&M by approximately \$4.14
4 million and to understate year 2007 forecasted O&M by approximately \$2.09
5 million. Year 2006 forecasted capital cost appears to be overstated by
6 approximately \$5.45 million. Year 2007 forecasted capital cost appears to be
7 overstated by approximately \$22.75 million.

- 8 • There may be some inconsistency between the customer forecast prepared by
9 RAP and the new service accounts (NSA) estimate used by Power Systems as
10 a driver for certain spending items. The relationship between NSAs and net
11 new customers is somewhat different for the forecast years 2006 and 2007
12 than the historical relationship. To assess the effect of this change in the
13 forecast relationship, the historical relationship between NSAs and net new
14 customers was applied to the 2006 and 2007 forecasts. Based on the historical
15 relationship, it appears that forecasted O&M expenses may have been
16 overstated by \$2.54 million in 2006 and \$2.00 million in 2007, and capital
17 expenditures may have been overstated by \$18.66 million in 2006 and \$14.68
18 million in 2007.
- 19 • The calculation of uncollectible expense was based on initial estimates of total
20 revenue that were lower than the total revenue in the final forecast used in the
21 CFM. As a result, uncollectible expense appears to be understated and so base
22 O&M appears to be understated. The effect of this difference appears to

1 understate 2006 forecasted O&M by approximately \$1.38 million and to
2 understate 2007 forecasted O&M by approximately \$0.59 million.

3

4 Document No. MEB-4 summarizes the effect of each of these differences on 2006
5 and 2007 O&M and capital spending, as well as the revenue requirement effect.

6 While the impacts on O&M directly translate into revenue requirement impacts,
7 this is not the case for the impacts on capital spending. Rather, the effect of

8 changes in capital spending on revenue requirements is the sum of the return on
9 that portion of the capital spending that is in rate base plus the depreciation

10 expense on that portion of the capital spending that is removed from rate base and
11 depreciated. The factor that relates capital spending to revenue requirements is

12 approximately 15%, which has been used to estimate the revenue requirement
13 effect. Document No. MEB-4 shows the impact on the financial forecast of these

14 differences and potential inconsistencies in assumptions. All of the individual
15 impacts on revenue requirement are under \$5 million, or less than 0.2% of

16 forecast base revenue, and the cumulative effect of the impacts is an estimated
17 potential understatement of the revenue requirement of approximately \$3.37

18 million in 2006 and an estimated potential overstatement of approximately \$1.16
19 million in 2007. Thus the differences or potential inconsistencies are immaterial

20 individually and in total.

1 **Q. During your review did you identify any misclassifications or potential**
2 **misclassifications?**

3 A. Yes. I identified two apparent misclassifications. First, approximately \$3.94
4 million in 2006 appeared to be misclassified as power supply costs rather than
5 administrative and general expenses. Since both of these items are part of O&M
6 there was no impact on the financial forecast or the revenue requirement
7 developed using the financial forecast. Second, approximately \$0.20 million in
8 2006 of hedging financing expense was properly reflected in the financial forecast
9 as recoverable under the Fuel Clause, but was improperly coded as incremental
10 hedging cost. Starting in 2006, FPL is proposing to recover its test year level of
11 incremental hedging cost through base rates, with only the excess (if any) above
12 that test year level to be recovered through the Fuel Clause. A Company
13 adjustment was made to recover through base rates the test year hedging finance
14 expense that had been misclassified as incremental hedging cost, with the result
15 that the 2006 and 2007 test year O&M expenses were overstated by an immaterial
16 \$0.20 million for the purpose of determining revenue requirements. Thus, the total
17 dollar amount of the financial forecast was correct with respect to the hedging
18 financing expense, but the Company adjustment was premised upon this
19 misclassification and should not have been made.

20 **Q. Have you reviewed the Company proposed adjustments presented in the**
21 **testimony of K. Michael Davis?**

22 A. I have confirmed the current treatment of the items proposed for adjustment and I
23 have reviewed the proposed adjustments conceptually. Based on this review, I

1 believe that the Company's proposed adjustments are reasonable, with the
2 exception of the adjustment for incremental hedging costs discussed above.

3
4 **REVIEW OF HISTORICAL PERFORMANCE OF THE FINANCIAL**
5 **FORECASTING PROCESS AND ACCOUNTABILITY FOR**
6 **PERFORMANCE**

7 **Q. How does FPL test its historical performance against forecast?**

8 A. As part of the budget and forecast process, FPL business units create key
9 performance measures. These measures, as well as the forecast inputs, are
10 compared to actual results on a monthly basis.

11
12 The budget inputs are the basis for accountability. The budgets are prepared at a
13 section or location level by the appropriate personnel. These section or location
14 budgets are combined into departmental and then business unit level budgets. The
15 budgets are reviewed and approved by department and then business unit
16 management. Ultimately the budgets are reviewed and approved by FPL
17 management. The comparison of budget to actual follows the same line of
18 reporting.

19 **Q. What analyses of the forecast comparisons have you performed?**

20 A. I reviewed forecast-to-actual results for 2002, 2003 and 2004. The results are
21 summarized in Document No. MEB-5. The following are my general
22 observations:

- 1 • FPL accurately forecasted O&M spending for 2002, 2003 and 2004. The
2 aggregate base O&M forecast, after adjustment for unique and unplanned
3 events, differed from actual during 2002-2004 by 0.8% or less as a percent of
4 base revenue as shown following.

<u>Year</u>	<u>O&M Variance</u>
2002	0.8%
2003	(0.3)%
2004	(0.1)%

9 The specific adjustments were to exclude:

- 10 i. A one-time \$35 million addition to the storm fund reserve approved by the
11 FPSC in 2002.
- 12 ii. The increase in Nuclear business unit spending above forecast in 2003,
13 which was significantly affected by Nuclear Regulatory Commission
14 orders in 2003 requiring more extensive inspections.

15

16 Both of these items were discussed in FPL Group Inc.'s 2003 Form 10-K
17 filing. Excluding these two items, no operating or staff business unit had a
18 variance between forecast and actual greater than 0.6% of base revenue, and
19 most variances were 0.3% or less. Further, even if these items are included,
20 actual O&M varied from forecast by 1.8% in 2002, 1.1% in 2003 and (0.1)%
21 in 2004.

- 22 • Capital spending forecasts are subject to greater fluctuations between forecast
23 and actual due to the potential impact of timing changes in major project

1 spending. Nonetheless, for all three years 2002, 2003 and 2004 FPL's
2 aggregate capital spending differed from actual by less than 3% as a percent
3 of base revenue. Further, as noted previously the effect of changes in capital
4 spending have a smaller effect on the revenue requirement, on the order of
5 15%. Thus the revenue requirement effects of the fluctuations between
6 forecast and actual capital spending as a percent of base revenue are less than
7 0.5% (i.e., 15% of 3%).
8

9 CONCLUSIONS

10 **Q. Please summarize your testimony.**

11 A. Based on the review described in my testimony, it is my opinion that the financial
12 forecasting process used by FPL is in conformity with the AICPA guidelines in
13 all material respects. The process for the preparation of the FPL financial forecast
14 was comprehensive. The significant assumptions used to develop the financial
15 forecast were reasonable, and the data used in applying those assumptions was
16 materially consistent throughout the forecast. The FPL financial forecast
17 represents an accurate simulation of the test period financial results, should the
18 significant assumptions prove true.

19 **Q. Does this conclude your direct testimony?**

20 A. Yes.

Curriculum Vitae of Mr. Michael E. Barrett, CPA

Mr. Barrett is a partner with the firm of Ernst & Young L.L.P. ("Ernst & Young"). Ernst & Young is one of the "Big Four" accounting firms and one of the largest professional services firms in the world. At Ernst & Young Mr. Barrett is the National Director-Electric & Gas Energy Industry, where he specializes in providing audit and consulting services to the electric, gas, water and wastewater industries. He is a Certified Public Accountant in several states Pennsylvania, Virginia, District of Columbia, and Florida. Mr. Barrett graduated cum laude from the University of Scranton in 1976 with a Bachelor of Science in Accounting. In 1976, Mr. Barrett started his career with the Federal Power Commission, which later became the Federal Energy Regulatory Commission, as a field auditor responsible for completing audits of electric and gas utilities for compliance with the Commission's Uniform System of Accounts. In 1980, he joined Harvey Hubbell, Inc. a manufacturing company in Orange, CT., as a senior internal auditor. There he was responsible for financial and operational audits of the various divisions of the Company. In 1981, he joined Coopers & Lybrand in their national utility industry program as a supervisor responsible for audits and consulting projects to utilities. He was admitted into the partnership in 1988 and served as the Firm's national utility industry leader for the business assurance line of business. In 1998, he joined the firm of Ernst & Young in his present role as National Director-Utilities.

Mr. Barrett's experience includes financial audits of numerous electric and gas utilities and several energy marketers and traders. He has also performed contract audits of power purchase agreements. He has also testified as an expert in regulatory proceedings and arbitrations. In addition to his audit experience his non audit client experience has included examinations of prospective financial information and analysis of projections, assistance in mergers and acquisitions including due diligence and financial analysis, financial systems design and implementation and organization and staffing assessments.

Mr. Barrett is a member of the American Institute of Certified Public Accountants and the Maryland Association of Certified Public Accountants. He is a member of the Corporate Accounting Committee of the Edison Electric Institute and American Gas Association. He is the Treasurer of the Alliance to Save Energy. Mr. Barrett also co-authors a biennial report "Survey of FERC Compliance Audit Findings" published by the Corporate Accounting Committee. He has also spoken at numerous industry conferences and training courses sponsored by both industry associations, Coopers & Lybrand and Ernst & Young.

Summary of Professional Testimony

2004

Application of Madison Gas and Electric Company for Authority to Adjust Electric and Natural Gas Rates Before the Wisconsin Public Service Commission

Application of Wisconsin Public Service Company for Authority to Adjust Electric Rates Before the Wisconsin Public Service Commission

South Jersey Gas Company
In matter of Petition for Approval Of Increased Base Tariff Rates
BPU Docket no. GR 03080683

Nicor Gas Company
vs.
Illinois Commerce Commission
Docket No. 01-0705, 02-0067, 02-0725

2001

Cinergy Corporation
vs.
The United States

2000

South Jersey Gas Company and Elizabethtown Gas Company
Before the
New Jersey Board of Public Utilities

1999

Docket 99-457
Delaware Electric Cooperative
Before the
Delaware Public Service Commission

DPU 97-95
Investigation by the D.T.E. into Boston Edison's Compliance With the Department's Order in D.P.U. 93-37

1998

Public Service of New Hampshire, North Atlantic Energy Corporation, Northeast Utilities and Northeast Utilities Service Company
vs.
Public Utilities Commission of the State of New Hampshire

Duquesne Light Company
vs.
State of Ohio
Re: Property Tax Assessment

1997 - 2000

City of Warton, Pasadena and Galveston Texas Individually and as Class Representatives
vs.
Houston Lighting & Power Company and Houston Industries Finance, Inc.
Pursuant to Texas Rule of Civil Procedures Regarding Cause No. 96-016613

1997

Old Dominion Electric Cooperative
Application of ODEC for correction of Assessments of Gross Receipts Taxes and for a Refund - tax year 1997
Case No. PST970002

American Bituminous Power Partners, L.P.
vs.
Monongahela Power Company

Case No 55-198-012-96 DAW

1992

Florida Cities Water Company
vs.
Hillsborough County, FL

City of Palm Bay, FL
and
City of North Port, FL
vs.
Generation Development Utilities, Inc.
Arbitration

North Carolina Municipal Power Agency No.
1
and Piedmont Municipal Power Agency
vs.
Duke Power Co.
Fourth Arbitration

Seaboard Water Co.
vs.
Hillsborough County, FL

The Florida Public Service Commission
vs.
General Development Utilities, Inc.
Port Malabar and West Coast Divisions
Docket No. 911030-WS
and
Docket No. 911-067-WS

1991

City of Austin - City Commissions
vs.

Southern Union Gas Company

Nevada Public Service Commission
vs.
Sierra Power Company
Docket No. 91-7079, et al

1989

Public Service Commission of The State of
Tennessee
vs.
United Cities Gas Company
Docket No. 89-10017

1987

Central Florida Gas Company
vs.
Florida Public Service Commission
Docket No. 8970118-GU

1985

Public Service Commission of Delaware
vs.
Chesapeake Utilities Corporation
Delaware Division
Docket No. 85-17

1983

Eastern Shore Natural Gas Company
vs.
Federal Energy Regulatory Commission
Docket No. RP83-32-000

Chesapeake Utilities - Citizens Division
vs.

Maryland Public Service Commission
Case No. 7952

1982

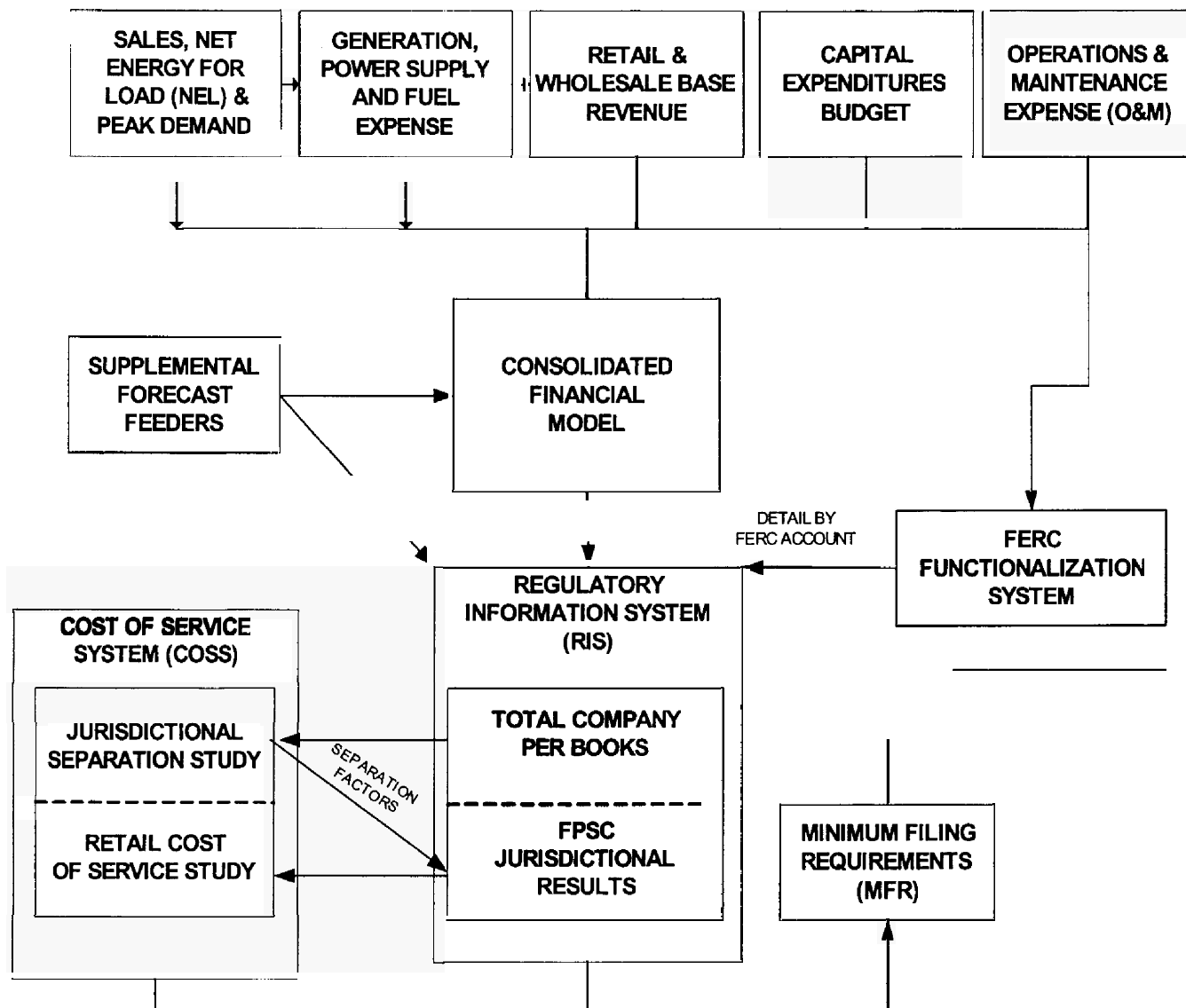
Chesapeake Utilities - Delaware Division
vs.
Delaware Public Service Commission
Docket No. 82-10

**American Institute of Certified Public Accountants Guidelines for Preparation of
Financial Forecasts**

1. Financial forecasts should be prepared in good faith.
2. Financial forecasts should be prepared with appropriate care by qualified personnel.
3. Financial forecasts should be prepared using appropriate accounting principles.
4. The process used to develop financial forecasts should provide for seeking out the best information that is reasonably available at the time.
5. The information used in preparing financial forecasts should be consistent with the plans of the entity.
6. Key factors should be identified as a basis for assumptions.
7. Assumptions used in preparing financial forecasts should be appropriate.
8. The process used to develop financial forecasts should provide the means to determine the relative effect of variations in the major underlying assumptions.
9. The process used to develop financial forecasts should provide adequate documentation of both the financial forecasts and the process used to develop them.
10. The process used to develop financial forecasts should include, where appropriate, the regular comparison of the financial forecasts with the attained results.
11. The process used to prepare financial forecasts should include adequate review and approval by the responsible party at the appropriate levels of authority.

FLORIDA POWER & LIGHT COMPANY FORECASTING PROCESS OVERVIEW

FLORIDA POWER & LIGHT COMPANY
 AND SUBSIDIARIES
 DOCKET NO. 050045-EI
 MFR NO. F-05
 ATTACHMENT 01 of 07
 PAGE 1 OF 1



Docket No. 050045-EI
 Michael E. Barrett, Exhibit No. ___
 Document MEB-3, Page 1 of 1
 FPL Forecasting Process

**Summary of Impact of Differences in Financial Forecast
(\$ in millions)**

Item	Adjustments		Revenue Requirement Effect ^{1/}	
	2006	2007	2006	2007
	Overstated/ (Understated)	Overstated/ (Understated)	Overstated/ (Understated)	Overstated/ (Understated)
<i>O&M Adjustments</i>				
Benefits cost/Headcount adjustment	(\$1.74)	(\$0.57)	(\$1.74)	(\$0.57)
Benefit adder adjustment	(\$2.68)	(\$3.72)	(\$2.68)	(\$3.72)
St. Lucie participation credit adjustment	(\$4.14)	(\$2.09)	(\$4.14)	(\$2.09)
Customer growth adjustment	\$2.54	\$2.00	\$2.54	\$2.00
Uncollectible adjustment	(\$1.38)	(\$0.59)	(\$1.38)	(\$0.59)
Total O&M adjustments	(\$7.40)	(\$4.97)	(\$7.40)	(\$4.97)
<i>Capital Adjustments</i>				
Benefit adder adjustment	\$2.75	\$3.44	\$0.41	\$0.52
St. Lucie participation credit adjustment	\$5.45	\$22.75	\$0.82	\$3.41
Customer growth adjustment	\$18.66	\$14.68	\$2.80	\$2.20
Total Capital adjustments	\$26.86	\$40.87	\$4.03	\$6.13
Total revenue requirement effect			(\$3.37)	\$1.16

1/ The impact of capital spending on revenue requirement is the sum of the return on the spending that is in rate base plus the depreciation expense on the capital that is depreciated. The factor is estimated to be roughly 15% of the capital spending.

Comparison of Prior Period Forecast to Actual Performance
(\$ in 000s)

	2002				2003				2004			
	Forecast	Actual	Variance	Var % of Rev	Forecast	Actual	Variance	Var % of Rev	Forecast	Est Actual	Variance	Var % of Rev
O&M (Base)												
Power Generation	\$147,875	\$154,203	\$6,328	0.2%	\$141,999	\$152,977	\$10,978	0.3%	\$152,000	\$151,662	(\$338)	0.0%
Nuclear	\$257,316	\$277,836	\$20,520	0.6%	\$257,991	\$306,921	\$48,930	1.3%	\$312,400	\$319,700	\$7,300	0.2%
Power Systems	\$268,284	\$270,125	\$1,841	0.1%	\$260,238	\$271,180	\$10,942	0.3%	\$273,961	\$261,000	(\$12,961)	-0.3%
Retail	\$112,398	\$114,223	\$1,825	0.1%	\$109,644	\$112,316	\$2,672	0.1%	\$112,039	\$119,040	\$7,001	0.2%
Human Resources	\$72,424	\$75,427	\$3,003	0.1%	\$115,237	\$100,848	(\$14,389)	-0.4%	\$107,752	\$96,190	(\$11,562)	-0.3%
Information Management	\$80,081	\$78,583	(\$1,498)	0.0%	\$76,475	\$76,398	(\$77)	0.0%	\$76,750	\$75,530	(\$1,220)	0.0%
Financial	\$65,684	\$96,718	\$31,034	0.9%	\$79,602	\$79,613	\$11	0.0%	\$95,067	\$91,300	(\$3,767)	-0.1%
Storm Fund	\$20,300	\$20,300	\$0	0.0%	\$20,300	\$20,300	\$0	0.0%	\$20,300	\$20,300	\$0	0.0%
General Counsel	\$46,739	\$57,530	\$10,791	0.3%	\$43,412	\$62,927	\$19,515	0.5%	\$42,922	\$37,989	(\$4,933)	-0.1%
Location 10	(\$26,248)	(\$32,038)	(\$5,790)	-0.2%	(\$8,510)	(\$47,781)	(\$39,271)	-1.1%	(\$46,931)	(\$29,800)	\$17,131	0.5%
Others	\$39,258	\$36,178	(\$3,080)	-0.1%	\$37,064	\$36,718	(\$346)	0.0%	\$38,663	\$39,489	\$826	0.0%
Total	\$1,084,111	\$1,149,085	\$64,974	1.8%	\$1,133,452	\$1,172,417	\$38,965	1.1%	\$1,184,923	\$1,182,400	(\$2,523)	-0.1%

Variance excluding one time \$35 million addition to storm fund in 2002

\$29,974 0.8%

Variance excluding variance in Nuclear which was significantly affected by NRC orders in 2003

(\$9,965) -0.3%

Capital Spending (Total)

Power Generation	\$89,300	\$89,327	\$27	0.0%	\$169,114	\$259,856	\$90,742	2.5%	\$187,166	\$187,166	\$0	0.0%
Nuclear	\$24,000	\$19,578	(\$4,422)	-0.1%	\$54,494	\$69,326	\$14,832	0.4%	\$205,200	\$212,000	\$6,800	0.2%
Power Systems	\$622,900	\$618,182	(\$4,718)	-0.1%	\$658,015	\$652,949	(\$5,066)	-0.1%	\$646,578	\$621,578	(\$25,000)	-0.7%
Retail	\$19,200	\$12,594	(\$6,606)	-0.2%	\$12,334	\$8,356	(\$3,978)	-0.1%	\$12,920	\$6,528	(\$6,392)	-0.2%
Plant Engineering	\$264,100	\$377,441	\$113,341	3.1%	\$359,429	\$352,365	(\$7,064)	-0.2%	\$317,650	\$279,250	(\$38,400)	-1.0%
Human Resources	\$62,800	\$58,667	(\$4,133)	-0.1%	\$31,257	\$28,333	(\$2,924)	-0.1%	\$56,347	\$48,547	(\$7,800)	-0.2%
Information Management	\$66,100	\$65,561	(\$539)	0.0%	\$40,825	\$40,200	(\$625)	0.0%	\$36,879	\$36,879	\$0	0.0%
Location 10	\$10,800	\$9,882	(\$918)	0.0%	\$38,578	\$32,693	(\$5,885)	-0.2%	\$82,361	\$55,033	(\$27,328)	-0.7%
Others	\$5,300	\$2,656	(\$2,644)	-0.1%	\$2,125	\$3,370	\$1,245	0.0%	\$4,572	\$3,362	(\$1,210)	0.0%
Total1/	\$1,164,500	\$1,253,888	\$89,388	2.5%	\$1,366,171	\$1,447,448	\$81,277	2.2%	\$1,549,673	\$1,450,343	(\$99,330)	-2.7%

Revenue (Base)2/

\$3,618,878

\$3,696,177

\$3,719,179

Notes:

1/ Capital spending forecast and actual for 2002 exclude AFUDC

2/ Revenue includes base and non-electric revenue