State of Florida

Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: June 30, 2005

TO: Sam Merta, Division of Economic Regulation

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

RE: **Audit Supplement Docket No.** 050045-EI; **Company Name:** Florida Power and Light Company; **Audit Purpose:** Rate Case; **Audit Control No.**:05-094-4-1

Attached is the supplemental audit report for the utility stated above. I am sending the utility a copy of this memo and the supplemental audit report. If the utility desires to file a response to the supplemental 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
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FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF REGULATORY COMPLIANCE AND CONSUMER ASSISTANCE
BUREAU OF AUDITING

Miami District Office

FLORIDA POWER AND LIGHT COMPANY
RATE CASE
SUPPLEMENT

YEAR ENDED DECEMBER 31, 2004

DOCKET NO. 050045-EI
AUDIT CONTROL NO. 05-094-4-1

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DIVISION OF REGULATORY COMPLIANCE AND CONSUMER ASSISTANCE
AUDITOR'S REPORT
JUNE 24, 2005

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described in this report to audit the management fee and affiliate transactions for the historical 12-month period ended December 31, 2004 for Florida Power and Light Company that were not completed in the rate case audit of June 10, 2005. The transactions affected the filing by the utility for its petition for rate relief in docket 050045-EI.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this document 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. There is confidential information associated with this report.

SUMMARY OF SIGNIFICANT PROCEDURES

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

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

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

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

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

Confirmed- Evidential matter supporting an account balance, transaction, or other information was obtained directly from an independent third party.

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

Management Fee: Reviewed the calculation by the company and verified that costs found in the sample that provided a benefit to the affiliates were included in the fee. For items that were not included we tested other costs in the budget activity code. Tested the methodology of the calculation and compared most items to actual costs. The Massachusetts formula used by the company to determine the allocation percentages could not be completed. Follow up questions could not have been answered in our time constraints.

Other Affiliate Costs: Rent charges to affiliates were analyzed by reviewing the cost and market rates provided and comparing the methodology to the affiliate transaction rule. Due to time constraints we were not able to perform an audit of the company determination of cost per square foot for the Miami General Office or the Juno office.

Affiliate Transactions: Scanned all intercompany receivables and payables and selected various accounts for testing. Compiled the selected accounts and determined which items to sample. Verified the sample items by tracing to source documentation.

AUDIT EXCEPTION NO. 1

SUBJECT: MANAGEMENT FEE CALCULATION

STATEMENT OF FACT: FPL allocates some costs directly when invoices or accruals are recorded. In addition, FPL designates budget activity codes for charges that affect the affiliated companies and allocates these with a credit to expense account 922. To do this, FPL computes the Massachusetts formula. The formula shows that 19.6% should be allocated to affiliate companies. However, only certain budget activity codes are allocated using this percentage. Some activities only affect certain affiliates and when this is the case, FPL deletes the information used in the Massachusetts formula for that subsidiary and recalculates the percents for the affiliates. All charges that go through the management fee are paid by FPL and the costs related to the affiliates backed out. Three problems were found with the calculation. They are as follows:

1. FPL estimates the management fee at the beginning of the year and does a monthly accrual. In October, it annualizes actual, adjusts for any major changes and new budget activities identified by the business units, and does a true-up of the accrual. It does not true-up for December actual amounts.

2. FPL allocated $13,004,046 of General Counsel expense at 12.59%. The supporting documentation showed that $13,773,113 should have been allocated. The difference of $769,067 at 12.59% is $96,825.53.

3. To arrive at the 12.59% that FPL used to allocate costs that do not benefit two affiliate companies, FPLE-OSI or Seabrook-OSI, FPL reduced the 19.6% arrived at in the Massachusetts formula by the following:

COMPUTATION USED BY COMPANY TO ALLOCATE:

MASSACHUSETTS FORMULA AFFILIATE %	19.60%
REMOVE OSI-FPLE	-3.16%
REMOVE OSI-SEABROOK	-3.85%
USED BY COMPANY	12.59%
AMOUNT LEFT IN FPL	87.41%

OPINION: We were unable to obtain all actual information in the format used in the management fee to determine if the difference between actual and the annualized October amounts was material. It was not for the accounts we were able to test, however, the company should true-up at December. The adjustments for the other items follow:

SUMMARY OF PROBLEMS WITH THE MANAGEMENT FEE

Difference due to incorrect number used for General Counsel	96,825.53
Difference between rate used and formula allocation OSI	247,088.58
	343,914.11

The amounts were determined as follows:

1. The difference for general counsel was multiplied by the 12.59% used to allocate. The difference is $96,825.53.

2. The difference attributed to the percent used by the company to allocate costs that have no benefit to OSI affiliates follows on a schedule attached to this exception. The Massachusetts formula follows:

ALL AFFILIATES	FPL Calculation REVENUES	%	PP & E	%	PAYROLL	%	AVG. %	TOTAL NON-REG %
FPL UTILITY	8,744,070,000.00	81.94%	22,860,942,000.00	74.34%	789,953,439.00	84.92%	80.40%	
FPL ENERGY	690,999,980.00	6.48%	6,884,915,004.00	22.39%	55,019,750.00	5.91%	11.59%	
FPL OSI	762,793,740.00	7.15%		0.00%	21,643,530.00	2.33%	3.16%	
PALMS INSURANCE	19,525,457.00	0.18%		0.00%		0.00%	0.06%	19.60%
FPLES	25,905,000.00	0.24%	1,534,881.00	0.00%	2,490,000.00	0.27%	0.17%	
FIBERNET	37,400,000.00	0.35%	293,250,000.00	0.95%	9,200,000.00	0.99%	0.76%	
SEABROOK-OSI	390,947,830.00	3.66%	713,292,027.00	2.32%	51,873,000.00	5.58%	3.85%	
	10,671,642,007.00	**100.00%**	**30,753,933,912.00**	**100.00%**	**930,179,719.00**	**100.00%**	**100.00%**	

FPL computed the 12.59% used to allocate costs that did not benefit the two affiliates by reducing the 19.6% by the two OSI affiliates percents. If this is done, the 7.01% not attributed OSI affiliates is not allocated between FPL and the other affiliates but charged in its entirety to FPL.

COMPUTATION USED BY COMPANY TO ALLOCATE BUDGET ACTIVITIES WITH NO OSI BENEFIT:

MASSACHUSETTS FORMULA AFFILIATE %	19.60%
REMOVE OSI-FPLE	-3.16%
REMOVE OSI-SEABROOK	-3.85%
USED BY COMPANY	12.59%

AMOUNT LEFT IN FPL USING CO. METHOD:

AMOUNT FOR FPL IN FPL MASSACHUSETTS	80.40%
OSI-FPLE SHARE	3.16%
OSI-SEABROOK SHARE	3.85%
TOTAL LEFT IN FPL USING CO. METHOD	87.41%

The method that should have been used is to eliminate the affiliate information totally so that 100% of the costs are appropriately allocated among the divisions they relate to. The revised formula follows and shows the proper allocation factor to be 13.27%.

ALL AFFILIATES W/O OSI								NON-REG
	REVENUES	%	PP & E	%	PAYROLL	%	AVG. %	%
FPL UTILITY	8,744,070,000.00	91.87%	22,860,942,000.00	76.10%	789,953,439.00	92.21%	86.73%	
FPL ENERGY	690,999,980.00	7.26%	6,884,915,004.00	22.92%	55,019,750.00	6.42%	12.20%	
PALMS INSURANCE	19,525,457.00	0.21%		0.00%		0.00%	0.07%	13.27%
FPLES	25,905,000.00	0.27%	1,534,881.00	0.01%	2,490,000.00	0.29%	0.19%	
FIBERNET	37,400,000.00	0.39%	293,250,000.00	0.98%	9,200,000.00	1.07%	0.81%	
	9,517,900,437.00	**100.00%**	**30,040,641,885.00**	**100.00%**	**856,663,189.00**	**100.00%**	**100.00%**	

Using this method 86.73% of the costs remain in FPL Utility instead of the 87.41% the company used. The budget activity codes that do not benefit the two affiliates are shown on the attached schedule and allocated at both the 12.59% and the 13.27%. The difference is shown in the schedule summarizing the adjustments above and amounts to $247,088.58.

DIVISION		BA #	AMOUNT ALLOCATED
finance		10105	24,572,927.00
finance		10360	39,466.00
finance		10362	198,041.00
finance		10393	72,196.00
finance		10367	298,812.00
finance		10367	342,616.00
finance		1215	154,285.00
finance		10390	178,177.00
finance		10261	2,191,600.00
finance		1148	113,495.00
finance		90002	589.00
finance		del	15,334.00
finance		cip	261.00
finance		dt	29,700.00
supply chain		10301	435,119.00
supply chain		25386	980,929.00
supply chain		25386	97,346.00
corp comm		10341	591,292.00
corp comm		11564	18,314.00
corp comm		11566	87,691.00
corp comm		11623	12,451.00
corp comm		12050	505,117.00
corp comm		12051	181,831.00
corp comm		12056	744,581.00
corp comm		12066	380,760.00
corp comm		12244	1,044.00
corp comm		12245	17,287.00
corp comm		20100	169,270.00
corp comm		25412	88,322.00
hr		11707	3,686,706.00
TOTAL NOT AFFECTING OSI			**36,205,559.00**
x 13.27	**STAFF ALLOCATION**		**4,805,368.45**
x 12.59	**COMPANY ALLOCATION**		**4,558,279.88**
	DIFFERENCE		**247,088.58**

AUDIT EXCEPTION NO. 2

SUBJECT: RENT TO AFFILIATES

STATEMENT OF FACT: FPL charges its affiliates for rent based on market rates. The market study for Juno was done in December 2002. According to an audit response, the rent rates were determined as follows:

	JUNO MARKET	JUNO COST	JUNO DIFFERENCE	GO MARKET	GO COST	GO DIFFERENCE
OPERATING EXP.	6.00	7.12	(1.12)	6.00	5.41	0.59
BASE RENT	14.00	17.63	(3.63)	11.50	9.06	2.44
TOTAL	20.00	24.75	(4.75)	17.50	14.47	3.03

The cost determined by the company for each office could not be verified due to time constraints. The market study used to determine the cost for the General Office in Miami (GO) was not reviewed due to time constraints. The company used the same market rate for the Flagler (LFO) office as the General Office.

Rule 25-6.1351 (3)(b) F.A.C. states that a utility must charge an affiliate the higher of fully allocated costs or market price for all non-tariffed services and products purchased by the affiliate from the utility. Except, a utility may charge an affiliate less than fully allocated costs or market price if the charge is above incremental costs.

OPINION: According to the rule, unless FPL can prove that the charge is above incremental costs, FPL should have charged its affiliates cost for the Juno office. In addition, the market analysis needs to be updated. The General Office is located near the PSC Miami District Office. Approximately four months ago, Department of Management Services (DMS) did a study of average rent prices and determined that the average market rate was $21.50 a square foot ($4 more than the rate used by FPL). Since FPL has security and food service it would probably be at the higher end of the market rates. We do not have comparable rates for Juno but would also expect those rates to be higher. The difference in rent using the difference between cost and market rate for Juno and the difference between the DMS rate and the market rate for the Miami General office follows:

	FLAGLER	GO	JUNO	TOTAL
FPL ENERGY SERVICES (sq. ft.)	226.62	1,133.14	817.29	
FPL GROUP RESOURCES (sq. ft.)			2,390.32	
FPL ENERGY INC. (sq. ft.)		435.41	117,975.05	
FIBER NET (sq. ft.)		17,062.00	317.00	
	226.62	18,630.55	121,499.66	
COST HIGHER THAN MARKET			4.75	
			577,123.39	577,123.39
MARKET PRICE UNDERESTIMATED	4.00	4.00		
	906.48	74,522.20		75,428.68
TOTAL ALL				652,552.07

This would increase rent due from affiliates by $652,552.07. Due to time constraints, we were unable to verify that these are the only affiliates that were charged rent.

AUDIT EXCEPTION NO. 3

SUBJECT: BUDGET ACTIVITY CODES THAT SHOULD HAVE BEEN INCLUDED IN THE MANAGEMENT FEE

STATEMENT OF FACT: In the audit report submitted on June 10, 2005, audit exception two reported items in the sample that should have been allocated to the affiliates and had not been. At that time, we reported that we would follow up to determine if the budget activity groups that the expenses were charged to should have been included in their entirety in the management fee calculation.

Three budget activity groups were reviewed for this audit. All transactions were provided by FPL on a CD. These amounts were sorted by dollars and by description and reviewed for types of charges. Some items were selected for testing. When names of employees were found in the file, FPL was questioned as to the employees' duties and whether the duties benefited the affiliates. The following is the result of the sample review:

Budget Activity 13397-This group included payroll, cafeteria subsidies, actuarial studies for pension benefits, and other human resource related costs. The majority of the voucher dollars related to the actuarial reports and consulting services. Two items were identified by the company as being FPL specific, one of which was a payment to the actuary. The company reported that the rest of the actuary payments and all of the employees selected did work that benefits the affiliates. The company prepared a schedule of the cafeteria subsidies that were not included in the last audit. The total of these subsidies is $272,589. Allocated at 16.9% using headcount, the affiliate portion would be $46,067.54. The file was re-sorted and the items found in the last audit report, the subsidy entries, the pension and welfare entries and the two invoices identified by the company as being utility related were removed. The amount remaining in the budget activity group is $2,057,567.03. If this amount was allocated at the 16.9%, the affiliates would have been allocated $347,728.83. With the difference for the cafeteria subsidy, the estimated amount for affiliates is $393,796.37.

Budget Activity 11737-This group contains costs related to recruiting and hiring. According to FPL's review of the sample, the vouchers tested should have been allocated to affiliates. Seven of the ten employees tested should have been allocated. The file excluding the accrual entries and the pension and welfare loading entries totaled $904,638.83. The amount reported in the last report of $80,000 was removed leaving $824,638.83. Of this amount, $446,703.79 appears to be payroll, which leaves $377,935.04 of non-payroll related costs. If 70% of the payroll costs were assumed to be allocable, then $312,692.65 of payroll costs should be allocated. This leaves a total of $690,627.69 ($377,935.04 + $312,692.65) that would be allocated at the 16.9%, or $116,716.08.

Budget Activity 13391-This group contains medical expenses that were FPL specific. When these specific costs were removed, $2,678,555.33 remains in the budget activity group. When the amounts adjusted in the last audit and the items in the sample that the company identified as specific to the utility are removed, $899,112.47 remains in this group. Allocating this amount at the 16.9%, would charge $151,950 to the affiliates.

OPINION: Staff has estimated the portion attributed to the affiliates based on the above assumptions. Without a complete review, which was not possible with the time constraints, we cannot determine that 100% of the costs should be allocated. However, based on the employees in the group and the types of expenses the following should be a reasonable estimate of the affiliate allocation. FPL is working on identifying these costs for 2005 and correcting its management fee calculation.

BUDGET ACTIVITY	AMOUNT
13397	393,796.37
13391	151,950.01
11737	116,716.08
	662,462.46