REDACTED

DOCKET NO. 050045-EI: Petition for rate increase by Florida Power & Light Company

WITNESS: **Direct Testimony Of Kathy L. Welch,** Appearing On Behalf Of the Staff of the Florida Public Service Commission

DATE FILED: July 8, 2005

DIRECT TESTIMONY OF KATHY L. WELCH

Q. Please state your name and business address.

A. My name is Kathy L. Welch and my business address is 3625 N.W. 82nd Ave., Suite 400, Miami, Florida, 33166.

Q. By whom are you presently employed and in what capacity?

A. I am employed by the Florida Public Service Commission as a Public Utilities Supervisor in the Division of Regulatory Compliance and Consumer Assistance.

Q. How long have you been employed by the Commission?

A. I have been employed by the Florida Public Service Commission since June, 1979.

Q. Briefly review your educational and professional background.

A. I have a Bachelor of Business Administration degree with a major in accounting from Florida Atlantic University and a Masters of Adult Education and Human Resource Development from Florida International University. I have a Certified Public Manager certificate from Florida State University. I am also a Certified Public Accountant licensed in the State of Florida, and I am a member of the American and Florida Institutes of Certified Public Accountants. I was hired as a Public Utilities Analyst I by the Florida Public Service Commission in June of 1979. I was promoted to Public Utilities Supervisor on June 1, 2001.

Q. Please describe your current responsibilities.

A. Currently, I am a Public Utilities Supervisor with the responsibilities of administering the Commission's Miami District Office and reviewing work load and allocating resources to complete field work and issue audit reports when due. I also supervise, plan, and conduct utility audits of manual and automated accounting systems for historical and forecasted financial statements and exhibits.

Q. Have you presented expert testimony before this Commission or any other regulatory agency?

A. Yes. I have testified in several cases before the Florida Public Service Commission. Exhibit KLW-1 lists these cases.

Q. What is the purpose of your testimony today?

A. The purpose of my testimony is to sponsor the staff audit report of Florida Power & Light Company (Company) which addresses the Company's petition for rate increase, Audit Control Number 05-094-4-1. This audit report is filed with my testimony and is identified as Exhibit KLW-2. I am also sponsoring the supplemental audit report which addresses the management fee and affiliate transactions. This audit report is filed with my testimony and is identified as Exhibit KLW-3.

Q. Did you prepare or cause to be prepared under your supervision, direction, and control these audit reports?

A. Yes, I was the supervisor in charge of these audits.

Q. Please describe the work performed in the initial audit (KLW-2).

A. For rate base, we selected major additions and construction projects and traced them to contracts, change orders, payments, and bidding procedures. We reviewed a sample of retirements and overhead calculations and examined entries for Allowance for Funds Used During Construction (AFUDC). We examined accumulated depreciation and traced selected accounts to the depreciation computation and to the rates previously ordered by the Commission. We also obtained a list of Property Held for Future Use projects and randomly sampled and traced each project to the closing settlement statements and other related documents. For working capital, we reconciled accounts to the general ledger and reviewed all adjustments, and we reviewed selected accounts for affiliate activity. We reconciled rate base adjustments to supporting documentation and traced each adjustment to the general ledger.

For operating income, we compiled revenues and verified the company calculation of unbilled revenues. We extracted a sample of expenses and agreed the expenses selected to source documentation. We also examined depreciation and selected random entries in the depreciation schedule to verify the calculation and traced the depreciation rates to the Commission's prior depreciation order. We also compiled taxes, selected payments, and traced some property tax amounts to invoices. We obtained a reconciliation schedule of total paid property and real estate taxes to amounts on the MFR filing and reconciled the Regulatory Assessment Fee and Gross Receipts tax amounts in the filing to the returns. We also compiled income taxes. We reconciled Net Operating Income Tax Adjustments to supporting documentation and traced each adjustment to the general ledger.

For cost of capital, we reconciled all components to the books and compared long-term debt issuances and preferred stock issuances to authorized documents. We recalculated cost rates, obtained a reconciliation of rate base to capital structure and determined that non-utility assets were removed, and traced all company adjustments to schedules and explanations.

Q. Please review the audit exceptions in the initial audit report.

A. Audit Exceptions disclose substantial non-compliance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA), a Commission rule or order, or formal company policy. Audit Exceptions also disclose company exhibits that do not represent company books and records and company failure to provide underlying records or documentation to support the general ledger or exhibits.

Audit Exception No. 1

Audit Exception No. 1 discusses rate base adjustments included in the environmental cost recovery clause. In reviewing the 2004 adjustments to rate base, we determined that FPL did not remove the construction work in progress (CWIP) that FPL is recovering through the environmental clause. There are two projects that are included in the environmental cost recovery clause. According to the environmental cost recovery clause filing, the 13-month average CWIP for the Manatee Reburn No. 24 project was $5,621,823.85 for 2004. The 13-month average CWIP for the Port Everglades ESP No. 25 is $6,605,703.23. The total CWIP included in the environmental clause is $12,227,527.08. This amount should be removed from CWIP in the 2004 rate base in the MFR filing for the historical year. If the environmental projects are still included in construction work in progress projected in 2006, they need to be removed.

In addition, the company removed all projects from CWIP that accrued an allowance for funds used during construction (AFUDC). FPL excluded $4,600,000 each month from AFUDC eligible CWIP projects it claimed were already in base rates. This adjustment leaves a 13-month average effect of $4,600,000 in rate base for CWIP projects that would normally be excluded because they qualify for AFUDC. The reason the company made the adjustment was because it included $4,648,000 of construction projects in its last rate filing in 2001 (Docket No. 001148-EI, Review of the retail rates of Florida Power & Light Company.) The settlement agreement approved in that docket allowed the company to keep construction work in progress in rate base, thus the construction projects are already in base rates. When the company calculates the allowance for funds used during construction, it removes this amount of CWIP before calculating the AFUDC. The adjustment for the $4,600,000 increases rate base for CWIP projects that would normally not be included because they are eligible for AFUDC. This adjustment was also made in FPL's MFRs filed in this docket for 2004 and 2005.

Audit Exception No. 2

Audit Exception No. 2 discusses the allocation of common costs. In reviewing the sample of expenses, we found expenses that relate to all affiliates that should have been charged to a budget activity code so that they could be allocated among all affected affiliates through the management fee (the management fee is recorded as a contra expense account to remove costs that relate to affiliated companies.) We identified $2,464,330.68 of costs charged to the human resource division that appear to be costs that benefit the affiliate companies. Therefore, we allocated these costs based on the headcount percent used in the revised management fee for 2004. This results in $416,471.88 that should be removed from the 2004 surveillance report and historical test year.

Q. Please review the audit disclosures in the initial audit report.

A. Audit disclosures disclose material facts that are outside the definition of an Audit Exception.

Audit Disclosure No. 1

Audit Disclosure No. 1 discusses adjustments to the working capital allowance. FPL has included two adjustments to remove working capital accounts that were not adjusted in its last rate case. First, the company has removed all assets and liabilities related to the asset retirement obligation related to Statement of Financial Accounting Standards (SFAS) 143. The net effect on rate base is zero. Rule 25-14.014 Florida Administrative Code (F.A.C.) requires the company to record the effects of SFAS as revenue neutral. Since the accounts have a zero balance, the company has complied with the rule. The second new adjustment removes $1,926,000 of Design Basis Threat deferred security costs from working capital.

Audit Disclosure No. 2

Audit Disclosure No. 2 discusses material and supply write offs. The MFR historical test year schedules included write-offs in 2004 of materials and supplies (M&S) for items no longer used. These write offs include:

- $115,397.52 in January, 2004 (Account 506.960 - Misc. Steam Power Expense) for a write off of a Bi-Metal Repair Kit that is no longer required at FPL's Martin generating plant.
- $78,370.16 and $69,427.88, totaling $147,798.04 in December, 2004 (Account 562.160 - Station Expenses-Transmission) for transmission bushings and switches.

Audit Disclosure No. 3

Audit Disclosure No. 3 discusses cancelled work orders. The company charges cancelled work orders to Account 584.650, Underground Line Expense Distribution-Cancelled Work Orders. A total of $369,395.07 was expensed in this account in 2004. In the sample we selected, there were several work orders that were cancelled but later re-opened. No credits were taken out of the account for the re-opened work orders. The company is planning to correct this error.

Audit Disclosure No. 4

Audit Disclosure No. 4 discusses storm related costs included in the historical test year 2004. Account 590, Maintenance Supervision and Engineering Distribution, includes four entries that were transferred from the storm accrual because the internal auditors considered them "image enhancing." These costs were included in the expenses in the 2004 MFR filing. The entries totaled $3,180,806.10. The invoices removed related to valet charges, flower purchases, storm appreciation parties, storm appreciation t-shirts and caps, storm tents for hurricane Ivan, and image enhancing ads after Hurricane Jeanne.

Also in Account 590, the company created a reserve for possible disallowances by the Public Service Commission in FPL's storm cost recovery docket (Docket No. 041291-EI, In re: Petition for authority to recover prudently incurred storm restoration costs related to 2004 storm season that exceed storm reserve balance, by Florida Power & Light Company.) The company originally estimated the disallowances at $22,000,000 and then reduced it by $6,600,000 to $15,400,000.

The company expensed an additional $189,968.26 in the same account in 2004 for Florida Power and Light-Energy (FPLE) storm loadings. The total amount billed by FPLE was at the regular inter-company billing rate for FPLE (payroll and payroll and loading). However, FPL loaded its own payroll for only pension, welfare, taxes, and insurance in determining the amount to charge to the storm reserve. To be consistent, FPL loaded the storm work orders for FPLE payroll only for pension, welfare, taxes, and insurance. This reduced the amount charged to the storm work orders. The difference between the pension, welfare, taxes and insurance, and the normal FPLE payroll loading rate was charged to the 590 expense account along with other costs FPL did not include in its request for storm cost recovery. By doing so, FPL charged a consistent loading rate to the storm work orders for the FPLE payroll and did not penalize FPLE for its participation in the storm restoration effort.

Audit Disclosure No. 5

Audit Disclosure No. 5 discusses affiliate transactions. We found several expenses that appeared to need to be allocated to affiliates. The company response was that these expenses are charged as part of its rent fee to affiliates. This issue is discussed in more detail in the supplemental audit.

Audit Disclosure No. 6

Audit Disclosure No. 6 discusses pension expense. The majority of Account 926, Employee Pension and Benefits, in 2004 relates to expenses from the actuarial studies for pension, Supplemental Executive Retirement Plan (SERP), SFAS 106, and medical and dental expenses. The company allocated the pension accrual, which was a negative (credit) balance, differently than the actuarial study by Towers Perrin. The actuarial study allocated the cost to the utility and the affiliates based on headcount. The company allocated the cost based on payroll dollars. If FPL charged the pension fee by headcount, Account 926 would be reduced by $3,489,424.28.

In Account 926.500, we found a charge of $105,428 in November that included affiliate charges of $11,000. Account 926.600 had a charge in February 2004 for $1,706,754 for a settlement with Ernst and Young for a non-recurring project (BVA 17) that related to all affiliate companies and was not allocated through the management fee.

Audit Disclosure No. 7

Audit Disclosure No. 7 discusses rate case expense. In Account 928, Regulatory Commission Expense, in 2004, the company has included rate case expenses. The company responded that it removes and adjusts these in 2005. When the rate case expense is approved, these expenses need to be removed from 2004 expenses and allocated to a deferred account.

Audit Disclosure No. 8

Audit Disclosure No. 8 discusses membership dues. In Account 930.260, Miscellaneous General Expense, in 2004, the company included both the 2003 and the 2004 dues paid to the EPRI for the Nuclear Energy Institute assessment. The dues were $240,000 each year.

Audit Disclosure No. 9

Audit Disclosure No. 9 discusses expenses related to Grid Florida. Account 930.200, Miscellaneous General Expense, for 2004 includes $650,000 for a reserve for the collectibility of notes receivable for Grid Florida.

Audit Disclosure No. 10

Audit Disclosure No. 10 discusses a reserve for mitigation costs. Included in Account 907, Supervision-Customer Service, in 2004, is a $1,000,000 charge to set up a reserve for inadequate installations by a contractor that is now out of business related to the conservation multi-family insulation program. This is the estimate of the cost of mitigation.

Audit Disclosure No. 11

Audit Disclosure No. 11 discusses Outside Services. Our audit found certain legal costs that are allocated between FPL and an affiliate. The company has requested confidential classification of this disclosure. More details regarding this disclosure can be found in the confidential version of Exhibit KLW-2.

Audit Disclosure No. 12

Audit Disclosure No. 12 discusses liaison expenses. FPL did not remove liaison expenses in its Net Operating Income adjustments in 2004. The liaison expenses have been removed from the Surveillance Reports in the Net Operating Income adjustments prior to 2002. After 2002, Staff Advisory Bulletin 35, which required FPL to remove these expenses, was discontinued along with all staff advisory bulletins. The work order that contained the charges for the Tallahassee office totals $503,819.59 for 2004. The company does not remove this amount in the rate case because it doesn't believe liaison expenses should be considered lobbying. According to a company response, "The instruction to Account 426.4 expenditures for certain civic, political and related activities, 18 CFR, Part 101 Uniform System of Accounts (SofA) states in part '... but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.' FPL's liaison expenses fall within this exception. FPL is not aware of any FPSC order or rule which supersedes the instruction for Account 426.5 in the SofA with respect to liaison expenses."

Audit Disclosure No. 13

Audit Disclosure No. 13 discusses charitable expenses. The company included cash vouchers for charitable expense in Work Order 9934 for the Manatee Combined Cycle Project. The total charitable expense charged to the work order was $27,650. These amounts were included in Construction Work in Progress for 2004.

Audit Disclosure No. 14

Audit Disclosure No. 14 discusses accounts receivable for retiree medical reimbursement. Included in the rate case filing as part of the working capital computation, the company shows a 13-month average for Account 143.126 of $8,641,542 for Retiree Medical Reimbursements. Cigna is FPL's insurance agent that pays for FPL's self insurance plan for medical reimbursement. FPL pays Cigna on a weekly basis. The company closes at the end of the year what was paid to expense and allocates approximately 10% to non-regulated affiliates. However, the affiliate amounts remain in the monthly balances until December and therefore, the 13-month average balance includes amounts for non-regulated affiliates. Nine percent is used in the 2004 management fee for allocation of retiree costs to non-regulated affiliates based on head count. If the 13-month average of $8,641,542 is multiplied by the 9%, then $777,738.78 would have to be removed as non-regulated. The company agrees with this exception, and is taking steps to correct the problem.

Q. Please describe the work performed in the supplemental audit (KLW-3).

A. For the management fee, we reviewed the calculation by the company and verified that costs found in the sample that provided a benefit to FPL's affiliates were included in the fee. For budget activity codes that were not included in the management fee calculation, we tested other costs in the budget activity code. We tested the methodology of the calculation and compared most items to actual costs. For other affiliate costs, we analyzed rent charges to affiliates by reviewing the cost and market rates provided and comparing the methodology to the Commission's affiliate transaction rule, Rule 25-6.1351, F.A.C. We also scanned all intercompany receivables and payables and selected various accounts for testing. We verified the sample items by tracing them to source documentation.

Q. Please review the audit exceptions in the supplemental audit report.

A. **<u>Audit Exception No. 1</u>**

Audit Exception No. 1 discusses the management fee calculation. FPL allocates some costs directly when invoices or accruals are recorded. In addition, FPL designates common budget activity codes for charges that affect its affiliated companies and allocates these with a credit to expense Account 922. To do this, FPL computes the Massachusetts formula (a methodology that uses three ratios to determine an allocation percentage.) The formula shows that 19.6% of the shared expenses should be allocated to affiliate companies. However, only certain budget activity codes are allocated using this percentage. Some activities only affect certain affiliates. When this is the case, FPL deletes the information used in the Massachusetts formula for that subsidiary and recalculates the percentages for its affiliates. All charges that go through the management fee are paid by FPL and the costs related to the affiliates are 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 the actual expense and does a true-up of the accrual. It does not true-up for December actual amounts. 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. The difference was not material for the accounts we were able to test, however, the company should true-up at December.
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 3.16% and 3.85%, respectively. If this is done, the 7.01% (3.16% + 3.85%) not attributed to OSI affiliates is not allocated between FPL and the other affiliates but charged in its entirety to FPL. 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 is included in the audit report and shows the proper allocation factor to be 13.27%. Using this method, 86.73% of the costs remain with the regulated utility instead of the 87.41% the company used. The difference amounts to $247,088.58.

Audit Exception No. 2

Audit Exception No. 2 discusses the rent charged to affiliates. FPL charges its affiliates for rent based on market rates. 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. However, a utility may charge an affiliate less than fully allocated costs or market price if the charge is above incremental costs.

In response to an audit request, the company indicated the following unaudited market and cost rates for its General Office and its Juno Beach Office. Unless FPL can prove that the charge is above incremental costs, FPL should have charged its affiliates cost for the Juno Beach office.

General Office	Market: $17.50	Cost: $14.47
Juno Beach Office	Market: $20.00	Cost: $24.75

Regarding the General Office, we believe that 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). Because FPL has security and food service it would probably be at the higher end of the market rates.

The difference in rent using the difference between cost and market rate for the Juno Beach Office and the difference between the DMS rate and the market rate for the General Office results in an increase in rent due from affiliates of $652,552.07.

<u>Audit Exception No. 3</u>

Audit Exception No. 3 discusses budget activity codes that should have been included in the management fee. We reviewed three budget activity groups for this issue.

Budget Activity Code 13397: Audit Exception 2 in the initial audit identified specific vouchers that related to all affiliates, and we made a specific adjustment to allocate these costs. In this supplemental audit, we reviewed these areas in more depth. This budget group includes payroll, cafeteria subsidies, actuarial studies for pension benefits, and other human resource related costs. Two items were identified by the company as being FPL-specific. We removed utility-related costs and the costs that were adjusted in the initial audit. The amount remaining in the budget activity group is $2,057,567.03. If this amount was allocated at 16.9%, using an employee head count, the affiliates would have been allocated $347,728.83.

Budget Activity Code 11737: This budget group contains costs related to recruiting and hiring. According to FPL's review of our sample, the vouchers tested should have been allocated to affiliates. (Seven of the ten employees tested should have been allocated.) The company did not believe accruals and pension and welfare adjustments should have been allocated. The audit report provides the detailed calculation, but based on the company's response, we believe that $116,716.08 should be allocated to the affiliates.

Budget Activity Code 13391: This budget group contains medical expenses that were FPL-specific. When the amounts adjusted in the initial 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%, using an employee head count, the utility would charge $151,950 to the affiliates.

Q. Does this conclude your testimony?

A. Yes, it does.

DOCKET NO. 050045-EI: Petition for rate increase by Florida Power & Light Company

WITNESS: **Direct Testimony Of Kathy L. Welch,** Appearing On Behalf Of Staff of the Florida Public Service Commission

EXHIBIT KLW-1: History of Testimony Provided by Kathy L. Welch

Docket No. 050045-EI
Exhibit KLW-1 (Page 1 of 1)
History of Testimony
Provided by Kathy L. Welch

- In re: Application for approval of rate increase in Lee County by Tamiami Village Utility, Inc., Docket No. 910560-WS

- In re: Application for transfer of territory served by Tamiami Village Utility, Inc. in Lee County to North Fort Myers Utility, Inc., cancellation of Certificate No. 332-S and amendment of Certificate 247-S; and for a limited proceeding to impose current rates, charges, classifications, rules and regulations, and service availability policies, Docket No. 940963-SU

- In re: Application for a rate increase by General Development Utilities, Inc. (Port Malabar Division) in Brevard County, Docket No. 911030-WS

- In re: Dade County Circuit Court referral of certain issues in Case No. 92-11654 (Transcall America, Inc. d/b/a ATC Long Distance vs. Telecommunications Services, Inc., and Telecommunications Services, Inc. vs. Transcall America, Inc. d/b/a ATC Long Distance) that are within the Commission's jurisdiction, Docket No. 951232-TI

- In re: Application for transfer of Certificates Nos. 404-W and 341-S in Orange County from Econ Utilities Corporation to Wedgefield Utilities, Inc., Docket No. 960235-WS

- In re: Application for increase in rates and service availability charges in Lee County by Gulf Utility Company, Docket No. 960329-WS

- In re: Fuel and purchased power cost recovery clause and generating performance incentive factor, Docket No. 010001-EI

- In re: Application for staff-assisted rate case in Highlands County by The Woodlands of Lake Placid, L.P., Docket No. 020010-WS

- In re: Application for rate increase in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida, Docket No. 020071-WS

DOCKET NO. 050045-EI: Petition for rate increase by Florida Power & Light Company

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EXHIBIT KLW-2: Audit Report

FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF REGULATORY COMPLIANCE AND CONSUMER ASSISTANCE
BUREAU OF AUDITING

Miami District Office

FLORIDA POWER AND LIGHT COMPANY
RATE CASE

YEAR ENDED DECEMBER 31, 2004

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

Iliana Piedra, Audit Manager

Intesar Terkawi, Audit Staff

Yen Ngo, Audit Staff

Jeff Small, Audit Staff

Gabriela Leon, Audit Staff

Kathy L. Welch
Public Utility Supervisor

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DIVISION OF REGULATORY COMPLIANCE AND CONSUMER ASSISTANCE
AUDITOR'S REPORT
JUNE 10, 2005

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described in this report to audit the rate base, net operating income, and cost of capital schedules for the historical 12-month period ended December 31, 2004 for Florida Power and Light Company. These schedules were prepared by the utility as part of its petition for rate relief in docket 050045-ELI.

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.

GENERAL: Reconciled filing with ledger. Reviewed internal and external audits. Reviewed Board of Directors minutes and interrogatories.

RATE BASE:

Plant and Construction Work In Process-Selected major additions and construction projects and traced to contracts, change orders, payments, and bidding procedures. Reviewed a sample of retirements and overhead calculations. Examined entries for Allowance for Funds Used During Construction (AUDI).

Accumulated Depreciation-Examined accumulated depreciation and traced selected accounts to the depreciation computation and to the ordered rates.

Property Held for Future Use-Obtained a list of projects and related descriptions. Randomly sampled and traced to closing settlement statements and other related documents.

Working Capital-Reconciled accounts to the general ledger. Reviewed all adjustments to working capital. Selected accounts and reviewed for affiliate activity.

Rate Base Adjustments-The adjustments were reconciled to supporting documentation and traced to the general ledger. Adjustments related to the clause audits were traced to the audited work papers. Adjustments were traced to prior filings and orders.

NET OPERATING INCOME:

Revenues –Compiled revenues and verified company calculation of unbilled revenues.

Expenses - Examined expenses. Using audit analyzer, extracted a statistical sample of expenses based on an analytical review and agreed the expenses selected to source documentation.

Depreciation and Amortization-Examined depreciation. Selected random entries in the depreciation schedule to verify the calculation and trace rates to the order.

Taxes Other Than Income Taxes-Compiled taxes. Selected payments and traced some property tax to invoices. Obtained a reconciliation schedule of total paid property and real estate taxes to amounts on the filing. Reconciled the Regulatory Assessment Fee amount in the filing to the Regulatory Assessment fee return and traced revenues to the ledger. Reconciled the Gross Receipts tax amount to the returns.

Income Taxes-Compiled income taxes.

Net Operating Income Tax Adjustments- The adjustments were reconciled to supporting documentation and traced to the general ledger. Adjustments related to the clause audits were traced to the audited workpapers. Adjustments were traced to prior filings and orders.

COST OF CAPITAL: Reconciled all components of Cost of Capital to the books. Agreed long-term debt issuances and preferred stock issuances to authorized documents and recalculated cost rate. Recalculated cost rates for short-term debt, customer deposits and investment tax credits. Obtained a reconciliation of rate base to capital structure and determined that any non-utility assets were removed. We traced all company adjustments to company's schedule and explanations.

AUDIT EXCEPTION NO. 1

SUBJECT: RATE BASE ADJUSTMENTS ENVIRONMENTAL

STATEMENTS OF FACT: In reviewing the 2004 adjustments to rate base, we determined that FPL did not remove the construction work in process that FPL is recovering through the environmental clause. There are two projects that are included in the environmental recovery clause. According to the environmental filing, the 13-month average of the Manatee Reburn No. 24 project was $5,621,823.85 for 2004. The 13-month average of the Port Everglades ESP No. 25 is $6,605,703.23. The total construction work in process included in the environmental clause is $12,227,527.08.

The company removed all projects from construction work in process (CWIP) that accrued an allowance for funds used during construction (AFUDC). FPL excluded $4,600,000 each month from AFUDC eligible CWIP projects it claimed were already in base rates. This adjustment leaves a 13-month average effect of $4,600,000 in rate base for CWIP projects that would normally be excluded because they qualify for AFUDC. The reason they reduced (CWIP) was because FPL included $4,648,000 of construction projects in Schedule B-13a in the last rate filing. The settlement agreement allowed the company to keep construction work in process in rate base and thus the construction projects are already in base rates. When the company calculates the allowance for funds used during construction, it removes this amount before calculating the AFUDC.

OPINION: The $12,227,527.08 recovered in the environmental clause should be removed from construction work in process in the 2004 rate base in the filing B-1 for the historical year. Since Tallahassee staff is reviewing the 2006 rate base adjustments, they need to determine if the environmental projects are still included in construction work in process projected in 2006. If so, they need to be removed. The projects may have been transferred to plant. If so, the completed project balances should be included in projected plant adjustments to remove environmental plant since the assets will be recovered in the environmental clause.

The adjustment for the $4,600,000 increases rate base for CWIP projects that would normally not be included because they are eligible for AFUDC. This adjustment was also made in 2005. We did not have information about 2006 since the Tallahassee office is reviewing the adjustments.

AUDIT EXCEPTION NO. 2

SUBJECT: ALLOCATION OF COMMON COSTS

STATEMENT OF FACT: FPL charges expenses that relate to costs that should be allocated to affiliates to budget activity codes that go through the management fee. In reviewing the sample of expenses, there were expenses found that relate to all affiliates and should have been charged to a budget activity code charged to the management fee. The following are the charges found:

Account	Date	Source	Amount	Budget Activity	Headcount Allocation	Allocation Amount	Description
932.2	9/04	Cash Voucher	80,000.00	11737	16.90%	13,520.00	Internet Employment Service
926.6	4/04	Cash Voucher	153,475.00	13391	16.90%	25,937.28	Data Integration HR
926.12	12/04	Journal Voucher	51,901.08		16.90%	8,771.28	Cafeteria Subsidization GO
926.12	12/04	Journal Voucher	68,666.22		16.90%	11,604.59	Cafeteria Subsidization JUNO
926.12	12/04	Journal Voucher	13,534.38		16.90%	2,287.31	Cafeteria Subsidization Gift Shop
926.12	9/04	Cash Voucher	390,000.00	13397	16.90%	65,910.00	Software HR
926.6	2/04	Cash Voucher	1,706,754.00	13391	16.90%	288,441.43	HR Salary Project
			2,464,330.68			416,471.88	

OPINION: The above amounts appear to be related to the human resource division. Therefore, we allocated these costs based on the headcount percent used in the revised management fee for 2004. The $416,471.88 should be removed from the 2004 surveillance report and the Tallahassee analyst needs to determine if this problem carries forward into 2006. We have not been able to determine if all of the charges to these budget activities should also be allocated. We are following up on the management fee in the supplemental audit and will include verification of costs to these budget activity groups as part of that work.

AUDIT DISCLOSURE NO. 1

SUBJECT: RATE BASE ADJUSTMENTS

STATEMENT OF FACT: FPL has included two adjustments to remove working capital accounts that were not adjusted in the last rate case. The company has removed all assets and liabilities related to the asset retirement obligation related to Statement of Financial Accounting Standards (SFAS) 143. The net effect on rate base is zero. Rule 25-14014 F.A.C. requires the company to record the effects of SFAS as revenue neutral. Since the accounts have a zero balance, the company has complied with the rule. The other new adjustment removes $1,926,000 of Design Base Threat deferred security costs from working capital.

AUDIT DISCLOSURE NO. 2

SUBJECT: MATERIAL AND SUPPLY WRITE OFFS

STATEMENT OF FACT: C-1 Historical schedules included write-offs in 2004 of materials and supplies (M & S) for items no longer used. These write off's include:

Account 506.960 (Misc. Steam Power Expense) in January, 2004 $115,397.52 for M & S number 625825490 for dormant material; write off of a Bi-Metal Repair Kit that is no longer required at Martin.

Account 562.160 (Station Expenses-Transmission) in December, 2004 $78,370.16 and $69,427.88, total of $147,798.04 M & S numbers 308980068 and 271748829 for transmission bushings and switches.

OPINION: The Tallahassee staff needs to follow up on this issue to determine if write offs of obsolete materials are included in the 2006 forecast.

AUDIT DISCLOSURE NO. 3

SUBJECT: EXPENSE FOR CANCELLED WORK ORDERS

STATEMENT OF FACT: The company charges cancelled work orders to account 584.650, Underground Line Expense Distribution-Cancelled Work Orders. A total of $369,395.07 was expensed in this account in 2004 and included in the expenses in the C-1 schedules. In the sample we selected, there were several work orders that were cancelled that were later re-opened. No credits were taken out of the account so the new work order would be charged. The company is planning to correct this error. Only some of the work order invoices were sampled.

OPINION: FPL needs to provide the total charges that relate to the following work orders that were charged off as cancelled and review all other work orders charged to this account to determine if similar problems exist in its response to this audit report. When new work orders are opened, the costs need to be transferred out of account 584.650.

02967-007-0121
07370-007-0216
08662-007-0882
09385-007-0547
09208-007-0441

AUDIT DISCLOSURE NO. 4

SUBJECT: STORM RELATED COSTS INCLUDED IN 2004

STATEMENT OF FACT: Account 590, Maintenance Supervision and Engineering Distribution, includes four cash voucher entries that were transferred from the storm accrual because the internal auditors thought they were image enhancing. These costs were included in the expenses in the C-1 schedules in the filing. The entries were for:

$ 325,765.00	
600,928.36	
1,114,193.74	
1,139,919.00	
$3,180,806.10	Total

The invoices removed related to valet charges, flower purchases, storm appreciation parties, storm appreciation t-shirts and caps, storm tents for hurricane IVAN and image enhancing ads after Hurricane Jeanne.

Also in account 590, the company created a reserve for possible dissallowances by the Public Service Commission in the storm docket. The company originally estimated the disallowances at $22,000,000 and then reduced it by $6,600,000 to $15,400,000.

The company expensed an additional $189,968.26 in the same account in 2004 for FPL Energy (FPLE) storm loadings. The total amount billed by FPLE was at the regular inter-company billing rate for FPLE (payroll and payroll and loading). However, since FPL loaded its own payroll for only pension, welfare, taxes and insurance in determining the amount to charge to the storm reserve. To be consistent, FPL loaded the storm work orders for FPLE payroll only for pension, welfare, taxes and insurance. This reduced the amount charged to the storm work orders. The difference between the pension, welfare, taxes and insurance, and the normal FPLE payroll loading rate was charged to the 590 expense account along with other costs FPL did not include in storm recovery. By doing so FPL charged a consistent loading rate to the storm work orders for the FPLE payroll and did not penalize FPLE for its participation in the storm restoration effort.

OPINION: The Tallahassee staff needs to determine if these costs were trended up and included in the 2006 forecast. The Commission needs to determine whether storm costs that were image enhancing should be allowed in the Surveillance report or whether they should be below the line in 2004 for surveillance purposes.

AUDIT DISCLOSURE NO. 5

SUBJECT: AFFILIATE TRANSACTIONS

STATEMENT OF FACT: We found several expenses included in the C-1 schedules that appeared that they should be allocated to affiliates. The company response was that they charge these expenses as part of its rent fee to affiliates. These costs are:

JB Irrigation-irrigation repairs at Juno $31,920
Smallwares Café-replace kitchen equipment $24,743.63
Western Waterproofing-repair skylight GO $41,377.94
CDI Construction-Remodel LFO cafeteria $41,850
Ed Pl Trammell-Replace 20 ft of damage $49,822
AA Advanced Air-Convert Juno air to chilled loop $50,819
Western Waterproofing-GO skylight repairs $ 75,644.23 (total $520,201.22)
CDI Construction-LFO cafeteria repairs $83,259.90 (total 229,000)
Western Waterproofing-Seal penthouse Juno $112,375.21

OPINION: We were unable to verify that the charges were included in the rent rates. We will follow up this issue in a supplement to this audit to verify that these and other similar costs are included in the rent rates.

AUDIT DISCLOSURE NO. 6

SUBJECT: PENSION

STATEMENT OF FACT: The majority of account 926, Employee Pension and Benefits, in 2004 relates to expenses from the actuarial studies for pension, Supplemental Executive Retirement Plan (SERP), SFAS 106 and medical and dental expenses.

The company allocated the pension accrual, which was a negative (credit) balance, differently than the actuarial study by Towers Perrin. The actuarial study allocated the cost to the utility and the affiliates based on headcount. The company allocated the cost based on payroll dollars. The difference follows:

Pension Plan FAS 87 - Account 926.202 & 926.203				GENERAL	
			ACTUARIAL	LEDGER	
ALLOCATION HEADCOUNT	NUMBER	PERCENT	2004	2004	DIFFERENCE
Utility	10,086.00	83.65%	(101,917,007.28)	(98,427,583.00)	(3,489,424.28)
Group	10.00	0.08%	(101,047.99)		
Group Capital	1,237.00	10.26%	(12,499,636.92)		
Seabrook	724.00	6.00%	(7,315,874.80)		
	12,057.00	100.00%	(121,833,567.00)		

If FPL charged the pension fee by headcount, account 926 included in the C-1 schedule in 2004 would be reduced by $3,489,424.28.

In account 926.500, a charge of $105,428 in November was found to include affiliate charges of $11,000. Account 926.600 had a charge in February 2004 for $1,706,754 for a settlement with Ernst and Young for a non-recurring project (BVA 17) that related to all affiliate companies and was not allocated through the management fee.

OPINION: The Tallahassee staff should determine the appropriate allocation methodology for pension costs. The $11,000 should be removed from expenses because it relates to affiliate business. Staff also needs to determine if the Ernst and Young payment was excluded when the company prepared the 2006 forecast of the C-1 schedules.

AUDIT DISCLOSURE NO. 7

SUBJECT: RATE CASE EXPENSES

STATEMENT OF FACT: In account 928, Regulatory Commission Expense, in the C-1 expenses in 2004, the company has included rate case expenses. The company responded that it removes and adjusts these in 2005. The expenses found in the sample are:

$ 72,344.00	Ernst and Young December 2004
179,019.50	Accrual December 2004
229,084.00	Accrual December 2004

OPINION: For surveillance purposes, when the rate case expense is approved, these expenses need to be removed from 2004 expenses and the Tallahassee staff needs to verify that these costs are allocated to a deferred account.

AUDIT DISCLOSURE NO. 8

SUBJECT: DUES

STATEMENT OF FACT: In Account 930.260, Miscellaneous General Expense, which is included in the historical C-1 schedule expenses, the company included both the 2003 and the 2004 dues paid to the EPRI for the Nuclear Energy Institute assessment. The dues were $240,000 each.

OPINION: The Tallahassee staff needs to verify this is not trended up and included in 2006 expenses.

AUDIT DISCLOSURE NO. 9

SUBJECT: GRID FLORIDA

STATEMENT OF FACT: Account 930.200, Miscellaneous General Expense, included in historical expenses in the C-1 schedules for 2004 includes $650,000 for a reserve for the collectibility of notes receivable for Grid Florida.

OPINION: For 2006, the Tallahassee staff needs to verify that these are not included in the forecast.

AUDIT DISCLOSURE NO. 10

SUBJECT: RESERVE FOR MITIGATION

STATEMENT OF FACT: Included in account 907, Supervision-Customer Service, in 2004, is a $1,000,000 charge to set up a reserve for inadequate installations by a contractor that is now out of business related to the conservation multi-family insulation program. This is the estimate of the cost of mitigation. These costs are included in expenses in the C-1 historical filing.

OPINION: The analyst needs to determine if this non-recurring cost was removed when determining the forecast for 2006.

AUDIT DISCLOSURE NO. 11

SUBJECT: OUTSIDE SERVICES

STATEMENT OF FACT: [redacted]

OPINION: [redacted]

AUDIT DISCLOSURE NO. 12

SUBJECT: LIAISON EXPENSES

STATEMENT OF FACT: FPL did not remove liaison expenses in its Net Operating Income adjustments in 2004 in its C-1 schedules. The liaison expenses have been removed from the Surveillance Reports in the Net Operating Income adjustments prior to 2002. After 2002, the Staff Advisory Bulletin 35 that required FPL to remove these expenses was discontinued along with all staff advisory bulletins. The company was asked to provide the work order that contained the charges for the Tallahassee office. Total dollars spent on liaison costs for Work Order 06915, ER 90, Reporting Area R10000 are $503,819.59 for 2004.

The company does not include the adjustment in the rate case because they don't believe liaison expenses should be considered lobbying. According to a company response, "The instruction to account 426.4 expenditures for certain civic, political and related activities, 18 CFR, Part 101 Uniform System of Accounts (SofA) states in part "... but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations." FPL's liaison expenses fall within this exception. FPL is not aware of any FPSC order or rule which supersedes the instruction for account 426.5 in the SofA with respect to liaison expenses."

AUDIT DISCLOSURE NO. 13

SUBJECT: CHARITABLE EXPENSES

STATEMENT OF FACT: The company included cash vouchers for charitable expense in Work Order 9934 for the Manatee Combined Cycle Project. The total charitable expense charged to the work order was $27,650:

Vendors	Amount
American Red Cross	1,000.00
Boys & Girls Club	1,300.00
Brain Injury Association	1,000.00
Lakewood Ranch East Communities Charitable Fund	2,500.00
Manatee Chamber of Commerce	750.00
Manatee School Foundation	5,000.00
South Florida Museum	10,000.00
United Way of Manatee	5,600.00
Wilderness Charity	500.00
Total	27,650.00

These amounts were included in Construction of Work in Progress for 2004.

AUDIT DISCLOSURE NO. 14

SUBJECT: ACCOUNT 143.126 OTHER ACCOUNTS RECEIVABLE RETIREE MEDICAL REIMBURSEMENT

STATEMENT OF FACT: Included in the rate case filing as part of the working capital computation the company shows a 13-month average for Account 143.126 of $8,641,542 for Retiree Medical Reimbursements.

Cigna is FPL's insurance agent that pays for FPL's self insurance plan for medical reimbursement. FPL pays Cigna on a weekly basis. The company closes at the end of the year what was paid to expense and allocates approximately 10% to non-regulated affiliates. However, the affiliate amounts remain in the monthly balances until December and therefore, the 13-month average balance includes amounts for non-regulated affiliates.

9% is used in the 2004 management fee for allocation of retiree costs to non-regulated affiliates based on head count.

OPINION: If the 13 month average $8,641,542 is multiplied by the 9% then $777,738.78 would have to be removed as non-regulated. The company agrees with this exception, and is taking steps to correct the problem.

EXHIBITS

FLORIDA PUBLIC SERVICE COMMISSION

COMPANY: FLORIDA POWER & LIGHT COMPANY AND SUBSIDIARIES

DOCKET NO. 050045-EI

EXPLANATION: PROVIDE A SCHEDULE OF THE 13-MONTH AVERAGE ADJUSTED RATE BASE FOR THE TEST YEAR, THE PRIOR YEAR AND THE MOST RECENT HISTORICAL YEAR. PROVIDE THE DETAILS OF ALL ADJUSTMENTS ON SCHEDULE B-2.

TYPE OF DATA SHOWN:
__ PROJECTED TEST YEAR ENDED __/__/__
__ PRIOR YEAR ENDED __/__/__
X HISTORICAL TEST YEAR ENDED 12/31/04
WITNESS: K. MICHAEL DAVIS

($000)

LINE NO.		(1) PLANT IN SERVICE	(2) ACCUMULATED PROVISION FOR DEPRECIATION & AMORTIZATION	(3) NET PLANT IN SERVICE (1 - 2)	(4) CWIP	(5) PLANT HELD FOR FUTURE USE	(6) NUCLEAR FUEL	(7) NET UTILITY PLANT	(8) WORKING CAPITAL ALLOWANCE	(9) OTHER RATE BASE ITEMS	(10) TOTAL RATE BASE
2	UTILITY PER BOOK	21,553,493	11,129,604	10,423,890	998,768	58,127	153,294	11,634,079	(1,968,068)	0	9,666,011
4	SEPARATION FACTOR	0.992500	0.992312	0.992700	0.987698	0.994479	0.995288	0.992314	0.996525	0.000000	0.991458
6	JURIS UTILITY	21,391,831	11,044,036	10,347,795	986,481	57,806	152,572	11,544,654	(1,961,228)	0	9,583,426
8	COMMISSION ADJUSTMENTS	(593,499)	(456,268)	(137,231)	(721,923)	0	(152,572)	(1,011,726)	2,107,267	0	1,095,541
10	COMPANY ADJUSTMENTS	0	0	0	0	0	0	0	0	0	0
12	TOTAL ADJUSTMENTS	(593,499)	(456,268)	(137,231)	(721,923)	0	(152,572)	(1,011,726)	2,107,267	0	1,095,541
14	JURIS ADJ UTILITY	20,798,332	10,587,769	10,210,564	264,557	57,806	0	10,532,927	146,039	0	10,678,967

NOTE: TOTALS MAY NOT ADD DUE TO ROUNDING.

SUPPORTING SCHEDULES: B-2, B-3, B-6

FLORIDA PUBLIC SERVICE COMMISSION

COMPANY: FLORIDA POWER & LIGHT COMPANY
AND SUBSIDIARIES

DOCKET NO. 050045-EI

EXPLANATION:
PROVIDE THE CALCULATION OF JURISDICTIONAL NET OPERATING INCOME FOR THE TEST YEAR, THE PRIOR YEAR AND THE MOST RECENT HISTORICAL YEAR.

TYPE OF DATA SHOWN:
____ PROJECTED TEST YEAR ENDED __/__/__
____ PRIOR YEAR ENDED __/__/__
_X_ HISTORICAL TEST YEAR ENDED 12/31/04
WITNESS: K. MICHAEL DAVIS

($000)

LINE NO.		(1) TOTAL COMPANY PER BOOKS	(2) NON-ELECTRIC UTILITY	(3) TOTAL ELECTRIC (1)-(2)	(4) JURISDICTIONAL FACTOR	(5) JURISDICTIONAL AMOUNT (3)X(4)	(6) JURISDICTIONAL COMMISSION ADJUSTMENTS (SCHEDULE C-2)	(7) JURISDICTIONAL ADJUSTED PER COMMISSION (5)+(6)	(8) JURISDICTIONAL COMPANY ADJUSTMENTS	(9) JURISDICTIONAL ADJUSTED AMOUNT (7) + (8)
1										
2	REVENUE FROM SALES	8,536,654	0	8,536,654	0.990926	8,459,189	(4,904,736)	3,554,453	0	3,554,453
3										
4	OTHER OPERATING REVENUES	145,781	0	145,781	0.975871	142,264	(33,672)	108,592	0	108,592
5										
6	TOTAL OPERATING REVENUES	8,682,435	0	8,682,435	0.990673	8,601,452	(4,938,408)	3,663,044	0	3,663,044
7										
8	OTHER	1,230,881	0	1,230,881	0.990242	1,218,870	(81,927)	1,136,943	0	1,136,943
9										
10	FUEL & INTERCHANGE	3,178,572	0	3,178,572	0.984830	3,130,353	(3,112,376)	17,976	0	17,976
11										
12	PURCHASED POWER	1,125,629	0	1,125,629	0.986895	1,110,877	(1,047,941)	62,936	0	62,936
13										
14	DEFERRED COSTS	117,500	0	117,500	0.996490	117,088	(117,088)	0	0	0
15										
16	DEPRECIATION & AMORTIZATION	896,834	0	896,834	0.992439	890,054	(57,623)	832,431	0	832,431
17										
18	TAXES OTHER THAN INCOME TAXES	813,402	0	813,402	0.997846	811,650	(510,016)	301,634	0	301,634
19										
20	INCOME TAXES	422,605	0	422,605	1.003989	424,290	(4,422)	419,868	0	419,868
21										
22	(GAIN)/LOSS ON DISPOSAL OF PLANT	(1,722)	0	(1,722)	0.995057	(1,713)	762	(951)	0	(951)
23										
24	TOTAL OPERATING EXPENSES	7,783,701	0	7,783,701	0.989435	7,701,469	(4,930,632)	2,770,837	0	2,770,837
25										
26	NET OPERATING INCOME	898,734	0	898,734	1.001391	899,984	(7,776)	892,208	0	892,208
27										
28										
29										
30										
31										
32	NOTE: TOTALS MAY NOT ADD DUE TO ROUNDING.									
33										

SUPPORTING SCHEDULES: C-2, C-3, C-4 RECAP SCHEDULES: A-1

FLORIDA PUBLIC SERVICE COMMISSION

COMPANY: FLORIDA POWER & LIGHT COMPANY
AND SUBSIDIARIES

DOCKET NO. 050045-EI

EXPLANATION:
PROVIDE THE COMPANY'S 13-MONTH AVERAGE COST OF CAPITAL FOR THE TEST YEAR, THE PRIOR YEAR, AND HISTORICAL BASE YEAR.

TYPE OF DATA SHOWN:

____ PROJECTED TEST YEAR ENDED __/__/__

____ PRIOR YEAR ENDED __/__/__

_X_ HISTORICAL TEST YEAR ENDED 12/31/04

WITNESS: K. MICHAEL DAVIS, MORAY P. DEWHURST

($000)

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
LINE NO.	CLASS OF CAPITAL	COMPANY TOTAL PER BOOKS	SPECIFIC ADJUSTMENTS	PRO RATA ADJUSTMENTS	SYSTEM ADJUSTED	JURISDICTIONAL FACTOR	JURISDICTIONAL ADJUSTED	RATIO	COST RATE	WEIGHTED COST RATE
1	LONG TERM DEBT	3,258,584	(155,648)	(229,110)	2,873,825	1.00579	2,890,461	27.07%	5.24%	1.42%
2	PREFERRED STOCK	23,462		(1,502)	21,959	0.99221	21,788	0.20%	4.80%	0.01%
3	CUSTOMER DEPOSITS	369,226		(23,643)	345,583	1.00000	345,583	3.24%	5.94%	0.19%
4	COMMON EQUITY	6,105,009	(49,981)	(397,490)	5,657,539	0.98531	5,574,423	52.20%	12.30%	6.42%
5	SHORT TERM DEBT	258,008		(16,521)	241,487	0.99221	239,605	2.24%	2.05%	0.05%
6	DEFERRED INCOME TAX	1,639,939		(105,010)	1,534,929	0.99221	1,522,968	14.26%	0.00%	0.00%
7	INVESTMENT TAX CREDITS	90,601		(5,801)	84,799	0.99221	84,139	0.79%	9.02%	0.07%
8	TOTAL	11,744,827	(205,629)	(779,077)	10,760,121		10,678,967	100.00%		8.16%
9										
10										
11										
12										
13										
14										
15										
16										
17										
18										
19										
20										

21 NOTE 1: TOTALS MAY NOT ADD DUE TO ROUNDING.

22 NOTE 2: FPL HAS NO AUTHORIZED RETURN ON EQUITY(ROE) FOR THE PURPOSE OF ADDRESSING EARNINGS LEVELS, THEREFORE THE
23 COMMON EQUITY COST RATE THAT FPL IS USING ON THIS MFR IS THE SAME AS THE REQUESTED ROE IN THE TEST YEAR.

SUPPORTING SCHEDULES: D-6, D-5, D-4A, D-3, D-1B

RECAP SCHEDULES: A-1

DOCKET NO. 050045-EI: Petition for rate increase by Florida Power & Light Company

WITNESS: **Direct Testimony Of Kathy L. Welch,** Appearing On Behalf Of Staff of the Florida Public Service Commission

EXHIBIT KLW-3: Supplemental Audit Report

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

Iliana Piedra, Audit Manager

Yen Ngo, Audit Staff

Gabriela Leon, Audit Staff

Kathy L. Welch
Public Utility Supervisor

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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	REVENUES	%	PP & E	%	PAYROLL	%	AVG. %	NON-REG %
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

BEFORE THE PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Florida Power & Light Company.	DOCKET NO. 050045-EI
In re: 2005 comprehensive depreciation study by Florida Power & Light Company.	DOCKET NO. 050188-EI
	DATED: JULY 8, 2005

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct UNREDACTED copy of the DIRECT TESTIMONY AND EXHIBITS OF KATHY L. WELCH has been served by U. S. Mail to R. Wade Litchfield and Natalie F. Smith, Florida Power & Light Company, 700 Universe Blvd., Juno Beach, Florida, 33408-0420 on behalf of Florida Power & Light Company, and that a true and correct REDACTED copy thereof has been furnished to the following, by U. S. Mail, this 8th day of July, 2005:

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