

CONFIDENTIAL

Florida Power & Light Company
April 4, 2006

Audit Finding No. 1

060038-EI

In its Audit Finding No. 1, Audit Staff states “[i]f the Commission decides to remove regular pay, the \$826,853,000 of un-recovered storm costs from Exhibit A of the filing would be reduced by \$26,092,000. If the exempt overtime not in FPL’s policy is removed, Exhibit A would be reduced by \$768,000.”

FPL’s Response –

1) Regular Payroll

The amount of regular pay that would be removed under Audit Finding No. 1 is overstated. First, if the Commission follows the incremental cost approach, then offsetting adjustments such as those set forth below would be needed to enable FPL to fully recover its prudently incurred costs of providing service. Also under this approach, if the adjustments below are made, then the amount of base revenues not achieved due to the 2005 Hurricanes of \$51,354,000 must be considered. Although this represents the total loss of base revenues, the relevant amount under the incremental cost approach is the adjustment for the amount not recovered through base rates. Therefore, if the net adjustment shown below is made, then the amount not recovered through base revenues is decreased by the same amount, which results in a net zero adjustment to the total amount of recoverable 2005 storm payroll charged to the Reserve.

Estimated Regular Employee Salaries as Filed (1),(2)	(26,092,000)
Less: Nuclear Payroll Expected to be Recovered through Insurance (3)	<u>2,490,800</u>
Net Regular Employee Salaries Charged to Storm	(23,601,200)
Less: 2005 Backfill and Catch-up Work (4)	7,878,000
Payroll Normally Charged To Clauses (5)	2,730,000
Payroll Normally Charged To Capital (6)	8,000,000
Less: 2006 Catch-up Work (4)	787,000
Less: Vacation Buy Back (7)	<u>1,209,000</u>
Total Incremental Salary Adjustments	20,604,000
Net Regular Payroll Adjustment Under Incremental Cost Approach	(2,997,200)

Notes:

(1) As of December 31, 2005, the amount of regular employee salaries related to 2005 storm restoration activities FPL has actually incurred is \$22,680,076.

(2) This amount includes payroll that is part of the normal cost of capital associated with the 2005 storms, which is already included in the removal of estimated capital expenditures of \$63,855,000 when determining the amount of 2005 storm costs to be recovered. Therefore, the regular payroll associated with the normal cost of capital related to the 2005 storms should not be included in any such payroll adjustment. Otherwise, it will be subtracted from the total amount of 2005 storm costs twice. Please note that this amount has not been determined at this time.

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(3) The amount of regular employee salaries charged to the Reserve of \$26,092,000 included an estimate of \$2,490,800 related to nuclear Powerblock repairs, which is expected to be recovered through insurance. Under the incremental cost approach, nuclear payroll expected to be recovered through insurance should not be included in any such payroll adjustment. If it is, then it will be subtracted twice from the total amount of 2005 storm costs to be recovered. Please note that once there is final resolution of insurance recoveries related to the 2005 storm damages, an adjustment will be made to the Reserve accordingly.

(4) There are other payroll costs that should be taken into consideration when making an adjustment for regular payroll under the incremental cost approach, such as backfill and catch-up. The Commission has previously recognized that the presence of backfill and catch-up costs offset directly any amount of base payroll that is not ultimately deemed recoverable through the storm recovery mechanism. Without this offset, FPL is not able to fully recover its prudently incurred costs.

(5) Regular payroll charged to the storm reserve that would have ordinarily been charged to clauses should be allowed to be recovered through the storm reserve since they are not being recovered through a cost recovery clause or through base rates. Simply stated, they are not being recovered twice from customers and, therefore, should not be disallowed under the incremental cost methodology.

(6) Regular payroll charged to the storm reserve that would have ordinarily been charged to capital should be allowed to be recovered through the storm reserve since they are not being recovered through base rates. Normal payroll, i.e. regular payroll, has a capital component and the assumption that all regular payroll charged to storm is related to operations and maintenance work is incorrect. It includes payroll dollars for employees that under normal working conditions would charge their time, or a portion of their time, to capital projects. Therefore, these costs should not be disallowed under the incremental cost methodology.

(7) This represents the purchase of unused earned vacation from employees that could not take vacation due to the length of storm restoration efforts. These employees were unable to take all the vacation they were entitled to and normal workloads will not enable employees to take these days in the future. Therefore, these payments are a direct result of the 2005 storms.

As a general matter, if the Commission decides to use an incremental cost approach and/or if some costs are disallowed, then the amount of payroll costs included in any adjustment other than the regular payroll adjustment needs to be removed from that particular adjustment. If its not adjusted, then it will be subtracted from the total amount of 2005 storm costs to be recovered twice. The same is true for capital expenditures.

2) Lump sum exempt overtime pay

Lump sum exempt overtime should be allowed for employees working extraordinary hours in the storm restoration effort. Many employees who are not eligible for overtime under normal circumstances perform critical roles in the restoration effort (staging site managers, command center representatives, logistics representatives, etc.) that require extraordinary hours. Frequently, these employees work 16-plus hour days for weeks on end without a day off. To establish parity among employees who are not eligible for overtime and to encourage the work of exempt employees who are critical to the restoration effort, FPL should be permitted to charge to the Reserve lump sum overtime payments paid to exempt employees working extraordinary hours in storm restoration.

As addressed in Audit Finding No. 1, FPL paid a very small group of exempt employees performing critical storm restoration jobs an overtime lump sum payment in December 2005, which was charged to the Reserve. The employees receiving this lump sum payment did not receive any overtime on an hourly basis during storm restoration. These employees' earnings were compared with the earnings of those in like roles and employees working in the bargaining unit. The lump sum overtime payment was to establish pay parity among the employees that received no hourly overtime compensation and those that did not receive hourly overtime at different rates for performing the same work. This expense is not and generally would not be included in the cost of service for purposes of setting base rates due to the unusual and nonrecurring nature of the payments, but is a valid cost of providing service that is directly related to storm restoration.

Audit Finding No. 2

In its Audit Finding No. 2, Audit Staff states that, “[i]f the Commission decides to remove landscaping, the unrecovered storm costs from Exhibit A of the filing would be reduced by \$1,503,250.”

FPL’s Response

Reasonably and prudently incurred landscaping for substations and service centers should be allowed to be charged to the Reserve. Substation and service center landscaping is required to meet zoning requirements. This expense is not and generally would not be included in the cost of service for purposes of setting base rates due to the unusual and nonrecurring nature of the payments, but is a valid cost of service that is directly related to storm restoration.

Audit Finding No. 3

In its Audit Finding No. 3, Audit Staff states that “[i]f the Commission decides to remove legal settlements, the \$826,853,000 of un-recovered storm costs from Exhibit A of the filing would be reduced by 2,250,000.” [confidential amount]

FPL’s Response

Pursuant to the mutual aid agreement, FPL is required to indemnify foreign utilities for the uninsured portions of any lawsuits that result from their assistance in FPL’s storm restoration efforts. Similarly, FPL is indemnified from any lawsuits that result when FPL sends crews to assist foreign utilities in their restoration efforts. These are valid costs for which FPL cannot plan and they would not generally be susceptible to inclusion in the cost of service for purposes of setting base rates due to the unusual and nonrecurring nature of the costs. These lawsuit-related costs should be charged to the Reserve in order to encourage, not discourage, mutual aid.

In reviewing the litigation costs charged to the Reserve, FPL decided to reverse from the charges to the Reserve certain amounts associated with storm-related lawsuits charging FPL with negligence. The total amount reversed associated with 2005 storm-related lawsuits is \$2,200,000. [confidential amount] Thus, if the Commission decides that the uninsured portions of storm-related lawsuit settlements should not be charged to the Reserve, these amounts should not be included in any such disallowance. Otherwise, they would be reversed twice.

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Audit Finding No. 4

Audit Finding No. 4 concludes that "If contingencies are not allowed, the \$826,000 of un-recovered storm costs from Exhibit A of the filing would be reduced by \$44,666,201. The company has asked for a true-up mechanism for additional or over-accrued costs that have not been recorded. However, FPL is asking for approval of charges through this mechanism to be approved within a month which precludes an audit of the charges."

FPL's Response

The contingency piece of FPL's estimate is very small. This is especially true when compared to the total estimated costs of restoration. As of February 28, 2006, the contingency amount has been reduced from \$44.5 million from the time when FPL filed its petition to \$26.3 million.

FPL reviews its damages resulting from storms and estimates the cost of restoration work based on the best available information at the time the estimate is prepared. As such, when better information is known and/or projects become actualized, the amount of contingency FPL originally included in its filing will change. Ultimately, any unused contingency would be reflected in the true-up process.

FPL believes that removing the relatively small contingency portion of the estimated storm costs is inconsistent with Commission precedent and Section 366.8260, Florida Statutes, which permits the use of estimates for purposes of approval of cost recovery. Including a contingency in FPL's storm cost estimate is an integral part of its request if FPL is to recover its reasonably and prudently incurred storm costs. FPL's filing makes clear that it intends to credit the Reserve if actual costs are lower than estimated costs, so there is no detriment to the customer.

With respect to the nuclear accrual, the referenced 10% contingency does not relate to the \$1,615,530 for Project Management, which is the estimated cost of program management personnel to oversee the actual restoration activities, and should not be considered a contingency. Rather, the 10% contingency applies to the estimate of nuclear Powerblock repairs of \$1.322 million (so \$132,200 represents the referenced contingency). The repairs will be charged to various workorders and the Reserve will be credited to the extent actual repair costs are lower than estimated, or if the amount is recovered from insurance.

Finally, FPL notes that the last two sentences of the finding, quoted above, appear to reflect confusion regarding two different true-ups referenced by FPL in its filing. The true-up of the "Storm Charge" as proposed by FPL (for over- or under-collection, etc.) would have a 30-day approval period. However, FPL has proposed no time frame associated with true-up of the storm costs, which is what this Audit Finding appears to be addressing. As discussed above, when better information is known and/or projects become actualized, FPL will adjust the remaining contingency accordingly.

Audit Finding No. 5

In Audit Finding No. 5, Audit Staff states that “[t]he total un-recovered storm costs of \$826,853,000 should be reduced by the amount billed less the amount capitalized for the related poles.”

FPL’s Response

FPL agrees that the Reserve should be credited by amounts billed over the capitalized amount for repairing BellSouth poles during restoration for both 2004 and 2005 storm restoration activities. In March 2006, the billing for non-FPL poles replaced after the 2004 storms was prepared. The total amount billed was \$7,419,810, of which \$1,986,844 reduced capital and \$5,432,966 reduced the reserve. Additionally, in March 2006, FPL recorded an estimate for the non-FPL poles replaced after the 2005 storms. The total estimate was \$10,564,384, of which \$4,156,615 reduced capital and \$6,407,769 reduced the reserve. The survey to determine the actual number of poles replaced after the 2005 storm is expected to be completed in May 2006, with the billing to follow shortly thereafter.

The phrase “less the amount capitalized” reflected in the quote above should also be added to the end of the last sentence in the “Summary” statement on the audit disclosure for it to be consistent with the rest of the finding.

Audit Finding No. 6

In its Audit Finding No. 6, Audit Staff stated “[i]f the Commission decides that storm preparation costs should be excluded, it would reduce the \$826,853,000 of un-recovered storm costs from Exhibit A of the filing.”

FPL’s Response

Storm preparation activities to safeguard nuclear power plants and other facilities are in the best interests of the customers and help prevent the need for even more repairs after a storm strikes. This expense is not and generally would not be included in the cost of service for purposes of setting base rates due to the unusual and nonrecurring nature of the payments, but is a valid cost of providing service that is directly related to storm restoration.

Further, the amount of Nuclear storm preparation costs includes regular and overtime payroll, which is already included in the removal of regular and overtime payroll referenced in Audit Finding No. 1. Therefore, if the Commission requires an adjustment to remove Nuclear storm preparation costs from storm cost recovery in addition to an adjustment for regular payroll and overtime, the payroll costs included in the Nuclear storm preparation costs should not be included in any such adjustment. Otherwise, it will be subtracted from the total amount of 2005 storm costs twice.

Audit Finding No. 7

In its Audit Finding No. 7, Audit Staff stated “[a] reduction in the storm expense for image enhancing advertising would reduce the \$826,853,000 of un-recovered storm costs from Exhibit A of the filing.”

FPL’s Response

Public outreach advertising, including communications designed to keep customers informed of the status of FPL's restoration efforts and to inform customers of the extraordinary dangers that exist during storm restoration, should be encouraged, not discouraged. These communications meet a critical customer need for restoration and safety-related information after a natural disaster. As such, public safety and public outreach advertising costs should be allowed. Also, thank you advertising designed to recognize foreign crews who assist in restoration efforts should be allowed in order to encourage their continued support. These reasonable and necessary expenses are highly volatile and extraordinary and would generally not be included in the cost of service for purposes of setting base rates.

FPL determined that \$404,627 associated with the employee campaign radio and web advertisement was image enhancing and that amount has been reversed from the Reserve during March 2006’s business. FPL also determined that \$17,949 was for a conservation advertisement and that amount has also been reversed from the Reserve during March 2006's business. The effect of these adjustments will be reflected in FPL’s proposed true-up process for 2005 storm costs.

Audit Finding No. 8

In its Audit Finding No. 8, Audit Staff stated “[i]f the Commission decides that the event was planned and should not be included in storm costs, the \$1,193,404 would reduce the \$826,853,000 of un-recovered storm costs from Exhibit A of the filing.

FPL’s Response

The “event report” appears to have been misunderstood. The Power Generation Division uses event reports to report an event or plan a job. They were planning a partial re-tube during the 2006 three-year budget planning cycle and they used this form to do that. It was for a Spring 2008 outage for Martin Unit 1. It is estimated that 10% more of the condenser tubes at Martin Units 1& 2 need to be replaced due to Hurricane Wilma, so the amounts accrued to the Storm Reserve are only for incremental damage due to the storm, not planned maintenance.

Also, the dates referenced in the Audit Finding are incorrect (July 2005 and October 2005). The dates on the event report were for another job and should have been changed. Contrary to the audit finding, the “last modified” date is not the date FPL completed the work. The dates should not be referenced as the dates FPL completed the work. The work has not been done and cannot be done until the Spring 2008 outage.

It also needs to be noted that the amount estimated for the condenser tube repair for Martin Unit 2 is no longer required, and further analysis indicates the Martin Plant Unit 1 condenser tubes need to be completely replaced, not partially replaced as initially estimated. Therefore, the initial amount charged to the Reserve was revised to \$2,785,364, and then subsequently removed from the Reserve and charged as capital in March 2006’s business. The effect of this adjustment will be reflected in FPL’s proposed true-up process for 2005 storm costs.

Audit Finding No. 9

In Audit Finding No. 9, Audit Staff states that FPL's unrecovered 2004 storm costs should be reduced based on an internal audit report.

FPL's Response

FPL notes that the proper documentation was provided prior to the Auditor's Report being issued. FPL understands that this audit finding has been withdrawn based on the supplemental audit work.

Audit Finding No. 10

In its Audit Finding No. 10, Audit Staff states that “[i]f the company cannot provide support for the differences, the \$2,649,572 should be removed from the 228 account.”

FPL’s Response

The difference of \$2,649,572 between the Power Systems Business Unit accrual recorded on the general ledger as of December 31, 2005 and the supporting documentation provided was due to the following:

	As of December 31, 2005		
Power Systems - Supporting Documentation	\$ 438,697,353		
Pension, Welfare, Taxes, and Insurance - Wilma	2,034,977	(1)	
Estimated Changes in Other Business Units - Katrina	273,155	(2)	
Estimated Changes in Other Business Units - Rita	96,673	(2)	
Estimated Changes in Other Business Units - Wilma	244,768	(2)	
	\$ 441,346,925		

Notes:

(1) Represents Pension, Welfare, Taxes, and Insurance (PWTI) on the accrued costs for Hurricane Wilma recorded in the Power Systems Business Unit cost rollup rather than the Accounting/Financial Other cost rollup. The support for this amount should have been included along with the supporting documentation submitted for the Power Systems Business Unit; however, since PWTI is typically recorded in the Accounting/Financial Other cost rollup, it was inadvertently omitted when the supporting documentation was supplied to Staff.

(2) The monthly storm accrual process is based on a Business Unit aggregation of estimated storm restoration costs which is compared to actuals-to-date to derive the current accrual amount. The Company has not adjusted its total accrual each month as the difference has been immaterial, but reviews the estimate in order to determine if adjustments to the accrual should be made. As noted, the differences for Hurricane Wilma of \$244,768, Hurricane Katrina of \$273,155 and Hurricane Rita of \$96,673 represent the net over/under fluctuations within the Business Unit detail, which are not significant, and are therefore, not adjusted monthly; rather the differences will continue to be reviewed monthly and then adjusted at quarter-end.

According the supplemental audit report “Objectives and Procedures” the Audit Staff “obtained supporting documentation for the December 2005 accruals for the power systems business unit [and] ... for work that FPL has identified as follow up work after Hurricane Wilma. We traced those items to supporting documentation that shows these amounts are owed. ... We traced all journal vouchers to in the sample to source

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documentation to determine if they were for reasonable storm charges.” Thus, it appears the supplemental audit report negated the above finding.

Audit Finding No. 11

In its Audit Finding No. 11, Audit Staff states that the Company's filing for remaining unrecovered 2004 storm costs is overstated by \$749,636 based on the general ledger balances as of December 31, 2005.

FPL's Response

The amount recorded for unrecovered 2004 storm costs in the General Ledger and the amount shown on Document No. KMD-3 are different for several reasons.

1. The amount of costs approved for recovery from customers in the 2004 Storm Cost Recovery Order (PSC-05-0937-FOF-EI) was rounded to \$798,100,000. Therefore, after the amount of the storm fund available to offset this was applied, then the amount to be recovered from customers became a rounded number as well. Therefore, this amount did not tie to the \$441,634,351 of what was actually shown on the General Ledger;
2. The amount of interest shown on Document No. KMD-3 showed actuals through November 30, 2005, and the estimate for December 31, 2005 was based on the after-tax commercial paper rate at the end of November 30, 2005. Therefore, the amount recorded on the books will be different because it was based on actual interest; and
3. The amount of billed revenues shown on Document No. KMD-3 showed actuals through November 30, 2005, and the estimate for December 31, 2005 was based on forecasted kWh sales as illustrated in Dr. Green's direct testimony. Therefore, the amount recorded on the books will be different because it was based on actual billed kWh sales.

Nevertheless, FPL believes that making this adjustment is unnecessary since the amounts are going to change each month based on the actual dollar activity. As stated in K. Michael Davis' direct testimony, FPL believes that any difference in the estimated unrecovered 2004 storm recovery costs and the actual balance as of July 31, 2006 should be adjusted to the storm reserve accordingly. However, FPL will not exceed the total amount of 2004 storm costs approved for recovery in the 2004 Storm Cost Recovery Order (PSC-05-0937-FOF-EI).

Supplemental Audit Finding No. 1

In its Supplemental Audit Finding No. 1, Audit Staff states that FPL's internal audit department discovered that it had been over-billed by storm contractors in excess of \$807,000 for the 2004 storms. According to the supplemental report, "[t]he audit staff recommended that the un-recovered 2004 storm cost of \$213,307,000 in its filing should be reduced by \$807,000 if FPL could not prove that these cost had been removed."

FPL's Response

The statement in the summary finding that the invoice adjustment amounts were the result of an internal audit department discovery is incorrect. The invoice adjustments were the result of FPL's resource and performance management staff's (within the power systems business unit) invoice validation prior to approval for payment. Also, the summary finding infers that the "over-billed" amounts were paid to the storm contractors and foreign utilities.

The foreign utility invoice adjustment amounts were not paid. Invoice adjustments on utility invoices were reductions to the final invoice amount based on reviews performed by FPL's resource and performance management staff. At the request of resource and performance management, corrected invoices were submitted to FPL prior to final payment. For storm contractors, FPL has applied a credit to pending invoices.