FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA17-2-000
September 6, 2019

Ohio Power Company
Attention: Joseph Buonaiuto
Senior Vice President and Chief Accounting Officer
AEP Headquarters Building
1 Riverside Plaza
Columbus, OH 43215

Dear Mr. Buonaiuto:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (Commission) has completed an audit of Ohio Power Company (Ohio Power). The audit covered the period from January 1, 2012 through December 31, 2017.

2. The audit evaluated Ohio Power's compliance with: (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment H-14 of the PJM Interconnection, L.L.C. Open Access Transmission Tariff (OATT), and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; and (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1. The enclosed audit report contains four findings, one other matter, and 18 recommendations that require Ohio Power to take corrective action.

3. On August 29, 2019, you notified DAA that Ohio Power does not contest the four findings, one other matter, and 18 recommendations in the draft audit report and will submit within 30 days of the issuance of the final audit report a plan for implementing the audit recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.

4. Ohio Power should submit its implementation plan to comply with the recommendations within 30 days of this letter order. Ohio Power should make quarterly submissions to DAA describing the progress made to comply with the recommendations,

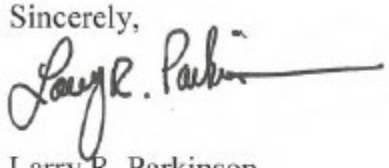
including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311. This letter order constitutes final agency action. Ohio Power may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713.

6. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of non-compliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Steven D. Hunt, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-6084.

Sincerely,



Larry R. Parkinson
Director
Office of Enforcement

Enclosure

Federal Energy Regulatory Commission
Office of Enforcement
Division of Audits and Accounting

AUDIT REPORT

Audit of Ohio Power Company's compliance with its transmission formula rate; the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees; and the reporting requirements of the FERC Form No. 1, Annual Report.

Docket No. FA17-2-000
September 6, 2019

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I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) in the Office of Enforcement of the Federal Energy Regulatory Commission (Commission) has completed an audit of Ohio Power Company (Ohio Power or the Company). The audit evaluated Ohio Power's compliance with: (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment H-14 of the PJM Interconnection, L.L.C. (PJM) Open Access Transmission Tariff (OATT), and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; and (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1. The audit covered the period from January 1, 2012 to December 31, 2017.

B. Ohio Power Company

Ohio Power was organized in Ohio in 1907 and re-incorporated in 1924, and is a wholly-owned electric public utility subsidiary of American Electric Power Company, Inc. (AEP). Ohio Power serves 1.5 million customers throughout the state of Ohio. Ohio Power is one of AEP's operating companies located under the PJM umbrella and has transferred operational control of its transmission facilities to PJM. As a member of PJM, Ohio Power has a transmission formula rate mechanism under Attachment H-14 of the PJM OATT. Ohio Power's parent company is AEP, which is an investor-owned electric public utility holding company that holds numerous wholly- and majority-owned subsidiaries and affiliates. AEP is one of the largest electric utility holding companies in the United States; its subsidiaries deliver electricity to more than 5.3 million customers in 11 states.

C. Summary of Audit Findings and Other Matter

Audit staff's compliance findings and one other matter are summarized below. Details of these findings and the other matter are in Sections IV and V of this report.

Findings

1. *Revenue Credits* – Ohio Power understated its revenue credits that are used to reduce the revenue requirement of its transmission formula rate by improperly excluding certain transmission-related revenues – specifically pole attachment revenue, causing an overstatement of its revenue requirement. This overstatement resulted in excess billings to wholesale transmission customers.

2. *Customer Funded Capital Projects* – Ohio Power did not properly return amounts collected in transmission rates in excess of its total investment on certain customer funded projects.

3. *Sales of Accounts Receivable* – Ohio Power misclassified non-operating expenses related to its servicing of accounts receivables, which were sold on a non-recourse basis, as operating expenses recorded in Account 903, Customer Records and Collection Expenses. Ohio Power should have recorded these non-operating expenses in Account 426.5 instead.

4. *FERC Form No. 1 Reporting* – Ohio Power did not report certain required information on select pages of its FERC Form No. 1. This reduced the transparency and usefulness of the information provided in the FERC Form No. 1.

Other Matter

1. *Accounting for Plant in Service* – Ohio Power should strengthen its policies and procedures to improve its accounting practices for work orders associated with construction projects that have been placed in service and ensure that these construction work orders are transferred to appropriate plant in service accounts in a timely manner.

D. Summary of Recommendations

Audit staff's recommendations to remedy the audit findings are summarized below. Details are in Sections IV and V of this report. Audit staff recommends that Ohio Power:

Classification of Pole Attachment Revenues

1. Develop and implement policies, procedures, and controls over the preparation and review of Worksheet E to ensure revenue credit amounts are calculated and reflected accurately in the transmission formula rate.

2. Train employees to ensure they fully understand the reporting requirements for Worksheet E and the importance of this information in determining the revenue credits provided to customers in the transmission formula rate.

3. Perform a review of all pole attachment agreements, identify the specific assets with pole attachments, and ensure that revenues are properly classified based on the functional classification of each asset, which drives the business unit/function where the associated pole attachment revenue is captured. Provide the results of this review to DAA.

4. Make correcting entries to reclassify pole attachment revenue to the proper business units and identify appropriate revenue credits.

5. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amount of revenue credits that were inappropriately excluded in transmission formula rates, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) refunds will be made.

6. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

7. Refund amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Reimbursable Capital Projects

8. Revise accounting procedures to ensure excess costs recovered related to customer funded projects are returned to ratepayers.

9. Submit correcting journal entries, within 60 days of receiving the final audit report, to DAA related to excess recovery associated with customer funded projects. Provide supporting documentation for the amounts of over recovery from 2012 through 2017.

10. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details the following: (1) calculation of refunds to wholesale customers since 2012, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

11. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

12. Refund amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Accounting for Non-Operating Activities

13. Revise procedures to ensure that all costs and account balances associated with the servicing of sold accounts receivables are accounted for in accordance with Commission accounting regulations. The corrected accounting should ensure that the costs are recorded in Account 426.5.

14. Provide the revised procedures to DAA for review within 60 days of receiving the final audit report.

15. Submit correcting journal entries to DAA within 60 days of receiving the final audit report.

FERC Form No. 1 Reporting Errors

16. Revise and strengthen documented policies, procedures, and practices to help ensure all schedule instructions are followed and all information is accurately reported in the FERC Form No. 1.

17. Provide training to staff on the revised FERC Form No. 1 policies, procedures, and practices. Also, develop a training program that supports the provision of periodic training in this area.

Other Matter – Accounting for Plant in Service

18. Revise and strengthen policies and procedures to improve accounting practices for plant in service and ensure that work order expenses associated with projects that have been placed in service are transferred to appropriate plant in service accounts in a timely manner.

E. Compliance and Implementation of Recommendations

Audit staff further recommends that Ohio Power submit the following for review:

- A plan for implementing the audit recommendations within 30 days after the final audit report is issued in this docket;

- Quarterly reports to DAA describing Ohio Power's progress in completing each corrective action recommended in the final audit report. Quarterly nonpublic submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after submission of the implementation plan, and continuing until completion of all recommended corrective actions; and

- Copies of any written policies and procedures developed in response to the recommendations in the final audit report. These documents should be submitted for audit staff's review in the first quarterly filing after completion.

II. Background

A. American Electric Power Service Corporation

AEP's centralized service company, American Electric Power Service Corporation (AEPSC), provides professional, managerial, and technical support services to the operating electric utility companies within the AEP affiliated system. The services performed by AEPSC for its affiliated companies include: management, accounting and financial reporting, tax, legal, engineering, treasury and cash management, regulatory and case management, insurance risk management, customer operations, generation, transmission, distribution, human resources, information technology and telecommunications, and supply chain services. AEPSC provides both operation and maintenance services and construction services to its affiliated entities.

B. Ohio Power Operations

Ohio Power engages in transmission and distribution of electric power to approximately 1,477,000 retail customers in the northwestern, central, eastern, and southern sections of Ohio. Among the principal industries served by Ohio Power are primary metals, chemicals and allied products, health services, electronic machinery, petroleum refining, and rubber and plastic products. Ohio Power is a transmission owning member of PJM and part of AEP's Transmission and Distribution Utilities segment. Ohio Power is also a Load Serving Entity in PJM, serving retail load customers in the state of Ohio. Ohio Power's transmission system is comprised of approximately 7,400 circuit miles of transmission lines and over 40,000 miles of distribution lines. Ohio Power also supplies and markets wholesale power to electric utility companies, municipalities, and other market participants.

C. Transmission Formula Rate

Ohio Power's transmission formula rate is provided in an attachment (as part of the AEP East zone) to PJM's OATT, which contains zonal rates and allows each transmission owning member to make filings to maintain a current annual transmission revenue requirement. The transmission formula rate calculates the annual transmission revenue requirement, which forms the basis for deriving rates for transmission services. The annual transmission revenue requirement for the AEP East zone in PJM is reflected in Attachment H-14 of the PJM OATT. Attachment H-14A provides the formula rate implementation protocols, and Attachment H-14B provides the formula rate template. The formula rate contains three cost-of-service provisions: (1) a historic cost-of-service, (2) a projected cost-of-service, and (3) a true-up cost-of-service, including protocols for updating the formula rate. Ohio Power's revenue requirement under the formula rate is calculated using FERC Form No. 1 cost data as well as data from its accounting ledgers.

D. Corporate Separation

On October 31, 2012, Ohio Power proposed to transfer its existing generating units, contractual entitlements, fuel-related assets and contracts, and other generation-related assets, at net book value, to AEP Generation Resources, Inc. (AEP Generation), which was a newly formed affiliate intended to be an indirect subsidiary of AEP at the transaction's close. In 2013, the Commission approved the transaction.[1] On December 31, 2013, Ohio Power transferred its generation assets and related generation liabilities at net book value to AEP Generation. The transaction did not include transfer to AEP Generation of certain contracts that Ohio Power had entered into to purchase renewable power from certain wind and solar facilities.[2] At closing, AEP Generation assumed the liabilities associated with the transferred assets, including generation-related debt and liabilities associated with certain generating plants that had been retired. Prior to this transaction, Ohio Power ran a generation and power marketing business, which transferred to AEP Generation, along with its transmission and distribution businesses. Ohio Power's generation at the time was used primarily to serve retail customers in its service area that were not served by a competitive retail electric service provider under Ohio's retail choice program.

[1] *Ohio Power Co.*, 143 FERC ¶ 61,075 (2013) (conditionally authorizing disposition of jurisdictional facilities), *granting clarification and dismissing reh'g request*, 146 FERC ¶ 61,016 (2014).

[2] *Ohio Power Co.*, 143 FERC ¶ 61,075 at P 8 ("The Proposed Transaction will not include . . . contracts that Ohio Power has entered into to purchase renewable power from certain wind and solar facilities.").

III. Introduction

A. Objectives

The audit evaluated Ohio Power's compliance with: (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment H-14 of the PJM OATT, and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101; and (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1. The audit covered the period from January 1, 2012 to December 31, 2017.

B. Scope and Methodology

Audit staff performed these specific actions to test and evaluate Ohio Power's compliance with Commission requirements relevant to the audit objectives:

- *Review of Public Information* – Reviewed publicly available materials to obtain a broad understanding of Ohio Power's corporate structure, regulatory actions and history, system infrastructure and operations, tariff procedures and services, wholesale energy transactions, transmission formula rate protocols and calculations, and other pertinent business and regulatory aspects. Also, reviewed information included in Ohio Power's FERC Form No. 1 and FERC Form No. 3-Q filings, Annual and Quarterly Reports, as well as prior Commission audit reports, and other relevant information in the Commission's eLibrary records system and on public web sites.

- *Collaboration with Commission Staff* – Conferred with Commission staff from other divisions within the Office of Enforcement, and with technical and legal staff from other Commission offices, including the Office of Energy Market Regulation (OEMR), who have knowledge and expertise about Ohio Power's transmission system and regulatory history. Also, discussed with Commission staff audit development and potential compliance issues to ensure audit report findings were consistent with Commission precedent and policy.

- *Regulatory Standards and Criteria* – Identified regulatory requirements, filings and criteria with which to evaluate Ohio Power's compliance with each audit objective. These requirements and filings included Attachment H-14 to PJM's OATT and related filings to understand Ohio Power's transmission formula rate

requirements. Also, reviewed Commission financial accounting and reporting requirements and other Commission orders relevant to the audit.

- *Data Collection and Data Requests* – Issued data requests, supplemental site visit informational requests, and numerous emails with questions and requests for clarification to obtain information to support compliance tests and evaluation of compliance. This information pertained to Ohio Power's corporate structure, policies and procedures, accounting systems and data, financial and reporting activity, transmission formula rate processes, procedures, and inputs, rate schedules and tariffs, internal audit, settlement agreements and contracts, FERC compliance program, and other pertinent information not publicly available. Audit staff used this information as the basis for compliance testing and evaluation.

- *Site Visits* – Conducted two site visits to Ohio Power for testing in audit scope areas. The visits enabled audit staff to understand Ohio Power's structure, activities, functions, systems, and the processes used in its operations. While on site, audit staff (i) interviewed those personnel with direct knowledge and involvement with activities in the audit scope areas about processes, procedures, operations, and preliminary observations; (ii) reviewed and discussed documented policies and procedures; and (iii) observed accounting system functionalities.

- *Interviews and Teleconferences* – Held an opening teleconference with Ohio Power to discuss audit objectives, scope, and process. Audit staff also held a closing teleconference about fieldwork completion and the extent of audit findings and recommendations. Audit staff conducted regular phone interviews and teleconferences with Ohio Power employees to clarify and understand Company policies, practices, and procedures relevant to the audit.

- *External Auditor Working Paper Review* – Reviewed Ohio Power's external audit working papers for Ohio Power's financial reporting in the FERC Form No. 1 and relevant accounting to substantiate audit staff's testing in these areas.

Audit staff performed the following reviews to evaluate Ohio Power's compliance with rate, accounting, and reporting requirements within this audit's scope:

Transmission Formula Rate

- *Formula Rate Schedules* – Reviewed Commission approved transmission formula rate schedules and tariff provisions in effect for Ohio Power as reported on page 106 of Ohio Power's FERC Form No. 1.

- *Commission Orders* – Reviewed initial and subsequent Commission orders accepting Ohio Power's transmission formula rate, including orders approving related settlements. Reviewed Commission orders for background information about specific cost treatments and unique inputs, and other matters disclosed as part of approving the derivation of Ohio Power's transmission formula rate.

- *Formula Rate Procedures* – Evaluated Ohio Power's processes, procedures, and controls used for preparing and reviewing annual and true-up informational filings and their supporting work papers. Reviewed transmission formula rate mechanics, such as annual informational filings, true-up informational filings, and summary report true-up informational filings associated with Ohio Power's transmission formula rate. Reviewed relevant provisions of PJM's OATT and its Attachment H-14 to determine the services rendered under the tariff.

- *Interviewed Responsible Employees* – Interviewed Ohio Power employees responsible for calculating the transmission formula rate and for providing data inputs into the rate. Assessed the level of oversight and controls to ensure complete and accurate transmission formula rate inputs.

- *Formula Rate Reconciliation* – Reconciled the transmission formula rate inputs to figures reported in the FERC Form No. 1. Evaluated the adequacy of disclosure for formula rate inputs not derived from the FERC Form No. 1.

- *Mathematical Accuracy* – Evaluated Ohio Power's mathematical accuracy of computations entered into the transmission formula rate to ensure all information was correctly entered. For example, audit staff reviewed supporting documentation for post-retirement other than pensions to verify amounts were correctly populated into the transmission formula rate template.

- *Formula and Input Analysis* – Reconciled the components of the approved rate formula to the corresponding calculations in the annual rate filings. Analyzed and assessed Ohio Power's compliance with Uniform System of Accounts and accounting treatment of select formula inputs. Reviewed the support behind allocation factors used in the transmission formula rate to ensure the correct amounts were used in the calculations.

Commission Accounting Regulations

- *Accounting Processes and Procedures* – Evaluated Ohio Power's financial accounting processes, procedures, and internal controls to assess compliance with Commission financial accounting regulations under 18 C.F.R. Part 101. Audit staff interviewed Ohio Power employees about accounting practices, reviewed

system processes for account assignments, and observed controls for achieving compliance with the Commission's accounting regulations.

- *Accounting Applications and Classifications* – Evaluated Ohio Power's chart of accounts used during the audit period to determine if it was consistent with the Commission's accounting regulations. Reviewed descriptions of accounting practices and tested examples for specific accounts in sample months against supporting material, and evaluated quality controls to ensure accounting classifications complied with the Commission's accounting regulations.

- *Accounting Systems* – Reviewed Ohio Power's financial accounting systems used to manage Company financial records, including the general ledger, work order system, expense system, billing system, and accounts payable system. Reviewed practices and procedures around the accounting cycle for charges, and the mapping of those charges to FERC accounts.

- *Project Tracking System* – Reviewed project tracking procedures for a project's life cycle, i.e., procurement, selection of cost allocators, tracking and billing of costs to affiliated companies, and system work order removal procedures.

- *Select Accounting Matters* – Tested select areas impacting the transmission formula rate to ensure the nature of costs recorded in those accounts complied with the Commission's accounting regulations. For example, audit staff performed select testing of these accounting matters:

    - *AFUDC* – Reviewed the Company's AFUDC rate calculation for consistent application with Electric Plant Instruction No. 3. Validated Ohio Power's methodology for determining the annual AFUDC rate to ensure it was based upon its own debt and equity book balances and to ensure the short term debt rate variance did not exceed 25 basis points. Reviewed work orders to confirm that the Company ceased accruing AFUDC upon in-service dates, periods of suspension, and abandonment. Examined the construction base component of its AFUDC accrual calculation to ensure it included amounts relating to construction activities.

    - *Revenue* – Reviewed accounting for revenues and revenue credits in the formula rate. Specifically, analyzed amounts included in Worksheet E of the formula rate identified as transmission and non-transmission revenues and reviewed for accuracy revenue credits reducing the transmission formula rate revenue requirement.

    - *Accounts Receivables Factoring and Servicing* – Reviewed Ohio Power's sales of receivables process. Analyzed whether the accounting for the sales

of receivables was in accordance with Opinion No. 375 and the USofA. Assessed the accounting of costs associated with servicing sold accounts receivables to determine compliance with the Commission's regulations.

FERC Form No. 1 Reporting Requirements

- *Reporting Processes and Procedures* – Evaluated Ohio Power's financial reporting processes, procedures, and quality controls used to prepare FERC Form No. 1 and comply with Commission regulations in Part 141.

- *Financial Reporting Instructions* – Evaluated Ohio Power's financial reporting to determine whether it complied with FERC Form No. 1 reporting.

- *Financial Statement Account Balances* – Reconciled select account balances reported in FERC Form No. 1 to Ohio Power's books and records. To facilitate this review, audit staff reviewed selected transactions to confirm the balances.

- *Account Variance Analysis* – Performed variance analyses for accounts reported in FERC Form No. 1 with large balances, unusual activity, and significant fluctuations.

- *Notes to Financial Statements* – Reviewed the Notes to Financial Statements of FERC Form No. 1 for significant accounting matters and followed up on these matters to understand financial statement and transmission formula rate implications.

IV. Findings and Recommendations

1. Revenue Credits

Ohio Power understated its revenue credits that are used to reduce the revenue requirement of its transmission formula rate by improperly excluding certain transmission-related revenues – specifically pole attachment revenue, causing an overstatement of its revenue requirement. This overstatement resulted in excess billings to wholesale transmission customers.

Pertinent Guidance

- Ohio Power's transmission formula rate, as provided in Attachment H-14 of the PJM OATT, provides guidance for transmission revenue credits. Specifically, Attachment H-14, Transmission Cost of Service Formula Rate, Notes, Item A, states:

  Revenue credits include:
  1) Forfeited Discounts.
  2) Miscellaneous Service Revenues.
  3) Rental revenues earned on assets included in the rate base.
  4) Revenues for associated business projects provided by employees whose labor and overhead costs are in the transmission cost of service.
  5) Other electric revenues.
  6) Revenues for grandfathered PTP contracts included in the load divisor.

Background

Audit staff reviewed Ohio Power's transmission formula rate as provided in Attachment H-14 of the PJM OATT. Ohio Power's transmission formula rate in Attachment H-14 includes Worksheet E, Supporting Revenue Credits, which identifies select operating revenues that, if transmission-related, serve as revenue credits used to reduce the annual transmission revenue requirement.

Specifically, Worksheet E identifies the following items as revenue credits:

Line No.	Description
1	Account 450, Forfeited Discounts
2	Account 451, Miscellaneous Service Revenues
3	Account 454, Rent from Electric Property
4	Account 4560015, Associated Business Development
5	Account 456, Other Electric Revenues
6	Accounts 4470004 and 4470005, Grandfathered Transmission Contracts

Ohio Power determined the revenue credits to include in the formula rate based on its functional categorization of revenue. Specifically, Ohio Power analyzed each revenue account, and identified revenues as transmission-related based on whether revenue was derived from Ohio Power's transmission business unit. Only the amounts that were derived from Ohio Power's transmission business unit were captured as revenue credits to reduce its annual transmission revenue requirement.

Audit staff found that Ohio Power earned pole attachment revenue stemming from the Public Utilities Commission of Ohio (PUCO) mandating that Ohio Power grant access for pole attachments for non-utility items such as telecommunication lines. Ohio Power's transmission formula rate requires rents from transmission-related electric property included in rate base to be included in the transmission formula rate and reduce the revenue requirement through revenue credits. However, in its review of Ohio Power's accounting, audit staff identified transmission-related revenues recorded in Account 454, Rent from Electric Property, that were improperly omitted from revenue credit amounts. Specifically, audit staff identified pole attachment revenues related to transmission pole assets that were recorded in Account 454, which should have been included as revenue credits.[3] Ohio Power considered all pole attachment revenues that

[3] For example, in *PJM Interconnection, L.L.C.*, 155 FERC ¶ 61,097, at P 155 (2016), *order on reh'g and compliance filing*, 158 FERC ¶ 61,060 (2017), the Commission stated:

> Since the Project facilities will ultimately be paid for by customers in their transmission rates, we find that the customers should benefit from any other rents generated by those Project facilities [in addition to other facility revenues received from PJM]. We direct NTD in its compliance filing to change Note A to include as a revenue credit all various rents it might receive from the use of the Project's poles, towers, etc.

were derived from rents from electric transmission property as distribution-related, which prevented the reduction of the revenue requirement for transmission formula rate customers.[4] For example, in 2015, Ohio Power recorded approximately $18 million as pole attachment revenues in Account 454 but did not identify any of these revenues as transmission-related. Ohio Power later determined that approximately $254,000 of the 2015 pole attachment revenues were, in fact, transmission-related and should be included as a revenue credit. Ohio Power committed to perform further review to identify additional transmission pole attachment revenues that should have been reported as a revenue credit on Worksheet E during the audit period.

Recommendations

We recommend that Ohio Power:

1. Develop and implement policies, procedures, and controls over the preparation and review of Worksheet E to ensure revenue credit amounts are calculated and reflected accurately in the transmission formula rate.

2. Train employees to ensure they fully understand the reporting requirements for Worksheet E and the importance of this information in determining the revenue credits provided to customers in the transmission formula rate.

3. Perform a review of all pole attachment agreements, identify the specific assets with pole attachments, and ensure that revenues are properly classified based on the functional classification of each asset, which drives the business unit/function where the associated pole attachment revenue is captured. Provide the results of this review to DAA.

4. Make correcting entries to reclassify pole attachment revenue to the proper business units and identify appropriate revenue credits.

[4] *See Idaho Power Co.*, 42 FERC ¶ 61,349, at *5 (1988) (affirming the finding that there was inadequate support for Idaho Power's "functionalization to distribution of rents for transformers and pole attachments").

5. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amount of revenue credits that were inappropriately excluded in transmission formula rates, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) refunds will be made.

6. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

7. Refund amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

2. Customer Funded Capital Projects

Ohio Power did not properly return amounts collected in transmission rates in excess of its total investment on certain customer funded projects.

Pertinent Guidance

- 18 C.F.R. Part 101, Electric Plant Instruction No. 2 (D), Electric Plant To Be Recorded at Cost, states:

> The electric plant accounts shall not include the cost or other value of electric plant contributed to the company. Contributions in the form of money or its equivalent toward the construction of electric plant shall be credited to accounts charged with the cost of such construction. Plant constructed from contributions of cash or its equivalent shall be shown as a reduction to gross plant constructed when assembling cost data in work orders for posting to plant ledgers of accounts. The accumulated gross costs of plant accumulated in the work order shall be recorded as a debit in the plant ledger of accounts along with the related amount of contributions concurrently be [sic] recorded as a credit.

Background

Audit staff reviewed Ohio Power's processes, procedures, and accounting for customer funded capital projects. Typically, customer funded projects are projects where a third party requests Ohio Power to perform work such as moving transmission poles, relocating certain facilities, or constructing new facilities. Audit staff found that for some customer funded projects, the third party requesting the project paid all of its contribution up front as contributions in aid of construction (CIAC) before any construction was performed. For other customer funded projects, there were multiple contribution payments based on project milestones or at certain dates. There were also some customer funded projects where the third party provided the contributions at the end of the project after the assets had been placed in service.

If both Ohio Power and the third party agree to the cost estimate for the customer funded project, the third party will provide a letter of commitment outlining what they agree to contribute for the work to be performed and the terms of the agreement. Ohio Power employees then create work orders upon agreement, and construction will begin. Customer funded project costs are accumulated in work orders in the same way as other project costs, with the only additional step being a credit to the work orders when the customer is billed for the reimbursable amount. When the customer funded project

commences, the charges are accumulated in construction work orders mapped to Account 107, Construction Work in Progress. While costs are incurred, AFUDC is accrued in the work orders. Once the facilities are constructed, placed in service, and being used for their intended purpose, the costs accumulated in the work orders, net of reimbursements already received, are transferred from Account 107 to Account 106 and ultimately unitized to Account 101. Also at this time, Ohio Power records the related depreciation expense in Account 403 and accumulated depreciation in Account 108. The balances in Accounts 101 and 108 are included in rate base and the balance in Account 403 is included in the revenue requirement of Ohio Power's transmission formula rate.

As a result of its review, audit staff noted that Ohio Power recovered, through depreciation expense, certain customer funded projects through its transmission formula rate prior to it receiving final reimbursements from the third parties for the projects. Audit staff found that Ohio Power subsequently received full reimbursement for certain projects for which it had already recovered a portion of costs through depreciation expense. As a result, Ohio Power recovered more than the cost of its investment related to such customer funded projects. Ohio Power did not return the excess amount recovered through depreciation expense to transmission customers. Audit staff believes that it is contrary to Commission policy on contributions for Ohio Power to retain amounts collected from transmission customers for projects fully reimbursable from another party. Ohio Power should return these amounts to transmission customers and make sure to accurately return any over recoveries to customers for future customer funded projects. Audit staff has concerns about whether it is appropriate to include in rate base amounts for which a third party has contractually committed to reimburse Ohio Power, i.e., to include such amounts in rate base, accumulate depreciation related to such amounts, and recover the depreciation expense when those costs are ultimately reimbursed fully by a third party. Cost-of-service ratemaking allows companies to recover investment in utility property. However, reimbursements from a third party are outside of Ohio Power's own investment, and Ohio Power must refund any over-recovered amounts associated with those reimbursements.[5]

[5] Including in rate base amounts expended by a public utility but for which a third-party has contractually obligated itself to fully repay – that is, has contractually obligated itself to make a CIAC – virtually guarantees that the public utility will collect excess depreciation expense on such amounts, as occurred in the present case, which will need to be backed out and refunded to customers when the CIAC is received. Including amounts in rate base for which a third party is contractually obligated to pay with a CIAC conflicts with the Commission's goal, when it eliminated a separate CIAC account from its Uniform System of Accounts in Order No. 490, of preventing customers from paying, through depreciation, " a recovery of investment not belonging to stockholders":

> We are convinced that the need to eliminate Account 271, Contributions in Aid of Construction, from the systems of

Recommendations

We recommend that Ohio Power:

8. Revise accounting procedures to ensure excess costs recovered related to customer funded projects are returned to ratepayers.

9. Submit correcting journal entries, within 60 days of receiving the final audit report, to DAA related to excess recovery associated with customer funded projects. Provide supporting documentation for the amounts of over recovery from 2012 through 2017.

10. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA that explains and details the following: (1) calculation of refunds to wholesale customers since 2012, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

11. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

12. Refund amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

> accounts is warranted . . . . Since the CIAC represents construction and property acquisition at no cost to the company it does not seem equitable that customers should pay, as now allowed through depreciation, a recovery of investment not belonging to stockholders.

Amendments to the Uniform System of Accounts for Public Utilities and Licensees and Natural Gas Companies (All Classes) and to Related Report Forms Concerning Contributions In Aid of Construction, Order No. 490, 50 F.P.C. 540, at 541, *reconsideration denied*, 50 F.P.C. 1020 (1973). Placing such amounts in rate base prior to receiving the related contractually-required CIAC thus inappropriately results in the "recovery of investment" relating to a CIAC, in conflict with the foregoing policy, and in conflict with the Commission's intent that there be no depreciation allowed with respect to such customer contributions: "In the regulated industries, contributions are treated as consumer donated capital on which there is no return allowed to stockholders, and on which we now believe no depreciation should be allowed." *Id.* at 542.

3. Sales of Accounts Receivable

Ohio Power misclassified non-operating expenses related to its servicing of accounts receivables, which were sold on a non-recourse basis, as operating expenses recorded in Account 903, Customer Records and Collection Expenses. Ohio Power should have recorded these non-operating expenses in Account 426.5, Other Deductions, instead.

Pertinent Guidance

- Opinion No. 375, 60 FERC 61,131 (1992) states, in part:

  We therefore agree with the staff that the proper account for recording the loss [associated with SERI's sale of accounts receivable] is Account 426.5, "Other Deductions." It follows that it was therefore improper for SERI to record the loss in Account 930.2 and thereby attempt to recover it through operation of the formula rate. [6]

- 18 C.F.R. Part 101, Account 426.5, Other Deductions, states, in part:

  This account shall include other miscellaneous expenses which are nonoperating in nature, but which are properly deductible before determining total income before interest charges.

- *Duke Energy Carolinas, LLC*, 156 FERC ¶ 61,201, at P 40 (2016), states, in part:

  Accounts receivable sales without recourse are therefore treated as a sale of assets . . . .[7]

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[6] *See System Energy Resources, Inc.*, Opinion No. 375, 60 FERC ¶ 61,131, at 61,480-81 (1992). Expenses recorded in Account 930.2 are considered utility operating expenses and are included in rates as part of cost-of-service. Expenses recorded in Account 426.5 are non-utility expenses and therefore are generally not included in cost-of-service rates. *Duke Energy Carolinas, LLC*, 156 FERC ¶ 61,201, at P 6 n. 20 (2016).

[7] In *Duke Energy Carolinas, LLC*, the Commission stated that "none of the Items [in Account 903] apply to Duke Companies' receivables that are sold without recourse." 156 FERC ¶ 61,201 at P 43 n.83. The Commission rejected the Duke Companies' proposal to record the Service Fee Percentage, representing "collection expenses," in Account 903, even after the Duke Companies pointed out that such expenses would be partially offset by the fee they collected under their separate service agreements with the receivables buyer. The Commission stated: "we are not persuaded by Duke Companies' contention that the actual servicing costs they incur, pursuant to the separate Service

Background

Ohio Power sold accounts receivables to AEP Credit at a discount, which allowed Ohio Power to collect its money on the same day that Ohio Power delivered utility service. AEP Credit, which is a wholly-owned subsidiary of AEP, was formed for the purpose of providing a low-cost financing source for AEP's public utilities through the selling of utility accounts receivables. These sales of receivables were governed by both a purchasing agreement and an agency agreement between Ohio Power and AEP Credit.

When accounts receivables were sold, they were sold "without recourse." A "without recourse" arrangement is one where the seller (Ohio Power) will have no obligation to the buyer (AEP Credit) with respect to the receivables sold if the buyer does not collect fully. Therefore, accounts receivables sales without recourse were treated as a sale of assets.[8]

The purchasing agreement authorized Ohio Power to sell, without recourse, certain outstanding receivables. The purchasing agreement also stipulated that Ohio Power and AEP Credit agreed that each sale of outstanding receivables constituted a true sale of all rights, title, and interest to such outstanding receivables. These receivables resulted from the sale of electricity and other related services that occurred in Ohio Power's ordinary course of business. Ohio Power received the face dollar amount of the receivables sold less a discount, which included items like carrying cost charge, collection experience charge, agency fee collected, and bank fees.

Agreements and subsequent to the receivables sale, should enable them to record a portion of the accounts receivable discount as a collection expense." *Id.* PP 42-43. The Commission reasoned that, "when selling accounts receivable and recognizing the discount on those sales, Duke Companies have not actually incurred any servicing costs, such as payroll expense, etc., related to collecting unpaid balances. Any servicing costs associated with the accounts receivable (discounted or not) will not occur until after the sale." *Id.* P 43. The Commission thus described Duke Companies' servicing costs as future servicing costs.

[8] *Id.* P 39-40. In contrast, in a sale of accounts receivables, with recourse, the utility remains at risk because it is responsible to the buyer for the full amount of the accounts receivable, either through payments to the buyer by the customer, or by the utility when the amounts due cannot be collected from the customer. Under this arrangement, any cost incurred by the utility associated with the sales of its accounts receivable is truly to accelerate the receipt of cash and is similar in nature to collateralized financing.

The agency agreement authorized Ohio Power, acting as the buyer's (AEP Credit's) agent, to service the receivables sold to AEP Credit on behalf of AEP Credit. The agreement stipulated that Ohio Power received an agent collection fee equal to two percent of the net dollar amount of collections that Ohio Power remits to AEP Credit. Additionally, the agreement stated that payment of the agent collection fee will be made contemporaneously with collections by deducting the fee from funds owed to AEP Credit for receivables collected. Also, the agency agreement noted that Ohio Power will collect all amounts associated with the sales of customer accounts receivables at its full cost and expense.

In reviewing the related accounting for these sales of receivables activities, audit staff reviewed the accounting for the discount components to determine compliance with Opinion No. 375 and Commission accounting regulations. Audit staff determined that Ohio Power appropriately recorded the discount components in Account 426.5, Other Deductions, which is consistent with Opinion No. 375.

Audit staff also reviewed Ohio Power's accounting for the labor expenses associated with the servicing of these receivables. Audit staff determined that Ohio Power recorded these labor expenses in Account 903, Customer Records and Collection Expenses, for collection and accounting activities for all accounts receivables sold to AEP Credit. However, these sales of accounts receivables resulted in a true sale of assets due to the sale agreement being "without recourse," and the costs of collecting the receivables were not considered part of Ohio Power's utility operations because the collections were done under a separate agency agreement that takes place after the sale of assets. The Commission addressed this matter in Opinion No. 375, and again in *Duke Energy Carolinas, LLC*, and determined that this activity is non-operating in nature.[9] Therefore, the labor activities related to the collection of accounts receivables sold without recourse were considered non-operating and not part of Ohio Power's utility operations. Accordingly, these collection and accounting activities must be recorded in Account 426.5, Other Deductions.

Audit staff notes that Account 903 was included within the customer-related expenses line item of Ohio Power's transmission formula rate. While Account 903 was not directly included as part of the annual transmission revenue requirement, the balance in Account 903 did factor into the wages and salaries allocator used to calculate the annual transmission revenue requirement.

[9] *Sys. Energy Resources*, 60 FERC ¶ 61,131 at 61,480-81; *Duke Energy Carolinas, LLC*, 156 FERC ¶ 61,201 at PP 42-43.

Recommendations

We recommend that Ohio Power:

13. Revise its procedures to ensure that all costs and account balances associated with the servicing of sold accounts receivables are accounted for in accordance with Commission accounting regulations. The corrected accounting should ensure that the costs are recorded in Account 426.5.

14. Provide the revised procedures to DAA for review within 60 days of receiving the final audit report.

15. Submit correcting journal entries to DAA within 60 days of receiving the final audit report.

4. FERC Form No. 1 Reporting

Ohio Power did not report certain required information on select pages of its FERC Form No. 1. This reduced the transparency and usefulness of the information provided in the FERC Form No. 1.

Pertinent Guidance

- 18 C.F.R § 141.1 (b) (2) (iii), FERC Form No. 1, Annual report of Major electric utilities, licensees and others, states:

  This report must be filed with the Federal Energy Regulatory Commission as prescribed in § 385.2011 of this chapter and as indicated in the General Instructions set out in this form, and must be properly completed and verified. Filing on electronic media pursuant to § 385.2011 of this chapter is required.

Background

Ohio Power is required to report financial and operational information on an annual basis in the FERC Form No. 1 in accordance with the instructions of the report. During fieldwork, audit staff reviewed Ohio Power's 2015-2017 FERC Form No. 1 and evaluated whether Ohio Power properly followed the requirements and instructions for populating and reporting the form. This review entailed a detailed analysis of each page in the FERC Form No. 1, focused on ensuring that the correct information was reported on the appropriate pages in accordance with the page instructions.

During this review, audit staff found several instances where Ohio Power did not accurately report the required information in its FERC Form No. 1 consistent with the form's instructions. The table below indicates Ohio Power's reporting errors and the locations of the errors in the 2015-2017 FERC Form No. 1. All reporting errors are for 2015-2017 except for item A, Page 232.1, Column (d), which is only for 2015 and 2016 and item A, Page 232.2, Column (d), which is only for 2015 and 2017.

Ref	Schedule(s)	Page(s)	Reporting Error
A.	Other Regulatory Assets	Page 232, Column (d), Page 232.1, Column (d), Page 232.2, Column (d)	Specific Accounts Credited not provided
B.	Miscellaneous Deferred Debits	Page 233, Column (d)	Specific Accounts Credited not provided

Ref	Schedule(s)	Page(s)	Reporting Error
C.	Accumulated Deferred Income Taxes	Page 234, Footnote Debits (c) and Credits (d)	Footnote data for Accounts Debited (c) & Credited (d) was not disclosed
D.	Other Deferred Credits	Page 269, Column (c)	Debit account charged not provided
E.	Accumulated Deferred Income Taxes-Other Property	Page 275, Columns (g) and (i)	Account Credited and Account Debited not provided
F	Accumulated Deferred Income Taxes-Other	Page 277, Columns (g) and (i)	Account Credited and Account Debited not provided
G.	Other Regulatory Liabilities	Page 278, Column (c)	Specific Accounts Credited not provided
H.	Other Regulatory Liabilities	Page 278.1, Column (c)	Account Credited not provided

Recommendations

We recommend that Ohio Power:

16. Revise and strengthen its documented policies, procedures, and practices to help ensure all schedule instructions are followed and all information is accurately reported in the FERC Form No. 1.

17. Provide training to staff on the revised FERC Form No. 1 policies, procedures, and practices. Also, develop a training program that supports the provision of periodic training in this area.

V. Other Matter

1. Accounting for Plant in Service

Ohio Power should strengthen its policies and procedures to improve its accounting practices for work orders associated with construction projects that have been placed in service and ensure that these construction work orders are transferred to appropriate plant in service accounts in a timely manner.

Background

Audit staff reviewed Ohio Power's construction process during the audit period. Ohio Power's construction process starts with identifying and budgeting for their construction needs. The corporate planning and budgeting department receives and approves all projects. After the approval of a project, the budgeting department opens a project code to track all work orders under the approved project. As part of this process, project managers create work orders and request approval from the accounting department. Once the accounting department approves a work order, interested individuals are notified to begin charging costs applicable to the work order. Work order costs are accumulated in Account 107 while the project is in construction. Once the facilities are constructed, placed in service, and being used for their intended purpose, the costs accumulated in the work orders are transferred from Account 107 to Account 106 and ultimately unitized to Account 101.

Per 18 C.F.R. Part 101, Account 107, Construction work in progress, "[t]his account shall include the total of the balances of work orders for electric plant in process of construction. Work orders shall be cleared from this account as soon as practicable after completion of the job." Therefore, when an asset is placed in service, the associated project work orders should be cleared from Account 107 in a timely manner so that only costs of construction work that is in progress are in Account 107, and costs associated with plant in service are in the appropriate plant in service account.

During its review, audit staff identified late in-service adjustments, which were adjustments Ohio Power made to appropriately account for late in-service work orders. These adjustments were necessary because certain assets were placed in service without the related work orders being transferred from Account 107 to the appropriate account for utility in-service. For example, in 2015, Ohio Power made approximately 300 late in-service adjustments, totaling over $850,000. Over half of those adjustments affected amounts reported to depreciation and accumulated deferred income tax (ADIT) accounts for multiple annual reporting periods. The gap between when the assets were placed in service and when the late in-service adjustment was identified spanned from 2 to 25 months, which is a significant amount of time and can affect amounts reported in plant in

service and ADIT accounts and affect the transmission formula rate. Based on this observation, audit staff determined that Ohio Power should improve its procedures to clear work orders from Account 107 in a timely manner.

Audit staff obtained and reviewed the late in-service entries for five selections to verify that the adjustments identified were actually booked. The assets selected to test were placed in service 6 to 19 months late. Based on audit staff's review, Ohio Power accurately updated depreciation and ADIT amounts and reversed the related AFUDC accruals in the adjustments based on the period the assets were placed in service. However, these adjustments did not appear to be accounted for "as soon as practicable" based on the requirement for Account 107, causing the inputs to the transmission formula rate not to be updated timely.

Ohio Power has notified audit staff that they plan to implement new controls to help improve this process and better identify, in a timely manner, work orders associated with projects that have been placed in service. During the audit period, Ohio Power performed its reviews on a quarterly basis, and Ohio Power indicated this will be changed to monthly reviews. Audit staff will work with Ohio Power to ensure that these controls are properly implemented and work order costs are transferred to plant in service accounts as soon as practicable after the associated projects are completed and placed in service.

Recommendations

We recommend that Ohio Power:

18. Revise and strengthen policies and procedures to improve its accounting practices for plant in service and ensure that work order expenses associated with projects that have been placed in service are transferred to appropriate plant in service accounts in a timely manner.

VI. Ohio Power Company's Response to the Draft Audit Report



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August 29, 2019

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Division of Audits and Accounting
Office of Enforcement
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888 First Street, N.E., Room 5K-13
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Via E-mail: Steven.Hunt@ferc.gov

Re: Docket No. FA17-2-000, Draft Audit Report

Dear Mr. Hunt,

On August 14, 2019, American Electric Power Service Corporation ("AEPSC") received the Draft Audit Report issued in the above-referenced docket. The Draft Audit Report contains four findings, 18 recommendations, and one other matter. Pursuant to Section 41.1(b) of the Commission's regulations and consistent with your request, AEPSC is hereby responding to the Draft Audit Report on behalf of Ohio Power Company ("Ohio Power") as follows:

Findings:

1. Revenue Credits

   Ohio Power accepts this finding and the related recommendations.

2. Customer Funded Capital Projects

   Ohio Power accepts this finding and the related recommendations.

3. Sales of Accounts Receivable

   It is Ohio Power's position that this finding overlooks important policy considerations, including benefits to customers in the form of lower financing costs,

that should inform the proper accounting of related expenses. Nonetheless, Ohio Power accepts this finding and the related recommendations.

4. FERC Form No. 1 Reporting

Ohio Power accepts this finding and the related recommendations.

Other Matter:

1. Accounting for Plant in Service

Ohio Power accepts the recommendation on this matter.

As requested at pages 5-6 of the Draft Audit Report, Ohio Power will submit within 30 days of the issuance of the final audit report a plan for implementing the audit recommendations. Ohio Power also will make quarterly reports of its progress in completing each corrective action and provide copies of any written policies and procedures developed in response to the recommendations.

Sincerely,

s/ Jessica A. Cano

Jessica A. Cano
Senior Counsel
American Electric Power
Service Corporation