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FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA17-1-000

April 23, 2019

American Electric Power Company, Inc.
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 American Electric Power Company, Inc. (AEP), including its service company and other affiliates in the AEP holding company system (collectively the companies). The audit covered the period from January 1, 2013 through August 31, 2018.

2. The audit evaluated AEP's compliance with: (1) cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35; (2) accounting, recordkeeping, and reporting requirements under 18 C.F.R. Part 366; (3) Uniform System of Accounts (USofA) for centralized service companies under 18 C.F.R. Part 367; (4) preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368; and (5) FERC Form No. 60 Annual Report requirements under 18 C.F.R. Part 369. The audit also evaluated the associated public utilities' transactions with affiliated companies for compliance with the Commission's accounting requirements under 18 C.F.R. Part 101, the applicable reporting requirements in the FERC Form No. 1 under 18 C.F.R. Part 141, and jurisdictional rates on file. The enclosed audit report contains 4 findings and 22 recommendations that require AEP to take corrective action.

3. On April 5, 2019, you notified DAA that AEP accepts all 4 findings and 22 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.

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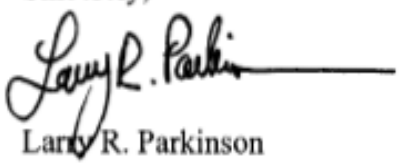
4. AEP should submit its implementation plan to comply with the recommendations within 30 days of this letter order. AEP should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the 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. AEP 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

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

AUDIT REPORT

Audit of American Electric Power Company, Inc.'s Compliance with:

- Cross-Subsidization Restrictions on Affiliate Transactions;
- Regulations Under the Public Utility Holding Company Act of 2005;
- Uniform System of Accounts for Public Utilities' Accounting for Service Company Billings;
- Preservation of Records Requirements for Holding Companies and Service Companies;
- FERC Form No. 60 Reporting Requirements; and
- FERC Form No. 1 Reporting Requirements, Accounting Requirements and Tariff Rate Provisions for Public Utilities' Transactions with Affiliated Companies.

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I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (Commission) has completed the audit of American Electric Power Company, Inc. (AEP), including its service company and other affiliates in the AEP holding company system (collectively the companies). The purpose of the audit was to evaluate AEP's compliance with the Commission's:
(1) cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35;
(2) accounting, recordkeeping, and reporting requirements under 18 C.F.R. Part 366;
(3) Uniform System of Accounts (USofA) for centralized service companies under 18 C.F.R. Part 367; (4) preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368; and (5) FERC Form No. 60 Annual Report requirements under 18 C.F.R. Part 369. The audit also evaluated the associated public utilities' transactions with affiliated companies for compliance with the Commission's accounting requirements under 18 C.F.R. Part 101, the applicable reporting requirements in the FERC Form No. 1 under 18 C.F.R. Part 141, and jurisdictional rates on file. The audit covered the period January 1, 2013 through August 31, 2018.

B. American Electric Power Company, Inc.

AEP is a public utility holding company based in Columbus, OH, which directly or indirectly owns some or all of the outstanding common stock of its jurisdictional utility and non-utility subsidiaries. Specifically, AEP has one centralized service company subsidiary, American Electric Power Service Corporation (AEPSC), and 24 jurisdictional subsidiaries and multiple non-jurisdictional companies.[1] AEP jurisdictional utilities are

[1] The AEP jurisdictional utilities include:

In PJM: Appalachian Power Company; Indiana Michigan Power Company; Kentucky Power Company; Kingsport Power Company; Ohio Power Company; Wheeling Power Company; AEP Appalachian Transmission Company, Inc.; AEP Indiana Michigan Transmission Company, Inc.; AEP Kentucky Transmission Company, Inc.; AEP Ohio Transmission Company, Inc.; AEP West Virginia Transmission Company, Inc.; PATH West Virginia Transmission Company, LLC; Indiana-Kentucky Electric Corporation; Ohio Valley Electric Corporation; AEP Generating Company; Transource West Virginia, LLC; Transource Maryland, LLC; and Transource Pennsylvania, LLC.

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members of two regional transmission organizations, PJM Interconnection, LLC (PJM) and Southwest Power Pool, Inc. (SPP), and one Independent System Operator, Energy Reliability Council of Texas (ERCOT). Collectively, AEP owns and operates approximately 26,000 megawatts of generation capacity, 40,000 miles of transmission lines, and 224,000 miles of distribution lines.

C. Summary of Compliance Findings

Below is a summary of audit staff's compliance findings. Audit staff identified four areas of noncompliance. Section IV details these compliance findings as a result of this audit.

- *Allowance for Funds Used During Construction (AFUDC)* – Certain AEP jurisdictional utilities' method for computing Allowance for Funds Used During Construction (AFUDC) improperly included Account 219, Accumulated Other Comprehensive Income, in the equity component of the formula and improperly determined the AFUDC rate on a monthly basis. As a result, three jurisdictional utilities over accrued AFUDC on transmission plant by approximately $6.1 million from 2012 through 2017. The three jurisdictional utilities overbilled wholesale transmission customers for the excessive AFUDC costs included in utility plant that was included in transmission formula rates.

- *Merger-Related Cost* – AEP jurisdictional utilities improperly included approximately $295,000 of merger-related capital costs in transmission formula rate determinations without first making a compliance filing under section 205 of the Federal Power Act. As a result, wholesale transmission customers were overbilled due to the inclusion of merger costs.

- *Accounting for Charitable Contributions and Penalties* – AEPSC improperly recorded charitable contributions and penalties in various administrative and

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In SPP: Public Service Company of Oklahoma; Southwestern Electric Power Company; AEP Oklahoma Transmission Company, Inc.; AEP Southwestern Transmission Company, Inc.; and Transource Missouri, LLC.

In ERCOT: AEP Texas, Inc.

The non-jurisdictional subsidiaries include, but are not limited to: AEP Coal, Inc.; AEP Credit, Inc.; AEP Energy Supply, LLC; and IMT Land Corp.

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general, and operation and maintenance expense accounts, instead of using the appropriate non-operating expense accounts. In addition, AEPSC allocated and billed these costs to the jurisdictional utilities, and these utilities then misclassified and misreported these costs in their FERC Form No. 1 filings. These amounts were included in the jurisdictional utilities' formula rate mechanisms. As a result, the improper accounting for charitable contributions and penalties amounts led to overbillings to wholesale transmission customers.

- *Accounting for Administrative and General Expenses* – AEPSC misclassified various administrative and general labor, membership dues, outside services, and advertising expenses among various administrative and general expense accounts. In addition, AEPSC allocated and billed these costs to the jurisdictional utilities, and these utilities then misclassified these costs in their FERC Form No. 1 filings. As a result, the improper accounting for certain administrative and general expenses led to overbillings to wholesale transmission customers through the jurisdictional utilities' formula rate mechanisms.

D. Summary of Recommendations and Corrective Actions Taken

Below is a summary of audit staff's recommendations to remedy the findings in this report. Detailed recommendations are in Sections IV. Audit staff recommends AEP:

Allowance for Funds Used During Construction

1. Revise and/or implement procedures to ensure its jurisdictional utilities' AFUDC rate calculations are consistent with Order Nos. 561 and 561-A, EPI 3(A)(17), and other applicable Commission requirements.

2. Revise its procedures to ensure that Account 219 is excluded from the equity components used to derive AFUDC rates.

3. Provide training to staff on the revised procedures implemented under recommendations 1 and 2. Provide periodic training in these areas as needed.

4. Adjust plant in service, accumulated depreciation, accumulated deferred income tax, and other affected accounts to remove the over accrual of AFUDC for the periods affected and included in each jurisdictional utility's calculation.

5. Submit correcting journal entries related to the calculation of AFUDC for all the affected AEP jurisdictional utilities to DAA within 60 days of receiving the final audit report. Provide supporting documentation for the amounts of AFUDC over accrued in 2012 through 2018.

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6. 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 2013, plus interest; (2) determinative components of the refund; (3) refund method; (4) refund amount; and (5) period(s) in which refunds will be made.

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

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

Merger-Related Costs

9. Establish, implement and/or update policies and procedures to ensure AEP jurisdictional utilities accurately exclude merger-related costs from their annual formula rate updates, as required by the hold harmless provisions in the Commission's merger orders.

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 and the amount of improper recoveries that resulted from the inclusion of merger transactions in wholesale power and transmission formula rates during the audit period, plus interest on the costs; (2) determinative components of the refund; (3) refund method; and (4) 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 power and transmission customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Accounting for Charitable Contributions and Penalties

13. Strengthen procedures to record all charitable contributions and penalties in Accounts 426.1, Donations; 426.3, Penalties; and 426.5, Other Deductions.

14. Provide training to staff on the importance of recording charitable contributions and penalties in below the line accounts for regulatory accounting and rate development. Provide periodic training in this area as needed.

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15. Submit a refund analysis, for the jurisdictional utilities within 60 days of receiving the final audit report, to DAA that explains and details the following: (1) calculation of refunds and the amount of improper cost of charitable contributions and penalties recovered that resulted from amounts included in the formula rates since 2013, plus interest; (2) determinative components of the refund; (3) refund method; and (4) period(s) in which refunds will be made.

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

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

Accounting for Administrative and General Expenses

18. Revise procedures to ensure that AEPSC properly accounts for all items reported in its FERC Form No. 60 in accordance with the USofA 18 C.F.R. Part 367.

19. Provide training to staff on the importance of recording administrative and general expenses in the accounts prescribed by the Commission accounting regulations and regulatory rate development. Provide periodic training in this area, as needed.

20. Submit a refund analysis, for the jurisdictional utilities within 60 days of receiving the final audit report, to DAA that explains and details the following: (1) calculation of refunds and the amount of improper administrative and general expenses recovered that resulted from amounts included in the formula rates since 2013, plus interest; (2) determinative components of the refund; (3) refund method; and (4) period(s) in which refunds will be made.

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

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

E. Compliance and Implementation of Recommendations

Audit staff further recommends that AEP submit for audit staff review the following:

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

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- Quarterly reports to DAA describing AEP's progress in completing each corrective action recommended in the final audit report. AEP should make these nonpublic quarterly filings 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 AEP completes 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 following their completion.

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II. Background

A. American Electric Power Service Corporation

AEPSC is a centralized service company that provides support services to both affiliated and non-affiliated companies at cost.[2] The services 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 also provides operation and maintenance and construction services to its affiliated jurisdictional public utilities. AEPSC recovers its costs of providing support services to the affiliated and non-affiliated companies through monthly billings. The affiliated and non-affiliated companies are directly billed or allocated a portion of AEPSC's costs of providing services based on the benefit(s) the companies derive from such services.

B. AEPSC Cost Accumulation and Allocation

AEPSC accounts for all transactions through a work order system. Expenditures for support services (operation and maintenance and administrative and general expenses) and construction services are accumulated in work orders. AEPSC's work orders include work orders for construction and plant retirement activities, research and development, IT projects, non-regulated activities, and other special projects. The work orders are set up to accumulate all costs of a specific project, and those costs are billed to the companies benefiting from the service.

The costs for services benefiting only one company are directly assigned and are billed 100 percent to that company. AEPSC employees directly assign costs on time and expense reports to the maximum extent practicable to the project for which they provided services. Certain costs, however, are incurred for services that benefit more than one company. When this occurs, the costs are allocated to the benefiting companies using allocation factors. The allocation factors equitably distribute costs that benefit multiple companies and are based on statistics such as number of customers, number of transmission pole miles, number of employees, etc. The allocation factor for any given cost is selected for use because it best reflects the cost driver associated with the services provided.

[2] AEPSC provides services at cost to two non-affiliated entities: Indiana Kentucky Electric Company and Ohio Valley Electric Company.

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AEPSC's total service costs incurred and billed to both affiliated and non-affiliated companies from 2014 through 2017 totaled $5.293 billion. AEPSC's affiliated companies received direct and allocated costs of approximately $5.270 billion which represent 99.57 percent of AEPSC's total costs from 2014 through 2017. The remaining $22.940 million representing 0.43 percent were billed to non-affiliated companies.

C. Transource and Grid Assurance

In 2012, AEP, in partnership with Great Plains Energy, created Transource Energy, LLC and its affiliates (collectively, Transource) pursuant to the Commission's Order No. 1000 for the development and investment in competitive electric transmission projects across the U.S. AEP owns 86.5 percent of Transource, and Great Plains Energy owns the remaining 13.5 percent. Transource itself formed other entities to bid on or build transmission projects in specific jurisdictions. For example, Transource Maryland, LLC was formed to bid on transmission projects in the PJM territory. The initial costs of forming the subsidiary companies were separately tracked on Transource's books and expensed during the development stage.

When Transource obtains development rights to a project pursuant to Commission Order No. 1000, it requests approval from the Commission through a section 205 application for a regulatory asset to capture pre-commercial expenses. During the audit period, the Commission approved regulatory asset treatment for pre-commercial costs incurred by four Transource entities.[3]

Grid Assurance, LLC (Grid Assurance) was founded in 2016 by AEP, Berkshire Hathaway Energy, Duke Energy, Edison International, Eversource Energy, and Great Plains Energy. It was formed to enhance grid resiliency and give electric transmission owners faster access to long-lead time critical equipment necessary to recover from catastrophic events that could impact the nation's electric grid. AEP owns 16.67 percent of Grid Assurance, with Berkshire Hathaway Energy, Duke Energy, Edison International, Eversource Energy, and Great Plains Energy owning the remaining 83.33 percent.

Since 2013, AEPSC has provided more than $14 million in general and administrative services to Transource and Grid Assurance, including accounting and financial reporting, tax, and legal support. The initial accounting for the cost of services provided by AEPSC to Transource and Grid Assurance are recorded in the books of AEPSC in accordance with the Commission accounting regulations. AEPSC records these costs in administrative and general accounts, and operation and maintenance

[3] Transource Missouri, LLC (Docket No. ER12-2554-000), Transource West Virginia, LLC (Docket No. ER15-2114-000), Transource Pennsylvania, LLC (Docket No. ER17-419-000), and Transource Maryland, LLC (Docket No. ER17-419-000).

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accounts depending on the nature of services it's providing to Transource and Grid Assurance. These costs are billed to Transource and Grid Assurance either directly or through an allocation method.

D. AEPSC Construction Services

AEPSC provides construction services for the jurisdictional utilities and non-jurisdictional affiliated companies within AEP, for which AEPSC billed approximately $1.15 billion during the audit period. The construction process starts with each company identifying and budgeting for its construction needs. The corporate planning and budgeting department receives and approves all projects. After approval of a project, the corporate planning and budgeting department opens a project code to track all work orders under the project.

As part of this process, project managers create work orders and request approval from the accounting department. Once approved, interested individuals are notified to begin charging costs to the work order. Costs accumulated in the construction work orders consist of: (1) labor, (2) fringe benefits, (3) incentives, (4) overhead and shared services, (5) outside services, (6) materials and supplies, (7) travel and employee expenses, and (8) other costs. The costs accumulated in the construction work orders do not include AFUDC since AFUDC is computed on the books of the jurisdictional utility subsidiaries.

AEPSC bills construction costs monthly to the affiliated subsidiaries in work orders based on location codes identified during work order creation. The coding ensures subsidiaries benefiting from the construction services are charged the associated construction costs. The affiliated subsidiaries track the monthly costs billed by AEPSC in separate work orders for generation, distribution, and transmission. On a monthly basis, the jurisdictional utilities compute AFUDC using their respective short-term debt, capital structure, and construction work in progress balances.

E. Accounting and Financial Reporting

AEPSC uses a chart of accounts to code and record transactions within its accounting system. The chart of accounts is set up similar to the FERC USofA. For this reason, AEPSC's accounting system allows for direct preparation of the FERC Form Nos. 1 and 60 without reclassification of amounts. The costs incurred by AEPSC are recorded according to the chart of accounts using one of 171 cost component codes. For example, cost component code 11E represents exempt labor costs and cost component code 260 represents professional services. AEPSC bills all costs incurred or accrued on a monthly basis to its affiliated jurisdictional utilities and non-jurisdictional companies.

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The jurisdictional utilities' accounting for the charges received from AEPSC in most cases mirrors that of AEPSC. For example, charges that were recorded by AEPSC as an administrative and general expense are recorded as an administrative and general expense by the jurisdictional utilities. The jurisdictional utilities report all charges from AEPSC on FERC Form No.1 and recover these charges through jurisdictional rates on file with the Commission.

F. Transmission Formula Rates and Cost Recovery

AEP jurisdictional utilities are transmission-owning members in PJM, SPP, and ERCOT. For AEP jurisdictional utilities in PJM and SPP,[4] these utilities operate their transmission assets under PJM's or SPP's direction pursuant to the PJM and SPP Open Access Transmission Tariffs (OATTs). These utilities recover their costs of owning, operating, and maintaining the transmission system through transmission formula rates approved by the Commission and included in Attachment H of the OATTs. With respect to the AEP transmission and distribution company in ERCOT (that is, AEP Texas), that utility provides energy delivery service in Texas under ERCOT's direction. The utility recovers its costs of providing transmission service through fixed transmission and distribution rates that are subject to the jurisdiction of the Public Utility Commission of Texas.

[4] AEP jurisdictional utilities in PJM with Commission approved transmission formula rates are Appalachian Power Company; Indiana Michigan Power Company; Kentucky Power Company; Kingsport Power Company; Ohio Power Company; Wheeling Power Company; AEP Appalachian Transmission Company Inc.; AEP Indiana Michigan Transmission Company, Inc.; AEP Kentucky Transmission Company, Inc.; AEP Ohio Transmission Company, Inc.; AEP West Virginia Transmission Company, Inc.; Ohio Valley Electric Corporation; Transource Maryland LLC; Transource Pennsylvania LLC; Transource West Virginia LLC; and Path West Virginia Transmission Company, LLC.

AEP jurisdictional utilities in SPP with Commission approved transmission formula rates are Public Service Company of Oklahoma; Southwestern Electric Power Company; AEP Oklahoma Transmission Company, Inc.; AEP Southwestern Transmission Company, Inc.; and Transource Missouri, LLC.

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III. Introduction

A. Objectives

The audit evaluated AEP and its jurisdictional utilities' compliance with the Commission's: (1) cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35; (2) accounting, recordkeeping, and reporting requirements under 18 C.F.R. Part 366; (3) USofA for centralized service companies under 18 C.F.R. Part 367; (4) preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368; and (5) FERC Form No. 60 Annual Report requirements under 18 C.F.R. Part 369. The audit also evaluated the associated public utilities' transactions with affiliated companies for compliance with the Commission's accounting requirements under 18 C.F.R. Part 101, the applicable reporting requirements in the FERC Form No. 1 under 18 C.F.R. Part 141, and jurisdictional rates on file. The audit covered the period January 1, 2013 through August 31, 2018.

B. Scope and Methodology

Audit staff performed the following to facilitate testing and evaluation of AEP's compliance with Commission requirements relevant to the audit objectives:

- *Reviewed Public Information* – Conducted an extensive review of public information before commencing the audit. The review provided audit staff with an understanding of AEP's corporate structure, the services it provides, major events affecting operations and finances, mergers, significant contracts, prior audit issues and other key regulatory and business activities. Examples of materials reviewed include AEP's annual reports and SEC Forms 10-K and 10-Q, FERC Form Nos. 1 and 60, prior FERC audit reports, company-related websites, and other relevant regulatory and media sources.

- *Identified Audit Criteria* – Identified audit criteria including Commission rules, regulations, and other requirements necessary to evaluate compliance with the audit objectives.

- *Issued Data Requests* – Issued data requests to collect audit evidence and information. The information related to internal policies, procedures and controls, business practices, risk management, corporate structure, contractual agreements, financial accounting and reporting activities, corporate compliance, regulatory filings, and other pertinent information. The evidence and information were used to test and evaluate compliance with Commission requirements relevant to audit objectives.

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- *Conducted Teleconferences* – Held multiple teleconferences with AEP employees to discuss audit objectives, testing, data request responses, technical and administrative matters, and compliance concerns.

- *Attended Site Visits* – Made three site visits to AEP's headquarters in Columbus, OH to discuss and observe controls and procedures related to audit objectives. For example, to understand AEP's cost allocation procedures and methodologies, audit staff interviewed accounting managers, supervisors, and staff to discuss their duties and responsibilities.

- *Internal Commission Collaboration* – Conferred with other Commission staff on compliance issues to ensure audit findings were consistent with Commission precedent and policy. For example, audit staff spoke with 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 and the Office of the General Counsel.

Audit staff performed specific actions to evaluate AEP's compliance with the requirements relevant to this audit's objectives. In summary, these actions included:

Cross-Subsidization Restrictions

- Reviewed policies, procedures, and practices relating to the sale of non-power goods and services to understand (1) the types of services provided by AEPSC to the jurisdictional utilities, (2) the contract terms on pricing of non-power goods and services to the jurisdictional utilities, and (3) how transactions are invoiced by AEPSC;

- Interviewed AEP accounting staff to discuss transfers of non-power goods and services and AEPSC's related procedures, policies, and practices as well as Commission regulations on the pricing and accounting for non-power goods and services;

- Reviewed FERC Form No. 1, page 429, for the audit period to determine the dollar amount of transactions received by the jurisdictional utilities and to confirm that the amounts reported by the jurisdictional utilities correspond with the amounts AEPSC reported in its accounting system and FERC Form No. 60;

- Sampled charges for non-power goods and services provided to and received by AEP and its subsidiaries to ensure compliance with Commission pricing rules; and

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- Reviewed affiliate invoices and related detail to verify proper classification of the amounts and compliance with the "at cost" standard.[5]

Financial Reporting

To evaluate compliance with the books, records, and filing requirements, audit staff performed the following as they relate to AEP's FERC-65 filings, FERC Form No. 1 filings for multiple subsidiaries,[6] and the FERC Form No. 60 filings for AEPSC:

- Reconciled selected information reported on the FERC Form No. 1 at page 429 to information reported in the AEPSC FERC Form No. 60 to ensure information was reported accurately and consistently;

- Evaluated whether the schedules filed with select FERC Form Nos. 1 and 60 were consistent with the Commission's reporting requirements and the instructions contained in the forms;

- Reviewed notes to the financial statements and obtained explanations from AEP for any unclear or questionable accounting practices, events, or disclosures; and

- Verified that the FERC Form Nos. 1, 60, and 65 were timely filed. If they were not, then determined whether an extension was granted, obtained an explanation from the companies for the delay, and concluded whether the delay was a systemic or recurring issue.

Accounting

To facilitate the review of AEP's compliance with Commission accounting requirements, audit staff:

- Reviewed AEPSC's accounting and financial reporting controls to ensure compliance with Commission requirements. Specifically, audit staff reviewed

[5] *See* 18 C.F.R. § 35.44(b)(3) (2018) ("A franchised public utility that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, may only purchase or receive non-power goods and services from a centralized service company at cost.").

[6] Audit staff performed a FERC Form No. 1 review of Southwestern Electric Power Company, Appalachian Power Company, and Ohio Power Company.

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controls for selected FERC Form No. 1 and No. 60 pages and AEP's procedures relating to the mapping of costs to FERC accounts;

- Reviewed 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.

- Reviewed the account numbering system used by AEPSC and the jurisdictional utilities to record and account for transactions. Audit staff performed this audit step to understand how AEPSC and the jurisdictional utilities internal chart of accounts translates to the Commission's accounting regulations;

- Compared AEPSC's and the jurisdictional utilities' account numbering systems and titles with the USofA and obtained explanations for any unusual differences; and

- Reviewed affiliate jurisdictional utilities' books to ensure their accounting for selected charges conformed to the USofA. Audit staff reviewed how certain transactions are coded and recorded in AEPSC's books compared to how they are recorded in the jurisdictional utilities' books when billed. This was done to ensure transactions are recorded similarly in both the jurisdictional utilities' and AEPSC's books.

Cost Allocation and Billings

To facilitate the review of cost allocation methods and costs billed by AEPSC to its affiliates and non-affiliated companies, audit staff:

- Reviewed cost allocation methods used during the audit period and the components of each method. For example, audit staff compared AEPSC's allocation methods to the methods reported in its cost allocation manual and on its FERC Form No. 60;

- Reviewed and tested supporting details for cost allocation methods, and recalculated a sample of allocation percentages used in 2015. The team also selected allocation methods and verified how frequently AEPSC updated the inputs used to determine the ratios for each affiliate. For example, audit staff confirmed AEPSC updates the number of employees allocation factor monthly using information from its payroll system;

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- Reviewed selected billings from AEPSC to its associated companies and related accounting to ensure compliance with established cost allocation methods; and

- Determined whether the cost allocation methodologies and billing methods used during the audit period were reasonable based upon (1) their explained intended use, (2) supporting analysis, and (3) actual operations.

Preservation of Records

To evaluate compliance with preservation of records requirements for AEP, audit staff:

- Interviewed AEP officials responsible for complying with Commission requirements;

- Reviewed company policies, procedures, and practices for maintaining company records;

- Reviewed controls for preservation of records, including internal record retention audits;

- Performed selective testing of records to ensure AEP followed Commission regulations as well as its own internal policies and procedures; and

- Observed the record retrieval process and documented the steps taken and the effectiveness of the process.

Order 1000 Companies

- Identified all AEP jurisdictional companies created pursuant to the Commission's Order No. 1000 to bid on transmission projects;

- Reviewed the conceptual and legal startup of AEP jurisdictional companies to determine the purpose and objective of the entities. In addition, reviewed the organizational structure to understand AEP's percentage ownership in the Order No. 1000 companies; and

- Reviewed the initial costs incurred by AEP jurisdictional companies created pursuant to Order No. 1000 to determine if the costs were appropriately tracked and accounted for in the books of the new entities.

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Construction Services

- Reviewed AEP construction process to understand construction planning, budgeting, and approval within AEP;

- Evaluated the construction project and work order creation process. This review include evaluation of the initial project and work order request, opening, and closing process;

- Reviewed the functionalization of projects and work orders by transmission, distribution, production, and general. This was done to ensure that construction projects and work orders were appropriately functionalized;

- Reviewed sample construction projects and work orders to identify the various category of costs incurred/accrued in the projects and work orders;

- Reviewed samples and related supporting documentation for selected cost categories to determine if the costs were appropriately recorded in the projects and work orders by the service company; and

- Reviewed sample construction billings by AEPSC to the jurisdictional utilities to determine if the costs were appropriately billed to the jurisdictional utility benefiting from the construction project.

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IV. Findings and Recommendations

1. Allowance for Funds Used During Construction

Certain AEP jurisdictional utilities' method for computing Allowance for Funds Used During Construction (AFUDC) improperly included Account 219, Accumulated Other Comprehensive Income, in the equity component of the formula and improperly determined the AFUDC rate on a monthly basis. As a result, three jurisdictional utilities over accrued AFUDC on transmission plant by approximately $6.1 million from 2012 through 2017. The three jurisdictional utilities overbilled wholesale transmission customers for the excessive AFUDC costs included in utility plant that was included in transmission formula rates.

Pertinent Guidance

- Order No. 561 states, in part:

  [T]he balances of long-term debt, preferred stock, and common equity for use in the formula for the current year will be the balances in such accounts at the end of the prior year….[7]

- 18 C.F.R. Part 101, Electric Plant Instruction No. 3(A)(17), Allowance for Funds Used During Construction states, in part:

  Allowance for funds used during construction (Major and Nonmajor Utilities) includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds. . . . The rates shall be determined annually.

Background

Audit staff reviewed AEP jurisdictional utilities' process and policy for computing AFUDC rates and the application of such rates to construction projects. Audit staff

[7] Order No. 561, *Amendments To Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies (Classes A, B, C and D) to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports*, 57 FPC 608, at 610, *reh'g denied and clarification granted,* Order No. 561-A, 59 FPC 1340 (1977), *clarification granted*, 2 FERC ¶ 61,050 (1978).

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observed that AEP computed AFUDC rates individually for its jurisdictional utilities using each jurisdictional utility's capital structure, short-term debt, and Construction Work-In-Progress (CWIP) amounts. In addition, the jurisdictional utilities computed AFUDC rates on a monthly basis using actual prior month balances for short-term debt, long-term debt, preferred stock, common stock, and CWIP.

Audit staff reviewed the jurisdictional utilities' AFUDC rate calculations, including determination of the debt and equity rates applied to construction costs to derive capitalized interest and equity AFUDC. Based on audit staff's review, certain AEP jurisdictional utilities improperly included Account 219, Accumulated Other Comprehensive Income, as part of the equity component when computing their AFUDC rates.[8] In addition, multiple AEP jurisdictional utilities improperly computed AFUDC rates on a monthly basis by using actual prior month balances for long-term debt, preferred stock, and common stock instead of using actual prior year-end balances. The Commission's regulations governing AFUDC require jurisdictional utilities to use the weighted cost for all issuances of long-term debt, preferred stock, and common equity as of the end of the prior year rather than prior-month balances.

Equity Component of AFUDC Rate

Audit staff's review of the equity component of AEP jurisdictional utilities' AFUDC rate calculations revealed that certain of the jurisdictional utilities improperly included balances from Account 219. Account 219 balances reported by the jurisdictional utilities represented unrealized gains and losses attributable to pensions, post-retirement obligations, cash flow hedges related to foreign exchange, and interest rate hedges.

AFUDC includes the net cost of borrowed funds used for construction purposes and an allowed rate on other funds. Since the gains and losses in accumulated other comprehensive income were *unrealized* and not funds available to finance construction, those amounts should not have been considered funds available for construction in deriving the rates used in AFUDC.

[8] The jurisdictional utilities that included Account 219 in their AFUDC rate calculation are: AEP Texas Inc., Appalachian Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, Public Service Company of Oklahoma, Southwestern Electric Power Company, and Wheeling Power Company.

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Monthly AFUDC Rate

Audit staff determined that 12 of AEP jurisdictional utilities computed AFUDC monthly by using actual prior month ending balances for long-term debt, preferred stock, and common equity, instead of using those balances from the prior year end. AEP jurisdictional utilities computed AFUDC monthly because of waivers that were granted to four, but not all, jurisdictional utilities within the AEP holding company system.[9] AEP considered those three waivers to be a blanket authorization by the Commission to compute AFUDC on a monthly basis for all jurisdictional utilities within the AEP holding company system, as well as to use actual prior-month ending balances for long-term debt, preferred stock, and common equity.

AEP jurisdictional utilities' procedure to compute AFUDC rates monthly is inconsistent with the Commission's requirements in Order No. 561 and EPI 3(A)(17). Order No. 561 required jurisdictional utilities to compute AFUDC rates annually using the actual prior year-end book balances for long-term debt, preferred stock, and common equity. The methodology used by AEP jurisdictional utilities contributed to an overstatement of three jurisdictional utilities' AFUDC rates and over-accrual of plant accounts.[10] In addition, only certain AEP jurisdictional utilities were actually granted Commission waiver to compute AFUDC monthly, making it improper for all other jurisdictional utilities to do so without the Commission's authorization.

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[9] *See Central Power and Light Company* (currently, AEP Texas Inc.), Undocketed (Aug. 15, 1984) (letter from FERC Chief Accountant granting waiver to permit monthly calculation of AFUDC rates); *Central and South West Services, Inc.*, Docket No. AC95-35-000 (Jan. 23, 1995) (delegated letter order granting request made on behalf of Public Service Company of Oklahoma and Southwestern Electric Power Company to calculate AFUDC rate on a monthly basis, subject to certain conditions). The Commission granted AFUDC waivers to AEP Texas Inc., Public Service Company of Oklahoma, and Southwestern Electric Power Company to compute the AFUDC rate on a monthly basis. The Commission approved the waivers by stating that, the companies "request is approved, provided that the AFUDC rate is determined using the cost levels and balances for the long-term debt and equity capital components at the end of the prior month, [fn1] and the average short-term debt cost levels and balances and the average construction work in progress balance for the current month." Fn 1: "The common equity rate used should be the last common equity rate approved in the primary rate jurisdiction."

[10] The three jurisdictional utilities whose plant account balances were overstated due to the monthly AFUDC rate computation are AEP Indiana Michigan Transmission Company, Inc.; AEP Ohio Transmission Company, Inc.; and AEP Oklahoma Transmission Co., Inc.

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AEP jurisdictional utilities' method for computing AFUDC rates resulted in overstated transmission plant account balances for the three jurisdictional utilities, due to over accrual of AFUDC from 2012 to 2017, by approximately $6.1 million. The over-accrual of AFUDC led to overstatements of income statement and balance sheet accounts, which led to overstatement of the transmission revenue requirement and over billings to wholesale transmission customers.

Recommendations

We recommend AEP:

1. Revise and/or implement procedures to ensure its jurisdictional utilities' AFUDC rate calculations are consistent with Order Nos. 561 and 561-A, EPI 3(A)(17), and other applicable Commission requirements.

2. Revise its procedures to ensure that Account 219 is excluded from the equity components used to derive AFUDC rates.

3. Provide training to staff on the revised procedures implemented under recommendations 1 and 2. Provide periodic training in these areas as needed.

4. Adjust plant in service, accumulated depreciation, accumulated deferred income tax, and other affected accounts to remove the over accrual of AFUDC for the periods affected and included in each jurisdictional utility's calculation.

5. Submit correcting journal entries related to the calculation of AFUDC for all the affected AEP jurisdictional utilities to DAA within 60 days of receiving the final audit report. Provide supporting documentation for the amounts of AFUDC over accrued in 2012 through 2018.

6. 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 2013, plus interest; (2) determinative components of the refund; (3) refund method; (4) refund amount; and (5) period(s) in which refunds will be made.

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

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

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2. Merger-Related Costs

AEP jurisdictional utilities improperly included approximately $295,000 of merger-related capital costs in transmission formula rate determinations without first making a compliance filing under section 205 of the Federal Power Act. As a result, wholesale transmission customers were overbilled due to the inclusion of merger costs.

Pertinent Guidance

- The Commission's Merger Orders provide in relevant part:

  > Applicants commit to hold harmless wholesale requirements and transmission customers from any transaction-related costs for a period of five years following the closing of the Transaction. Applicants state that for that five-year period, Applicants will not seek to include transaction-related costs in any wholesale requirements rates or in transmission revenue requirements, except to the extent that they can demonstrate that merger-related savings are equal to or in excess of the transaction related costs included in the rate filing. Applicants' commitment is interpreted to include all transaction-related costs, not only costs related to consummating the transaction. The Commission will be able to monitor the Applicants' hold harmless provision under its authority under section 301(c) of the FPA and the books and records provision of PUHCA 2005, and the commitment is fully enforceable based on the Commission's authority under section 203 of the FPA.[11]

Background

In 2013, the Commission approved separate but related transactions under Section 203 of the Federal Power Act among AEP jurisdictional utilities.[12] The first transaction

[11] *Appalachian Power Co.*, Order Authorizing Disposition of Jurisdictional Facilities, 143 FERC ¶ 62,072, at 64,205 (2013); *Ohio Power Co.*, Order Conditionally Authorizing Disposition of Jurisdictional Facilities, 143 FERC ¶ 61,075, at PP 43-44 (2013), *clarification granted*, 146 FERC ¶ 61,016 (2014) (similar); *Appalachian Power Co.*, Order Authorizing Disposition of Jurisdictional Facilities, 143 FERC ¶ 61,074, at P 37 (2013) (similar).

[12] The following jurisdictional utilities were involved in the three FPA Section 203 transactions: Ohio Power Company (Ohio Power), AEP Generation Resources Inc. (AEP Generation Resources), Appalachian Power Company (Appalachian Power), Kentucky Power Company (Kentucky Power), and Wheeling Power Company (Wheeling Power).

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was approved by the Commission under Docket No. EC13-26-000 for an internal corporate reorganization that resulted in the separation of Ohio Power's generation and power marketing businesses from its transmission and distribution businesses.[13] In the second transaction, the Commission granted authorization under Docket No. EC13-28-000 for AEP Generation Resources to transfer jurisdictional facilities to Appalachian Power and Kentucky Power Company.[14] These transactions were consummated on December 13, 2013.

The Commission approved the transactions subject to certain conditions, including that AEP jurisdictional utilities were to hold wholesale requirements and transmission customers harmless from any merger transaction-related costs for a period of five years. Pursuant to this condition, all merger transaction-related costs, including costs related to consummating the merger and transition costs (both capital and operating) incurred to achieve merger synergies were required to be excluded from rates charged to wholesale customers.

Merger-Related Capital Costs

Audit staff evaluated the merger transactions for compliance with the hold harmless commitment made by the AEP jurisdictional utilities and imposed on them as a condition of the transactions. Appalachian Power and Wheeling Power incurred both transaction and transition costs (capital and operating). The transaction costs were properly recorded in Account 426.5, Other Deductions. The transition costs were capital in nature and included information technology (IT) costs to support the merger transaction such as work to support finance and accounting changes, modify and integrate systems, move Wheeling Power employees to Appalachian Power, and revise system controls. Appalachian Power recorded merger-related capital costs of approximately $295,000 in plant in service accounts. The merger-related capital costs recorded in plant in service accounts were amortized for a period of five years to Account 404, Amortization of Limited-Term Electric Plant.

Based on audit staff's review, Appalachian Power appropriately recorded merger-related capital costs in electric plant in service accounts but improperly included them in wholesale requirements and transmission customers' billings. Audit staff points out that, although Appalachian Power properly tracked and recorded the merger-related capital costs on its FERC Form No. 1, it did not prevent such costs from inclusion in the

[13] *Ohio Power Co.*, 143 FERC ¶ 61,075 (2013), *clarification granted*, 146 FERC ¶ 61,016 (2014).

[14] *Appalachian Power Co.*, 143 FERC ¶ 61,074 (2013).

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wholesale transmission formula rates. The Merger Order required Appalachian Power to make a section 205 filing with the Commission before recovering any merger-related costs from its wholesale customers.[15] By not following the hold harmless commitment in the Commission's Merger Order, Appalachian Power over-billed wholesale transmission customers.

Recommendations

We recommend AEP:

9. Establish, implement and/or update policies and procedures to ensure AEP jurisdictional utilities accurately exclude merger-related costs from their annual formula rate updates, as required by the hold harmless provisions in the Commission's merger orders.

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 and the amount of improper recoveries that resulted from the inclusion of merger transactions in wholesale power and transmission formula rates during the audit period, plus interest on the costs; (2) determinative components of the refund; (3) refund method; and (4) 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 power and transmission customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

[15] *Appalachian Power Co.*, 143 FERC ¶ 62,072 at 64,206; *Appalachian Power Co.*, 143 FERC ¶ 61,074 at P 38.

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3. Accounting for Charitable Contributions and Penalties

AEPSC improperly recorded charitable contributions and penalties in various administrative and general, and operation and maintenance expense accounts, instead of using the appropriate non-operating expense accounts.[16] In addition, AEPSC allocated and billed these costs to the jurisdictional utilities, and these utilities then misclassified and misreported these costs in their FERC Form No. 1 filings. These amounts were included in the jurisdictional utilities' formula rate mechanisms. As a result, the improper accounting for charitable contributions and penalties amounts led to overbillings to wholesale transmission customers.[17]

Pertinent Guidance

- 18 C.F.R. § 367.4261, Account 426.1, Donations, states:

  > This account must include all payments or donations for charitable, social or community welfare purposes.

- 18 C.F.R. § 367.4263, Account 426.3, Penalties, states:

  > This account must include payments by the service company for penalties or fines for violation of any regulatory statutes by the service company or its officials.

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[16] AEPSC recorded charitable contributions in the following above the line Accounts: 560, Operation Supervision and Engineering; 563, Overhead Line Expenses (Major only); 566, Miscellaneous Transmission Expenses (Major only); 921, Office Supplies and Expenses; 923, Outside Services Employed; and 930.1, General Advertising Expenses for Associated Companies.

AEPSC also recorded a Department of Homeland Security penalty in Account 921, Office Supplies and Expenses.

[17] AEP jurisdictional utilities recorded the charitable contributions and the Department of Homeland Security penalty in the following FERC USofA Accounts: Accounts 107, Construction Work in Progress; 560, Operation Supervision and Engineering; 566, Miscellaneous Transmission Expenses (Major only); 921, Office Supplies and Expenses; 923, Outside Services Employed; and 930.1, General Advertising Expenses for Associated Companies.

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- 18 C.F.R. § 367.4265, Account 426.5, Other Deductions, states:

> This account must include other miscellaneous expenses that are not properly included in service company operations.

Background

Audit staff reviewed selected transactions to determine if AEPSC complied with the Commission's accounting regulations for charitable contributions and penalties. In its review, audit staff determined that AEPSC misclassified charitable contributions and penalties in various administrative and general, and operation and maintenance expense accounts, instead of using the appropriate non-operating expense account, such as Accounts 426.1, 426.3, and 426.5. Specifically, audit staff identified the following misclassifications:

Charitable Contributions

From 2013 to 2016, AEPSC donated $275,443 to several charitable and nonprofit organizations, including colleges, universities, and other charitable organizations. AEPSC improperly recorded the $275,443 of charitable contributions in various administrative and general, and operation and maintenance expense accounts. Under the Commission's accounting regulations, these costs should have been recorded in Accounts 426.1, Donations, or 426.5, Other Deductions. Further, AEPSC allocated these costs to jurisdictional utilities that also improperly recorded the costs in various administrative and general, and operation and maintenance expense accounts.[18] These accounts were included in the jurisdictional utilities' formula rate mechanism.

[18] *See Pacific Power & Light Co.*, 11 FERC ¶ 61,073, at 61,104 (1980) (believing that "dues and other payments to community social and service organizations should be classified to the appropriate 426 account"; these expenditures are "unrelated to utility operations" and require "below the line" classification); *Trunkline Gas Co.*, Opinion No. 441, 90 FERC ¶ 61,017, at 61,064 (2000) ("The financial burden of charitable contributions should be borne by the stockholders for whom such contributions are intended to retain customer good will and employee loyalty. Charitable contributions are not operating expenses and bear no relationship to the necessary costs of providing utility service."); *EPGT Texas Pipeline, L.P.*, 99 FERC ¶ 61,295, at 62,249-62,250 (2002), *reh'g denied sub. nom. GulfTerra Texas Pipeline, L.P.*, 106 FERC ¶ 61,184, *reh'g denied*, 109 FERC ¶ 61,350 (2004), *reconsideration granted sub. nom. Enterprise Texas Pipeline L.P.*, 117 FERC ¶ 61,025 (2006) (requiring that charitable contributions be excluded from cost of service in determining interstate rates regardless of what a state

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Penalties

In June of 2015, the Department of Homeland Security imposed a $20,017 penalty on AEP for violating the Immigration and Nationality Act. The penalty was recorded on the books of AEPSC in Account 921, Office Supplies and Expenses, and included in monthly billings to jurisdictional utilities and non-jurisdictional affiliates. Audit staff's review of the affiliates' books found that the cost of the penalty was recorded in various administrative and general, and operation and maintenance expense accounts by the jurisdictional utilities.[19] Under Commission accounting regulations, penalties are required to be recorded in Account 426.3, Penalties.[20] AEPSC and the jurisdictional

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utility commission permits for intrastate rates); *Williston Basin Interstate Pipeline Co.*, 95 FERC ¶ 63,008, at 65,095 (2001) (rejecting inclusion of civic and charitable donations in cost of service even where the utility argued the donations were made to local charities benefiting communities served by the utility and "represent[ed] a minimal amount of the overall cost of service"), *aff'd in relevant part, and rev. in part,* 104 FERC ¶ 61,036, at P 65 (2003), *reh'g granted in part and denied in part*, 107 FERC ¶ 61,164 (2004) (even if the ratepayers chose charities to which utility made contributions "and there was such a demonstrable connection between the charities and the ratepayers," this does not "overcome[] the conclusion that such costs are not operating expenses and bear no relationship to the necessary costs of providing utility service."); *id.* at P 65 n.89 stating:

> Because our policy of denying inclusion of charitable contributions in a pipeline's cost of service is premised upon such contributions being primarily for the benefit of a company's shareholders, and that they are not operating expenses and bear no relationship to the necessary costs of providing utility service, a pipeline has a heavy burden indeed in including any amounts for charitable contributions in its cost of service.

[19] The jurisdictional utilities that were billed a portion of the Department of Homeland Security penalty recorded the amounts in Accounts 107, Construction Work in Progress; 921, Office Supplies and Expenses; and 923, Outside Services Employed.

[20] *See* 18 C.F.R. § 367.4263, Account 426.3, Penalties (2018) ("This account must include payments by the service company for penalties or fines . . . ."); *see, e.g.*, *Central Illinois Public Service Co*., 36 FERC ¶ 61,202, at 61,507 (1986) (noting recommendation by staff that company revise its procedures so that penalties are charged to Account 426.3); *Utah Power & Light Co*., 39 FERC ¶ 61,282, at 61,926 (1987) (explaining that $345,022 in civil penalties assessed by Mine Safety and Health Administration belonged in Account 426.3, not in Account 151, Fuel Stock costs); *Missouri Public Service*, 40 FERC ¶ 61,121, at 61,338 (1987) (explaining that company improperly accounted for IRS tax penalties assessed for "negligence and intentional disregard of Internal Revenue

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utilities' accounting and recovery of penalties in the transmission formula rate is contrary to the Commission's regulations and orders.

AEPSC's improper accounting for charitable contributions and penalties resulted in AEP jurisdictional utilities also improperly accounting for the costs. AEP jurisdictional utilities' accounting error led to the inclusion of charitable contributions and penalties in transmission formula rate determinations and the jurisdictional utilities overbilling wholesale transmission customers.

Recommendations

We recommend AEPSC:

13. Strengthen procedures to record all charitable contributions and penalties in Accounts 426.1, Donations; 426.3, Penalties; and 426.5, Other Deductions.

14. Provide training to staff on the importance of recording charitable contributions and penalties in below the line accounts for regulatory accounting and rate development. Provide periodic training in this area as needed.

15. Submit a refund analysis, for the jurisdictional utilities within 60 days of receiving the final audit report, to DAA that explains and details the following: (1) calculation of refunds and the amount of improper cost of charitable contributions and penalties recovered that resulted from amounts included in the formula rates

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Code," which belonged in Account 426.3); *Revisions to Uniform Systems of Accounts to Account for Allowances Under the Clean Air Act Amendments of 1990 and Regulatory-Created Assets and Liabilities and to Form Nos. 1, 1-F, 2 and 2-A*, Order No. 552, 58 Fed. Reg. 17,982, at 17,999 (1993) ("The Commission continues to believe that the proper account to use for all fines and penalties incurred through noncompliance with the CAAA is Account 426.3, Penalties."); *Kentucky Utilities Co.*, 61 FERC ¶ 62,133, at 63,214 (1992) (company agreed to DAA finding that "payments related to citation issued by Kentucky Occupational Safety and Health Administration" belonged in Account 426.3, not in Account 925, Injuries and Damages); *To All Jurisdictional Public Utilities and Licensees, Natural Gas Companies, Oil Pipeline Companies and Centralized Service Companies*, 119 FERC ¶ 62,167, at 64,455 (2007) (Office Director Order) (noting with respect to underpayment of income taxes that "[t]he Commission's Uniform Systems of Account . . . require interest and penalties on tax deficiencies to be charged to Account 431, Interest Expense and Account 426.3, Penalties, *respectively*. Therefore, public utilities and licensees, natural gas companies and centralized service companies should comply. . . .") (Citation omitted, emphasis added).

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since 2013, plus interest; (2) determinative components of the refund; (3) refund method; and (4) period(s) in which refunds will be made.

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

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

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4. Accounting for Administrative and General Expenses

AEPSC misclassified various administrative and general labor, membership dues, outside services, and advertising expenses among various administrative and general expense accounts. In addition, AEPSC allocated and billed these costs to the jurisdictional utilities, and these utilities then misclassified these costs in their FERC Form No. 1 filings. As a result, the improper accounting for certain administrative and general expenses led to overbillings to wholesale transmission customers through the jurisdictional utilities' formula rate mechanisms.

Pertinent Guidance

- 18 C.F.R. § 367.9200, Account 920, Administrative and General Salaries, states in part:

  This account must include salaries, wages, bonuses and other consideration for services, with the exception of director's fees paid directly to officers and employees of the service company.

- 18 C.F.R. § 367.9210, Account 921, Office Supplies and Expenses, states in part:

  (a) This account must include office supplies and expenses incurred in connection with the general administration of service company operations assignable to specific administrative or general departments and not specifically provided for in other accounts….

  (b) . . . The following items must be included in this account:

  (7) Membership fees and dues in trade, technical, and professional associations paid by a utility for employees….

- 18 C.F.R. § 367.9230, Account 923, Outside Services Employed states:

  (a) This account must include the fees and expenses of professional consultants and others for general services with the exception of fees and expenses for outside services of account 928, Regulatory commission expenses (§ 367.9280), and account 930.1, General advertising expenses (§ 367.9301). Separate subaccounts must be provided for auditing, legal, engineering, management consulting fees and any other fees for professional or outside services.

- 18 C.F.R. § 367.9301, Account 930.1, General Advertising Expenses for Associated Companies, states in part:

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(a) This account must include the cost of labor, materials used, and expenses incurred in advertising and related activities, the cost of which by their content and purpose are not provided for elsewhere.

- 18 C.F.R. § 367.9302, Account 930.2, Miscellaneous General Expenses, states in part:

(a) This account must include the cost of expenses incurred in connection with the general management of the service company not provided for elsewhere.

(c) This account must include the following expense items:

(1) Industry association dues for company memberships.

Background

Audit staff reviewed selected transactions to determine if AEPSC complied with the Commission's accounting regulations for administrative and general expenses. In its review, audit staff determined that AEPSC misclassified certain administrative and general costs. Specifically, audit staff identified the following misclassifications:

Description	Accounts Used by AEPSC	Appropriate FERC Account	Amount
A&G Labor Cost	921, 923	920	$ 8,161,050
Employee Memberships	923	921	$ 25,667
Company Memberships	921, 923, 930.1	930.2	$ 696,926
Outside Services	930.2	923	$ 50,000
A&G Advertising Expense	923	930.1	$ 53,000

AEPSC allocated and billed these costs to its jurisdictional utilities, and these utilities then misclassified and misreported these costs in their FERC Form No. 1 filings. Under AEP jurisdictional utilities' transmission formula rates under PJM and SPP OATTs, costs reported in Account 930.1 are allocated using a transmission plant allocator to determine the annual transmission revenue requirement and Account 930.2 is directly assigned. All other administrative and general expense accounts are allocated using wages and salary or gross plant allocators to determine the annual transmission revenue requirements. Therefore, misclassifications amongst the administrative and general expense accounts that include Accounts 930.1 and 930.2 impact the transmission revenue requirement and billings to transmission customers. Audit staff determined that AEP jurisdictional utilities' accounting misclassifications impacted the jurisdictional utilities' transmission formula rates, which led to overbillings to transmission customers.

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Recommendations

We recommend AEPSC:

18. Revise procedures to ensure that AEPSC properly accounts for all items reported in its FERC Form No. 60 in accordance with the USofA 18 C.F.R. Part 367.

19. Provide training to staff on the importance of recording administrative and general expenses in the accounts prescribed by the Commission accounting regulations and regulatory rate development. Provide periodic training in this area, as needed.

20. Submit a refund analysis, for the jurisdictional utilities within 60 days of receiving the final audit report, to DAA that explains and details the following: (1) calculation of refunds and the amount of improper administrative and general expenses recovered that resulted from amounts included in the formula rates since 2013, plus interest; (2) determinative components of the refund; (3) refund method; and (4) period(s) in which refunds will be made.

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

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

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v. AEP's Response to Draft Audit Report

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April 5, 2019

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Via E-mail: Steven.Hunt@ferc.gov

Re: Docket No. FA17-1-000, Draft Audit Report

Dear Mr. Hunt,

On March 21, 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 and 22 recommendations. 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 as follows:

1. Allowance for Funds Used During Construction

   AEPSC accepts this finding and the related recommendations.

2. Merger-Related Costs

   AEPSC accepts this finding and the related recommendations.

3. Accounting for Charitable Contributions and Penalties

   AEPSC accepts this finding and the related recommendations.

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4. Accounting for Administrative and General Expenses

AEPSC accepts this finding and the related recommendations. AEPSC already has implemented controls that prevent employees from charging labor to Accounts 921 and 923.

As requested at pages 5-6 of the Draft Audit Report, AEPSC will submit within 30 days of the issuance of the final audit report a plan for implementing the audit recommendations. AEPSC 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 Attorney
American Electric Power
Service Corporation

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