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Tel: 513-419-1837  
Fax: 513-419-1846  
[dianne.kuhnelli@duke-energy.com](mailto:dianne.kuhnelli@duke-energy.com)

**RECEIVED**

**VIA HAND DELIVERY**

**JUL 16 2009**

July 16, 2009

**PUBLIC SERVICE  
COMMISSION**

Dianne B. Kuhnell  
Senior Paralegal

Mr. Jeff Derouen  
Executive Director  
Kentucky Public Service Commission  
211 Sower Blvd  
Frankfort, KY 40601

Re: In the Matter of Application of Duke Energy Kentucky, Inc. For An Adjustment  
of Gas Rates  
Case No. 2009-00202

Dear Mr. Derouen:

Enclosed are an original and ten copies of Duke Energy Kentucky's Responses to Commission Staff's First Data Requests in the above-referenced case. Please note that the responses are contained in five volumes.

Also enclosed is a Petition for Confidential Treatment for several individual responses being sent under seal. The redacted version of these responses is included in the filing and the unredacted version is included in the sealed envelope stamped "Confidential."

Please date stamp and return the extra copies of the Table of Contents, Petition and cover letter in the enclosed self-addressed overnight envelope.

Very truly yours,

Dianne B. Kuhnell  
Senior Paralegal

cc: Hon. Dennis G. Howard (w/encl.)

**RECEIVED**

**JUL 16 2009**

**PUBLIC SERVICE  
COMMISSION**

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF THE GAS RATES                    )  
OF DUKE ENERGY KENTUCKY, INC.                    )        CASE NO. 2009-00202

---

PETITION OF DUKE ENERGY KENTUCKY, INC.  
FOR CONFIDENTIAL TREATMENT OF INFORMATION  
CONTAINED IN ITS FIRST SET OF RESPONSES TO DISCOVERY  
PROPOUNDED BY COMMISSION STAFF

---

Duke Energy Kentucky, Inc. (Duke Energy Kentucky or Company), pursuant to 807 KAR 5:001, Section 7, respectfully requests the Kentucky Public Service Commission (Commission) to classify and protect certain information in responses to Staff's Data Request Nos. 26, 34, 36 47 and 49 contained in the Commission's data requests, as set forth in the Commission's Order dated June 19, 2009.

The information in response to Data Request No. 26 for which Duke Energy Kentucky seeks confidential treatment includes sensitive information regarding the Company's cash balances in the several bank accounts. The disclosure of details in respect of bank accounts could unfairly provide Duke Energy Kentucky's competitors with the Company's plans for future investments. Furthermore, account numbers maintained by financial institutions are confidential and proprietary in nature such that they should be protected from public dissemination.

The response to Data Request No. 34 includes employee benefit studies, analyses or surveys assembled by an outside vendor and utilized by the Company. The information reflected in these documents is confidential, and Duke Energy Kentucky agreed not to

disclose said information to third parties absent the vendor's consent. Moreover, the information, if disclosed, would provide competitors with an unfair advantage in their efforts to develop and implement compensation and employee benefit plans offered to, among others, prospective employees.

The attachment to the response to Data Request No. 36 lists executive compensation for the Company's executive leaders, including individuals whose compensation is not otherwise subject to disclosure under federal requirements. This information is confidential and its disclosure threatens reasonable privacy considerations. Furthermore, its disclosure would undeniably provide competitors with an unfair advantage in their negotiations, particularly with respect to negotiations involving prospective employees.

The attachments to the response to Data Request No. 47 contains federal income tax information filed by the Corporation for Duke Energy Ohio and its affiliates and state income tax information filed by Duke Energy Kentucky as well as franchise fees paid during the test year. The level of detail in these documents could readily provide competitors with an unfair advantage in that these returns provide a concise summary of business and financial activities over a calendar year. With respect to franchise fees, the disclosure of this information would likely provide competitors with an unfair advantage. Again, this information is a concise format detailing the structure of Duke Energy Kentucky and financial aspects of its operations.

The response to Data Request No. 49 requests written policies for professional services, including those services retained in the context of the attorney-client relationship. Disclosure of this information could provide a distinct competitive advantage to vendors in

soliciting and securing new contracts for services to Duke Energy Kentucky, not to mention its affiliates.

In support of this Petition, Duke Energy Kentucky states as follows:

1. The Kentucky Open Records Act exempts from disclosure certain commercial information. KRS 61.878(1)(c). To qualify for this exemption and, therefore, maintain the confidentiality of the information, a party must establish that the disclosure of the commercial information would permit an unfair advantage to competitors of that party. Public disclosure of the information identified herein would, in fact, prompt such a result for the reasons set forth below.

2. The Confidential Information contained in the attachment provided in response to Data Request No. 26 includes sensitive information regarding the Company's cash balances in the several bank accounts utilized by the Company. If released, this information could provide Duke Energy Kentucky's competitors with its plans for future investments. Thus, such information must be exempt from disclosure. Moreover, bank account numbers reflect proprietary information that must be shielded from public disclosure.

3. The Confidential Information contained in response to Data Request No. 34 includes, but is not limited to, employee benefit studies, analyses or surveys assembled by an outside vendor and utilized by the Company. The Company has an agreement with the vendor that it will only release the information contained in the vendor's documents to entities approved by the vendor as it contains sensitive employee statistics and analyses. Furthermore, the Confidential Information, if disclosed, would provide competitors with an unfair advantage in their efforts to develop and implement compensation and employee benefit plans offered to, among others, prospective employees.

4. The Confidential Information contained in the attachment in response to Data Request No. 36 supports the request for executive compensation of the executive officers of the Company. The list of executive officers includes individuals whose professional compensation is not subject to disclosure under federal reporting requirements. Thus, this information is sensitive and proprietary information that, if disclosed, would undeniably present competitors with an advantage in their negotiations.

5. The Confidential Information contained in response to the response to Data Request No. 47 contains federal income tax information filed by the Corporation for Duke Energy Ohio and its affiliates and state income tax information filed by Duke Energy Kentucky as well as franchise fees paid during the test year. The level of detail in these documents could readily provide competitors with an unfair advantage in that these returns provide a concise summary of business and financial activities over a calendar year. With respect to franchise fees, the disclosure of this information would likely provide competitors with an unfair advantage. Again, this information is a concise format detailing the structure of Duke Energy Kentucky and financial aspects of its operations.

6. The Confidential Information contained in response to Data Request No. 49 contains written policies for professional services, including those secured in the context of the attorney-client relationship. This information, if disclosed, could provide a distinct competitive advantage to vendors in soliciting and securing new contracts for services to Duke Energy Kentucky, not to mention its affiliates.

7. All of the Confidential Information referenced in Paragraphs 2 through 6 above is distributed within Duke Energy Kentucky and Duke Energy Corporation (collectively

referred to as Duke Energy) only to those employees who must have access for business reasons and it is generally recognized as confidential and proprietary in the energy industry.

8. The information for which Duke Energy Kentucky is seeking confidential treatment is not known outside of Duke Energy.

9. Duke Energy Kentucky does not object to limited disclosure of the Confidential Information described herein, provided such disclosure is pursuant to an acceptable protective agreement and limited to those intervening Parties with a legitimate interest in reviewing the same.

10. Duke Energy Kentucky has taken steps to only seek confidential treatment of the sensitive information contained in the responses, and in the interest of disclosure is only seeking confidential treatment of specifically identified information.

11. In accordance with the provisions of 807 KAR 5:001 Section 7, Duke Energy Kentucky is providing the Commission with one copy of the Confidential Material highlighted and ten copies without the confidential information.

WHEREFORE, Duke Energy Kentucky, Inc. respectfully requests that the Commission classify and protect as confidential the specific information described herein.

Respectfully submitted,

DUKE ENERGY KENTUCKY



Rocco D'Ascenzo (92796)

Senior Counsel

Amy B. Spiller (85309)

Associate General Counsel

139 E. Fourth Street, 25 AT II

P.O. Box 960

Cincinnati, OH 4520

(513) 419-1852 (telephone)

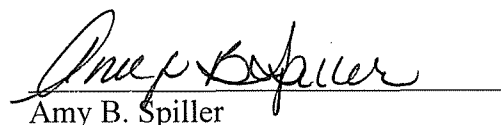
(513) 419-1846 (facsimile)

e-mail: rocco.d'ascenzo@duke-energy.com

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the Petition of Duke Energy Kentucky, Inc. For Confidential Treatment of Information Contained in Its First Set of Responses To Discovery Propounded By Commission Staff was hand-delivered, on this 16<sup>th</sup> day of July 2009.

Hon. Dennis Howard  
Office of Attorney General  
Utility Intervention and Rate Division  
1024 Capital Center Drive  
Frankfort, Kentucky 40601

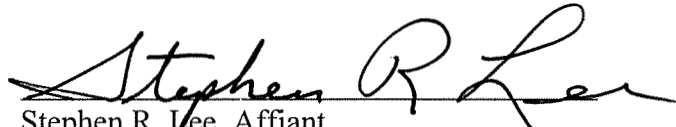


Amy B. Spiller

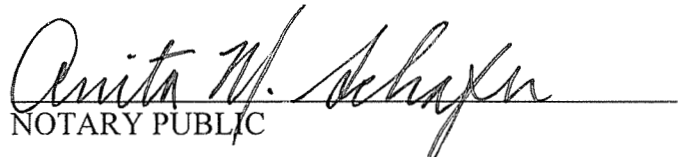
VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

The undersigned, Stephen R. Lee being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Director, Financial Forecasting; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.

  
Stephen R. Lee, Affiant

Subscribed and sworn to before me by Stephen R Lee on this 14~~th~~ day of July, 2009.

  
NOTARY PUBLIC

My Commission Expires:



**ANITA M. SCHAFER**  
Notary Public, State of Ohio  
My Commission Expires  
November 4, 2009

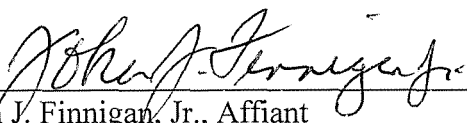





VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

The undersigned, John J. Finnigan, Jr., being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Vice-President, Government and Regulatory Affairs; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.

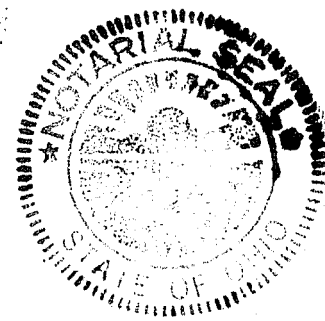
  
\_\_\_\_\_  
John J. Finnigan, Jr., Affiant

Subscribed and sworn to before me by John J. Finnigan, Jr. on this 10<sup>TH</sup> day of July, 2009.

  
\_\_\_\_\_  
NOTARY PUBLIC

My Commission Expires:

**MICHAEL A. GRIBLER, Attorney at Law**  
Notary Public, State of Ohio  
My Commission has no expiration date.  
Section 147.03 O. R. C.




VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

The undersigned, Gary J. Hebbeler being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as General Manager, Gas Engineering; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.

  
\_\_\_\_\_  
Gary J. Hebbeler, Affiant

Subscribed and sworn to before me by Gary J. Hebbeler on this 6<sup>th</sup> day of July, 2009.

  
\_\_\_\_\_  
NOTARY PUBLIC

My Commission Expires:




**ANITA M. SCHAFER**  
Notary Public, State of Ohio  
My Commission Expires  
November 4, 2009

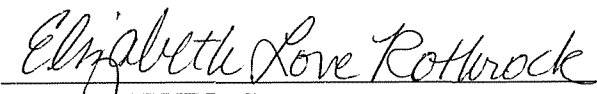
VERIFICATION

State of North Carolina   )  
  )  
County of Mecklenburg   )

The undersigned, Stephen G. De May, being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Vice President and Treasurer of Duke Energy Corporation; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.

  
\_\_\_\_\_  
Stephen G. De May, Affiant

Subscribed and sworn to before me by Stephen G. De May on this 10<sup>th</sup> day of July, 2009.

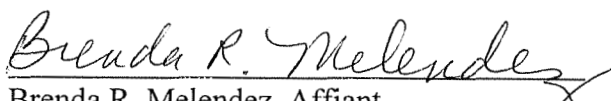
  
\_\_\_\_\_  
NOTARY PUBLIC

My Commission Expires: 12/7/2013

VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

The undersigned, Brenda R. Melendez being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Manager, Accounting; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquiry.

  
\_\_\_\_\_  
Brenda R. Melendez, Affiant

Subscribed and sworn to before me by Brenda R. Melendez on this 7<sup>th</sup> day of July, 2009.

  
\_\_\_\_\_  
NOTARY PUBLIC

My Commission Expires:




**ANITA M. SCHAFER**  
Notary Public, State of Ohio  
My Commission Expires  
November 4, 2009


VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

The undersigned, Robert M. Parsons being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Rates Manager; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.

  
\_\_\_\_\_  
Robert M. Parsons, Affiant

Subscribed and sworn to before me by Robert M. Parsons on this 1<sup>st</sup> day of July, 2009.

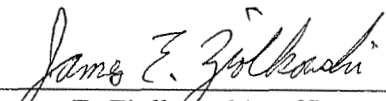
  
\_\_\_\_\_  
NOTARY PUBLIC

My Commission Expires: **PATTY A. SELM**  
**Notary Public, State of Ohio**  
**My Commission Expires 09-15-2014**

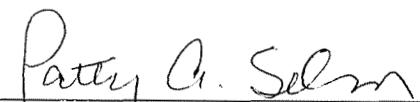
VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

The undersigned, James E. Ziolkowski being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Rates Manager; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.

  
\_\_\_\_\_  
James E. Ziolkowski, Affiant

Subscribed and sworn to before me by James E. Ziolkowski on this 2<sup>nd</sup> day of July, 2009.

  
\_\_\_\_\_  
NOTARY PUBLIC

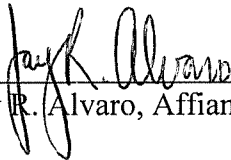
My Commission Expires:

PATTYA SELIN  
Notary Public, State of Ohio  
My Commission Expires 09-15-2014

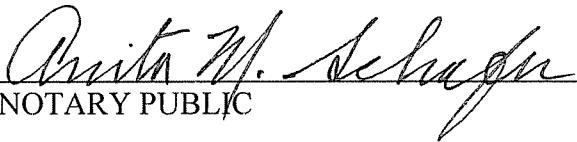
VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

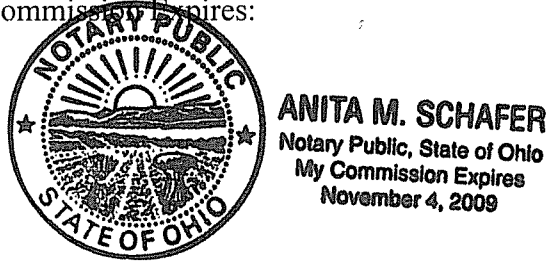
The undersigned, Jay R. Alvaro being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Vice President – Total Rewards; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquiry.

  
\_\_\_\_\_  
Jay R. Alvaro, Affiant

Subscribed and sworn to before me by Jay R. Alvaro on this 15<sup>th</sup> day of July, 2009.

  
\_\_\_\_\_  
NOTARY PUBLIC

My Commission Expires:






VERIFICATION

State of Ohio            )  
                                  )  
County of Hamilton    )

The undersigned, Julia S. Janson being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as President – Duke Energy Ohio, Inc. and Duke Energy Kentucky, Inc.; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.

  
\_\_\_\_\_  
Julia S. Janson, Affiant

Subscribed and sworn to before me by Julia S. Janson on this 1st day of July, 2009.

  
\_\_\_\_\_  
NOTARY PUBLIC

My Commission Expires:



**ANITA M. SCHAFER**  
Notary Public, State of Ohio  
My Commission Expires  
November 4, 2009



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**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-001**

**REQUEST:**

Provide a copy of the current bylaws. Indicate any changes made to the bylaws since Duke Kentucky's last gas rate case.

**RESPONSE:**

See Attachment STAFF-DR-01-001.

**PERSON RESPONSIBLE:** Julia S. Janson



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**THE UNION LIGHT, HEAT AND POWER COMPANY**

---

**BY-LAWS**

---

**ADOPTED BY SHAREHOLDERS, APRIL 27, 1948**  
**AMENDED BY BOARD OF DIRECTORS, MAY 3, 1950**  
**AMENDED BY SHAREHOLDERS, MAY 2, 1984**  
**AMENDED BY SHAREHOLDERS, MAY 3, 1989**  
**AMENDED BY SHAREHOLDERS, JUNE 16, 1995**  
**AMENDED BY SHAREHOLDERS, MAY 8, 1996**  
**AMENDED EFFECTIVE JULY 24, 1997**  
**AMENDED BY SHAREHOLDERS, MAY 26, 1999**  
**AMENDED BY SHAREHOLDERS, JULY 23, 2003**  
**AMENDED EFFECTIVE APRIL 3, 2006**

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**BY-LAWS  
OF  
THE UNION LIGHT, HEAT AND POWER COMPANY**

**ARTICLE I**

Offices

*Section 1. Offices.* The registered office of the Corporation shall be located in the City of Louisville, Jefferson County, Commonwealth of Kentucky. The Corporation may establish branch offices and conduct and carry on business at such other places within or without the Commonwealth of Kentucky as the Board of Directors may from time to time fix or designate, and any business conducted or carried on at such other place or places shall be as binding and effectual as if transacted at the registered office of the Corporation.

**ARTICLE II**

Shareholders' Meetings

*Section 1. Annual Meeting.* The annual meeting of the shareholders may be held either within or without the Commonwealth of Kentucky, at such place, time, and date designated by the Board of Directors, for the election of directors, the consideration of the reports to be laid before the meeting and the transaction of such other business as may be brought before the meeting.

*Section 2. Notice of Annual Meeting.* Notice of the annual meeting shall be given in writing to each shareholder entitled to vote thereat, at such address as appears on the records of the Corporation at least ten (10) days, and not more than forty (40) days prior to the meeting.

*Section 3. Special Meetings.* Special meetings of the shareholders may be called at any time by the Chairman, Vice Chairman, Chief Executive Officer, Chief Operating Officer, or President, or by a majority of the members of the Board of Directors acting with or without a meeting, or by the persons who hold in the aggregate one-fifth of all the shares outstanding and entitled to vote thereat, upon notice in writing, stating the time, place and purpose of the meeting. Business transacted at all special meetings shall be confined to the objects stated in the call.

*Section 4. Notice of Special Meeting.* Notice of a special meeting, in writing, stating the time, place and purpose thereof, shall be given to each shareholder entitled to vote thereat, not less than ten (10) nor more than thirty-five (35) days after the receipt of said request.

*Section 5. Waiver of Notice.* Notice of any shareholders' meeting may be waived in writing by any shareholder at any time before or after the meeting.

*Section 6. Quorum.* At any meeting of the shareholders, the holders of a majority of the shares of stock of the Corporation, issued and outstanding, and entitled to vote, present in person or by proxy, shall constitute a quorum for all purposes, unless otherwise specified by law or the Articles of Incorporation.

If, however, such majority shall not be present or represented at any meeting of the shareholders, the shareholders entitled to vote, present in person or by proxy, shall have power to adjourn the meeting from time to time without further notice, other than by announcement at the

meeting, until the requisite amount of voting stock shall be present. At any such adjourned meeting, at which a quorum shall be present, any business may be transacted which might have been transacted at the meeting as originally called.

*Section 7. Voting.* At any meeting of the shareholders, every shareholder having the right to vote shall be entitled to vote in person, or by proxy appointed by an instrument in writing subscribed by such shareholder and bearing a date not more than eleven (11) months prior to said meeting, unless some other definite period of validity shall be expressly provided therein.

Each shareholder shall have one (1) vote for each share of stock having voting power, registered in his or her name on the books of the Corporation, at the date fixed for determination of persons entitled to vote at the meeting or, if no date has been fixed, then at the date of the meeting. Cumulative voting shall be permitted only as expressly required by statute.

A complete list of shareholders entitled to vote at the shareholders' meetings, arranged in alphabetical order, with the address and the number of voting shares held by each, shall be produced on the request of any shareholder, and such list shall be prima facie evidence of the ownership of shares and of the right of shareholders to vote, when certified by the Secretary or by the agent of the Corporation having charge of the transfer of shares.

*Section 8. Written Consent of Shareholders in Lieu of Meeting.* Any action required or permitted by statute, the Restated Articles of Incorporation of the Corporation, or these By-Laws, to be taken at any annual or special meeting of shareholders of the Corporation, may be taken without a meeting, without prior notice, and without a vote, if a written consent in lieu of a meeting, setting forth the actions so taken, shall be signed by all the shareholders entitled to vote thereon. Any such written consent may be given by one or any number of substantially concurrent written instruments of substantially similar tenor signed by such shareholders, in person or by attorney or proxy duly appointed in writing, and filed with the records of the Corporation. Any such written consent shall be effective as of the effective date thereof as specified therein.

### ARTICLE III

#### Board of Directors

*Section 1. Number of Directors, Tenure, Vacancies.* The business and affairs of the Corporation shall be managed and controlled by a Board of Directors (who need not be shareholders) consisting of not less than three (3) persons and not more than seven (7), the exact number of which may be fixed or changed either by the affirmative vote of the majority of the shares represented and entitled to vote at any meeting of the shareholders called for the purpose of electing directors, or by the affirmative vote of the majority of the directors then in office at any stated or special meeting of the Board of Directors; provided, however, that the board may be subject to certain limitations as expressly provided for under and pursuant to Kentucky Revised Statutes §271B.8-030(2), or such similar successor governing statute. Directors shall be elected annually by the shareholders at the annual meeting, and each director shall hold office until his successor shall have been elected and qualified. Any director may resign at any time. Vacancies occurring in the Board of Directors shall be filled by the remaining members of the board. A director thus elected to fill any vacancy shall hold office for the unexpired term of his predecessor and until his successor is elected and qualifies. Any director may be removed at any time by the affirmative vote of a majority of the stock then issued and entitled to vote at a special meeting of shareholders called for the purpose.

*Section 2. Annual Organization Meeting.* Immediately after each annual election, the newly elected directors may meet forthwith (either within or without the State of Kentucky) for the purpose of organization, the election of officers and the transaction of other business. If a majority of the directors be then present no prior notice of such meeting shall be required to be given. The place and time of such first meeting may, however, be fixed by written consent of all the directors, or by three (3) days written notice given by the Secretary of the Corporation.

*Section 3. Regular Meetings.* Regular meetings of the Board of Directors may be held at such time and place (either within or without the State of Kentucky), and upon such notice, as the Board of Directors may from time to time determine.

*Section 4. Special Meetings.* Special meetings of the Board of Directors may be called by the Chairman, Vice Chairman, Chief Executive Officer, Chief Operating Officer, or President, or may be called by the written request of two (2) members of the Board of Directors.

*Section 5. Notice of Meetings.* Notice of meetings shall be given to each director in accordance with Article X, Section 1, of these By-Laws.

*Section 6. Quorum.* A majority of the Board of Directors shall constitute a quorum for the transaction of business, but a majority of those present at the time and place of any meeting, although less than a quorum, may adjourn the same from time to time, without notice, until a quorum be had. The act of a majority of the directors present at any such meeting at which a quorum is present shall be the act of the Board of Directors.

*Section 7. Compensation of Directors.* Each director of the Corporation (other than directors who are salaried officers of the Corporation or of The Cincinnati Gas & Electric Company or any of its affiliates) shall be entitled to receive as compensation for services such amounts as may be determined from time to time by the Board of Directors in form either in fees for attendance at the meeting of the Board of Directors, or by payment at the rate of a fixed sum per month, or both. The same payment may also be made to anyone other than a director officially called to attend any such meeting.

*Section 8. Executive Committee.* The Board of Directors may, by resolution passed by a majority of the whole Board, designate annually three (3) of their number to constitute an Executive Committee, who to the extent provided in the resolution, shall exercise in the intervals between the meetings of the Board of Directors the powers of the Board in the management of the business and affairs of the Corporation.

The Executive Committee may act by a majority of its members at a meeting or by a writing signed by all of its members.

All action by the Executive Committee shall be reported to the Board of Directors at its meeting next succeeding such action.

Non-employee members of such Executive Committee shall be entitled to receive such fees and compensation as the Board of Directors may determine.

*Section 9. Other Committees.* The Board of Directors may also appoint such other standing or temporary committees from time to time as they may see fit, delegating to such committees all or any part of their own powers. The members of such committees shall be entitled to receive such fees as the Board may determine.

*Section 10. Actions of Board.* Unless otherwise provided by the Restated Articles of Incorporation of the Corporation or these By-Laws, any action required or permitted to be taken at any meeting of the Board of Directors of the Corporation, or of any committee(s) thereof, may be taken without a meeting, if all the members of the Board of Directors, or of such committee(s), as the case may be, consent thereto in writing, and such writing(s) is filed with the minutes of proceedings of the Board of Directors, or of such committee(s), of the Corporation. Any such written consent to action of the Board of Directors, or of such committee(s), shall be effectuated by the signature of the member lastly consenting thereto in writing, unless the consent otherwise specifies a prior or subsequent effective date.

## ARTICLE IV

### Officers

*Section 1. Officers.* The officers of the Corporation shall consist of a President, a Secretary, a Treasurer, and may consist of a Chairman of the Board, a Chief Executive Officer, a Controller, one or more Vice Presidents, one or more Assistant Secretaries, one or more Assistant Treasurers, and such other officers as the board shall from time to time deem necessary, all of whom shall be elected by the board, and shall hold office until their successors are duly elected and qualified.

Any two of the offices of Vice President, Secretary and Treasurer may be combined in one person unless otherwise prohibited by statute, the Articles of Incorporation, or these By-Laws. All vacancies occurring among any of the above offices shall be filled by the Board of Directors. Any officer may be removed with or without cause by the affirmative vote of a majority of the number of Directors at any meeting of the Board of Directors.

*Section 2. Subordinate Officers.* The Board of Directors may appoint such other officers and agents with such powers and duties as they shall deem necessary.

*Section 3. The Chairman of the Board.* The Chairman of the Board shall be a director and shall preside at all meetings of the Board of Directors and, in the absence or inability to act of the Chief Executive Officer, meetings of shareholders and shall, subject to the Board's direction and control, be the Board's representative and medium of communication, and shall perform such other duties as may from time to time be assigned to the Chairman of the Board by the Board of Directors. The Chairman of the Board shall direct the long-term strategic planning process of the Corporation and shall also lend his or her expertise to such other officers as may be requested from time to time by such officers. The Chairman shall be a member of the Executive Committee.

*Section 4. The Vice Chairman.* The Vice Chairman of the Board, if there be one, shall be a director and shall preside at meetings of the Board of Directors in the absence or inability to act of the Chairman of the Board or meetings of shareholders in the absence or inability to act of the Chief Executive Officer and the Chairman of the Board. The Vice Chairman shall perform such other duties as may from time to time be assigned to him or her by the Board of Directors. The Vice Chairman shall be a member of the Executive Committee.

*Section 5. The Chief Executive Officer.* The Chief Executive Officer shall be a director and shall preside at all meetings of the shareholders, and, in the absence or inability to act of the Chairman of the Board and the Vice Chairman, at all meetings of the Board of Directors. The Chief Executive Officer shall from time to time report to the Board of Directors all matters within his or her knowledge which the interests of the Corporation may require be brought to their notice.



The Chief Executive Officer shall be the chairman of the Executive Committee and ex officio a member of all standing committees.

*Section 6. The Chief Operating Officer.* The Chief Operating Officer of the Corporation, if there be one, shall have general and active management and direction of the affairs of the Corporation, shall have supervision of all departments and of all officers of the Corporation, shall see that the orders and resolutions of the Board of Directors and of the Executive Committee are carried into effect, and shall have the general powers and duties of supervision and management usually vested in the office of a Chief Operating Officer of a corporation. Unless otherwise provided, all corporate officers and functions shall report directly to the Chief Operating Officer, if there be one, or, if not, to the Chief Executive Officer.

*Section 7. The President.* The President shall have such duties as may be delegated by the Board of Directors, Chief Executive Officer or Chief Operating Officer.

*Section 8. The Vice Presidents.* The Vice Presidents shall perform such duties as the Board of Directors shall, from time to time, require. In the absence or incapacity of the President, the Vice President designated by the Board of Directors or Executive Committee, Chief Executive Officer, Chief Operating Officer, or President shall exercise the powers and duties of the President.

*Section 9(a). The Secretary.* The Secretary shall attend all meetings of the Board of Directors, of the Executive Committee and of the shareholders and act as clerk thereof and record all votes and the minutes of all proceedings in a book to be kept for that purpose, and shall perform like duties for the standing committees when required.

The Secretary shall keep in safe custody the seal of the Corporation, and, whenever authorized by the Board of Directors or the Executive Committee, affix the seal to any instrument requiring the same.

The Secretary shall see that proper notice is given of all meetings of the shareholders of the Corporation and of the Board of Directors and shall perform such other duties as may be prescribed from time to time by the Board of Directors, Chief Executive Officer, Chief Operating Officer or President.

*(b) Assistant Secretaries.* At the request of the Secretary, or in his or her absence or inability to act, the Assistant Secretary or, if there be more than one, the Assistant Secretary designated by the Secretary, shall perform the duties of the Secretary and when so acting shall have all the powers of and be subject to all the restrictions of the Secretary. The Assistant Secretaries shall perform such other duties as may from time to time be assigned to them by the Board of Directors, Chief Executive Officer, Chief Operating Officer, President, or Secretary.

*Section 10(a). The Treasurer.* The Treasurer shall be the financial officer of the Corporation, shall keep full and accurate accounts of all collections, receipts and disbursements in books belonging to the Corporation, shall deposit all moneys and other valuables in the name and to the credit of the Corporation, in such depositories as may be directed by the Board of Directors, shall disburse the funds of the Corporation as may be ordered by the Board of Directors, Chief Executive Officer, Chief Operating Officer, or President, taking proper vouchers therefor, and shall render to the Chief Executive Officer, Chief Operating Officer, or President, and directors at all regular meetings of the Board, or whenever they may require it, and to the annual meeting of the shareholders, an account of all his or her transactions as Treasurer and of the financial condition of the Corporation.

The Treasurer shall also perform such other duties as the Board of Directors may from time to time require.

If required by the Board of Directors, the Treasurer shall give the Corporation a bond in a form and in a sum with surety satisfactory to the Board of Directors for the faithful performance of the duties of his or her office and the restoration to the Corporation in the case of his or her death, resignation or removal from office of all books, papers, vouchers, money and other property of whatever kind in his or her possession belonging to the Corporation.

*(b) Assistant Treasurers.* At the request of the Treasurer, or in his or her absence or inability to act, the Assistant Treasurer or, if there be more than one, the Assistant Treasurer designated by the Treasurer, shall perform the duties of the Treasurer and when so acting shall have all the powers of and be subject to all the restrictions of the Treasurer. The Assistant Treasurers shall perform such other duties as may from time to time be assigned to them by the Board of Directors, Chief Executive Officer, Chief Operating Officer, President, or Treasurer.

*Section 11(a). The Controller.* The Controller shall have control over all accounts and records of the Corporation pertaining to moneys, properties, materials and supplies. He or she shall have executive direction over the bookkeeping and accounting departments and shall have general supervision over the records in all other departments pertaining to moneys, properties, materials and supplies. He or she shall have such other powers and duties as are incident to the office of Controller of a corporation and shall be subject at all times to the direction and control of the Board of Directors, Chief Executive Officer, Chief Operating Officer, President and a Vice President.

*(b) Assistant Controllers.* At the request of the Controller, or in his or her absence or inability to act, the Assistant Controller or, if there be more than one, the Assistant Controller designated by the Controller, shall perform the duties of the Controller and when so acting shall have all the powers of and be subject to all the restrictions of the Controller. The Assistant Controllers shall perform such other duties as may from time to time be assigned to them by the Board of Directors, Chief Executive Officer, Chief Operating Officer, President, or Controller.

## ARTICLE V

### Indemnification of Directors, Officers, Employees, and Agents

#### *Section 1. Definitions.* As used in this Article:

A. "Corporation" includes any domestic or foreign predecessor entity of the Corporation in a merger or other transaction in which the predecessor's existence ceased upon consummation of the transaction.

B. "Director" means an individual who is or was a Director of the Corporation or an individual who, while a Director of the Corporation, is or was serving at the Corporation's request as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise. A Director shall be considered to be serving an employee benefit plan at the Corporation's request if his or her duties to the Corporation also impose duties on, or otherwise involve services by, him or her to the plan or to participants in or beneficiaries of the plan. "Director" includes, unless the context requires otherwise, the estate or personal representative of a Director.

C. "Expenses" include counsel fees.

D. "Liability" means the obligation to pay a judgment, settlement, penalty, fine (including an excise tax assessed with respect to an employee benefit plan), or reasonable expenses incurred with respect to a proceeding.

E. "Official capacity" means:

(1) When used with respect to a Director, the office of Director in the Corporation, and

(2) When used with respect to an individual other than a Director, as contemplated in Section 6, the office in the Corporation held by the officer or the employment or agency relationship undertaken by the employee or agent on behalf of the Corporation. "Official capacity" shall not include service for any other foreign or domestic corporation or any partnership, joint venture, trust, employee benefit plan, or other enterprise.

F. "Party" includes an individual who was, is, or is threatened to be made a named defendant or respondent in a proceeding.

G. "Proceeding" means any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative and whether formal or informal.

#### *Section 2. Indemnification.*

A. Except as provided in subsection (D) of this Section, the Corporation shall indemnify an individual made a party to a proceeding because he or she is or was a Director against liability incurred in the proceeding if:

(1) He or she conducted himself or herself in good faith; and

(2) He or she reasonably believed:

(a) In the case of conduct in his or her official capacity with the Corporation, that his or her conduct was in its best interest; and

(b) In all other cases, that his or her conduct was at least not opposed to its best interests; and

(3) In the case of any criminal proceeding, he or she had no reasonable cause to believe his or her conduct was unlawful.

B. A Director's conduct with respect to an employee benefit plan for a purpose he or she reasonably believed to be in the interests of the participants in and beneficiaries of the plan shall be conduct that satisfies the requirement of subsection A(2)(b) of this Section.

C. The termination of a proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent shall not be, of itself, determinative that the Director did not meet the standard of conduct described in this Section.

D. The Corporation may not indemnify a Director under this Section:

(1) In connection with a proceeding by or in the right of the Corporation in which the Director was adjudged liable to the Corporation; or

(2) In connection with any other proceeding charging improper personal benefit to him or her, whether or not involving action in his or her official capacity, in which he or she was adjudged liable on the basis that personal benefit was improperly received by him or her.

E. Indemnification permitted under this Section in connection with a proceeding by or in the right of the Corporation shall be limited to reasonable expenses incurred in connection with the proceeding.

*Section 3. Mandatory Indemnification.* Unless limited by the Articles of Incorporation, the Corporation shall indemnify a Director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which he or she was a party because he or she is or was a Director of the Corporation against reasonable expenses incurred by him or her in connection with the proceeding.

*Section 4. Advance for Expenses.*

A. The Corporation may pay for or reimburse the reasonable expenses incurred by a Director who is a party to a proceeding in advance of final disposition of the proceeding if:

(1) The Director furnishes the Corporation a written affirmation of his or her good faith belief that he or she has met the standard of conduct described in Section 2;

(2) The Director furnishes the Corporation a written undertaking, executed personally or on his or her behalf, to repay the advance if it is ultimately determined that he or she did not meet the standard of conduct; and

(3) A determination is made that the facts then known to those making the determination would not preclude indemnification under this article.

B. The undertaking required by subsection A(2) of this Section shall be an unlimited general obligation of the Director but shall not be required to be secured and may be accepted without reference to financial ability to make repayment.

C. Determinations and authorizations of payments under this Section shall be made in the manner specified in Section 5.

*Section 5. Determination and Authorization of Indemnification.*

A. The Corporation shall not indemnify a Director under Section 2 of this Article unless authorized in the specific case after a determination has been made that indemnification of the Director is permissible in the circumstances because he or she has met the standard of conduct set forth in Section 2.

B. The determination shall be made:

(1) By the Board of Directors by majority vote of a quorum consisting of Directors not at the time parties to the proceeding;

(2) If a quorum cannot be obtained under subsection B(1) of this Section, by majority vote of a committee duly designated by the Board of Directors (in which designation Directors who are parties may participate), consisting solely of two or more Directors not at the time parties to the proceeding;

(3) By special legal counsel:

(a) Selected by the Board of Directors or its committee in the manner prescribed in subsection B(1) and (2) of this Section; or

(b) If a quorum of the Board of Directors cannot be obtained under subsection B(1) of this Section and a committee cannot be designated under subsection B(2) of this Section, selected by majority vote of the full Board of Directors (in which selection Directors who are parties may participate); or

(4) By the shareholders, but shares owned by or voted under the control of Directors who are at the time parties to the proceeding shall not be voted on the determination.

C. Authorization of indemnification and evaluation as to reasonableness of expenses shall be made in the same manner as the determination that indemnification is permissible, except that if the determination is made by special legal counsel, authorization of indemnification and evaluation as to reasonableness of expenses shall be made by those entitled under subsection B(3) of this Section to select counsel.

*Section 6. Indemnification of Officers, Employees, and Agents.* Unless the Corporation's Articles of Incorporation provide otherwise:

A. An officer of the Corporation who is not a Director shall be entitled to mandatory indemnification under Section 3, and is entitled to apply for court-ordered indemnification under the Kentucky Business Corporation Act, in each case to the same extent as a Director;

B. The Corporation may indemnify and advance expenses under this Article to an officer, employee, or agent of the Corporation who is not a Director to the same extent as to a Director; and

C. The Corporation may also indemnify and advance expenses to an officer, employee, or agent who is not a Director to the extent, consistent with public policy, that may be provided by the Articles of Incorporation, By-Laws, general or specific action of the Board of Directors, or contract.

*Section 7. Insurance.* The Corporation may purchase and maintain insurance on behalf of an individual who is or was a Director, officer, employee, or agent of the Corporation, or who, while a Director, officer, employee, or agent of the Corporation, is or was serving at the request of the Corporation as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise, against liability asserted against or incurred by him or her in that capacity or arising from his or her status as a Director, officer, employee, or agent, whether or not the Corporation would have power to indemnify him or her against the same liability under either Section 2 or 3.

*Section 8. Application of this Article.*

A. The indemnification and advancement of expenses provided by, or granted pursuant to, this Article shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under the By-Laws, any agreement, vote of shareholders or disinterested Directors, or otherwise, both as to action in his or her official capacity and as to action in another capacity while holding such office.

B. This Article shall not limit the Corporation's power to pay or reimburse expenses incurred by a Director in connection with his or her appearance as a witness at a proceeding at a time when he or she has not been made a named defendant or respondent to the proceeding.

## ARTICLE VI

### Capital Stock

*Section 1. Form and Execution of Certificates.* The certificates for shares of the capital stock of the Corporation shall be of such form and content, not inconsistent with the law and the Articles of Incorporation, as shall be approved by the Board of Directors. The certificates shall be signed by (1) either the Chairman, Chief Executive Officer, President or a Vice President, and (2) any one of the following officers: Secretary or Assistant Secretary, Treasurer or Assistant Treasurer. All certificates shall be consecutively numbered in each class of shares. The name and address of the person owning the shares represented thereby, with the number of shares and the date of issue, shall be entered on the Corporation's books.

*Section 2. Transfer of Shares.* Transfer of shares shall be made upon the books of the Corporation or respective Transfer Agents designated to transfer each class of stock, and before a new certificate is issued the old certificates shall be surrendered for cancellation.

*Section 3. Appointment of Transfer Agents and Registrars.* The Board of Directors may appoint one or more transfer agents or one or more registrars or both, and may require all stock certificates to bear the signature of either or both. When any such certificate is signed, by a transfer agent or registrar, the signatures of the corporate officers and the corporate seal, if any, upon such certificate may be facsimiles, engraved or printed.

In case any officer designated for the purpose, who has signed or whose facsimile signature has been used on any such certificate, shall, from any cause, cease to be such officer before the certificate has been delivered by the Corporation, the certificate may nevertheless be adopted by the Corporation and be issued and delivered as though the person had not ceased to be such officer.

*Section 4. Closing of Transfer Books or Taking Record of Shareholders.* The Board of Directors may fix a time not exceeding forty (40) days preceding the date of any meeting of shareholders or any dividend payment date or any date for the allotment of rights as a record date for the determination of the shareholders entitled to notice of such meeting or to vote thereat or to receive such dividends or rights as the case may be; or the Board of Directors may close the books of the Corporation against transfer of shares during the whole or any part of such period.

*Section 5. Lost Stock Certificates.* In the case of a lost stock certificate, a new stock certificate may be issued in its place upon proof of such loss, destruction or mutilation and upon the giving of a satisfactory bond of indemnity to the Corporation and/or to the transfer agent and registrar of such stock, if any, in such sum and under such terms as the Board of Directors may provide.

## ARTICLE VII

### Dividends

*Section 1. Dividends.* Dividends may be declared by the Board of Directors (or the Executive Committee, if there be one and the authority to declare dividends is delegated to the Executive Committee by the Board of Directors) and paid in cash, shares, or other property out of the annual net income to the Corporation or out of its net assets in excess of its capital, computed in accordance with the state statute and subject to the conditions and limitations imposed by the Articles of Incorporation.

No dividends shall be paid to the holders of any class of shares in violation of the rights of the holders of any other class of shares.

Before payment of any dividends or making distribution of any profits, there may be set apart out of the excess of assets available for dividends such sum or sums as the Board of Directors (or Executive Committee, if there be one and the authority to declare dividends or make distributions is delegated to the Executive Committee) from time to time in its absolute discretion thinks proper as a reserve fund for any purpose.

## ARTICLE VIII

### Fiscal Year

*Section 1. Fiscal Year.* The fiscal year of the Corporation shall begin on the first day of January and terminate on the thirty-first day of December in each year.

## ARTICLE IX

### Contracts, Checks, Notes, etc.

*Section 1. Contracts, Checks, Notes, etc.* All contracts and agreements authorized by the Board of Directors and all bonds and notes shall, unless otherwise directed by the Board of Directors or unless otherwise required by law, be signed by (1) either the Chairman, Vice Chairman, Chief Executive Officer, Chief Operating Officer, President, or a Vice President, and (2) any one of the following officers: Secretary or Assistant Secretary, Treasurer or Assistant

Treasurer. The Board of Directors may by resolution adopted at any meeting designate officers of the Corporation who may in the name of the Corporation execute checks, drafts and orders for the payment of money in its behalf and, in the discretion of the Board of Directors, such officers may be so authorized to sign such checks singly without necessity for counter-signature.

## ARTICLE X

### Notice and Waiver of Notice

*Section 1. Notice and Waiver of Notice.* Any notice required to be given by these By-Laws to a Director or officer may be given in writing, personally served or through the United States Mail, or by telephone, telegram, cablegram or radiogram, and such notice shall be deemed to be given at the time when the same shall be thus transmitted. Any notice required to be given by these By-Laws may be waived by the person entitled to such notice.

## ARTICLE XI

### Corporate Seal

*Section 1. Corporate Seal.* The corporate seal of the Corporation shall consist of a metallic stamp, circular in form, bearing in its center the word "Seal", and on the outer edge the name of the Corporation.

## ARTICLE XII

### Amendment

*Section 1. Amendment.* These By-Laws may be amended or repealed at any meeting of the shareholders of the Corporation by the affirmative vote of the holders of record of shares entitling them to exercise a majority of the voting power on such proposal, or, without a meeting, by the written consent of the holders of record of shares entitling them to exercise a two-thirds majority of the voting power on such proposal.





**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-002**

**REQUEST:**

Provide the current organization chart, showing the relationship between Duke Kentucky and any affiliates. Show the relative positions of all entities and affiliates with which Duke Kentucky routinely has business transactions.

**RESPONSE:**

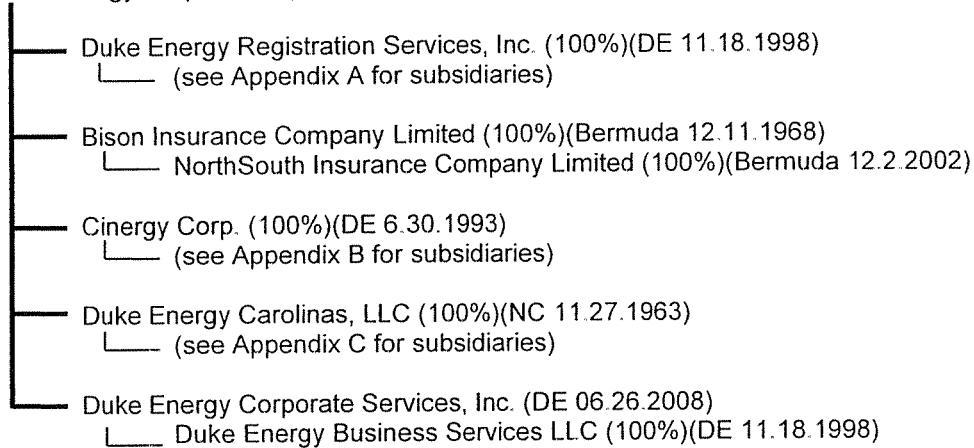
See Attachment STAFF-DR-01-002. Duke Energy Kentucky routinely has business transactions with its affiliated utility operating companies, Duke Energy Ohio, Duke Energy Indiana, and Duke Energy Carolinas, as well as with Duke Energy Business Services. These transactions are pursuant to service agreements filed with the Kentucky Public Service Commission.

Duke Energy Kentucky may also provide to or receive services from other affiliated companies that are parties to the utility/non-utility service agreement. Copies of all service agreements are included in Duke Energy Kentucky's Cost Allocation Manual contained in Volume 10 of the Company's Application in this proceeding.

**PERSON RESPONSIBLE:** Julia S. Janson

## DUKE ENERGY CORPORATION CORPORATE STRUCTURE

Duke Energy Corporation (DE 5.3.2005)



Information contained in the World Records database takes precedence over information disclosed in this document.  
Balance of ownership for entities <100% owned by a Duke entity can be referenced in World Records.

Duke Energy Corporation

└─ Duke Energy Registration Services, Inc. (100%)

Duke Energy Registration Services, Inc. (100%)(DE 11.18.1998)

└─ PanEnergy Corp. (100%) (DE 1.26.1981)

└─ Duke Energy Services, Inc. (100%)(DE 6.8.1959)

└─ Duke Energy Marketing Corp. (100%)(NV 11.7.1994)

└─ Duke/Louis Dreyfus L.L.C. (50%)(NV 3.1.1995)

└─ DETMI Management, Inc. (100%)(CO 6.21.1994)

└─ DTMSI Management Ltd. (100%)(Alberta Canada 7.9.1996)

└─ Duke Energy Services Canada ULC (31%)(Alberta Canada 8.30.1995)

└─ DE Marketing Canada Ltd. (60%)(Canadian Federal 7.17.1996)

└─ Duke Energy Marketing Limited Partnership (1%)(Alberta 8.1.1996)

└─ KEFI-Exchange Inc. (4%)(Alberta Canada 10.28.1999)

└─ Duke Energy Trading and Marketing, L.L.C. (60%)(DE 7.10.1996)

└─ Duke Ventures, LLC (100%)(NV 12.19.2000)

└─ Crescent Holdings, LLC (49%)(DE 8.30.2006)

└─ Crescent Resources, LLC (100%)(GA 12.31.2000)

└─ Duke Capital Partners, LLC (100%)(DE 3.14.2000)

└─ Duke Ventures Real Estate, LLC (100%)(DE 6.09.2009)

└─ Dixilyn-Field Drilling Company (100%)(DE 1.31.1977)

└─ Dixilyn-Field (Nigeria) Limited (100%)(Nigeria 11.14.1977)

└─ Dixilyn-Field International Drilling Company, S.A. (100%)(Panama 6.10.1970)

└─ Duke Energy Services Canada ULC (69%)(Alberta Canada 8.30.1995)

└─ Duke Energy Marketing Limited Partnership (59.40%)(Alberta Canada 8.1.1996)

└─ KEFI-Exchange Inc. (4%)(Alberta Canada 10.28.1999)

└─ Duke Energy Services Ireland Limited (100%)

└─ DukeNet Communications, LLC (100%)(DE 12.15.2000)

└─ Conterra Ultra Broadband Holdings, Inc. (16.11%)(NC 7.28.2006)

└─ DukeNet Communication Services, LLC (100%)(DE 12.21.2006)

└─ Tower Management, Inc. (IN, 05.16.2008)

└─ DukeNet/TCG LLC (21.6%)(NC 12.12.1997)

└─ Eastman Whipstock do Brasil Ltda (100%)(Brazil, 5.21.1979)

└─ Eastman Whipstock S.A. (100%)(Argentina 10.13.1981)

└─ Energy Pipelines International Company (100%)(DE 4.28.1975)

└─ Pan Service Company (100%)(DE 8.13.1976)

└─ Seahorse do Brasil Servicos Maritimos Ltda. (100%)(Brazil 3.30.1979)

└─ Duke Energy Americas, LLC (100%)(DE 7.2.2004)

└─ Duke Energy Global Markets, Inc. (100%)(NV 8.2.1996)

└─ Duke Energy Carolinas Plant Operations, LLC (100%)(DE 5.29.2001)

└─ DE Nuclear Engineering, Inc. (100%)(NC 3.17.1969)

└─ Duke Energy Fossil-Hydro, LLC (100%)(DE 7.6.2001)

└─ Duke Energy Fossil-Hydro California, Inc. (100%)(DE 8.1.2001)

└─ Duke Energy Royal, LLC (100%)(DE 3.13.2002)

└─ Duke Engineering & Services (Europe) Inc. (100%)(DE 10.13.1993)

└─ Duke Engineering & Services International, Inc. (100%)(Cayman Islands 5.8.1996)

└─ Duke/Louis Dreyfus L.L.C. (50%)(NV 3.1.1995)

└─ Duke Energy International, LLC (DE 9.18.1997)

└─ (See separate chart for subsidiaries)

└─ Duke Energy Merchants, LLC (100%)(DE 4.23.1999)

└─ Duke Energy North America, LLC (100%)(DE 9.18.1997)

└─ DENA Asset Partners, L.P. (1%)(DE 12.14.2001)

└─ DENA Partners Holding, LLC (100%)(DE 11.30.2001)

└─ DENA Asset Partners, L.P. (99%)(DE 12.14.2001)

└─ Duke Energy Allowance Management, LLC (100%)(DE 5.15.2001)

└─ Duke Energy Marketing America, LLC (100%)(DE 1.3.2001)

└─ Duke Energy Moapa, LLC (100%)(DE 4.11.2000)

└─ Duke Energy Trading Exchange, LLC (100%)(DE 8.3.2000)

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 Balance of ownership for entities <100% owned by a Duke entity can be referenced in World Records.



Information contained in the World Records database takes precedence over information disclosed in this document.  
Balance of ownership for entities <100% owned by a Duke entity can be referenced in World Records.

Duke Energy Corporation  
└─ Cinergy Corp. (100%)

Cinergy Corp. (100%)(DE 6.30.1993)

- └─ Cinergy Global Resources, Inc. (100%)(DE 5.15.1998)
  - └─ (See Appendix D for subsidiaries)
- └─ Cinergy Investments, Inc. (100%)(DE 10.24.1994)
  - └─ Cinergy Capital & Trading, Inc. (100%)(IN 10.8.1992)
    - └─ (see Appendix E for subsidiaries)
  - └─ Cinergy-Centrus, Inc. (100%)(DE 4.23.1998)
  - └─ Cinergy-Centrus Communications, Inc. (100%)(DE 7.17.1998)
  - └─ Cinergy Technology, Inc. (100%)(IN 12.12.1991)
  - └─ Duke-Cadence, Inc. (100%)(IN 12.27.1989)
    - └─ Advantage IQ, Inc. (4.09%)(WA 11.6.1995)
  - └─ Duke Communications Holdings, Inc. (100%)(DE 9.20.1996)
    - └─ Q-Comm Corporation (32.7%)(NV 9.26.1996)
  - └─ Duke Energy Engineering, Inc. (100%)(OH 3.28.1997)
  - └─ Duke Energy Generation Services Holding Company, Inc. (100%)(DE 2.11.1997)
    - └─ (see Appendix F for subsidiaries)
  - └─ Duke-Reliant Resources, Inc. (100%)(1.14.1998)
    - └─ Reliant Services, LLC (50%)(IN 6.25.1998)
      - └─ Fiber Link, LLC (75%)(IN 9.5.2000)
- └─ Cinergy Receivables Company, LLC (100%)(DE 1.10.2002)
- └─ Cinergy Wholesale Energy, Inc. (100%)(OH 11.27.2000)
  - └─ Cinergy Origination & Trade, LLC (100%)(DE 10.19.2001)
  - └─ Cinergy Power Generation Services, LLC (100%)(DE 11.22.2000)
- └─ Duke Energy Indiana, Inc. (100%)(IN 9.6.1941)
  - └─ South Construction Company, Inc. (100%)(IN 5.31.1934)
- └─ Duke Energy Ohio, Inc. (100%)(OH 4,3,1837)
  - └─ Cinergy Power Investments, Inc. (100%)(OH 12.5.2000)
  - └─ Duke Energy Kentucky, Inc. (100%)(KY 3.20.1901)
  - └─ KO Transmission Company (100%)(KY 4.11.1994)
  - └─ Miami Power Corporation (100%)(IN 3.25.1930)
  - └─ Ohio Valley Electric Corporation (9%)
  - └─ Sugartree Timber, LLC (100%)(DE 7.24.2008)
  - └─ Tri-State Improvement Company (100%)(OH 1.14.1964)
- └─ Duke Energy Transmission Holding Company (100%)(DE 7.16.2008)
  - └─ Pioneer Transmission, LLC (50%)(IN 7.31.2008)
- └─ DukeTec LLC (100%)(DE 11.16.2000)
  - └─ DukeTec I LLC (100%)(DE 11.16.2000)
    - └─ eVent Resources I LLC (80%)(DE 11.17.2000)
      - └─ eVent Resources Holdings LLC (100%)(DE 12.13.2000)
  - └─ DukeTec II LLC (100%)(DE 12.23.2003)
    - └─ eVent Resources I LLC (20%)(DE 11.17.2000)
      - └─ eVent Resources Holdings LLC (100%)(DE 12.13.2000)
- └─ Duke Technologies, Inc. (100%)(DE 7.26.2000)
  - └─ Cinergy Two, Inc. (100%)(DE 11.6.2000)
  - └─ Duke Broadband, LLC (100%)(DE 9.22.2003)
  - └─ Duke Energy One, Inc. (100%)(DE 9.5.2000)
    - └─ Cinergy Solutions – Utility, Inc. (100%)(DE 9.27.2004)
  - └─ Duke Investments, LLC (100%)(DE 7.25.2000)
    - └─ Current Group, LLC (9.34%)(DE 10.24.2000)
  - └─ Duke Supply Network, LLC (100%)(DE 8.10.2000)
  - └─ Duke Ventures II, LLC (100%)(DE 9.1.2000)
    - └─ Catalytic Solutions, Inc. (12.9%)(CA 1.31.1996)

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Duke Energy Corporation  
└─ Duke Energy Carolinas, LLC (100%)

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Duke Energy Carolinas, LLC (100%)(NC 11.27.1963)  
└─ APOG, LLC (20%)(DE 6.22.2007)  
└─ Advance SC LLC (100%)(SC 7.9.2004)  
└─ Caldwell Power Company (100%)(NC 7.28.1921)  
└─ Carolinas Virginia Nuclear Power Associates, Inc. (25%)(NC 10.4.1956)  
└─ Catawba Manufacturing and Electric Power Company (100%)(NC 10/15/1901)  
└─ Claiborne Energy Services, Inc. (100%)(LA 3.1.1990)  
└─ Duke Energy Receivables Finance Company, LLC (100%)(DE 7.16.2003)  
└─ Eastover Land Company (100%)(KY 6.30.1970)  
└─ Eastover Mining Company (100%)(KY 7.15.1970)  
└─ Greenville Gas and Electric Light and Power Company (100%)(SC 1.28.1861)  
└─ MCP, LLC (100%)(SC 8.18.2000)  
└─ NuStart Energy Development (16.67%)(DE 4.19.2004)  
└─ Piedmont Venture Partners Limited Partnership (10.64%)(NC 10/3/1996)  
└─ Sandy River Timber, LLC (100%)(SC, 10.26.2007)  
└─ Southern Power Company (100%)(NC 12.30.1927)  
└─ TBP Properties, LLC (100%)(SC 12.11.2006)  
└─ TRES Timber, LLC (100%)(SC 12.11.2006)  
└─ Wateree Power Company (100%)(SC)  
└─ Western Carolina Power Company (100%)(NC 9.10.1907)

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Duke Energy Corporation  
└─ Cinergy Corp. (100%)  
    └─ Cinergy Global Resources, Inc. (100%)

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Cinergy Global Resources, Inc. (100%)(DE 5.15.1998)  
└─ Cinergy Global Power, Inc. (100%)(DE 9.4.1997)  
    └─ CGP Global Greece Holdings, SA (99.99%)(Greece 8.10.2001)  
        └─ Attiki Denmark ApS (51%)(Denmark 10.1.2000)  
            └─ Attiki Gas Supply Company, SA (49%)(Greece 11.2.2001)  
    └─ Cinergy Global Ely, Inc. (100%)(DE 8.28.1998)  
    └─ Cinergy Global (Cayman) Holdings, Inc. (100%)(Cayman Islands 9.4.1997)  
        └─ Cinergy Global Tsavo Power (100%)(Cayman Islands 9.4.1997)  
            └─ IPS-Cinergy Power Limited (48.2%)(Kenya 4.28.1999)  
                └─ Tsavo Power Company Limited (49.9%)(Kenya 1.22.1998)  
    └─ Cinergy Global Holdings, Inc. (100%)(DE 12.18.1998)  
        └─ CGP Global Greece Holdings, SA (.01%)(Greece 8.10.2001)  
        └─ Cinergy Holdings, BV (100%)(Netherlands 4.7.1948)  
    └─ Cinergy Global Power Africa (Proprietary) Limited (100%)(South Africa 8.3.1999)  
    └─ Cinergy Global Power Services Limited (100%)(England 8.14.1997)  
    └─ Cinergy Global Power (UK) Limited (100%)(England 2.5.1998)  
        └─ Cinergy Global Trading Limited (100%)(England 5.25.1999)  
            └─ Cinergy Global Power Iberia, SA (100%)(Spain 6.17.1998)  
            └─ Commercial Electricity Supplies Limited (100%)(England 8.10.1993)  
            └─ UK Electric Power Limited (100%)(England 12.24.1920)  
    └─ eVent Resources Overseas I, LLC (DE 5.29.2001)  
└─ Cinergy UK, Inc. (100%)(DE 5.1.1996)

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Duke Energy Corporation

- └─ Cinergy Corp. (100%)
    - └─ Cinergy Investments, Inc. (100%)
      - └─ Cinergy Capital & Trading, Inc. (100%)
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Cinergy Capital & Trading, Inc. (100%)(IN 10.8.1992)

- └─ Brownsville Power I, L.L.C. (100%)(DE 7.13.1998)
- └─ CinCap IV, LLC (10%)(DE 12.3.1997)
- └─ CinCap V, LLC (10%)(DE 7.21.1998)
- └─ Cinergy Climate Change Investments, LLC (100%)(DE 6.9.2003)
- └─ Cinergy General Holdings, LLC (100%)(DE 12.14.2001)
- └─ Cinergy Limited Holdings, LLC (100%)(DE 12.14.2001)
- └─ Cinergy Retail Power General, Inc. (100%)(DE 8.7.2001)
  - └─ Cinergy Retail Power, L.P. (0.1%)(DE 8.8.2001)
- └─ Cinergy Retail Power Limited, Inc. (100%)(DE 8.6.2001)
  - └─ Cinergy Retail Power, L.P. (99%)(DE 8.8.2001)
- └─ CinFuel Resources, Inc. (100%)(DE 1.10.2002)
  - └─ Spruce Mountain Investments, LLC (1%)(DE 11.8.2006)
    - └─ Spruce Mountain Products, LLC (100%)(DE 10.27.2006)
  - └─ LH1, LLC (1%)(DE 1.10.2002)
    - └─ Oak Mountain Products, LLC (100%)(DE 7.9.2001)
- └─ CinPower I, LLC (100%)(DE 6.12.1998)
- └─ Duke Energy Retail Sales, LLC (100%)(DE 12.9.2003)
- └─ LH1, LLC (99%)(DE 1.10.2002)
  - └─ Oak Mountain Products, LLC (100%)(DE 7.9.2001)
- └─ Ohio River Valley Propane, LLC (100%)(DE 10.18.2001)
- └─ Spruce Mountain Investments, LLC (99%)(DE 11.8.2006)
- └─ SynCap II, LLC (100%)(DE 10.13.2000)

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Duke Energy Corporation

- └─ Cinergy Corp. (100%)
  - └─ Cinergy Investments, Inc. (100%)
    - └─ Duke Energy Generation Services Holding Company, Inc. (100%)

Duke Energy Generation Services Holding Company, Inc. (100%)(DE 2.11.1997)

- └─ DEGS Biomass, LLC (100%)(DE 9.22.2008)
  - └─ ADAGE LLC (50%)(DE 9.9.2008)
  - └─ ADAGE Hamilton LLC (50%)(DE 5.6.2009)
- └─ DEGS EPCOM College Park, LLC (100%)(DE 8.20.1999)
- └─ DEGS of Boca Raton, LLC (100%)(DE 9.4.1998)
- └─ DEGS of Cincinnati, LLC (100%)(OH 7.29.1997)
- └─ DEGS of St. Paul, LLC (100%)(DE 8.13.1998)
  - └─ Environmental Wood Supply, LLC (50%)(MN 8.10.2000)
  - └─ St. Paul Cogeneration, LLC (50%)(MN 12.18.1998)
- └─ DEGS of Tuscola, Inc. (100%)(DE 10.13.1998)
- └─ DEGS Wind I, LLC (100%)(DE 5.23.2007)
  - └─ DEGS Three Buttes, LLC (100%)(DE 8.26.2008)
    - └─ Three Buttes Windpower, LLC (100%)(DE 8.26.2008)
  - └─ DEGS Wind Supply, LLC (100%)(DE, 12.11.2007)
  - └─ DEGS Wind Supply II, LLC (100%)(DE 8.26.2008)
  - └─ Catamount Energy Corporation (100%)(VT 6.23.1992)
    - └─ (see Appendix G for subsidiaries)
  - └─ Notrees Windpower, LP (99%)(DE 9.30.2005)
  - └─ TE Notrees, LLC (100%)(DE 9.30.2005)
    - └─ Notrees Windpower, LP (1%)(DE 9.30.2005)
  - └─ Ocotillo Windpower, LP (99%)(DE 12.22.2004)
  - └─ TE Ocotillo, LLC (100%)(DE 12.21.2004)
    - └─ Ocotillo Windpower, LP (1%)(DE 12.22.2004)
  - └─ TE Silver Sage, LLC (100%)(DE 4.16.2007)
    - └─ Silver Sage Windpower, LLC (100%)(DE 4.16.2007)
  - └─ TE Happy Jack, LLC (100%)(DE 10.27.2006)
    - └─ Happy Jack Windpower, LLC (100%)(DE 10.27.2006)
  - └─ Kit Carson Windpower, LLC (100%)(DE 6.23.09)
- └─ Delta Township Utilities, LLC (51%)(DE 7.5.2001)
- └─ Delta Township Utilities II, LLC (46%)(DE 3.25.2004)
- └─ Duke Energy Generation Services, Inc. (DE 6.2.2000)
  - └─ (See Appendix H for subsidiaries)
- └─ Energy Equipment Leasing LLC (49%)(DE 11.12.1998)
- └─ Owings Mills Energy Equipment Leasing, LLC (49%)(DE 10.20.1999)
- └─ SUEZ-DEGS, LLC (50%)(DE 2.18.1997)
- └─ SUEZ-DEGS of Ashtabula, LLC (49%)(DE 4.21.1999)
- └─ SUEZ-DEGS of Lansing, LLC (51%)(DE 11.3.1999)
  - └─ SUEZ/WNA/DEGS of Lansing, LLC (80%)(DE 11.3.1999)
- └─ SUEZ-DEGS of Orlando, LLC (100%)(DE 6.12.1998)
- └─ SUEZ-DEGS of Owings Mills, LLC (49%)(DE 9.20.1999)
- └─ SUEZ-DEGS of Rochester, LLC (49%)(DE 10.20.1999)
- └─ SUEZ-DEGS of Silver Grove, LLC (49%)(DE 3.18.1999)
- └─ SUEZ-DEGS of Tuscola, LLC (49%)(DE 8.21.1998)

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Duke Energy Corporation

- └─ Cinergy Corp. (100%)
  - └─ Cinergy Investments, Inc. (100%)
    - └─ Duke Energy Generation Services Holding Company, Inc. (100%)
      - └─ DEGS Wind I, LLC (100%)(DE 5.23.2007)

DEGS Wind I, LLC (100%)(DE 5.23.2007)

- └─ Catamount Energy Corporation (100%)(VT 6.23.1992) [DEGS Wind Vermont, Inc. (VT, 06.20.2008)]
  - └─ Equinox Vermont Corporation (100%)(VT 5.1.1990)
    - └─ Catamount Rumford Corporation (100%)(VT 4.11.1989)
      - └─ Rumford Cogeneration Company Limited Partnership (15.0537%)(ME 1.10.1986)
    - └─ Ryegate Associates (33.1126%)(UT 12.3.2002)
  - └─ Catamount Sweetwater Corporation (100%)(VT 6.17.2003)
    - └─ Sweetwater Development LLC (50%)(TX 11.5.2002)
    - └─ Sweetwater Wind 6 LLC (50%)(DE 4.29.2004)
    - └─ Sweetwater Wind Power L.L.C. (50%) (TX 11.5.2002)
  - └─ Catamount Sweetwater Holdings LLC (100%)(VT 6.20.2005)
    - └─ Catamount Sweetwater 1 LLC (100%)(VT 12.12.2003)
      - └─ Sweetwater Wind 1 LLC (13.59%)(DE 6.24.2003)
    - └─ Catamount Sweetwater 2 LLC (100%)(VT 5.5.2004)
      - └─ Sweetwater Wind 2 LLC (13.14%)(DE 4.19.2004)
    - └─ Catamount Sweetwater 3 LLC (100%)(VT 6.3.2004)
      - └─ Sweetwater Wind 3 LLC (13.18%)(DE 4.29.2004)
  - └─ Catamount Sweetwater 4-5 LLC (100%)(VT 3.8.2005)
    - └─ Sweetwater 4-5 Holdings LLC (18.72%)(DE 4.18.2007)
      - └─ Sweetwater Wind 4 LLC (100%) (DE 4.29.2004)
      - └─ Sweetwater Wind 5 LLC (100%)(DE 4.29.2004)
  - └─ Laurel Hill Wind Energy, LLC (50%)(PA 12.14.2004)
  - └─ CEC Wind Development LLC (100%)(VT 1.12.2007)
  - └─ Searchlight Wind Energy LLC (100%)(NV 1.17.2008)
  - └─ Willow Creek Wind Energy LLC (100%)(DE 6.18.2007)
  - └─ Top of the World Wind Energy LLC (100%)(DE 3.13.2008)
  - └─ Catamount Sweetwater 6 LLC (100%)(VT 9.7.2005)
  - └─ Catamount Heartlands Corporation (100%)(DE 12.12.1997)
  - └─ CEC UK1 Holding Corp. (100%)(VT 9.11.2002)
    - └─ Catamount Energy SC 1 (1%)(Scotland 10.8.2002)
      - └─ Catamount Energy SC 2 (99%)(Scotland 10.8.2002)
    - └─ Catamount Energy SC 2 (1%)(Scotland 10.8.2002)
      - └─ Catamount Energy SC 3 (99%)(Scotland 10.8.2002)
    - └─ Catamount Energy SC 3 (1%)(Scotland 10.8.2002)
      - └─ Catamount Celtic Energy Limited (100)(Scotland 6.8.2007)
      - └─ Catamount Energy Limited (50%)(UK 8.15.2002)
  - └─ CEC UK2 Holding Corp. (100%)(VT 9.11.2002)
    - └─ Catamount Energy SC 1 (99%)(Scotland 10.8.2002)

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Duke Energy Corporation

- └─ Cinergy Corp. (100%)
  - └─ Cinergy Investments, Inc. (100%)
    - └─ Duke Energy Generation Services Holding Company, Inc. (100%)
      - └─ Duke Energy Generation Services, Inc. (100%)

Duke Energy Generation Services, Inc (100%)(DE 6.2.2000)

- └─ BSPE Holdings, LLC (50%)(DE 1.10.2001)
  - └─ BSPE Limited, LLC (100%)(DE 1.10.2001)
    - └─ BSPE, L.P. (99%)(DE 1.16.2001)
  - └─ BSPE General, LLC (100%)(DE 1.11.2001)
    - └─ BSPE, L.P. (1%)(DE 1.16.2001)
- └─ Cinergy Solutions Partners, LLC (100%)(DE 9.12.2000)
  - └─ CST Limited, LLC (100%)(DE 5.18.2001)
    - └─ CST Green Power, L.P. (99%)(DE 5.23.2001)
      - └─ Green Power Holdings, LLC (50%)(DE 12.12.2000)
        - └─ Green Power G.P., LLC (100%)(TX 12.15.2000)
          - └─ South Houston Green Power, L.P. (1%)(DE 12.19.2000)
        - └─ Green Power Limited, LLC (100%)(DE 12.12.2000)
          - └─ South Houston Green Power, L.P. (99%)(DE 12.19.2000)
  - └─ CST General, LLC (100%)(TX 5.22.2001)
    - └─ CST Green Power, L.P. (1%)(DE 5.23.2001)
      - └─ Green Power Holdings, LLC (50%)(DE 12.12.2000)
        - └─ Green Power G.P., LLC (100%)(TX 12.15.2000)
          - └─ South Houston Green Power, L.P. (1%)(DE 12.19.2000)
        - └─ Green Power Limited, LLC (100%)(DE 12.12.2000)
          - └─ South Houston Green Power, L.P. (99%)(DE 12.19.2000)
  - └─ CSGP General, LLC (100%)(TX 4.5.2001) – transferred to external party
  - └─ CSGP Limited, LLC (100%)(DE 4.5.2001) – transferred to external party
  - └─ DEGS GASCO, LLC (100%)(DE 11.9.2000)
  - └─ DEGS O&M, LLC (100%)(DE 8.30.2004)
  - └─ DEGS of Delta Township, LLC (100%)(DE 12.15.2004)
  - └─ DEGS of Lansing, LLC (100%)(DE 6.25.2002)
  - └─ DEGS of Monaca, LLC (100%)(DE 12.16.2003)
  - └─ DEGS of Narrows, LLC (100%)(DE 3.17.2003)
  - └─ DEGS of Oklahoma, LLC (100%)(DE 8.13.2002)
  - └─ DEGS of Parlin, LLC (100%)(DE 4.10.2006)
  - └─ DEGS of Philadelphia, LLC (100%)(DE 5.11.2001)
  - └─ DEGS of San Diego, Inc. (100%)(DE 1.9.2004)
  - └─ DEGS of Shreveport, LLC (100%)(DE 6.28.2002)
  - └─ DEGS of South Charleston, LLC (100%)(DE 8.24.2004)
  - └─ DEGS of St. Bernard, LLC (100%)(DE 1.6.2003)
  - └─ Duke Energy Industrial Sales, LLC (100%)(DE 6.6.2006)
  - └─ Oklahoma Arcadian Utilities, LLC (40.8%)(DE 12.5.2000)
  - └─ Shreveport Red River Utilities, LLC (40.8%)(DE 10.16.2000)
  - └─ Teak Mountain Products, LLC (100%)(DE 5.1.2007)
  - └─ Willow Mountain Products, LLC (100%)(DE 5.1.2007)

Information contained in the World Records database takes precedence over information disclosed in this document.  
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**Changes to Corporate Structure – April 1, 2009 – June 30, 2009**

Entities Removed:

Lansing Grand River Utilities, LLC (100%)(DE 9.14.2000) – dissolved 05/04/2009  
DEGS of Rock Hill, LLC (100%)(DE 3.17.2003) -- dissolved 05/11/2009  
DEGS Biogas, Inc (100%)(DE 11.9.2000) – dissolved 05/05/2009  
Duke Energy Merchants Investments (UK) Limited (100%)(England and Wales 5.1.2001) – liquidated 5/13/2008  
Duke Energy Merchants UK LLP (50%)(England and Wales 10.25.2001) – liquidated 5/13/2008  
Duke Energy Merchants Trading and Marketing (UK) Limited (100%)(England 12.18.2000) – liquidated 5/13/2008  
Duke Energy Merchants UK LLP (50%)(England and Wales 10.25.2001) – liquidated 5/13/2008  
Midlands Hydrocarbons (Bangladesh) Limited (100%)(England 6.29.1993) – liquidated 4/21/09

Formations

Duke Ventures Real Estate, LLC (100%)(DE 6.9.2009)  
Kit Carson Windpower, LLC (100%)(DE 6.23.09)  
ADAGE Hamilton LLC (50%)(DE 5.6.2009)

Information contained in the World Records database takes precedence over information disclosed in this document.  
Balance of ownership for entities <100% owned by a Duke entity can be referenced in World Records.



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-003**

**REQUEST:**

Provide the capital structure at the end of the 10 most recent calendar years and each of the other periods shown in Schedule 3a and Schedule 3b.

**RESPONSE:**

See Attachment STAFF-DR-01-003.

**PERSON RESPONSIBLE:** Stephen G. De May / Brenda R. Melendez

### Duke Energy Kentucky, Inc.

Case No. 2009-00202  
 Calculation of Capital Structure  
 12 Months Ended December  
 Dollars In Thousands

Line No.	Type of Capital	2008		2007		2006		2005		2004	
		Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1.	Long Term Debt <sup>1</sup>	\$ 316,168	44.3%	\$ 265,334	39.1%	\$ 283,192	41.9%	\$ 103,626	31.4%	\$ 100,118	32.9%
2.	Short-Term Debt	3,241	0.5%	27,470	4.0%	42,603	6.3%	29,777	9.0%	11,246	3.7%
3.	Preferred & Preference Stock	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%
4.	Common Equity <sup>2</sup>	394,025	55.2%	385,546	56.9%	349,348	51.8%	196,459	59.6%	192,511	63.4%
5.	Total Capitalization	\$ 713,434	100.0%	\$ 678,350	100.0%	\$ 675,143	100.0%	\$ 329,862	100.0%	\$ 303,875	100.0%

Line No.	Type of Capital	2003		2002		2001		2000		1999		Mar-09	
		Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1.	Long Term Debt <sup>1</sup>	\$ 54,685	18.9%	\$ 74,653	28.1%	\$ 74,621	27.3%	\$ 74,589	29.7%	\$ 74,557	30.5%	\$ 325,518	44.5%
2.	Short-Term Debt	45,233	15.6%	14,076	5.3%	26,432	9.7%	29,403	11.7%	37,752	15.4%	-	0.0%
3.	Preferred & Preference Stock	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%
4.	Common Equity <sup>2</sup>	189,356	65.5%	177,163	66.6%	172,203	63.0%	147,188	58.6%	132,050	54.1%	405,815	55.5%
5.	Total Capitalization	\$ 289,274	100.0%	\$ 265,892	100.0%	\$ 273,256	100.0%	\$ 251,180	100.0%	\$ 244,359	100.0%	\$ 731,333	100.0%

(1) Includes current portion of Long Term Debt  
 (2) Includes Common Stock, Additional Paid in Capital, Retained Earnings and Other Comprehensive Income



**Duke Energy Kentucky, Inc.**

Case No. 2009-00202

Calculation of Average Capital Structure  
 12 Months Ended December 31, 2008

Dollars in Thousands

Line No.	Item (a)	Total Capital (b)	Long-term Debt <sup>1</sup> (c)	Short-term Debt (d)	Preferred Stock (e)	Common Stock <sup>2</sup> (f)	Retained Earnings (g)	Total Common Equity (h)
1	Balance at the beginning of Jan 1, 2008	\$ 684,938	\$ 271,923	\$ 27,470	\$ -	\$ 175,275	\$ 210,270	\$ 385,545
2	1st Month	683,503	271,930	21,385	-	174,902	215,286	390,188
3	2nd Month	666,407	271,936	-	-	174,917	219,554	394,471
4	3rd Month	671,485	271,942	485	-	176,274	222,784	399,058
5	4th Month	655,169	251,948	2,330	-	176,274	224,617	400,891
6	5th Month	655,924	251,952	1,083	-	176,274	226,615	402,889
7	6th Month	663,699	251,957	7,663	-	176,274	227,805	404,079
8	7th Month	667,023	251,962	7,241	-	176,274	231,546	407,820
9	8th Month	670,262	251,966	6,908	-	176,274	235,114	411,388
10	9th Month	737,842	324,628	-	-	176,274	236,940	413,214
11	10th Month	739,305	324,632	-	-	176,274	238,399	414,673
12	11th Month	743,133	325,498	-	-	176,274	241,361	417,635
13	12th Month	722,769	325,503	3,241	-	176,274	217,751	394,025
14	Total (L1 through L13)	8,961,459	3,647,777	77,806	-	2,287,834	2,948,042	5,235,876
15	Average Balance (L14 / 13)	\$ 689,343	\$ 280,598	\$ 5,985	\$ -	\$ 175,987	\$ 226,772	\$ 402,760
16	Average Capitalization Ratio	100.00%	40.70%	0.87%	0.00%	25.53%	32.90%	58.43%
17	End-of-period capitalization Ratio	100.00%	45.03%	0.45%	0.00%	24.39%	30.13%	54.52%

(1) Includes current portion of Long Term Debt

(2) Includes Common Stock, Additional Paid in Capital and Other Comprehensive Income

## Duke Energy Corp. / Cinergy Corp. <sup>1</sup>

Case No. 2009-00202  
 Calculation of Capital Structure  
 12 Months Ended December  
 Dollars in Thousands

Line No.	Type of Capital	1999		2000		2001		2002		2003	
		Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1.	Long Term Debt <sup>2</sup>	3,055,669	48.1%	2,972,849	42.8%	3,780,104	45.8%	4,315,081	49.9%	5,026,040	55.0%
2.	Short Term Debt	550,194	8.7%	1,128,657	16.2%	1,155,786	14.0%	667,973	7.7%	351,412	3.8%
3.	Preferred Trust Securities	-	0.0%	-	0.0%	306,327	3.7%	308,187	3.6%	-	0.0%
4.	Preferred & Preference Stock	92,597	1.5%	62,834	0.9%	62,833	0.8%	62,828	0.7%	62,818	0.7%
5.	Common Equity	2,653,721	41.7%	2,788,961	40.1%	2,941,459	35.7%	3,293,476	38.1%	3,700,682	40.5%
6.	Total Capitalization	6,352,181	100.0%	6,953,301	100.0%	8,246,509	100.0%	8,647,545	100.0%	9,140,952	100.0%

Line No.	Type of Capital	2004		2005		2006		2007		2008		Latest Available Quarter <sup>3</sup>	
		Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1.	Long Term Debt <sup>2</sup>	4,512,203	46.8%	4,820,425	46.6%	19,722,741	42.6%	11,023,958	33.4%	13,896,771	39.2%	15,216,827	41.4%
2.	Short Term Debt	948,327	9.8%	923,600	8.9%	450,241	1.0%	742,441	2.3%	543,074	1.5%	279,289	0.8%
3.	Preferred Trust Securities	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%
4.	Preferred & Preference Stock	62,818	0.7%	31,743	0.3%	-	0.0%	-	0.0%	-	0.0%	-	0.0%
5.	Common Equity	4,115,922	42.7%	4,577,395	44.2%	26,102,309	56.4%	21,198,853	64.3%	20,988,472	59.3%	21,215,191	57.8%
6.	Total Capitalization	9,639,270	100.0%	10,353,163	100.0%	46,275,291	100.0%	32,965,252	100.0%	35,428,317	100.0%	36,711,307	100.0%

- (1) Amounts for the years 1999 - 2005 represent Cinergy Corp.; amounts thereafter represent Duke Energy Corp.  
 (2) Includes current portion of Long Term Debt  
 (3) Latest available quarter is as of March 31, 2009

**Duke Energy Corp.**  
 Case No. 2009-00202  
 Calculation of Average Capital Structure  
 12 Months Ended December 31, 2008  
 Dollars in Thousands

Line No.	Item (a)	Total Capital (b)	Long-term Debt <sup>1</sup> (c)	Short-term Debt (d)	Preferred Stock (e)	Common Stock <sup>2</sup> (f)	Retained Earnings (g)	Total Common Equity (h)
1	Balance Beginning of test year	32,965,252	11,023,958	742,441	-	19,800,595	1,398,258	21,198,853
2	1st Month	33,660,085	11,917,773	592,318	-	19,812,697	1,337,297	21,149,994
3	2nd Month	33,664,228	11,937,511	378,603	-	19,864,350	1,483,764	21,348,114
4	3rd Month	33,510,978	11,414,880	686,814	-	19,835,628	1,573,656	21,409,284
5	4th Month	34,312,776	12,197,973	557,046	-	19,871,746	1,686,011	21,557,757
6	5th Month	34,096,294	12,208,567	459,493	-	19,921,421	1,506,813	21,428,234
7	6th Month	34,589,172	12,873,616	414,191	-	19,948,162	1,353,203	21,301,365
8	7th Month	34,839,303	12,894,179	401,010	-	20,520,972	1,023,142	21,544,114
9	8th Month	35,254,627	13,342,508	279,567	-	19,952,045	1,680,507	21,632,552
10	9th Month	36,249,545	14,018,375	901,314	-	19,762,767	1,567,089	21,329,856
11	10th Month	35,224,073	13,365,164	850,356	-	19,648,496	1,360,057	21,008,553
12	11th Month	35,716,273	14,096,193	597,311	-	19,569,047	1,453,722	21,022,769
13	12th Month	35,428,317	13,896,771	543,074	-	19,381,479	1,606,993	20,988,472
14	Total (L1-L13)	449,510,923	165,187,468	7,403,538	-	257,889,405	19,030,512	276,919,917
15	Average Balance (L14/13)	34,577,763	12,706,728	569,503	N/A	19,837,647	1,463,886	21,301,532
16	Average capitalization ratios	100.00%	36.75%	1.65%	0.00%	57.37%	4.23%	61.60%
17	End-of-period capitalization ratios	100.00%	39.22%	1.53%	0.00%	54.71%	4.54%	59.25%

(1) Includes current portion of long-term debt.

(2) Includes Common Stock, Additional Paid in Capital and Other Comprehensive Income



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-004**

**REQUEST:**

Provide the following:

- a. A list of all outstanding issues of long-term debt as of the end of the latest calendar year together with the related information as shown in Schedule 4a.
- b. An analysis of short-term debt as shown in Schedule 4b as of the end of the latest calendar year.

**RESPONSE:**

See Attachment STAFF-DR-01-004 (a) and Attachment STAFF-DR-01-004(b).

**PERSON RESPONSIBLE:** Stephen G. De May

DUKE ENERGY KENTUCKY, INC.  
CASE NO. 2009-00202  
Schedule of Outstanding Long-Term Debt  
For The Period Ended December 31, 2008

Line No.	Type of Debt Issue (a)	Date of Issue (b)	Date of Maturity (c)	Amount Outstanding (1) (d)	Coupon Interest Rate (2) (e)	Cost Rate At Issue (3) (f)	Cost Rate to Maturity (4) (g)	Bond Rating at Time of Issue (5) (h)		Type of Obligation (i)	Annualized Cost Col. (d) x Col. (g) (j)
1	Capital Leases:										
2	Capital Lease - Meters (2001 Acquisitions)	12/20/01	9/20/10	415,088	5.284%	5.284%	5.997%	N/A	N/A	Capital Lease	24,893
3	Capital Lease - Meters (2002 Acquisitions)	12/20/02	9/20/11	411,721	3.734%	3.734%	4.481%	N/A	N/A	Capital Lease	18,449
4	Capital Lease - Meters (2003 Acquisitions)	12/20/03	9/20/12	1,010,278	3.962%	3.962%	4.740%	N/A	N/A	Capital Lease	47,887
5	Capital Lease - Meters (2004 Acquisitions)	12/20/04	9/20/13	1,183,976	4.257%	4.257%	5.010%	N/A	N/A	Capital Lease	59,317
6	Capital Lease - Meters (2005 Acquisitions)	12/30/05	12/30/14	1,403,783	4.194%	4.194%	4.893%	N/A	N/A	Capital Lease	68,687
7	Capital Lease - Meters (2006 Acquisitions)	12/28/06	12/28/15	1,837,951	4.288%	4.288%	5.000%	N/A	N/A	Capital Lease	91,898
8	Capital Lease - Meters (2007 Acquisitions)	12/31/07	12/31/16	2,598,973	4.397%	4.397%	5.115%	N/A	N/A	Capital Lease	132,937
9	Capital Lease - Erlanger Facility	9/30/05	9/30/20	1,744,888	8.403%	8.403%	8.634%	N/A	N/A	Capital Lease	150,654
10											
11	Unamortized Loss on Reacquired Debt:										
12	10.25% due 6/1/2020			(448,401)			8.759%				39,276
13	9.7% due 7/1/2019			(703,458)			9.524%				66,996
14	10.25% due 11/15/2020			(444,885)			8.421%				37,464
15	7.65% due 7/15/2025			(1,057,380)			6.045%				63,922
16	5.5% due 1/1/2024			(579,804)			6.667%				38,654
17	6.25% due 8/1/2013			(76,550)			21.818%				16,702
18	6.5% due 1/15/2022			(63,289)			7.207%				4,561
19	Variable Rate Pollution Control Bond, due 8/1/27			(289,319)			5.381%				15,569
20											
21	Long-Term Debt:										
22	Debentures	12/9/04	12/15/14	39,568,587	5.000%	5.119%	5.254%	Baa1	BBB	Unsecured Debentures	2,078,780
23	Debentures	3/10/06	3/10/16	49,700,757	5.750%	5.758%	5.869%	Baa1	BBB	Unsecured Debentures	2,917,003
24	Debentures	3/10/06	3/10/36	64,086,417	6.200%	6.250%	6.342%	Baa1	BBB	Unsecured Debentures	4,064,044
25	Debentures	7/26/06	8/1/27	26,538,829	Variable	0.260%	0.310%	Aaa	AAA	Pollution Control Bond	82,382
26	Debentures	12/3/08	8/1/27	49,822,320	Variable	0.362%	0.363%	Aaa	AAA	Pollution Control Bond	180,820
27	Long-Term Notes Payable	9/30/08	6/28/12	73,491,183	Variable	2.256%	2.268%	N/A	N/A	Draw Under Master Credit Facility	1,666,661
28	Other	7/31/07	7/31/27	851,494	4.770%	4.770%	4.770%	N/A	N/A		40,616
29											
30											311,003,158
31											11,908,171
32	Annualized Cost Rate [total										
33	Col. (j) / Total col. (d)]										3.829%
34											
35	(1) Represents Carrying Value										
36	(2) Nominal Rate										
37	(3) Nominal Rate Plus Discount or Premium Amortization										
38	(4) Nominal Rate Plus Discount or Premium Amortization, and Issuance Cost										
39	(5) Standard & Poor's, Moody, etc.										

DUKE ENERGY KENTUCKY, INC.  
CASE NO. 2009-00202  
Schedule of Short-Term Debt  
For The Period Ended December 31, 2008

Line No.	Type of Debt Issue (a)	Date of Issue (b)	Date of Maturity (c)	Amount Outstanding (d)	Nominal Interest Rate (e)	Effective Interest Rate (f)	Annualized Cost Col. (f) x Col. (d) (g)
1	Capital Leases:						
2	Capital Lease - Meters (2000 Acquisitions)	12/25/00	9/20/09	1,160,138	5.250%	6.089%	70,641
3	Capital Lease - Meters (2001 Acquisitions)	12/20/01	9/20/10	152,195	5.284%	5.997%	9,127
4	Capital Lease - Meters (2002 Acquisitions)	12/20/02	9/20/11	107,796	3.734%	4.481%	4,830
5	Capital Lease - Meters (2003 Acquisitions)	12/20/03	9/20/12	197,856	3.962%	4.740%	9,378
6	Capital Lease - Meters (2004 Acquisitions)	12/20/04	9/20/13	183,685	4.257%	5.010%	9,203
7	Capital Lease - Meters (2005 Acquisitions)	12/30/05	12/30/14	181,370	4.194%	4.893%	8,874
8	Capital Lease - Meters (2006 Acquisitions)	12/28/06	12/28/15	198,990	4.288%	5.000%	9,950
9	Capital Lease - Meters (2007 Acquisitions)	12/31/07	12/31/16	239,961	4.397%	5.115%	12,274
10	Capital Lease - Erlanger Facility	9/30/05	9/30/20	90,093	8.403%	8.634%	7,779
11							
12	Current Maturities of Long-Term Debt:						
13	7.875% due 9/15/09	9/15/99	9/15/09	20,000,000	7.875%	7.875%	1,575,000
14							
15	Other:						
16	Notes Payable - Money Pool			3,241,044	0.490%	0.490%	15,881
17	Amount Sold for Cash/Classified as Receivable			41,861,284	3.200%	3.200%	1,339,561
18	Unamortized (discount) or premium			(56,767)			(56,767)
19							
20	Total Short-Term Debt			67,557,646			3,015,732
21	Annualized Cost Rate [Total Col. (g) / Total Col. (d)]						<u>4.464%</u>
22	Actual Interest Paid or Accrued on Short-Term						
23	Debt during the Test Year [report in Col. (g) of this schedule]						\$ 2,158,511
24	Average Short-Term Debt - Format 3, Schedule 2, Line 15 Col. (d) [Report in Col. (g) of this Schedule]						\$ 50,412,869
25	Test-Year Interest Cost Rate [Actual Interest /						
26	Average Short-Term Debt] [Report in Col. (f) of this schedule]						<u>4.282%</u>

Note: In all instances where the Effective Interest Cost Rate is different from the Nominal Interest Rate, provide a calculation of the effective Interest Cost Rate in sufficient detail to show the items of costs that cause the difference.





**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-005**

**REQUEST:**

Provide a list of all outstanding issues of preferred stock as of the end of the latest calendar year as shown in Schedule 5.

**RESPONSE:**

Duke Energy Kentucky has no outstanding preferred stock.

**PERSON RESPONSIBLE:** Stephen G. De May



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-006**

**REQUEST:**

Provide the following:

- a. List all issues of common stock in the primary market during the 10 most recent calendar years as shown in Schedule 6a.
- b. The common stock information on a quarterly and yearly basis for the five most recent calendar years available, and through the latest available quarter as shown in Schedule 6b.
- c. The market prices for common stock for each month during the five most recent calendar years and for succeeding months through the date the application is filed. List all stock splits and stock dividends by date and type.

**RESPONSE:**

- a. None.
- b. See Attachment STAFF-DR-01-006 (b).
- c. N/A, not publicly traded.

**PERSON RESPONSIBLE:** Brenda R. Melendez

Duke Energy Kentucky, Inc.  
Case No. 2009-00202

Case No. 2009-00202  
STAFF-DR-01-006(b)  
Page 1 of 1

Quarterly and Annual Common Stock Information  
For the Periods as Shown

Period	Average No. of Shares Outstanding (000)	Book Value (000)	Earnings per Share (a)	Dividend Rate Per Share	Return on Average Common
<b>5th Calendar Year</b>					
3/31/2004	585	\$ 197,244	\$ 13.48	\$ -	4.08%
6/30/2004	585	\$ 200,335	\$ 5.28	\$ -	1.55%
9/30/2004	585	\$ 202,635	\$ 3.93	\$ -	1.14%
12/31/2004	585	\$ 192,511	\$ 9.16	\$ 24.94	2.71%
Annual	585	\$ 192,511	\$ 31.84	\$ 24.94	9.76%
<b>4th Calendar Year</b>					
3/31/2005	585	\$ 198,706	\$ 10.58	\$ -	3.17%
6/30/2005	585	\$ 198,219	\$ (0.83)	\$ -	-0.25%
9/30/2005	585	\$ 201,837	\$ 6.21	\$ -	1.82%
12/31/2005	585	\$ 196,459	\$ 9.06	\$ 17.02	2.66%
Annual	585	\$ 196,459	\$ 25.02	\$ 17.02	7.53%
<b>3rd Calendar Year</b>					
3/31/2006	585	\$ 346,672	\$ 17.70	\$ -	3.81%
6/30/2006	585	\$ 344,226	\$ (4.18)	\$ -	-0.71%
9/30/2006	585	\$ 344,073	\$ 0.74	\$ -	0.13%
12/31/2006	585	\$ 349,348	\$ 4.06	\$ -	0.69%
Annual	585	\$ 349,348	\$ 18.32	\$ -	3.93%
<b>2nd Calendar Year</b>					
3/31/2007	585	\$ 362,117	\$ 22.05	\$ -	3.63%
6/30/2007	585	\$ 369,842	\$ 6.32	\$ -	1.01%
9/30/2007	585	\$ 376,936	\$ 12.99	\$ -	2.04%
12/31/2007	585	\$ 385,546	\$ 15.81	\$ -	2.43%
Annual	585	\$ 385,546	\$ 57.18	\$ -	9.11%
<b>1st Calendar Year</b>					
3/31/2008	585	\$ 399,058	\$ 21.38	\$ -	3.19%
6/30/2008	585	\$ 404,079	\$ 8.58	\$ -	1.25%
9/30/2008	585	\$ 413,214	\$ 15.61	\$ -	2.24%
12/31/2008	585	\$ 394,025	\$ 18.47	\$ 51.25	2.68%
Annual	585	\$ 394,025	\$ 64.03	\$ 51.25	9.62%
<b>Latest</b>					
3/31/2009	585	\$ 405,815	\$ 20.14	\$ -	2.95%

(a) Earnings per Share for Duke Energy Kentucky, Inc. is not publicly reported.



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-007**

**REQUEST:**

Provide a computation of fixed charge coverage ratios for the 10 most recent calendar years as shown in Schedule 7.

**RESPONSE:**

See Attachment STAFF-DR-01-007.

**PERSON RESPONSIBLE:** Stephen G. De May

Duke Energy Kentucky  
 Case No. 2009-00202

Computation of Fixed Charge Coverage Ratio (SEC Method)  
 For the Periods as Shown  
 (000 except ratios)

Line No.		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
1	Net Income	\$ 12,274	\$ 24,632	\$ 35,924	\$ 12,150	\$ 19,029	\$ 18,638	\$ 14,645	\$ 10,723	\$ 33,469	\$ 37,481
2	Additions:										
3	Interest on Long-Term Debt	5,192	5,451	5,531	5,533	5,526	4,398	6,371	12,636	15,568	15,433
4	Other Interest	1,147	1,288	963	618	672	828	756	3,928	2,320	2,729
5	Interest Component of Rents (a)	1,359	1,276	1,288	959	906	928	418	1,052	1,419	1,419
6	Income Taxes	10,183	13,800	13,699	12,349	9,781	10,376	7,833	8,584	19,017	20,590
7	Deductions:										
8	AFUDC - Debt	225	431	181	213	71	47	223	788	474	494
9	AFUDC - Equity	36	61	142	794	183	(18)	642	626	219	778
10	Income Available for Fixed Charge Coverage	\$ 29,894	\$ 45,955	\$ 57,082	\$ 30,602	\$ 35,660	\$ 35,139	\$ 29,158	\$ 35,509	\$ 71,100	\$ 76,380
11	Fixed Charges										
12	Interest Charges	\$ 6,339	\$ 6,739	\$ 6,493	\$ 6,151	\$ 6,198	\$ 5,226	\$ 7,127	\$ 16,564	\$ 17,888	\$ 18,162
13	Interest Component of Rents (a)	1,359	1,276	1,288	959	906	928	418	1,052	1,419	1,419
14	Total Fixed Charges	\$ 7,698	\$ 8,015	\$ 7,781	\$ 7,110	\$ 7,104	\$ 6,154	\$ 7,545	\$ 17,616	\$ 19,307	\$ 19,581
15	Ratio of Earnings to Fixed Charges	3.88	5.73	7.34	4.30	5.02	5.71	3.86	2.02	3.68	3.90





**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-008**

**REQUEST:**

Provide Duke Kentucky's internal accounting manuals, directives, and policies and procedures.

**RESPONSE:**

Please refer to Attachment STAFF-DR-01-008 for Duke Energy Corp.'s internal controls and financial controls policies applicable to Duke Energy Kentucky. Also included in the attachment are Cash Management Guidelines and a Financial Analysis Manual. Duke Energy Kentucky, Inc.'s Cost Allocation Manual has been provided in Volume 10 of its Application in this proceeding.

**PERSON RESPONSIBLE:** Brenda R. Melendez

## Tracking Sheet - List of Internal Controls and Financial Controls Policies

This list was last updated on 06-17-2009	Current Revision Date *	Original Effective Date
<b>Accounting and Financial Reporting</b>		
<u>Account Analysis and Reconciliation</u>	3/31/2008	4/30/2001
<u>Accounting for Cash Overdrafts</u>	5/15/2009	3/31/2006
<u>Accounting for Claims between Captive Insurer and Affiliates</u>	3/31/2008	12/16/2004
<u>Accounting for Defined Benefit Pension Plans and Other Post-Retirement Benefit Plans</u>	12/31/2008	12/1/2004
<u>Accounting for Derivative Instruments and Hedging Activities</u>	12/31/2008	12/1/2004
<u>Accounting for Goodwill</u>	12/31/2008	12/1/2004
<u>Accounting for Intercompany Transactions</u>	5/15/2009	7/31/2004
<u>Accounting for Loss Contingencies</u>	12/31/2008	12/18/2007
<u>Accounting for Regulated Entities (SFAS No. 71)</u>	12/31/2008	12/1/2004
<u>Accrual Guidelines</u>	5/15/2009	3/31/2003
<u>Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments.</u>	12/31/2008	12/1/2004
<u>Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)</u>		
<u>Duke Energy International (DEI) Capitalization Policy</u>	6/15/2009	5/31/2009
<u>Fair Value Measurements Used in Accounting</u>		1/1/2008
<u>Financial Statement Disclosure of Related Party Transactions</u>	5/15/2009	12/15/2004
<u>Form 8-K Requirements and Filing Procedure</u>	4/30/2009	8/23/2004
<u>Journal Entry Creation and Approval Requirements for Non-System Generated Journals</u>	3/1/2008	9/30/2003
<u>Other Comprehensive Income Accounting Procedures</u>	5/15/2009	12/31/2003
<u>Preparing &amp; Reviewing Financial Schedules, Statements, or Reports</u>	2/1/2008	3/31/2004
<u>Property/Business Interruption Reserve Eliminations in Consolidation</u>	3/31/2008	12/31/2004
<u>Reclassification of Realized Income Statement Activity in Consolidation - Net vs. Gross</u>	4/1/2007	9/30/2003
<u>Revenue and Accounts Receivable</u>		8/31/2000
<u>Revenue Recognition</u>	12/31/2008	12/1/2004
<u>Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters</u>	12/31/2008	12/15/2004
<u>U.S. GAAP Compliance Checklist</u>	12/31/2008	12/1/2004
<b>Expenditures</b>		
<u>Accounts Payable and Imprest Petty Cash</u>	4/20/2009	7/19/2006
<u>Approval of Annual Budget</u>	4/1/2008	8/31/2000
<u>Approval of Business Transactions</u>	1/1/2009	7/1/2000
<u>Check Signing</u>	1/1/2009	8/31/2000
<u>Contract Administration Policy</u>		7/1/2008
<u>Delegation of Authority</u>	1/1/2008	8/31/2000
<u>Delegation of Authority - International Employees</u>	5/15/2009	8/31/2000
<u>Employee Expense Reimbursement Policy</u>	4/20/2009	8/31/2000
<u>Purchasing Authority Policy</u>	1/1/2008	1/1/2008
<u>Purchasing Controls Policy</u>	4/1/2008	3/31/2004
<b>External Auditor and Other Major Accounting Firms</b>		
<u>Engaging Major Accounting Firms for All Services</u>		4/30/2009
<u>Engaging the Independent Auditor for Services</u>	12/9/2008	4/4/2006
<u>Hiring Policy for Employees and Former Employees of the External Auditor</u>	2/1/2008	4/24/2003
<b>Fixed Assets</b>		
<u>Property, Equipment and Inventory Policy</u>		8/31/2000
<b>Other Internal Controls</b>		
<u>Creation, Dissolution or Restructuring of Legal Entities and Subsidiaries</u>	5/15/2009	3/25/2004
<u>Disclosure Committee Charter</u>	1/8/2009	
<u>Disclosure Controls and Procedures Overview</u>	1/1/2008	1/1/2008
<u>Sarbanes-Oxley Change Control</u>	9/15/2007	10/1/2004
<b>Payroll</b>		
<u>Payroll Policy</u>		8/31/2000
<b>Risk Management</b>		
<u>Commodity Risk Policy</u>	4/1/2006	5/24/2004

### Tracking Sheet - List of Internal Controls and Financial Controls Policies

This list was last updated on 06-17-2009	Current Revision Date *	Original Effective Date
<u>Credit Policy</u>	5/1/2008	7/15/2003
<u>Loan Policy</u>	4/1/2006	1/7/2002

<b>Summary of Internal Controls and Financial Controls Policies</b>		
Summary of Internal Controls and Financial Controls Policies		12/16/2004

<b>Taxes</b>		
<u>Accounting for Income Taxes</u>	3/31/2009	6/30/2004
<u>Property Tax</u>	3/31/2009	8/31/2000
<u>Relations with Tax Authorities</u>	3/31/2009	8/31/2000
<u>Sales/Use and Excise Tax</u>	3/31/2009	8/31/2000
<u>Tax Reserves Policy</u>	3/31/2009	12/31/2004

<b>Treasury</b>		
<u>Bank Account and Check Disbursement Policy</u>	1/1/2009	8/31/2000
<u>Corporate Cash Management Policy</u>	1/1/2009	3/10/2000
<u>Financing Activity and Financial Risk Management Policy</u>	4/1/2006	4/1/2006
<u>Intercompany Funding Policy</u>	1/1/2009	11/1/2004
<u>Property and Liability Insurance</u>		1/1/2009
<u>Surety Bonds</u>	1/1/2009	9/26/2000
<u>Wire Transfer Policy</u>	1/1/2008	8/31/2000

\* If no Revision Date is indicated, it is the same as the Effective Date and/or there have been no revisions.



## Duke Energy Accounting Policy Statement

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### Account Analysis and Reconciliation Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	04/30/2001
<b>Revision Date:</b>	03/31/2008
<b>Reissue Date:</b>	03/31/2008

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#### **Statement of Purpose and Philosophy**

The purpose of this Policy is to provide guidelines for analyzing and reconciling balance sheet account balances. Routine account analysis and reconciliation is a foundation for strong internal controls and ensuring an accurate general ledger and financial statements. This Policy is applicable to all Business Units/Corporate Areas.

#### **Policy Expectations**

- Each Business Unit/Corporate Area should ensure account analysis and reconciliation procedures, at a minimum, comply with the requirements of this Policy.

#### **Accountabilities: Roles and Responsibilities**

##### Corporate Controller's Department

- Maintain a policy for account analysis and reconciliation processes to help ensure that Business Units/Corporate Areas maintain accurate general ledger and financial statement account balances.
- Internal Controls reviews overrides to this Policy for reasonableness and, if appropriate, reports to Corporate Controller.
- Corporate Controller reviews and approves, if appropriate, requests for an exception to this Policy.

##### Business Units/Corporate Areas

- Ensure the appropriate individuals in the Business Unit/Corporate Area are aware of and comply with the requirements of this Policy
- Implement routine account analysis and reconciliation procedures sufficient to ensure balance sheet accounts and financial statements are accurate, including reconciling to supporting schedules and documentation which substantiate ending balances.
- Ensure account analysis and reconciliations, and necessary corrections, are completed in a timely manner. Reconciliations shall be performed by the last business day of the month following the General Ledger month for which accounts are being reconciled, e.g., March General Ledger account balances shall be reconciled by the last business day in April.
- Maintain adequate documentation to support account balance, account reconciliation, and management review process.
- Reconcile High Risk Accounts on a monthly basis.

- Reconcile Low Risk Accounts at least every three months.
- Define each account as either High Risk or Low Risk and maintain documentation supporting the rationale for such classification. See the "Standards and Requirements" section below for the definition of High Risk Accounts and Low Risk Accounts. It is anticipated that High Risk Accounts and Low Risk Accounts would be a subset of the Chart of Accounts.
- Perform account reconciliations at the General Ledger (GL) account chartfield level, or a level that includes more than one GL account chartfield where the activity in the grouping of accounts is similar and can be reconciled together.
- Ensure the account reconciliation documentation is reviewed by management, or management designee, as evidenced by a signature and date. Each Business Unit/Corporate Area is responsible for maintaining this documentation.
- Ensure the "Exceptions Report - Unreconciled Accounts" report is accurate and timely, and management adequately monitors results and implements corrective actions, as necessary.
- Use the "Exceptions Report - Unreconciled Accounts" report to notify the Corporate Controller (submit reports to Internal Controls) of any exception items, Accounts Not Analyzed and/or Accounts Not Current, as described in the Guidelines section below that meet the following thresholds for the applicable registrant:

Entities	Threshold (in dollars)
Duke Energy Carolinas, LLC and subsidiaries	\$3,000,000
Duke Energy Indiana, Inc. and subsidiaries	\$1,000,000
Duke Energy Ohio, Inc. and subsidiaries	\$1,000,000
All other Duke Energy Corporation subsidiaries	\$6,500,000

Business Unit/Corporate Areas may adopt, at their discretion, lower reporting thresholds. In addition, for administrative ease, Business Units/Corporate Areas may adopt one reporting threshold. However, the threshold adopted for any entity can not be higher than the amounts indicated above. For example, the threshold for Duke Energy Ohio, Inc. and subsidiaries can not be higher than \$1 million.

This exception report must be submitted to Internal Controls by the last business day of each month. Report exception items on a GL account chartfield basis.

If there are no exceptions to report, indicate such positive affirmation, to Internal Controls by the last business day of each month.

- Send Policy exception requests to Internal Controls, Corporate Controller's Department. See attached "Request for Ongoing Exception to Policy" for the form to use to request a Policy exception.

### **Standards and Requirements**

- Account Definition - Each balance sheet account should be described adequately to enable a clear determination of proper transactions in the account.
- Comparative and Trend Analysis - Comparative metrics, such as dollar or percent change, or other appropriate measures, should be established to identify significant account fluctuations that need

accelerated detail journal analysis. If unusual comparisons or trends cannot be reasonably explained, closely review transactions to identify and correct errors. Metrics should be easily generated and updated.

- Documentation - Documentation should be maintained to support the amounts in accounts, analysis and reconciliation of each account, correcting entries, and the management review process.
- Electronic Reconciliations - The reconciliation process must be documented for an automated reconciliation performed using software applications or computer programs. Management must review and approve the automated process to ensure that the appropriate controls are in place to perform an adequate reconciliation. The electronic reconciliation must be reviewed to ensure that the reconciliation was performed adequately. At a minimum, print summary documentation to provide evidence of the reconciliation. Documentation should be maintained to support that the electronic reconciliation was reviewed for adequate reconciliation and must be signed and dated by management or their designee.
- Frequency - Balance sheet accounts must be routinely analyzed or reconciled at least quarterly to ensure accuracy of financial statements. High Risk Accounts should be analyzed or reconciled monthly.
- High Risk Accounts - Accounts which should be reconciled on a monthly basis even if the balance contained in the accounts is below the applicable registrant materiality threshold level (see Materiality Thresholds), e.g., Cash and Cash Equivalents, Trading and Hedging Accounts, and Clearing Accounts and accounts with subsidiary ledgers. Business Units/Corporate Areas will define which accounts are high risk for their unit/area. In addition to account balance, other factors which Business Unit/Corporate Areas may consider when defining the risk of an account may include the nature of the account, complexity of transactions, volume of transactions, variability of account balance, regulatory and audit impacts, and other factors deemed applicable. Business Units/Corporate Areas must maintain documentation of accounts deemed to be high risk which includes the rationale used to classify accounts as High Risk Accounts.
- Low Risk Accounts - Accounts which contain activity deemed to be of a low risk nature that can be reconciled on a quarterly basis, even if the balances are greater than the applicable registrant materiality threshold (see Materiality Thresholds) level, e.g., accounts which contain balances which amortize on a prorated basis. Business Units/Corporate Areas will define which accounts are low risk for their unit/area. In addition to account balance, other factors which Business Unit/Corporate Areas may consider when defining the risk of an account may include the nature of the account, complexity of transactions, volume of transactions, variability of account balance, regulatory and audit impacts, and other factors deemed applicable. Business Units/Corporate Areas must maintain documentation of accounts deemed to be Low Risk which includes the rationale used to classify accounts as Low Risk Accounts.
- Materiality Thresholds - For purposes of classifying an account as either High Risk or Low Risk, the following materiality thresholds should be considered for each registrant:

Entities	Threshold (in dollars)
Duke Energy Carolinas, LLC and subsidiaries	\$10,000,000
Duke Energy Indiana, Inc. and subsidiaries	\$3,500,000
Duke Energy Ohio, Inc. and subsidiaries	\$4,000,000
All other Duke Energy Corporation subsidiaries	\$22,000,000

- General Ledger Reports - Printing details of general ledger balances and activity alone (i.e. Roll-Forward Analysis) does not represent reconciling an account.
- Specific Assignment - Responsibility for analysis of each balance sheet account should be assigned to specific individuals.

- Subsidiary Ledgers - Accounts with subsidiary ledgers must be reconciled to the sub-ledger balance at least monthly. For systems with large transaction volumes, daily reconciliation may be a necessary control. Depending on the number of sub-accounts, sub-ledgers can be very large, or as simple as a one-page spreadsheet.

### **Guidelines**

- Report the following items on the Exceptions Report - Unreconciled Accounts.
  - Accounts Not Analyzed - partially unknown content or unidentified out-of-balance between the balance sheet account and supporting documents or ledger.
  - Accounts Not Current - accounts (a) that contain identified transactions that do not belong in the account, or b) where required control activities have not taken place (i.e., bank reconciliations or 3rd party confirmations), or c) which are clearing accounts that are not expected to clear by year-end.
- Calculated Accounts - Calculated accounts are usually reconciled by reviewing the calculation, such as known basis amount times a predetermined rate.
- Clearing Accounts - Clearing accounts should be analyzed by documenting estimated or calculated future transactions including loading or clearing rates to determine the estimated month of account balance clearance to zero balance. Rates should be adjusted or entries made to clear significant account balances by each quarter-ending month.
- Deferred Debits/Credits - All items comprising the balance should be listed, with each item identified by nature of item, contact name, and anticipated time of resolution. Asset accounts, including Goodwill, must also be routinely analyzed for impairment when warranted by relevant circumstances.
- External Source Accounts - External source accounts must be reconciled to the outside source or statement. For example, cash accounts must be reconciled to checkbooks and bank statements monthly.
- Intercompany Accounts - During the reconciliation process, account owners should coordinate with affiliate account owners to ensure accurate account balances.
- Physical Assets - Physical assets that can be inventoried are considered reconciled if there is a process in place to periodically verify and correct asset quantities to physical counts. In some cases estimates are used (such as aerial surveys for coal inventory). Accounts must also be routinely analyzed for impairment when warranted by relevant circumstances.
- Receivables and Payables - Receivables and payables balances must be reconciled to sub-ledgers that provide a detail list of each account name and amount. Aging schedules should be maintained, and a routine process should be in place to write-off or escheat as appropriate. In some cases, estimates must be used, for example accounts receivables for unread meters.
- Reserve Accounts - Appropriate documentation must be maintained to justify the balance. For example, bad debt reserves may equal a percentage of accounts receivable; injuries and damages reserve may be supported by known claims and estimated claims based on historical experience.
- Roll-Forward Accounts - Roll-forward accounts should be analyzed by reviewing monthly transactions for appropriateness and confirming that the beginning balance plus appropriate monthly transactions equals the ending balance. Roll-forward accounts should be limited to accounts for which the activity in the accounts is determined by entries booked to other accounts (example: Equity). Any accounts which contain balances which can be substantiated by supporting schedules or documentation should not be classified as roll-forward accounts.
- Unamortized Balances - Unamortized balances can be reconciled by comparing the account balance to a monthly amortization rate and the remaining number of months.

### **Related Links:**

- [Request for Exception Process](#)
- [Accounting for Intercompany Transactions](#)
- [Exceptions Report - Unreconciled Accounts](#)
- [Policy Highlights and FAQs](#)



## Duke Energy Accounting Policy Statement

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### Accounting for Cash Overdrafts

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**Applicability:** Applies to Enterprise

**Originator:** Corporate Controller

**Approval:** Corporate Controller

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**Effective Date:** March 31, 2006

**Revision Date:** May 15, 2009

**Reissue Date:** October 31, 2007

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#### Statement of Purpose and Philosophy

The purpose of this policy is to provide guidelines at the Business Unit Accounting level to follow which will allow for a consistent application of generally accepted accounting principles ("GAAP") throughout the Company with respect to cash overdrafts.

Book overdrafts representing outstanding checks in excess of funds on deposit should be classified as liabilities at the balance sheet date. Generally, credit book balances are not offsets to other cash accounts or equivalent accounts (including time deposits, certificates of deposit, money market funds and similar temporary investments) except where the legal right of offset may exist within the same financial institution and legal entity. Where right of offset does not exist, credit balances are a reinstatement of the liabilities that were cleared in the bookkeeping process.

Cash overdrafts can be either book or bank overdrafts. Book balances reflect the amount recorded on the general ledger which is reconciled to the respective bank statement. Bank balances simply represent the amount of funds on deposit at the bank at any point in time. A book overdraft represents outstanding checks in excess of funds on deposit, while bank overdrafts represent the total of payments honored by the bank without sufficient funds in the account to cover them (a loan). For purposes of the Company's monthly analysis, both bank and book overdrafts must be considered for purposes of determining materiality and proper classification.

Duke Energy utilizes a central Cash Management group for the maintenance of the bank accounts at the corporate level. Part of Cash Management's role is to reduce the Company's interest expense. One way they are able to achieve this reduction is through notional pooling of bank accounts. Cash Management pools (groups) different accounts together at financial institutions. As part of the pooling agreements, the financial institutions look at these multiple accounts as sub accounts that are consolidated into a large main account. However, when Cash Management sets up these pooled accounts, their grouping is not based on Business Units, but rather on different factors, such as geography, currency, etc. As a result, a Business unit may be in an overdraft position at their sub account level, but the pooled level (consolidated) is actually not in an overdraft position.

#### Policy Expectations





## Duke Energy Accounting Policy Statement

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### Accounting for Cash Overdrafts

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This policy should be applied to all Business Units to ensure a consistent and proper approach to accounting for cash overdrafts. Proper execution of this policy will require participation by the Corporate Controller's Department (specifically, the Corporate and Business Unit Accounting groups), and the Treasury Department (Cash Management).

#### Accountability: Roles and Responsibilities

- Cash Management – Provide an updated list of all notionally pooled accounts and the month-end bank balance, including proper exchange rates, to both Business Unit Accounting and the Corporate Reporting groups on the first business day of each month<sup>1</sup> reflecting the balance as of the last day of the previous month.
- Business Unit Accounting – 1) Record journal entries as outlined below for non-pooled accounts. Analyze bank and book balances for non-pooled accounts by financial institution and legal entity on a monthly basis and make reclassification entries for negative balances, ensuring pooled accounts are excluded from the analysis. 2) Record journal entries as outlined below for pooled accounts. Analyze bank and book balances for pooled accounts by financial institution and legal entity on a monthly basis and make reclassification entries for negative balances, ensuring non-pooled accounts are excluded from the analysis. Provide month-end bank and book balances, including proper exchange rates, by financial institution and legal entity as well as details of any reclassifications made to Corporate Accounting (per data request)
- Corporate Accounting – Review pooled accounts analysis received from Business Unit Accounting for reasonableness. Determine if any reclass entries recorded for pooled accounts by Business Unit Accounting areas should be reversed at each consolidated SEC registrant level to ensure the net balance of each pool is correct. If material, record proper journal entry for pooled accounts. On the quarters, communicate to Corporate Reporting the results of the analysis and whether or not an entry was required so that Corporate Reporting can factor the adjustment into the Statement of Cash Flows.

#### Analysis of Bank Accounts

Each Business Unit Accounting area is responsible for the analysis of non-pooled and notionally pooled bank accounts at the segment level. Bank accounts should be analyzed by financial institution and legal entity where the legal right of setoff (offset) exists. The analysis of non-pooled accounts must be performed independently of the analysis of notionally pooled accounts. Balances between pooled and non-pooled accounts with the same financial institution cannot be offset.

In general, to offset the overdraft (liability) with cash (asset), the four conditions stated below must all be met.

Paragraph 5 of FASB Interpretation No. 39: Offsetting of Amounts Related to Certain Contracts states the following:



## Duke Energy Accounting Policy Statement

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### Accounting for Cash Overdrafts

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A right of setoff is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. A right of setoff exists when all of the following conditions are met:

- a. Each of two parties owes the other determinable amounts.
- b. The reporting party has the right to set off the amount owed with the amount owed by the other party.
- c. The reporting party intends to set off.
- d. The right of setoff is enforceable at law.

A debtor having a valid right of setoff may offset the related asset and liability and report the net amount.

The entry to record a cash overdraft is as follows:

Dr. Cash (PeopleSoft Acct #: within GAAP Node 1111 -- Cash)

Cr. Bank Overdraft (PeopleSoft Acct #: within GAAP Node 2104-- AP Banks)

<sup>1</sup> Note: The first business day of each month is defined as the first day that the banks provide previous day balances. If an international holiday falls on the first U.S. business day of the month, the bank balances will not be available until the following day.



Duke Energy Accounting Policy Statement

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## Accounting for Claims Between Captive Insurer and Affiliates

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller's Department - Corporate Accounting
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	12/30/2004
<b>Revision Date:</b>	03/31/2008
<b>Reissue Date:</b>	03/31/2008

### **Statement of Purpose and Philosophy**

The purpose of this Policy is to provide guidelines for recording insurance claims between Duke Energy Corporation's wholly-owned Captive insurance entities (*Bison Insurance Company Limited* and *NorthSouth Insurance Company Limited*, and other affiliates of Duke Energy which are covered by policies issued by these captives (see related Policy titled, "Property/Business Interruption Reserve Eliminations in Consolidation"), as well as other "self-insured" events. Additionally, a systematic process has been implemented to calculate adjusting or elimination entries needed in consolidation for the Duke Energy Corporation consolidated financial statements (see related Policy titled, "Property/Business Interruption Reserve Eliminations in Consolidation").

### **Policy Expectations and Scope**

This Policy is applicable to all Business/Corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company") which are covered by insurance policies by Duke Energy's captive insurance entities. This Policy should help ensure consistent application of the accounting for insurance activities across the consolidated Duke Energy group and assist with the consolidation/elimination process.

The scope of this Policy is related to insurance accounting for policies written between Duke Energy affiliated entities. This Policy does not cover other insurance activities, such as the purchase of policies from third party insurance providers. Additional details or procedural information may exist at the individual Business or Corporate unit level.

### **Materiality**

Financial Accounting Standards Board ("FASB") Statements note that "The provisions of this Statement need not be applied to immaterial items." However, since this Policy will be utilized to ensure the proper elimination or consolidation of affiliated transactions, materiality thresholds should not be applied to this Policy.

### **Accountability: Roles and Responsibilities**

#### Business/Corporate Unit Management

The Business/Corporate Unit is responsible for timely communication to Captive Insurer of a covered claim. In the initial discussion regarding a claim, the Business/Corporate Unit must provide the PeopleSoft Business Unit (BU) number of the entity making the claim. If the PeopleSoft BU number is not provided in the initial discussion, the Captive claims representative should remind the contact person that the Business/Corporate Unit maintains responsibility for communicating the PeopleSoft BU number to the Captive Insurer before the end of the month in which the claim is initially reported. The Business/Corporate Unit is responsible for recording claims receivable as detailed in the examples below under the "Procedural Details" section. The recording of Business Unit intercompany entries must be completed by the end of the calendar month (i.e. - June '05 intercompany with captive entities must be recorded by June 30th). Please note this is in advance of deadlines established in the Policy on "Accounting for Intercompany Transactions."

#### Insurance and Risk Management

The Duke Energy Director of Claims is responsible for timely assessment of whether a reported event is covered by insurance. If the event is covered, the Director of Claims is also responsible for communicating to the Business/Corporate Unit the PeopleSoft BU number of the Captive Insurer and whether the claim is covered by Property/Business Interruption insurance or another insurance coverage, such as general liability, in addition to providing a claim number. On a quarterly basis, the Director of Captive Insurance will be responsible for providing a current month-end Outstanding Loss Reserve (OSLR) report to Corporate Accounting. The OSLR report must contain the details requested in the periodic data request from the Corporate Controller's Department.

#### Corporate Controller's Department

Corporate Accounting is responsible for recording Captive outstanding losses by affiliate each month. Since the information from Insurance and Risk Management is only provided quarterly, approval of this Policy constitutes approval for an exception to the Policy on "Accounting for Intercompany Transactions." In addition, Corporate Accounting will collect data from the general ledger to determine the claims receivable recorded by each BU. By detailed analysis of Captive and BU figures, Corporate Accounting will then prepare and record the necessary elimination/consolidation entries (see related Policy titled, "Property/Business Interruption Reserve Eliminations in Consolidation"). The Captive intercompany entries will be recorded by work-day 2 (i.e. - July 5th for June '05 accounting).

#### **Background**

Duke Energy has two wholly-owned Captive insurance entities which primarily provide insurance coverage to Duke Energy affiliated entities. A brief description of each Captive is contained below:

#### *Bison Insurance Company Limited (Bison)*

Bison is a Captive insurance company and a wholly-owned subsidiary of Duke Energy domiciled in Bermuda. Captive insurance is by definition a limited purpose insurance company established with

the specific objective of insuring risks of its parent company and affiliates. The three categories of insurance covered by Bison that are relevant to this summary are business interruption, property, and general liability. Bison utilizes reinsurance, or insuring with third parties, in order to further limit financial risk over specific dollar levels, by type of coverage. Bison's contractual policy is to indemnify Duke Energy affiliates after an insurable event has occurred and been settled by the affiliate. Each affiliate may choose a range of deductibles with Bison, thus providing them some control over their premium expense.

NorthSouth Insurance Company Limited (NorthSouth)

NorthSouth was formed on December 31, 2002 and insures exposures of Duke Power Company. NorthSouth is wholly-owned by Bison and is domiciled in Bermuda. All insured risks covered by NorthSouth have been fully reinsured by Bison.

Therefore, as a result of the insurance coverage provided by the Captives to the Duke Energy affiliated entities, Duke Energy has self-insured risk (for book purposes) up to the amount of the per incident deductible for the reinsurance policy purchased by the Captive, which in effect minimizes the exposure to the consolidated group for insured events. Self-insured reserves must meet the definition of Statement of Financial Accounting Standards ("SFAS") No. 5, "Accounting for Contingencies" (see related Policy, Accounting for Loss Contingencies) which clarifies the following criteria for recognition of a contingent liability:

An estimated loss from a loss contingency shall be accrued by a charge to income if *both* of the following conditions are met:

- a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- b. The amount of loss can be reasonably estimated.

During the policy year, affiliates recognize premium expense and remit payments to the Captive Insurance entity. On the financial records of the Captive entity, premium receipts are recognized as revenue over the policy period. Through intercompany accounting, the premium expense recognized by the Business Unit and the corresponding revenue recorded by Bison is eliminated at the consolidated level. See separate guidance titled "Methodology to Record Intercompany Insurance Activity."

This Policy is meant to derive consistency between amounts recorded as reserves by the Captive (which represent liabilities to the affiliated Duke Energy entities) and amounts recorded as receivables by the Business/Corporate Units (which represent reimbursement amounts due from the Captive for insured events). The policies written by the Duke Energy Captive entities represent indemnity policies which dictate that the Captive is responsible for directly reimbursing the Business/Corporate Unit for covered losses only to the extent the losses have been actually incurred

by the Business/Corporate Unit. Therefore, the Captive Insurer is not directly responsible for making payments directly to third parties.

**Procedural Details**

The following examples provide the appropriate intercompany account(s) and other required fields in order to successfully implement these procedures:

Procedure for Business Units Recording Insured Events

*Scenario A- A non-property or non-business interruption claim is incurred by the Business Unit which will not be covered by insurance coverage with the Captive Insurer (amount of claim is below the Business Unit per incident deductible with the Captive Insurer or is not covered by the Captive insurance policies)*

1) At the date any third party claim meets the SFAS No. 5 definition for accrual as a loss contingency (loss is probable and estimable), the Business Unit will record the following journal entry:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Operating expenses (per incident deductible)	xxx	
xxx-xx	Accrued expenses		xxx

The above amount recorded as an accrued expense will be required to be readjusted in each subsequent period (if estimates of the probable loss change), until settlement occurs, with offsetting adjustments being recorded to operating expenses. If at any time the probability of loss no longer meets both the criteria in SFAS No. 5, the above accrued expense should be immediately reversed.

2) Business Unit makes payment to the third party for their claim as a result of the incident:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Accrued expenses	xxx	
xxx-xx	Cash		xxx

If this payment closes out the claim by the third party, the accrued expense for the claim should be zero.

*Scenario B- A non-property or non-business interruption claim is incurred by the Business Unit which will be covered by insurance coverage with the Captive Insurer (amount of claim is above the Business Unit per incident deductible with the Captive Insurer)*

1) At the date any third party claim meets the SFAS No. 5 definition for accrual as a loss contingency (loss is probable and estimable), the Business Unit will record the following journal entry (A/R NonProp/ Non BI Interco balance represents the amount which will be claimed for reimbursement from the Captive Insurer):

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
0146960	A/R NonProp/Non BI Interco	xxx	
xxx-xx	Operating expenses (per incident deductible)	xxx	
xxx-xx	Accrued expenses		xxx

The intercompany receivable will also need to have the following chartfields populated:

Affiliate: PeopleSoft BU number of the Captive Insurer.

Description: This field should only contain the claim number as provided by the Captive insurance company. The Business/Corporate Unit is responsible for obtaining a claim number and at the same time must be able to provide the PeopleSoft BU number for consolidating entities with claims. Multiple claims should **not** be aggregated in one amount, as the detail amount by claim number must be readily determinable.

The intercompany receivable should be probable of recovery at the Balance Sheet date in order to be recorded.

The above amount recorded as an accrued expense will be required to be readjusted in each subsequent period (if estimates of the probable loss change), until settlement occurs, (with offsetting adjustments being recorded to the A/R NonProp/Non BI Interco account) as changes to the estimate of the loss occur. If at any time the probability of loss no longer meets both the criteria in SFAS No. 5, the above accrued expense should be immediately reversed. Corporate Accounting will collect data from the General Ledger, after the intercompany posting deadline, to determine the claims receivable recorded by each BU. Corporate Accounting will then record a reclassification from third party loss reserves to affiliate payables based on the claims receivable recorded by each BU. Additionally, the Captive insurance company is responsible for communicating claim number changes to the Business/Corporate Unit in the same quarter in which such a change occurs.

2) Business Unit makes payment to the third party for their claim as a result of the incident:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Accrued expenses	xxx	
xxx-xx	Cash		xxx

If this payment closes out the claim by the third party, the accrued expense for the claim should be zero.

3) Business Unit receives reimbursement from the Captive Insurer for their claim:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Cash	xxx	
0146960	A/R NonProp/Non BI Interco		xxx

The same chartfields are required for the intercompany receivable entry as described in step one above. If this payment closes out the claim, the A/R NonProp/BI Interco related to this claim should be zero. The Business Unit should include a "c" in the description field for any claim for which cash receipts from the Captive Insurer have been received (recorded as a reduction in the receivable).

*Scenario C- A property claim to Business Unit owned property (excluding business interruption coverage) is incurred by the Business Unit which will be covered by insurance coverage with the Captive Insurer (amount of claim is above the Business Unit per incident deductible with the Captive Insurer). Additionally, the property has been damaged and is not able to be used and will be replaced*

1) At the date of the incident or when the Business Unit determines that specific property has been damaged and will need to be replaced, the carrying value of the damaged equipment is written off:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
0146990	A/R Prop/BI Interco	xxx	
xxx-xx	Operating expenses (per incident deductible)	xxx	
xxx-xx	PP&E - Accumulated Depreciation	xxx	
xxx-xx	PP&E - Cost		xxx

The intercompany receivable will also need to have the following chartfields populated:

Affiliate: PeopleSoft BU number of the Captive Insurer

Description: This field should only contain the claim number as provided by the Captive insurance company. The BU is responsible for obtaining a claim number and at the same time must be able to provide the PeopleSoft BU number for consolidating entities with claims. Multiple claims should **not** be aggregated in one amount, as the detail amount by claim number must be readily determinable.



The intercompany receivable should be probable of recovery at the Balance Sheet date in order to be recorded.

2) The Business Unit expends cash to replace the damaged equipment and capitalizes the replacement cost:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
0146990	A/R Prop/BI Interco	xxx	
xxx-xx	PP&E - Cost	xxx	
xxx-xx	Cash		xxx
0421120	Captiv Invol'tary Cnvsn Clm		xxx

The same chartfields are required for the intercompany receivable entry as described in step one above. The Captiv Invol'tary Cnvsn Clm (intercompany gain) above will eliminate with the expense recorded by the Captive Insurer based on procedures in Corporate Accounting and represents the difference between the carrying value of the damaged equipment and the replacement cost. This entry will also require the affiliate chartfield to be populated.

All contingencies related to the involuntary conversion gain should be resolved prior to recognition of the intercompany receivable. This is a higher threshold than for recognition of an incurred loss as noted in (1) above.

3) Business Unit receives reimbursement from the Captive Insurer for their claim:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Cash	xxx	
0146990	A/R Prop/BI Interco		xxx

The same chartfields are required for the intercompany receivable entry as described in step one above. If this payment closes out the claim, the A/R Prop/BI Interco related to this claim should be zero. The Business Unit should include a "c" in the description field for any claim for which cash receipts from the Captive Insurer have been received (recorded as a reduction in the receivable).

*Scenario D- A property claim to Business Unit owned property (excluding business interruption coverage) is incurred by the Business Unit which will be covered by insurance coverage with the Captive Insurer (amount of claim is above the Business Unit per incident deductible with the Captive Insurer). Additionally, the property is still usable and will require repairs (which will be expensed).*

1) At the date of the incident or when the Business Unit determines that specific property has been damaged and will need to be repaired, no entries are recorded.

2) The Business Unit expends cash to repair the damaged equipment and expenses the repair:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Operating expenses (repairs)	xxx	
xxx-xx	Cash		xxx

Claim has been filed with the Captive Insurer for reimbursement of the repair costs:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
0146990	A/R Prop/BI Interco	xxx	
xxx-xx	Operating expenses (repairs)		xxx

The intercompany receivable will also need to have the following chartfields populated:

Affiliate: PeopleSoft BU number of the Captive Insurer

Description: This field should only contain the claim number as provided by the Captive insurance company. The BU is responsible for obtaining a claim number and at the same time must be able to provide the PeopleSoft BU number for consolidating entities with claims. Multiple claims should **not** be aggregated in one amount, as the detail amount by claim number must be readily determinable.

The intercompany receivable should be probable of recovery at the Balance Sheet date in order to be recorded.

The amount of the A/R Prop/BI Interco will be for the amount expended by the Business Unit less the per incident deductible with Captive. Therefore, the net Income Statement impact of the above entries (operating expenses) is the per incident deductible.

3) Business Unit receives reimbursement from Captive for their claim:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Cash	xxx	
0146990	A/R Prop/BI Interco		xxx

The same chartfields are required for the intercompany receivable entry as described in step one above. If this payment closes out the claim, the A/R Prop/BI Interco related to this claim should be zero. The Business Unit should include a "c" in the description field for any claim for which cash receipts from the Captive Insurer have been received (recorded as a reduction in the receivable).

Scenario E- A property claim to a 3rd party's owned property is incurred by the Business Unit which will be covered by insurance coverage with the Captive (amount of claim is above the Business Unit per incident deductible with the Captive Insurer).

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
0146990	A/R Prop/BI Interco	xxx	
xxx-xx	Operating expenses (per incident deductible)	xxx	
xxx-xx	Accrued expenses		xxx

The intercompany receivable will also need to have the following chartfields populated:

Affiliate: PeopleSoft BU number of the Captive Insurer

Description: This field should only contain the claim number as provided by the Captive insurance company. The Business Unit is responsible for obtaining a claim number and at the same time must be able to provide the PeopleSoft BU number for consolidating entities with claims. Multiple claims should **not** be aggregated in one amount, as the detail amount by claim number must be readily determinable.

The intercompany receivable should be probable of recovery at the Balance Sheet date in order to be recorded.

Scenario F - Same as Scenario E above except amount of claim is below the Business Unit per incident deductible with the Captive Insurer.

Accounting for this transaction will follow Scenario A above.

Scenario G - Business Unit incurs property damage and will be unable to provide some or all of its services to customers over a period of time until the property damage has been corrected. This economic loss as a result of services to customers will be covered by business interruption insurance written by the Captive Insurer.

1) Once the per incident policy deductible has been met, each month as the Business Unit incurs additional economic losses which will be covered by a Captive Insurer business interruption policy, the Business Unit will record a journal entry.

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
0146990	A/R Prop/BI Interco	xxx	
0495030	Captive Revenue BI Interco		xxx

The intercompany receivable will also need to have the following chartfields populated:

Affiliate: PeopleSoft BU number of the Captive Insurer

Description: This field should only contain the claim number as provided by the Captive insurance company. The Business Unit is responsible for obtaining a claim number and at the same time must be able to provide the PeopleSoft BU number for consolidating entities with claims. Multiple claims should **not** be aggregated in one amount, as the detail amount by claim number must be readily determinable.

The Captive Revenue BI Interco (Other Revenue) above will eliminate with the expense recorded by the Captive Insurer based on procedures in Corporate Accounting. This entry will also require the affiliate chartfield to be populated.

The intercompany receivable should be probable of recovery at the Balance Sheet date in order to be recorded.

2) Business Unit receives reimbursement from the Captive Insurer for their claim:

<u>A/C #</u>		<u>Dr</u>	<u>Cr</u>
xxx-xx	Cash	xxx	
0146990	A/R Prop/BI Interco		xxx

The same chartfields are required for the intercompany receivable entry as described in step one above. If this payment closes out the claim, the A/R Prop/BI Interco related to this claim should be zero. The Business Unit should include a "c" in the description field for any claim for which cash receipts from the Captive Insurer have been received (recorded as a reduction in the receivable).

Cash Flow Reporting

For property claims related to the replacement of a Business Unit's owned property which has been damaged in an insured event, any amounts received as reimbursement from the wholly-owned Captive Insurer to the Business/Corporate Unit should not be netted against the capital expenditure. Rather, these reimbursements should be classified in the same way the expenditure is classified by the Captive entity to ensure elimination in the Consolidated Statement of Cash Flow.

Regulatory Accounting Treatment Under SFAS No. 71

Any entity subject to the regulatory accounting treatment of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" should evaluate whether any of the per incident deductible for insured events should be deferred as a regulatory asset. The above journal entries should be revised for such treatment, as applicable.

**Standards/Requirements**

The intercompany accounts identified in this Policy are exclusively for use in recording Captive insurance affiliate activity, with the following distinction:

<u>Account</u>	<u>Purpose</u>
0146960	All Captive receivables (i.e. - general liability), except receivables for property and business interruption claims
0146990	Receivables for property and business interruption claims only
0421120	This account captures the BU gain, if any, from replacement of property
0495030	This account captures the revenues recognized from captive coverage of business interruption claims
0421040	This account captures the revenues recognized from captive coverage of business interruption claims (Franchised Electric only)

The PeopleSoft BU numbers for the Captive companies are as follows:

10006	Bison Insurance Company Limited
10221	NorthSouth Insurance Company Limited

**Related Links:**

[Accounting for Intercompany Transactions Policy](#)

[Accounting Process to Record Intercompany Insurance Activity \(Dated March 2007\)](#)

[Property/Business Interruption Reserve Eliminations in Consolidation Policy](#)



## Duke Energy Accounting Policy Statement

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# Accounting for Defined Benefit Pension and Other Post-Retirement Benefit Plans

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<b>Applicability:</b>	Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller
<hr/>	
<b>Approval Date:</b>	December 9, 2004
<b>Effective Date:</b>	December 1, 2004
<b>Reissue Date:</b>	December 31, 2008

### Statement of Purpose and Philosophy

The purpose of this policy is to provide guidelines for the accounting and disclosure of the defined benefit pension and other post-retirement benefit ("OPEB") plans by Duke Energy Corporation and its subsidiaries. Duke Energy is committed to preparing and providing financial information with the utmost integrity. To facilitate this corporate value, the Corporate Controller's Department will approve policies to ensure the accuracy of books and records (as detailed in the Code of Business Ethics).

### Policy Expectations and Scope

All Duke Energy employees involved in the accounting or disclosures for defined benefit pension and other post-retirement benefit plans are expected to be familiar with the accounting and disclosure guidance provided in this policy. This policy should help ensure consistent application of the accounting for defined benefit pension and other post-retirement benefit plans across the consolidated Duke Energy group. This policy contains a high-level summary of the key requirements of U. S. generally accepted accounting principles ("GAAP") as it applies to Duke Energy, including any significant interpretations or policy elections made by Duke Energy, but is not intended to be a substitute for the detail requirements of authoritative GAAP literature for specific issues or matters that may arise. This policy is applicable to all business/corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company").

This policy does not address accounting and disclosures for defined contribution pension plans. The scope of this policy excludes stock-based compensation and post-employment benefits not provided through a pension or other post-retirement benefit plan.

### Materiality

FASB Statements note that "The provisions of this Statement need not be applied to immaterial items." Accordingly, materiality should be considered when applying this policy. However, materiality must be assessed at the consolidated Duke Energy Corporation level (as well as being assessed at the SEC sub-registrant level), and involves consideration of both quantitative as well as qualitative factors. Any questions regarding materiality should be directed to the Corporate Controller's Department.

## **Accountability: Roles and Responsibilities**

### **Corporate Controller's Department –**

- Maintain an accounting policy for defined benefit pension and post-retirement benefit plans available on the Duke Energy Portal to help ensure that business/corporate units are aware of the accounting and disclosure requirements related to the plans.
- Establish and communicate the reporting timetable for defined benefit pension and other post-retirement benefit plan information needed for SEC filings, accumulate the information reported by the business/corporate units for periodic reporting and disclosure purposes, prepare the required footnote disclosures and maintain supporting documentation for the disclosures made in the interim and annual SEC filings (e.g. Form 10-K, Form 10-Q, etc).
- Provide guidance/assistance to business/corporate units on accounting and disclosures for the defined benefit pension and other post-retirement benefit plans.
- Determine the appropriate assumptions to be used by the actuary for the annual calculations for the defined benefit pension and other post-retirement benefit plans.
- Coordinate with the third party actuaries and trustees to obtain the results of the annual valuations and measurements.
- Provide the domestic business/corporate units with the appropriate amounts to be recorded for the U.S. defined benefit pension and other post-retirement benefit plans.

### **Business/Corporate Unit –**

- Ensure all reporting requirements for the defined benefit pension and other post-retirement benefit plans are accumulated and reported to the Corporate Controller's Department in accordance with the established reporting timetable.
- Ensure proper support/documentation exists for amounts recorded related to the defined benefit pension and other post-retirement plans (Corporate Accounting records the amounts for all domestic business units for all plans)
- Ensure that the accounting for the defined benefit pension and other post-retirement plans is applied consistently between periods.

## **Standards/Requirements/Background Information**

### **Background Information**

During the three years ended December 31, 2008, Duke Energy and its subsidiaries have maintained a variety of employee benefit plans, including qualified pension plans, nonqualified pension plans, and savings plans (collectively referred to as "Retirement Plans") and other post-retirement benefits/welfare plans. In general,

1. Duke Energy has maintained substantially all plans sponsored by Duke Energy, Duke Energy Carolinas and Crescent Resources (up through the date of the sale of the effective 50% interest in Crescent Resources in 2006) throughout the three year period.
2. Duke Energy has been the ultimate parent company with respect to the plans sponsored by Cinergy Corp. and its subsidiaries (referred to as the "legacy Cinergy plans") since April 1, 2006, the effective date of the merger with Cinergy.
3. Duke Energy has been the ultimate parent company with respect to the pension and other post-retirement plans sponsored by Westcoast, Union Gas, Engage Energy and Duke Energy Gas Transmission - Canada since the effective date of the merger with Westcoast Energy (March 1, 2002) These plans were transferred to Spectra Energy as a result of the spin-off of Duke Energy's natural gas businesses to Duke Energy shareholders, which was effective January 2, 2007. Accordingly, a discussion of these plans is not included within this accounting policy for 2008.
4. Certain subsidiaries in Duke Energy's international segment have obligations to provide employee benefits which may be funded in part through retirement plans and other post-retirement benefit/welfare plans.

The remainder of this background is focused on the benefit plans described in items 1 and 2 above (the Duke Energy U.S. Plans".)

### **Retirement Plans**

#### **Duke Energy U.S. Plans**

Duke Energy and its subsidiaries (including legacy Cinergy businesses) maintain qualified, non-contributory defined benefit retirement plans ("U.S. Plans"). U.S. Plans covering most employees in the Carolinas use a cash balance formula. Under a cash balance formula, a plan participant accumulates a retirement benefit consisting of pay credits that are based upon a percentage (which varies with age and years of service) of current eligible earnings and current interest credits. Certain legacy Cinergy U.S. employees are covered under plans that use a final average earnings formula. Under a final average earnings formula, a plan participant accumulates a retirement benefit equal to a percentage of their highest 3-year average earnings, plus a percentage of the their highest 3-year average earnings in excess of covered compensation per year of participation (maximum of 35 years), plus a percentage of their highest 3-year average earnings times years of participation in excess of 35 years. Many employees covered under the legacy Cinergy plans are also under a cash balance formula instead of a final averages earnings formula.

In a typical cash balance plan, each employee has a hypothetical account that is used to track his or her accumulated benefits. The value of the employee's cash balance account grows each year with the addition of an annual interest credit and an annual service credit. When the employee becomes entitled to receive benefits under the cash balance plan, the benefits are defined by a guaranteed rate of return and based on the ending value of the employee's account.

The benefits in most cash balance plans, as in most traditional defined benefit plans, are protected, within certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation. Questions have arisen under GAAP as to whether a cash balance plan be accounted for under Statement 87 as a defined contribution or defined benefit plan. EITF Issue No. 03-4, "Determining the Classification and Benefit Attribution Method for a 'Cash Balance' Pension Plan," addresses this question. A cash balance pension plan for purposes of applying Statement 87 is considered a defined benefit pension plan. Though cash balance plans are similar to defined contribution plans in that a specified amount is credited annually to individual employee accounts [similar to a 401(k) plan], the underlying premise of the cash balance plan is that a defined benefit will be paid to the employee during retirement. The amount of this defined benefit is not known until retirement because the final balance of the employee's hypothetical account continues to grow until the retirement date. However, the defined benefits can be estimated and actuarially determined in a manner similar to accounting for traditional defined benefit pension plans.

Duke Energy also maintains non-qualified, non-contributory defined benefit retirement plans which cover certain U.S. executives.

Duke Energy also sponsors employee savings plans that cover substantially all U.S. employees. Most employees participate in a matching contribution formula where Duke Energy provides a matching contribution generally equal to 100% of before-tax employee contributions, of up to 6% of eligible pay per pay period. This accounting policy does not specifically address the accounting for employee savings plans since it is relatively straight-forward in nature.

### **Welfare Plans (Other Post-retirement Benefit Plans)**

#### **Duke Energy U.S. Plans**

Duke Energy and most of its subsidiaries provide some health care and life insurance benefits for retired employees on a contributory and non-contributory basis. Employees are eligible for these benefits if they have met age and service requirements at retirement, as defined in the plans.

### **Employee Benefit Plan Asset Management and Administration**

*The following discussion relates to the Duke Energy U.S. Plans only. Responsibilities for asset management and benefit plan administration of the Westcoast plans were transferred to Spectra Energy effective January 2, 2007.*



The assets for Duke Energy U.S. pension and other post retirement benefit plans are maintained in a master trust. The investment objective of the master trust is to achieve reasonable returns on trust assets, subject to a prudent level of portfolio risk, for the purpose of enhancing the security of benefits for plan participants. The asset allocation targets were set after considering the investment objective and the risk profile with respect to the trust. U.S. equities are held for their relatively high expected return. Non-U.S. equities, debt securities, and real estate are held for diversification. Investments within asset classes are to be diversified to achieve broad market participation and reduce the impact of individual managers or investments. Duke Energy regularly reviews its actual asset allocation and periodically rebalances its investments to the targeted allocation when considered appropriate.

Duke Energy also invests other post-retirement assets in various VEBA trusts, grantor trusts, and rabbi trusts for employee benefits, post-retirement medical benefits, deferred compensation, and other benefits. The investment objective of these trusts is to achieve sufficient returns on trust assets, subject to a prudent level of portfolio risk, for the purpose of promoting the security of plan benefits for participants. The trusts are passively managed.

As discussed in greater detail below, in 2008 Duke Energy has adopted the fair value measurement guidance in SFAS No. 157, "Fair Value Measurements Used in Accounting" for financial assets, which includes assets held in pension and OPEB funds.

#### Benefit Plan Administration

Designated members of the Duke Energy Treasury Group regularly review the actual asset allocations and advise the investment committees about the performance of the trusts for the Duke Energy U.S. Plans. The investment committees consist primarily of members familiar with financial or investment matters and meets on at least a quarterly basis to monitor the activities of the trusts. For the Duke Energy U.S. plans, the investment committees make the decisions to periodically rebalance the investments to the targeted allocations when considered appropriate. The fair value of the plan assets is the current market value of the assets, as determined by the trustee. The trustee provides this information to Duke Energy after the monthly close.

Annually, a third party actuary is to be engaged by Duke Energy to assess the plans and is to present a range of assumptions, based upon factors including, the terms of the plan, the demographics of the plan participants, current economic environment, investment mix, discount rate, return on assets and salary increases, to a committee of Duke Energy personnel including representatives from the Corporate Controller and the Human Resource groups. The Corporate Controller determines the assumptions to be used by the actuary to calculate the pension and other post-retirement benefit obligation based upon the range of assumptions presented by the third party actuary.

Using the assumptions selected by management, the actuary calculates the following valuations:

- **Obligation Valuation** - determines appropriate liabilities and funding requirements based on rules and regulations of applicable pension regulatory groups. These two items may also be used to calculate any cash contribution required for the ongoing plan. The Obligation Valuation is performed as of December 31 and the funded status of the benefit plans is booked as of December 31<sup>st</sup> in compliance with SFAS No. 158 (the valuation date changed from September 30 to December 31 effective in 2007 with the adoption of SFAS No. 158).
- **Expense Valuation** - determines the expense of the ongoing plan for accounting purposes for the following year.
- **Accrued Benefits Valuation** - determines liabilities for benefits accrued as of the valuation date.

#### Funding

Duke Energy's policy is to fund amounts on an actuarial basis to provide assets sufficient to meet benefits to be paid to plan participants.

**Supporting Accounting Guidance**

Duke Energy's plans for retirement benefits are generally treated for accounting purposes as defined benefit or defined contribution pension plans. The welfare benefits provided by Duke Energy's plans are generally treated for accounting purposes as post-retirement benefits other than pensions ("OPEB").

The remainder of this policy relates to defined benefit pension (hereafter referred to as "pension") plans and OPEB.

The primary authoritative accounting standards for pensions and OPEB plans are the following pronouncements of the Financial Accounting Standards Board:

- Statement of Financial Accounting Standards (SFAS) No. 87, "**Employers' Accounting for Pensions**," (SFAS No. 87)
- SFAS No. 88, "**Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits**"
- SFAS No. 106, "**Employers' Accounting for Postretirement Benefits Other Than Pensions**," (SFAS No. 106)
- SFAS No. 132(R), "**Employers' Disclosures about Pensions and Other Postretirement Benefits**"
- SFAS No. 157, "**Fair Value Measurements**," (SFAS No. 157)
- SFAS No. 158, "**Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106 and 132(R)**"

The Emerging Issues Task Force has also published issues that provide supplemental guidance. These EITF issues and topics are listed in Appendix A.

These standards include requirements and guidance related to (1) measurement of employee benefit plan assets and obligations, (2) settlements and curtailments of obligations, (3) recognition of assets and obligations on the balance sheet ("balance sheet recognition"), (4) determination of net period pension cost ("income statement recognition"), (5) measurement dates, and (6) disclosures. In some cases, different standards apply to pension plans from standards for other post-retirement benefit plans.

The following paragraphs contain excerpts from the most significant applicable accounting literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

**Periodic Cost Recognition**

The following discussion uses the term "periodic cost" to refer to the amount of defined benefit pension and OPEB benefits attributable to an accounting period. The periodic costs includes the amount of "expense" reflected in the income statements as wells as amounts that may be capitalized as part of the cost of an asset.

Net periodic benefit cost is made up of several components that reflect different aspects of the employer's financial arrangements as well as the cost of benefits earned by employees. The cost of a benefit can be determined without regard to how the employer decides to finance the plan.

The net periodic benefit cost recognized for a period consists of the following components.

**Components of Net Periodic Benefit Cost**

Component	Pensions (Reference to SFAS No. 87)	OPEB (Reference to SFAS No. 106)
Service cost	(¶21)	(¶47)
Interest cost	(¶22)	(¶48)
Actual return on plan assets	(¶23)	(¶49)
Amortization of unrecognized prior service cost	(¶24-28)	(¶50-55)
Gain or loss (a/k/a "actuarial gains or losses")	(¶30-34)	(¶56-63)

Amortization of the unrecognized net transition asset or liability	(¶77)	(¶110-112)
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**Recognition of Assets and Obligations on the Balance Sheet**

Under SFAS No. 158, effective for fiscal years ending after December 15, 2006, an employer that is a business entity with publicly traded equity securities and sponsors one or more single-employer defined benefit plans is required to:

- a. Recognize the funded status of a benefit plan -- measured as the difference between the fair value of plan assets and the benefit obligation – in its statement of financial position. For a pension plan, the benefit obligation is the projected benefit obligation; for any other post-retirement benefit plan, the benefit obligation is the accumulated post-retirement benefit obligation. (¶4a)
- b. Aggregate the statuses of all overfunded plans and recognize that amount as a noncurrent asset in its statement of financial position. (¶4b)

Aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position. The current portion of such liability (determined on plan-by-plan basis) is the amount by which (1) the actuarial present value of benefits included in the benefit obligation payable in the next 12 months exceeds (2) the fair value of plan assets. (¶4b)

- c. Recognize as a component of other comprehensive income the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost of the period. (¶4c) *:(Note: For Duke Energy, the unrecognized components of net periodic benefit cost related to the company's regulated operations (e.g., the majority of Duke Energy's electric operations are regulated and thus subject to the accounting requirements of SFAS No. 71), should be reflected in regulatory assets (or regulatory liabilities), subject to the regulatory treatment of such costs for each regulated jurisdiction. See Duke Energy's separate policy entitled "Accounting for Regulated Entities (SFAS No. 71)".*
- d. Recognize corresponding adjustments in AOCI when (1) gains or losses, (2) prior service costs or credits, and (3) transition assets or obligations remaining from the initial application of SFAS No. 87 and SFAS No. 106 are subsequently recognized as components of net period benefit costs. (¶4d)
- e. Apply the provisions of FASB Statement No. 109, Accounting for Income Taxes, to determine the applicable income tax effects of items (a)-(d) above. (¶4e)

**Measurement of Benefit Plan Costs, Obligations and Assets,**

Pension Benefit Obligations

*(References to SFAS No. 87 are in italics)*

For a pension plan, the projected benefit obligation is the actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. (¶264)

- The projected benefit obligation is based on an attribution of pension benefits to periods of employee services and on the use of actuarial assumptions to calculate the actuarial present value of those benefits. Actuarial assumptions reflect the time value of money (discount rate) and the probability of payment (assumptions as to mortality, turnover, early retirement, and so forth). (¶39)
- The projected benefit obligation reflects future compensation levels to the extent that the pension benefit formula defined pension benefits wholly or partially as a function of future compensation levels (that is, for a final-pay plan or a career-average-pay plan) (¶46)

OPEB Obligations

An OPEB obligation is measured as the actuarial present value of the benefits expected to be provided under the plan, reduced by the actuarial present value of contributions expected to be received from the plan participants during their remaining active service and post-retirement periods.

- In determining the amount of the contributions expected to be received from those participants toward the cost of their post-retirement benefits, consideration is given to any related substantive plan provisions, such as an employer's past practice of consistently increasing or reducing the contribution rates.
- An obligation to return contributions received from employees who do not attain eligibility for post-retirement benefits and, if applicable, any interest accrued on those contributions shall be recognized as a component of an employer's post-retirement benefit obligation.

For further information, see SFAS No. 106, ¶127.

### Pension Plan Assets

For purposes of measuring plan assets, plan investments, whether equity or debt securities, real estate, or other, are measured at their fair value (see "Fair Value" below) as of the measurement date. (See SFAS No. 87, ¶49)

In accordance with SFAS No. 158, the fair value of the plan assets is combined with the projected benefit obligation to arrive at the appropriate asset/liability presentation in the balance sheet.

### OPEB Plan Assets

Plan assets are assets—usually stocks, bonds, and other investments (except certain insurance contracts)—that have been segregated and restricted (sometimes in a trust) to be used for post-retirement benefits. The amount of plan assets includes amounts contributed by the employer, and by plan participants for a contributory plan, and amounts earned from investing the contributions, less benefits, income taxes, and other expenses incurred. Plan assets ordinarily cannot be withdrawn by the employer except under certain circumstances when a plan has assets in excess of obligations and the employer has taken certain steps to satisfy existing obligations. Securities of the employer held by the plan are includable in plan assets provided they are transferable. (See SFAS No. 106, ¶63)

Assets not segregated in a trust, or otherwise effectively restricted, so that they cannot be used by the employer for other purposes are not plan assets for purposes of accounting for OPEB, even though the employer may intend that those assets be used to provide post-retirement benefits. Those assets shall be accounted for in the same manner as other employer assets of a similar nature and with similar restrictions. Amounts accrued by the employer but not yet paid to the plan are not plan assets for purposes of accounting for OPEB. (See SFAS No. 106, ¶64.)

For purposes of measuring plan assets, plan investments, whether equity or debt securities, real estate, or other, are measured at their fair value (see "Fair Value" below) as of the measurement date. See SFAS No. 106, ¶65.

In accordance with SFAS No. 158, the fair value of the plan assets is combined with the accumulated benefit obligation to arrive at the appropriate asset/liability presentation in the balance sheet.

### Fair Value

In 2008 Duke Energy adopted the fair value measurement guidance in SFAS No. 157, "Fair Value Measurements" (SFAS No. 157) for financial assets, which includes assets held in pension and OPEB funds.

Fair value is defined in SFAS No. 157 as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. (See SFAS No. 157, ¶5)

- The measurement should consider attributes specific to the asset, for example, the condition and/or location of the asset and restrictions, if any, on the sale or use of the asset at the measurement date. (See SFAS No. 157, ¶6)
- An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions

involving such assets. The objective of a fair value measurement is to determine the price that would be received to sell the asset at the measurement date (an exit price). (See SFAS No. 157, ¶7)

The implications of SFAS No. 157, "Fair Value Measurements," for pensions and other post-retirement benefits are addressed in Duke Energy's separate policy entitled "Fair Value." While the measurement principles under SFAS No. 157 are not expected to have a significant effect on the recorded value of plan assets, particular attention should be given to non-publicly traded plan asset investments such as real estate or private entity debt and equity interests.

### **Settlements and Curtailments**

A transaction may result in the settlement or curtailment of a benefit obligation. SFAS No. 88's provisions related to settlements and curtailments are to be applied on a plan-by-plan basis. Therefore, the significance of a reduction or elimination should be evaluated in relation to the participants of the affected pension plan, not to the total work force employed at the affected division or by the company as a whole.

- A settlement is defined as a transaction that:
  - Is an irrevocable action, and
  - Relieves the employer (or the plan) of primary responsibility for a benefit obligation, and
  - Eliminates significant risk related to the obligation and the asset used to effect the settlement.

A transaction that does not meet these three criteria does not constitute a settlement. (SFAS No. 88 ¶3 and 4 and SFAS No. 106 ¶90 and 91). SFAS No. 88 provides two examples of transactions that meet all three criteria: 1) Making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits; and 2) Purchasing nonparticipating annuity contracts to cover vested benefits. In addition to the examples in SFAS No. 88, a settlement could be accomplished by payments to participants in noncash assets, by transfer of employee interests into a defined contribution plan, or by selling a plant, division, subsidiary or business segment where the buyer assumes all or part of the seller's pension obligation provided all the criteria are met. Determining whether other types of transactions constitute settlements requires a careful analysis of the substance of the transactions.

- For a pension plan, a curtailment is an event that significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of benefits for some or all of their future services. (SFAS No. 88 ¶6) For other post-retirement benefits, a curtailment is an event that reduces significantly the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of active plan participants. (SFAS No. 106 ¶96) Curtailments include termination of employees' services earlier than expected or by termination or suspension of a plan so that employees do not earn additional benefits for future services. Consistent with interpretative guidance from Deloitte & Touche, the threshold for significance as used in the definition of curtailment is a matter of judgment; however, in general, 10 percent or more is considered significant. Thus, a significant reduction would be deemed to occur when the decrease in the expected years of future service is 10 percent or more. Likewise, a curtailment would be deemed to occur when benefits are eliminated for 10 percent or more of the employees.
- If a transaction does not meet the definition of a settlement or a curtailment, it is treated as a plan amendment. In other words, if "curtailment" or "settlement" is deemed not to have occurred, any changes in the benefit obligations that result from the event that led to the settlement or curtailment analysis is "rolled" into the existing actuarial gains and losses and recognized in future periods. This recognition model is consistent with the guidance in paragraphs 29, 32, and 33 of SFAS 87.

A plan termination occurs when the obligation is settled and the plan ceases to exist. If a plan termination occurs and the plan is not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer). (SFAS 106 ¶100)

If an action by the Duke Energy is believe to potentially have triggered an accounting settlement or curtailment of pension or OPEB benefits, consulting with the Controller's Department is required.

### Accounting for a Settlement

A settlement may result in recognizing a gain or loss.

### Pension Plans Settlements

*(¶ references in italics refer to paragraphs in SFAS No. 88.)*

For pension plans, the maximum amount of gain or loss subject to recognition in earnings is the sum of (a) the unrecognized net gain or loss, including any gain or loss first measured at the time of settlement, and (b) any remaining unrecognized net asset existing at the time of initial application of SFAS 87 that remains unamortized at the date of settlement (*¶9 and ¶21*)

The gain or loss is accounted for as follows:

- If the entire benefit obligation is settled, the maximum amount of gain or loss is recognized in earnings.
- If only a part of the projected benefit obligation is settled, a pro rata portion of the maximum amount equal to the percentage reduction in the project benefit obligation is recognized in earnings. (*SFAS No. 88, ¶ 9 and 21*)

### OPEB Settlements

*(¶ references in italics refer to paragraphs in SFAS No. 106.)*

For settlements of other post-retirement benefits plans, the gain or loss subject to recognition in income (the "maximum gain or loss") is the sum of (a) the unrecognized net gain or loss, including the gain or loss resulting from remeasurements of plan assets and the accumulated OPEB obligation at the time of settlement, and (b) any remaining unrecognized transition asset. (*¶92*)

The gain or loss is accounted for as follows (¶93):

Determination of Gain or Loss on OPEB Settlement

If...	...and the amount subject to recognition is a	
	Gain	Loss
The entire accumulated benefit obligation is settled	Recognize the maximum settlement gain as (1) a reduction in any remaining unrecognized transition obligation and (2) any excess gain in income	The maximum settlement loss is recognized in income
Only part of the accumulated benefit obligation is settled	Recognize a pro rata portion of the maximum settlement gain as (1) a reduction in any remaining unrecognized transition obligation and (2) the excess, if any, in income	Recognize in income a pro rata portion of the maximum settlement loss

Accounting for a Curtailment

A curtailment may result in a gain or loss.

For a curtailment, the gain or loss subject to recognition in earnings consists of the following effects:

- (a) The unrecognized prior service cost associated with years of service no longer expected to be rendered as the result of a curtailment is a loss (*the description of this item differs slightly between SFAS No. 88 ¶12 and SFAS No. 106 ¶97*)
- (b) For pensions, any remaining net obligation existing at the time of initial application of SFAS 87 that remains unamortized at the date of the curtailment (*SFAS No. 88 ¶21*) and any unrecognized costs of retroactive plan amendments.  
 For OPEB, the portion of any remaining unrecognized transition obligation attributable to the previously expected remaining future years of service. (*SFAS No. 106 ¶97*)
- (c) The curtailment gain – i.e., the decrease in the projected benefit obligation to the extent that it exceeds any unrecognized net loss (*SFAS No. 88 ¶13 and SFAS No. 106 ¶98*)
- (d) The curtailment loss – i.e., the increase in the projected benefit obligation to the extent that it exceeds any unrecognized net gain (*SFAS No. 88 ¶13 and SFAS No. 106 ¶98*)

If the sum of effects (a) through (d) is a net loss, it is recognized in earnings when it is probable that a curtailment will occur and the effects are reasonably estimable. If the sum of effects (a) through (d) is a net gain, it is recognized in earnings when the related employees terminate or the plan suspension or amendment is adopted. (*SFAS No. 88 ¶14 and SFAS No. 106 ¶99*)

Measurement Dates

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Duke Energy has adopted the measurement date provisions of SFAS No. 158; therefore, all plan assets and obligations are required to be measured as of December 31 of each year (any exceptions desired should be reported to and discussed with the Corporate Controller's Department).

For interim and annual financial statements, the measurements of plan assets and benefit obligations used in determining net periodic pension cost are required to be based on the assumptions used for the previous year-end measurements unless either:

- More recent measurements of both plan assets and benefit obligations are available; or
- A "significant event" occurs, such as a plan amendment that would ordinarily call for such measurements.

The availability of more recent measurements largely depends on whether a company needs them during a year. For example, the company might obtain measurements of its benefit obligations and plan assets at midyear in

connection with negotiations relating to labor relations, merger or acquisition plans, or other business reasons. If so—and provided the measurements comply with Statement 87's "best estimate" and other requirements—the more recent measurements **are required to be used** for determining net periodic pension cost for the remainder of the year (or until more recent measurements are available, whichever occurs first).

The following are the *primary events that would ordinarily be considered significant events*:

- Plan amendments
- Business combinations
- Events covered by Statement 88 —settlements, curtailments, or in some cases, termination benefits
- Plan mergers, split-ups, or transfers of plan assets (without obligation transfers) from one plan to another

A plan amendment or significant event affecting one plan does not require more recent measurements for the unaffected plans.

### **Disclosures**

SFAS No. 132(R) ¶¶6-7 provide guidance for aggregating disclosure information for employers with two or more benefit plans.

SFAS No. 132(R) ¶5 and SFAS No. 158 ¶7 describe disclosures required in annual financial statements.

SFAS No. 132(R) ¶9 describes disclosure required in interim financial reports.

SFAS No. 132(R) also describes additional disclosures required for defined contribution plans (¶11) and multiemployer plans (¶12)

SFAS No. 158 describes additional disclosures required in the year of application.

Note: Each of the "Big 4" accounting firms (E&Y, D&T, PWC, and KPMG) maintain current, comprehensive accounting disclosure checklists that are useful for assessing required financial statement disclosures.



## **Accounting Policy**

The following is a discussion of matters specific or unique to Duke Energy with respect to the accounting for employee benefit plans.

### **Application to Duke Energy subsidiaries**

Subsidiaries of Duke Energy which participate in a plan sponsored by its parent should generally follow the accounting required in SFAS Nos. 87 and 106 for multiemployer plans. In general, a participant in a multiemployer plan recognizes as net pension cost the required contribution for the period and recognizing as a liability any contributions due and unpaid. However, the net periodic pension cost recognized by a subsidiary is not necessarily equivalent to the required contribution for the period. Rather, the net periodic pension cost recognized by the subsidiary should be the amounts allocated to the subsidiary from the parent company for pension cost and any related credits from the amortization of a net asset at transition, which may not equate to the subsidiary's required contribution for the period. Regardless of the amounts recorded, adequate disclosures should be provided to indicate the amounts recorded.

With respect to SEC sub-registrants, pension and OPEB plans are managed primarily either at the Cinergy Corp. level or at the Duke Energy Corporation level. The funded status of each pension and OPEB plan (fair value of assets less actuarially determined benefit obligation) is therefore recorded at the Duke Energy Corporation consolidated level. Duke Energy has determined that it is a requirement to "push down"/allocate pension and OPEB expenses to the SEC sub-registrant level, but that the "push down"/allocation of the funded status (i.e., balance sheet accounts) to the SEC sub-registrant level is not required, but is acceptable. Note that Duke Energy has elected to "push down" the funded status of the plans to Duke Energy Ohio and Duke Energy Indiana, but has elected to not "push down" the funded status of the plans to Duke Energy Carolinas.

### **Measurement Assumptions**

The calculation of pension expense, other post-retirement expense and related pension and other post-retirement liabilities require the use of assumptions. Changes in these assumptions can result in different expense and reported liability amounts, and future actual experience can differ from the assumptions. The most critical assumptions for pension and other post-retirement benefits are the expected long-term rate of return on plan assets and the assumed discount rate. Additionally, the health care trend rate assumption is critical for other post-retirement benefits.

### **Expected Long-term Rate of Return on Plan Assets**

The expected long-term rate of return ("LTRR") is developed using a weighted average calculation of expected returns based primarily on future expected returns across asset classes considering the use of active asset managers.

The development of future rate of return assumptions should be based on a coherent methodology that is prudent and reasonable. The plan sponsor must ensure that the approach used in determining its LTRR assumption is clear, logical, and comprehensive. It is the responsibility of the sponsor to ensure that adequate support for the LTRR assumption exists.

The following factors may be considered when a plan sponsor is developing its LTRR assumption (this list is not meant to be all-inclusive):

- The assumed asset allocation of pension plan assets (common stock, bonds, etc.);
- The assumed volatility of the portfolio;
- Investment manager performance;
- Investment policy;
- Historical return data by asset category;
- Rolling five and ten-year averages by asset category;
- Current trends with respect to economic conditions, inflation, and market sentiment;
- Views and forecasts by market analysts;
- Views of the plan sponsor; and
- Views of external investment managers.

### Discount rate

The discount rate used to determine the pension and other post-retirement benefit obligations is based on an AA bond yield curve. The yield is selected based on bonds with cash flows that match the timing and amount of the expected benefit payments under the plan. Unlike the determination of the expected long-term rate of return on plan assets which focuses on a long-term view of markets, the determination of the appropriate discount rate should focus on current general economic trends.

### Health Care Trends

Duke Energy's U.S. post-retirement plan uses a medical care trend rate which reflects the near and long-term expectation of increases in medical health care costs. Duke Energy's U.S. post-retirement plan uses a prescription drug trend rate which reflects the near and long-term expectation of increases in prescription drug health care costs.

### **Net Periodic Benefit Cost**

#### Service Costs

Pension and other post-retirement benefits costs are accrued over an employee's active service period to the date of full benefits eligibility. Service cost is the actuarial present value of benefits attributed by the plan's benefit formula to employee service rendered during a reporting period.

#### Actuarial Gains and Losses

Generally speaking, actuarial gains and losses are amortized over the average remaining service period of the active employees.

#### Actual Return on Plan Assets

Duke Energy determines the market-related value of plan assets using a calculated value that recognizes changes in fair value of the plan assets in a particular year on a straight-line basis over the next five years.

Consistent with FASB 87 Q&A #24, the expected return on plan assets should take into consideration the availability of all plan assets for investment throughout the year. For example, if the employer's pension plan contribution for the year is expected to be made two months before the next measurement date, then the expected return on plan assets should include an amount related to the expected return on that contribution only for those two months.

Dividends on Duke Energy shares held by the savings plan are charged to retained earnings when declared and shares held in the plan are considered outstanding in the calculation of basic and diluted earnings per share.

#### Amortization of Prior Service Costs

Prior service costs are amortized over the average remaining service period of the active employees.

### **Settlements and Curtailments**

Settlements:

Note that some plans have a policy of annually purchasing annuity contracts to cover each year's vested benefit accruals. Other plans maintain deposit administration contracts with insurance companies, whereby annuities are

purchased to cover the benefits of participants who retire each year. Also, it is not uncommon for partially vested participants to withdraw from a plan due to voluntary or involuntary termination of employment, and to be cashed out of the plan as of the date of withdrawal. Under SFAS No. 88, these situations literally are settlements, even though relatively small amounts may be involved.

To provide relief from what could be an onerous record-keeping and information gathering burden to account for numerous "mini-settlements" during a year, paragraph 11 of SFAS No. 88 provides:

"If the cost of all settlements in a year is less than or equal to the sum of the service cost and interest cost components of net periodic pension cost for the plan for the year, gain or loss recognition is permitted."

Therefore, Duke Energy's policy is if (i) the cost of all settlements in a year is less than or equal to (ii) the sum of the service component and interest cost component of net period benefit cost for the plan for the year, then Duke Energy does not recognize any of the gain or loss in earnings.

**Curtailments:**

For a pension plan, Duke Energy recognizes a curtailment when an event (1) reduces by 10% or more the expected years of future service of present employees or (2) eliminates for 10% or more of employees the accrual of benefits for some or all of their future services.

For other post-retirement benefits, Duke Energy recognizes a curtailment when an event (1) reduces by 10% or more the expected years of future service of active plan participants or (2) eliminates the accrual of defined benefits for some or all of the future services for of 10% or more of active plan participants.

If "curtailment" or "settlement" is deemed not to have occurred consistent with the above guidance, any changes in the PBO and APBO that result from terminations is "rolled" into the existing actuarial gains and losses and recognized in future periods (along with any prior service costs/transition costs related to terminated employees).

#### **Measurement Date**

Duke Energy adopted the change in measurement date from September 30 to December 31 effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. Net periodic benefit cost for the three-month period between September 30, 2006 and December 31, 2006 were recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, changes in plan assets and plan obligations between September 30, 2006 and December 31, 2006 not related to net periodic benefit cost were recognized, net of tax, as an adjustment to OCI.

#### **Accounting by Regulated Entities**

The implications of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," for operations of Duke Energy that are subject to this accounting are addressed in Duke Energy's separate policy entitled "Accounting for Regulated Entities (SFAS No. 71)."

#### **Key Terms**

Key terms used in the discussion of accounting for defined benefit pension plans and OPEB are FASB standards cited above and the FASB Current Text.

**Related Links:**

Enterprise-level Policy:

"Other Comprehensive Income Accounting Procedures"

"Accounting for Regulated Entities (SFAS No. 71)"

"Fair Value Measurements Used in Accounting"

"Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters"

Appendix A

**Supplemental Accounting Guidance from the Emerging Issues Task Force (EITF)**

EITF Issue No. 86-27, "*Measurement of Excess Contributions to a Defined Contribution Plan or Employee Stock Ownership Plan*," interprets Paragraph 64 of SFAS No. 87 and Paragraph 105 for SFAS No. 106

EITF Issue No. 88-1, "*Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan*"

EITF Issue No. 88-23, "*Lump-Sum Payments under Union Contracts*"

EITF Issue No. 90-3, "*Accounting for Employers' Obligations for Future Contributions to a Multiemployer Pension Plan*," interprets Paragraph 68 of SFAS No. 87

EITF Issue No. 91-7, "*Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits*," interprets Paragraphs 24 through 28 of SFAS No. 87

EITF Issue No. 92-12, "*Accounting for OPEB Costs by Rate-Regulated Enterprises*"

EITF Issue No. 92-13, "*Accounting for Estimated Payments in Connection with the Coal Industry Retiree Health Benefit Act of 1992*"

EITF Issue No. 93-3, "*Plan Assets under FASB Statement No. 106*," interprets Paragraphs 308 and 518 of SFAS 106

EITF Issue No. 03-2, "*Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities*"

EITF Issue No. 03-4, "*Determining the Classification and Benefit Attribution Method for a 'Cash Balance' Pension Plan*"

EITF Issue No. 06-4, "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*"

EITF Issue No. 06-10, "*Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements*"

EITF Topic No. D-27, "*Accounting for the Transfer of Excess Pension Assets to a Retiree Health Care Benefits Account*"

EITF Topic No. D-36, "*Selection of Discount Rates Used for Measuring Defined Benefit Pension Obligations and Obligations of Postretirement Benefit Plans Other Than Pensions*," interprets Paragraph 198 of SFAS No. 87 and Paragraph 186 of SFAS No. 106



Duke Energy Accounting Policy Statement

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## Accounting for Derivative Instruments and Hedging Activities

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**Applicability:** Enterprise

**Originator:** Corporate Controller

**Approval:** Corporate Controller

**Approval Date:** December 7, 2004

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**Effective Date:** December 1, 2004

**Reissue Date:** December 31, 2008

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### Statement of Purpose and Philosophy

The purpose of this policy is to provide guidelines related to the accounting and disclosure of derivatives and other instruments or contracts related to certain risk management functions (e.g., risks associated with commodity prices, credit exposure, interest rates, and foreign currency) and hedging activities. Duke Energy is committed to preparing and providing financial information with the utmost integrity. To facilitate this corporate value, the Corporate Controller's Department will approve policies to ensure the accuracy of books and records (as detailed in the Code of Business Ethics).

### Policy Expectations and Scope

This policy is applicable to all business/corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company"). This policy contains a high-level summary of the key requirements of U. S. generally accepted accounting principles ("GAAP") as it applies to Duke Energy, including any significant interpretations or policy elections made by Duke Energy, but is not intended to be a substitute for the detailed requirements of authoritative GAAP literature for specific issues or matters that may arise. This policy should help ensure consistent application of the accounting for derivative instruments and hedging activities across the consolidated Duke Energy group.

The scope of this policy is related to risk management functions surrounding derivative instruments and hedging activities, including any contracts whose terms and conditions qualify as derivative instruments even though the initial intent of the contract may not have been related to "risk management." This policy does not cover other risk management activities such as credit risk, allowances for bad debt, insurance contracts, etc. This policy does not apply to equity or cost method investments. In addition, this policy is intended to address matters of significance at the Duke Energy Corporation consolidated reporting level (and the SEC sub-registrant level). Additional details or procedural information may exist at the individual business or corporate unit level.

### Materiality

FASB Statements note that, "The provisions of this Statement need not be applied to immaterial items." Accordingly, materiality should be considered when applying this policy. However, materiality must be assessed at the consolidated Duke Energy Corporation level (as well as being assessed at the SEC sub-registrant level), and involves consideration of both quantitative as well as qualitative factors. Any questions regarding materiality should be directed to the Corporate Controller's Department.

## Derivative Instruments and Hedging Activities Policy

### **Accountability: Roles and Responsibilities**

#### Corporate Controller's Department -

- Maintain an accounting policy for derivative instruments and hedging activities available on the Duke Energy Portal to help ensure that business/corporate units are aware of the criteria in order to assess whether (1) a financial instrument or other contract is a derivative and (2) a derivative qualifies for the normal purchases and normal sales exception or hedge accounting.
- Accumulate the information reported by the business/corporate units for periodic reporting and disclosure purposes (e.g., Form 10-K, Form 10-Q, etc.), including SEC market risk disclosures, and ensure that GAAP, including SEC, disclosure requirements are met.
- Provide guidance/assistance to business/corporate units on the classification and disclosure of derivative instruments, derivative instrument transactions for which accrual accounting (as defined below in the section entitled "Accounting for Types of Instruments by Activity") is available, trading and marketing activities, and certain other risk management activities.
- Establish and communicate the reporting timetable for derivative instruments and hedging information needed for SEC filings.
- Provide guidance on the consideration of materiality as may be requested by the business/corporate units.

#### Business/Corporate Unit -

- Ensure all reporting requirements for derivative instruments, hedges, trading and risk management activities are reported to the Corporate Controller's Department in accordance with the established reporting timetable.
- Ensure proper support/documentation exists for the determination of whether: i) a contract or certain components of a contract meet the definition of a derivative or an embedded derivative, ii) a derivative instrument qualifies and the exemption is elected for the normal purchases and normal sales exception, and iii) hedge accounting is utilized to establish a hedging relationship.
- Ensure proper support/documentation exists for the determination of the fair value of derivative assets and liabilities at each reporting period and apply the guidance in the accounting policy entitled "Fair Value Measurements Used in Accounting."
- Ensure proper support/documentation exists for other risk management activities, such as hedge de-designation, calculated value reserve methodology, presentation, etc.
- Coordinate with the Corporate Controller's Department to ensure that all disclosure requirements are met in SEC filings.

### **Standards/Requirements/Background Information**

This section primarily contains references to, and excerpts from, the most significant or applicable GAAP authoritative literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

#### Standards

The various accounting standards that significantly impact the accounting recognition and disclosure of derivative instruments included the following:

- SFAS No. 133 (as amended), "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133")
- SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 149")
- SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157")
- SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133" ("SFAS No. 161") – effective Q1 2009
- EITF Issue 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" ("EITF Issue No. 99-19")

Derivative Instruments and Hedging Activities Policy

- EITF Issue 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities" ("EITF Issue No. 02-3")
- EITF Issue No. 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not 'Held for Trading Purposes' as Defined in Issue No. 02-3" ("EITF Issue No. 03-11")
- Issue papers from the Derivatives Implementation Group ("DIG"), a committee formed by the FASB to address interpretation issues involving SFAS No. 133. Issue papers from the DIG that are of the most relevance to Duke Energy include:
  - DIG Issue No. A6, "Definition of a Derivative: Notional Amounts of Commodity Contracts" ("DIG Issue No. A6")
  - DIG Issue No. A10, "Definition of a Derivative: Assets That Are Readily Convertible to Cash" ("DIG Issue No. A10")
  - DIG Issue No. A18, "Definition of a Derivative: Application of Market Mechanism and Readily Convertible to Cash Subsequent to the Inception of Acquisition of a Contract"
  - DIG Issue No. A19, "Definition of a Derivative: Impact of a Multiple-Delivery Long-Term Supply Contract on Assessment of Whether an Asset Is Readily Convertible to Cash" ("DIG Issue No. A19")
  - DIG Issue No. C15, "Scope Exceptions: Normal Purchases and Normal Sales Exception for Certain Option-Type Contracts and Forward Contracts in Electricity" ("DIG Issue No. C15")
  - DIG Issue No. C20, "Scope Exceptions: Interpretation of the Meaning of *Not Clearly and Closely Related* in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature" ("DIG Issue No. C20")
  - DIG Issue No. E7, "Hedging-General: Methodologies to Assess Effectiveness of Fair Value and Cash Flow Hedges"
  - DIG Issue No. G2, "Cash Flow Hedges: Hedged Transactions That Arise from Gross Settlement of a Derivative ("All in One" Hedges)" ("DIG Issue No. G2")
  - DIG Issue No. G7, "Cash Flow Hedges: Measuring the Ineffectiveness of a Cash Flow Hedge under Paragraph 30(b) When the Shortcut Method Is Not Applied"
  - DIG Issue No. G10, "Cash Flow Hedges: Need to Consider Possibility of Default by the Counterparty to the Hedging Derivative"

SFAS No. 157 was issued in September 2006 and was effective for Duke Energy, as it relates to valuations of derivative instruments and hedging activities, beginning on January 1, 2008. SFAS No. 157 does not require any new fair value measurements; however, SFAS No. 157 does amend certain accounting pronouncements discussed in this policy, and therefore, the application of SFAS No. 157 may change Duke Energy's current practice for determining fair values for the areas of accounting covered by this policy. For additional information and guidance with respect to the application of SFAS No. 157, refer to Duke Energy Accounting Policy Statement, "Fair Value Measurements Used in Accounting."

Background:

**Types of Activities:**

The Company primarily operates in various facets of the electric and natural gas industries including, but not limited to, the ownership and operation of power plants, electricity transmission and distribution lines in the Americas, and retail natural gas services in Ohio and Kentucky. Duke Energy is exposed to market risks associated with changes in commodity prices, credit exposure, interest rates, and foreign currency exchange rates. The Company's historical risk management and trading operations can be grouped into two broad categories - economic hedging and proprietary trading. Currently, the Company does not engage in any proprietary trading activities, but references to this activity are being retained in this policy as the company has trading activity in its discontinued operations for 2005 and 2006, and certain legacy trading contracts continue to wind-down.



## Derivative Instruments and Hedging Activities Policy

### *Power Purchase Agreements*

Duke Energy in the normal course of business enters in to power purchase agreements (PPAs), as either a buyer or seller of power. The number of these transactions is growing, especially in U.S. territories where the use of renewable energy sources is increasing and wind assets come on line. While PPAs are considered to be ordinary course of business contracts, the accounting for PPAs is often complex, as the authoritative literature requires an analysis of lease, derivative, and consolidation accounting for the underlying power producing fixed assets.

A PPA checklist has been created as a document that the Controller's Department believes will enhance internal controls around the accounting for PPAs. This checklist should be thoroughly considered when determining the appropriate accounting for all new and modified PPAs. Effective, October 1, 2008, the completion of the checklist is a mandatory SOX control for all new and modified PPAs.

### *Economic Hedging*

In connection with its operations, the Company has certain firm commitments and anticipated forecasted transactions that bear commodity price, interest rate and/or foreign currency exchange rate risk. To mitigate this exposure, the Company often enters into a forward type contract for the purpose of reducing the risk of price fluctuation upon settlement, delivery or execution of a particular transaction. Depending on the nature of the hedged transaction and the instrument used, the Company may or may not designate the instrument as an accounting hedge in accordance with SFAS No. 133. The Company's economic hedging activities will be classified in the consolidated financial statements as either 1) "hedging" if they are designated and documented as such for accounting purposes in accordance with SFAS No. 133 and meet all the hedge criteria in SFAS No. 133; 2) "other" or "undesignated" if they represent an economic hedge but are not formally designated and documented or do not qualify as a hedge for accounting purposes under SFAS No. 133; or 3) excluded from the consolidated financial statements until settlement occurs either because the forward-type contracts used represent normal purchases and normal sales of the Company, as defined in SFAS No. 133 (as amended), or the contract does not qualify as a derivative (e.g., an operating lease or an executory contract, which are described in greater detail below).

### *Proprietary trading (as previously noted, the Company does not currently engage in proprietary trading)*

Related, in part, to the Company's presence in the natural gas and electricity marketplace, the Company in the past entered into certain contracts to take a market view, capture market price or put capital at risk. This type of activity may use some of the same types of instruments as hedging activity described above and is generally short-term in nature. EITF Issue No. 02-3 clarified that classification of derivatives as held for "trading purposes" is based on the intent of the issuer or holder and shall be consistent with paragraph 12(a) of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which characterizes trading as "active and frequent buying and selling . . . with the objective of generating profits on short-term differences in price." On an ongoing basis, reclassifications into and out of the "trading" category, as defined in SFAS No. 115, should be rare. The SFAS No. 115 definition of trading involves holding an instrument for a short period of time, such as hours or days rather than months or years or to its maturity, in the case of debt instruments. Designation of a contract as proprietary trading activity is performed at the business/corporate unit level by the appropriate personnel and documented within the business/corporate unit's risk management system as such. Paragraph 16 of EITF 02-3 states that "A derivative held for trading purposes may be designated as a hedging instrument, prospectively, if all of the applicable criteria in Statement 133 have been met." As noted above, the Company currently does not engage in any significant proprietary trading activities and any such activity must be approved in accordance with Duke Energy internal control guidelines and policies.

### **Types of Instruments:**

#### *1. Derivative Instruments*

Derivative Instruments and Hedging Activities Policy

As provided in SFAS No. 133<sup>1</sup>, a derivative instrument is a financial instrument\* or other contract with all three of the following characteristics:

- a. It has (1) one or more **underlyings** and (2) one or more **notional amounts** or payment provisions or both.
- b. It requires **no initial net investment** or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors
- c. Its terms require or **permit net settlement**, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

SFAS No. 133 contains the following additional information on the determination of an underlying and a notional:

*7. Underlying, notional amount, and payment provision.* An underlying is a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself. A notional amount is a number of currency units, shares, bushels, pounds, or other units specified in the contract. The settlement of a derivative instrument with a notional amount is determined by interaction of that notional amount with the underlying. The interaction may be simple multiplication, or it may involve a formula with leverage factors or other constants. A payment provision specifies a fixed or determinable settlement to be made if the underlying behaves in a specified manner.

*57. a. Underlying.* An underlying is a variable that, along with either a notional amount or a payment provision, determines the settlement of a derivative. An underlying usually is one or a combination of the following:

- (1) A security price or security price index
- (2) A commodity price or commodity price index
- (3) An interest rate or interest rate index
- (4) A credit rating or credit index
- (5) An exchange rate or exchange rate index
- (6) An insurance index or catastrophe loss index
- (7) A climatic or geological condition (such as temperature, earthquake severity, or rainfall), another physical variable, or a related index.

However, an underlying may be any variable whose changes are observable or otherwise objectively verifiable. Paragraph 10(e) specifically excludes a contract with settlement based on certain variables unless the contract is exchange-traded. A contract based on any variable that is not specifically excluded is subject to the requirements of this Statement if it has the other two characteristics identified in paragraph 6 (which also are discussed in paragraph 57(b) and paragraph 57(c) below).

SFAS No. 133 contains the following additional information on the determination of whether a contract contains an initial net investment:

*8. Initial Net Investment.* Many derivative instruments require no initial net investment. Some require an initial net investment as compensation for time value (for example, a premium on an option) or for terms that are more or less favorable than market conditions (for example, a premium on a forward purchase contract with a price less than the current forward price). Others require a mutual exchange of currencies or other assets at inception, in which case

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<sup>1</sup> SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", paragraph 6.

\* See definition under "Key Terms"

## Derivative Instruments and Hedging Activities Policy

the net investment is the difference in the fair values of the assets exchanged. A derivative instrument does not require an initial net investment in the contract that is equal to the notional amount (or the notional amount plus a premium or minus a discount) or that is determined by applying the notional amount to the underlying. If the initial net investment in the contract (after adjustment for the time value of money) is less, by more than a nominal amount [*according to some interpretative guidance, greater than 15% is considered more than a nominal amount, however, considerable judgment is required in determining if an initial net investment amount is significant enough to avoid triggering the no initial net investment characteristic*], than the initial net investment that would be commensurate with the amount that would be exchanged either to acquire the asset related to the underlying or to incur the obligation related to the underlying, the characteristic in paragraph 6(b) is met. The amount of that asset acquired or liability incurred should be comparable to the effective notional amount<sup>4a</sup> of the contract.

<sup>4a</sup> The effective notional amount is the stated notional amount adjusted for any leverage factor.

57. b. *Initial net investment.* A derivative requires no initial net investment or a smaller initial net investment than other types of contracts that have a similar response to changes in market factors. For example, entering into a commodity futures contract generally requires no net investment, while purchasing the same commodity requires an initial net investment equal to its market price. However, both contracts reflect changes in the price of the commodity in the same way, (that is, similar gains or losses will be incurred). A swap or forward contract also generally does not require an initial net investment unless the terms favor one party over the other. An option generally requires that one party make an initial investment (a premium) because that party has the rights under the contract and the other party has the obligations. The phrase *initial net investment* is stated from the perspective of only one party to the contract, but it determines the application of the Statement for both parties.

SFAS No. 133 contains the following additional information on the determination of whether a contract contains the characteristics of net settlement:

9. *Net settlement.* A contract fits the description in paragraph 6(c) if its settlement provisions meet one of the following criteria:

- a. Neither party is required to deliver an asset that is associated with the underlying and that has a principal amount, stated amount, face value, number of shares, or other denomination that is equal to the notional amount (or the notional amount plus a premium or minus a discount). For example, most interest rate swaps do not require that either party deliver interest-bearing assets with a principal amount equal to the notional amount of the contract.
- b. One of the parties is required to deliver an asset of the type described in paragraph 9(a), but there is a market mechanism that facilitates net settlement, for example, an exchange that offers a ready opportunity to sell the contract or to enter into an offsetting contract.
- c. One of the parties is required to deliver an asset of the type described in paragraph 9(a), but that asset is readily convertible to cash<sup>5</sup> or is itself a derivative instrument. An example of that type of contract is a forward contract that requires delivery of an exchange-traded equity security. Even though the number of shares to be delivered is the same as the notional amount of the contract and the price of the shares is the underlying, an exchange-traded security is readily convertible to cash. Another example is a swaption—an option to require delivery of a swap contract, which is a derivative.

<sup>5</sup> FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states that assets that are readily convertible to cash "have (i) interchangeable (fungible) units and (ii) quoted prices available in an active market that can rapidly absorb the quantity held by the entity without

## Derivative Instruments and Hedging Activities Policy

significantly affecting the price" (paragraph 83(a)). For contracts that involve multiple deliveries of the asset, the phrase *in an active market that can rapidly absorb the quantity held by the entity* should be applied separately to the expected quantity in each delivery.

57. c. *Net settlement.* A contract that meets any one of the following criteria has the characteristic described as net settlement:

(1) Its terms implicitly or explicitly require or permit net settlement. For example, a penalty for nonperformance in a purchase order is a net settlement provision if the amount of the penalty is based on changes in the price of the items that are the subject of the contract. Net settlement may be made in cash or by delivery of any other asset, whether or not it is readily convertible to cash. A fixed penalty for nonperformance is not a net settlement provision.

(2) There is an established market mechanism that facilitates net settlement outside the contract. The term *market mechanism* is to be interpreted broadly. Any institutional arrangement or other agreement that enables either party to be relieved of all rights and obligations under the contract and to liquidate its net position without incurring a significant transaction cost is considered net settlement. The evaluation of whether a market mechanism exists and whether items to be delivered under a contract are readily convertible to cash must be performed at inception and on an ongoing basis throughout a contract's life.

(3) It requires delivery of an asset that is readily convertible to cash. The definition of *readily convertible to cash* in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, includes, for example, a security or commodity traded in an active market and a unit of foreign currency that is readily convertible into the functional currency of the reporting entity. A security that is publicly traded but for which the market is not very active is readily convertible to cash if the number of shares or other units of the security to be exchanged is small relative to the daily transaction volume...

The determination of the existence of the three characteristics identified above is often difficult to assess and requires judgment. Appendices A and B outline primary commodity contract types in existence within Duke Energy's operations and the analysis as to whether such contracts represent derivatives. As discussed further below, certain contracts that meet the requirements for a derivative can be excluded from the financial statements (not recorded at fair market value) until settlement occurs pursuant to the normal purchases and sales exception in SFAS No. 133 if certain criteria are met.

The following is a summary of the primary accounting categorization of derivative instruments as they apply to Duke Energy:

- *Normal purchases and normal sales ("NPNS")* – An elective accounting treatment for contracts that provide for the purchase or sale of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold by the reporting entity over a reasonable period in the normal course of business. It must be probable at inception and throughout the term of the individual contract that the contract will not settle net and will result in physical delivery (except for "capacity contracts" for power sale and purchase agreements under paragraph 10(b)(4) of SFAS No. 133). If a derivative contract qualifies for the normal purchases and normal sales exception and is documented as such, it is not subject to the requirements of SFAS No. 133 and shall be accounted for under the accrual method of accounting (as defined in "Accounting for Types of Instruments by Activity" below) and therefore is excluded from the consolidated financial statements until settlement occurs. Duke Energy also enters into power purchase or sales agreements that

## Derivative Instruments and Hedging Activities Policy

are also **capacity contracts\*** and these contracts may qualify for the normal purchases and normal sales exception even if they are subject to unplanned netting or bookout. The discussion in the "Key Terms" section details how the "clearly and closely related" provisions of normal purchases and normal sales differ from the "clearly and closely related" provisions of embedded derivatives (paragraph 12 of SFAS No. 133). To date, Duke Energy has applied the NPNS exemption to certain electricity contracts.

- *Commodity Cash Flow Hedges* – Some Duke Energy subsidiaries are exposed to market fluctuations in the prices of various commodities related to their power generating and natural gas distribution, sales and transportation activities (natural gas sales and transportation exposures are limited to certain "wind down" business). Duke Energy closely monitors the potential impacts of commodity price changes and, where appropriate, enters into contracts to protect margins for a portion of future sales and generation revenues and fuel expenses. Duke Energy may use commodity instruments, such as swaps, futures, forwards and options, as cash flow hedges for natural gas, coal, emission allowances and electricity capacity transactions.
- *Commodity Fair Value Hedges* – Some Duke Energy subsidiaries are exposed to changes in the fair value of some unrecognized firm commitments to sell or purchase generated power or natural gas due to market fluctuations in the underlying commodity prices or the changes in the fair value of recorded assets or liabilities, such as natural gas held in inventory. Duke Energy actively evaluates changes in the fair value of such unrecognized firm commitments due to commodity price changes and, where appropriate, may use various instruments to hedge its market risk. These commodity instruments, such as swaps, futures and forwards, may serve as fair value hedges for the firm commitments associated with generated power, natural gas or related product inventories.
- *Interest Rate (Fair Value or Cash Flow) Hedges* – Changes in interest rates expose Duke Energy to cash flow risk as a result of its issuance of variable-rate debt and expected issuance of fixed rate debt and to fair value risk as a result of its issuance of fixed-rate debt. Duke Energy manages its interest rate exposure by limiting its variable-rate and fixed-rate exposures to percentages of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy also may enter into financial derivative instruments, including, but not limited to, interest rate swaps, swaptions and U.S. Treasury lock agreements to manage interest rate risk exposure.
- *Foreign Currency (Fair Value, Net Investment or Cash Flow) Hedges* – Duke Energy is exposed to foreign currency risk from investments in international affiliate businesses owned and operated in foreign countries and from certain commodity-related transactions within domestic operations. To mitigate risks associated with foreign currency fluctuations, contracts may be denominated in or indexed to the U.S. dollar and/or local inflation rates, or investments may be naturally hedged through debt denominated or issued in the foreign currency. Duke Energy may also use foreign currency derivatives, where possible, to manage its risk related to foreign currency fluctuations. Please refer to the discussion in paragraph 40A of SFAS No. 133 for guidance pursuant to intercompany foreign currency derivatives.
- *Other Derivative Contracts (Trading)* – Duke Energy has been exposed to the impact of market fluctuations in the prices of natural gas, electricity and other energy-related products marketed and purchased as a result of proprietary trading activities. During 2003, Duke Energy prospectively discontinued propriety trading and, accordingly, the Company does not currently engage in any significant trading activities.
- *Undesignated* – Duke Energy uses derivative contracts to manage the market risk exposures that arise from energy supply, structured origination, marketing, risk management, and commercial optimization services to large energy customers, energy aggregators and other

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\* See definition under "Key Terms"

## Derivative Instruments and Hedging Activities Policy

wholesale companies, and to manage interest rate and foreign currency exposures. Derivative contracts that are not properly documented and designated, do not qualify for the normal purchases and normal sale exception or do not qualify for hedge accounting are automatically marked to market as undesignated derivatives. Duke Energy's exposure to commodity price risk is influenced by a number of factors, including contract size, length, market liquidity, location and unique or specific contract terms. This category also includes derivatives which are 'offset' with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS No. 71"), regulatory assets or regulatory liabilities.

### 2. Lease Contracts

Certain contracts may meet the requirements to be accounted for as leases. The accounting for these contracts is outside of the scope of this policy.

Leases can be either capital or operating leases. A lease is defined in accounting literature<sup>2</sup> as any agreement that transfers the right to use an asset usually for a specified period. EITF Issue No. 01-8 has clarified that contracts which convey the *right to use* specific property, plant and equipment, as defined, may meet the definition of a lease and be subject to SFAS No. 13. This definition is applicable even though the legal owner of the asset still provides substantial services. It should be noted that the agreement does not have to be specifically identified as a lease to be treated as such. EITF Issue 01-8 clarified that "leases that are within the scope of Statement 13 are not derivative instruments subject to Statement 133, although a derivative embedded in a lease may be subject to the requirements of Statement 133." Therefore, if a contract is considered a lease, mark-to-market accounting as a derivative is not permitted except for any derivatives which are embedded in the contract (see *embedded derivative* discussion below).

Duke Energy in the normal course of business enters in to power purchase agreements (PPAs), as either a buyer or seller of power. The number of these transactions is growing, especially in U.S. territories where the use of renewable energy sources is increasing and wind assets come on line. While PPAs are considered to be ordinary course of business contracts, the accounting for PPAs is often complex, as the authoritative literature requires an analysis of lease, derivative, and consolidation accounting for the underlying power producing fixed assets.

A PPA checklist has been created as a document that the Controller's Department believes will enhance internal controls around the accounting for PPAs. This checklist should be thoroughly considered when determining the appropriate accounting for all new and modified PPAs. Effective, October 1, 2008, the completion of the checklist is a mandatory SOX control for all new and modified PPAs.

### 3. Executory Contracts

An executory contract generally involves a purchase/sale of an asset or the providing of services and is distinct in that it does not have all three characteristics of a derivative, as defined above. If a contract is not a lease or a derivative, it is considered an executory contract and is accounted for under the accrual method as defined below.

#### **Accounting for Types of Instruments by Activity:**

Duke Energy uses two comprehensive accounting models for its derivative instruments (associated with commodity prices, credit exposure, interest rates, and foreign currency risks) in reporting its consolidated financial position and results of operations as required by GAAP: a "mark-to-market" ("MTM") model and an "accrual" model. Non-derivative instruments are accounted for as executory contracts, which is normally consistent with the normal purchases and normal sales methodology

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<sup>2</sup> SFAS No. 13, "Accounting for Leases" or EITF Issue No. 01-08, "Determining Whether An Arrangement Contains a Lease"

## Derivative Instruments and Hedging Activities Policy

discussed below. The use in this policy of the terms MTM and accrual accounting models, as defined below, may not be consistent with how other companies use these terms.

### *Mark-to-Market*

Under the MTM accounting method, which is the default for accounting for derivative instruments under SFAS No. 133, an asset or liability is recognized at fair value on the Consolidated Balance Sheet and the change in the fair value of that asset or liability is immediately recognized in the Consolidated Statement of Operations. This accounting method is applied only to derivative contracts that are not subject to hedge accounting or the normal purchases and normal sales exception (as described below). The guidance in EITF Issue No. 03-11, EITF Issue No. 02-3 and EITF Issue No. 99-19 should be considered for the appropriate income statement classification and presentation of derivative contracts. For entities subject to SFAS No. 71, any changes in the fair value of MTM derivatives should be recorded as a regulatory asset or liability, rather than in earnings, as long as the criteria in paragraphs 9 and 11 of SFAS No. 71, as applicable, are met. Refer to the accounting policy entitled "Accounting for Regulated Entities (SFAS No. 71)" for additional guidelines.

### *Accrual*

An accounting method whereby there is no recognition in the Consolidated Statements of Operations for changes in fair value of a contract until the service is provided or the associated delivery period occurs (settlement) except to the extent a cash flow or fair value hedge is ineffective. For a derivative instrument that is initially subject to MTM accounting, Duke Energy may apply either hedge accounting or the normal purchases and normal sales exception in accordance with SFAS No. 133. The use of hedge accounting (to the extent effective) and the normal purchases and normal sales exception provide effectively for the use of the accrual model from an income statement perspective. (Both hedge and MTM accounting require that the fair value of the derivative be reflected on the balance sheet.) The guidance in EITF Issue No. 03-11 and EITF Issue No. 99-19 should be considered for the appropriate income statement classification and presentation of derivative contracts. For entities subject to SFAS No. 71, any changes in the fair value of derivatives designated as cash flow hedges should be recorded as a regulatory asset or liability, rather than in Accumulated Other Comprehensive Income ("AOCI") or net income, as long as the criteria in paragraphs 9 and 11 of SFAS No. 71, as applicable, are met.

Hedge accounting treatment may be used when Duke Energy hedges the exposure to variability in future cash flows. These future cash flows could result from contracts to buy or sell a commodity at a fixed price for future delivery corresponding with anticipated physical sales or purchase, incur interest payments or transact in a foreign currency (cash flow hedge). In addition, hedge accounting treatment may be used when Duke Energy holds firm commitments, asset or liability positions and enters into transactions that "hedge" the risk that the fair value may change (fair value hedge). To the extent that the fair value of the hedge instrument offsets the hedged item, there is no impact to the Consolidated Statements of Operations prior to settlement of the hedge.

However, a certain degree of hedge ineffectiveness may be recognized in the Consolidated Statements of Operations for a variety of reasons. Those reasons include decisions to hedge only a component of the risk (spot price vs forward price, benchmark interest rate vs total interest rate exposure), deterioration of counterparty credit, the use of options to hedge only one direction of the change in fair value and differences in the location or timing of the delivery or flow of cash.

The normal purchases and normal sales exception, as provided in SFAS No. 133 as amended and interpreted by DIG Issue No. C15 as amended, indicates that no recognition of the contract's fair value in the Consolidated Financial Statements is required until settlement of the contract (in Duke Energy's case, the delivery of power or for capacity contracts, the availability of capacity). All criteria for obtaining the normal purchases and normal sales exclusion must be met initially and on an ongoing basis. Obtaining the normal purchases and normal sales exception is an election and is not automatic as the contract must be specifically designated and documented at inception as meeting the normal purchases and normal sales exception.

## Derivative Instruments and Hedging Activities Policy

From an income statement perspective, leases and executory contracts are also accounted for using the accrual method.

### Accounting Policy

Duke Energy shall evaluate each financial instrument or other contract to determine whether it is a *derivative instrument* based on the three characteristics as prescribed in paragraph 6 of SFAS No. 133 and as discussed above. Financial instruments or other contracts meeting the definition of a *derivative* shall be accounted for under either the MTM or accrual method of accounting. As such, all derivative instruments not designated and qualifying for the normal purchases and normal sales exception under SFAS No. 133, shall be recorded on the Consolidated Balance Sheets at their fair value as (current or non-current) "Unrealized Gains or Unrealized Losses on Mark-to-Market and Hedging Transactions." Duke Energy shall document, based on the three criteria that constitute a derivative instrument, whether each financial instrument or other contract used in commodity risk management or trading activities meets the definition of a derivative. Contracts shall also be evaluated for embedded derivatives.

As discussed above, a PPA checklist has been created as a document that the Controller's Department believes will enhance internal controls around the accounting for PPAs. This checklist should be thoroughly considered when determining the appropriate accounting for all new and modified PPAs.

The determination of whether a contract is a derivative or has an embedded derivative under SFAS No. 133 is an ongoing process and should be periodically reassessed, especially when facts and circumstances change significantly. For example, a commodity purchase contract may not be a derivative due to the underlying commodity not being readily convertible to cash; however, if the commodity subsequently was considered to be readily convertible to cash, the contract would be considered a derivative and subject to the provisions of SFAS No. 133. Certain aspects of contracts, such as the level of transaction costs, are assessed only at inception of the contract or when a contract subsequently meets the definition of a derivative for reasons other than the level of transaction costs.

Appendix A contains further interpretative guidance for use in determining whether a contract meets the definition of a derivative.

### *Normal Purchases and Normal Sales Exception*

Contracts which meet the definition of a derivative may qualify for the normal purchases and normal sales exception if it is probable at inception and throughout the term of the individual contract that the contract will not settle net and will result in physical delivery, except as discussed below for 'capacity contracts.' If a contract qualifies for the normal purchases and normal sales exception, as defined in paragraphs 10(b) and 58(b) of SFAS No. 133, and the exemption is elected, the instrument shall be accounted for under the accrual method of accounting and shall be excluded from the consolidated financial statements until settlement occurs.

Power purchase or sales agreements which are not subject to bookout apply paragraph 10(b)(1) (for those contracts without optionality) or paragraph 10(b)(3) (for those contracts with optionality) in order to determine whether they can qualify for the normal purchases and normal sales exception. However, if a power purchase or sales agreement (whether a forward contract, an option contract, or a combination of both) for the purchase or sale of electricity is subject to unplanned netting (or being booked out or are scheduled to be booked out), they can still qualify for the normal purchases and normal sales exception under paragraph 10(b)(4) if all of the following applicable criteria of paragraph 58(b) are met and the contract meets the definition of a "capacity contract," as discussed below: [paragraph 58(b) of SFAS No. 133 as amended]

- (1) For both parties to the contract:
  - (a) The terms of the contract require physical delivery of electricity... For an option contract, physical delivery is required if the option contract is exercised.



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- (b) The power purchase or sales agreement is a *capacity contract*\* ...
- (2) For the seller of electricity: The electricity that would be deliverable under the contract involves quantities that are expected to be sold by the reporting entity in the normal course of business.
- (3) For the buyer of electricity:
  - (a) The electricity that would be deliverable under the contract involves quantities that are expected to be used or sold by the reporting entity in the normal course of business.
  - (b) The buyer of the electricity under the power purchase or sales agreement is an entity that is engaged in selling electricity to retail or wholesale customers and is statutorily or otherwise contractually obligated to maintain sufficient capacity to meet electricity needs of its customer base.
  - (c) The contracts are entered into to meet the buyer's obligation to maintain a sufficient capacity, including a reasonable reserve margin established by or based on a regulatory commission, local standards, regional reliability councils, or regional transmission organizations.

For a power purchase or sale contract (whether a forward contract, an option contract, or a combination of both) that meets the definition of a "capacity contract" under paragraph 540, all of the above criteria (1-3 of paragraph 58(b)) must be evaluated by both parties in order to qualify for the normal purchases and normal sales exception under paragraph 10(b)(4). For a power purchase or sale contract that contains optionality, the characteristics of an option contract that is a capacity contract and a traditional option contract, which are set forth in the appendix of DIG Issue No. C15, should be considered in the evaluation of whether the contract meets the definition of a "capacity contract."

For power purchase or sale agreements that qualify for the normal purchases and normal sales exception as described above, the Company shall document the designation as normal purchases and normal sales and the basis for concluding that the agreement meets the requirements for the normal purchases and normal sales exception. The documentation must be in place at the time of application of the normal purchases and normal sales exclusion, which would normally be at inception of the contract. The documentation requirements can be applied either to groups of similarly designated contracts or to each individual contract. Failure to comply with the documentation requirements precludes the application of the normal purchases and normal sales exclusion to the contract, even if the contract would otherwise have qualified. For power purchase or sale agreements that qualify for the normal purchases and normal sales exclusion under either paragraph 10(b)(1) or 10(b)(3), the Company is required to document the basis for concluding that it is probable that the contract will not settle net and will result in physical delivery. For power purchase or sale agreements that qualify for the normal purchases and normal sales exclusion under paragraph 10(b)(4), the Company is required to document the basis for how the contracts meet the criteria in paragraph 58(b).

For those contracts qualifying for the normal purchases and normal sales exception, if the underlying of the price adjustment feature is based on an index or other variable that is not "clearly and closely related" to the asset to be delivered under the contract, the normal purchases and normal sales exception cannot be obtained (refer to "Key Terms" and the guidance provided by DIG Issue No. C20). Contracts with inflation indexes should be documented that the index is clearly and closely related in order to meet the normal purchases and normal sales exception.

All criteria for obtaining the normal purchases and normal sales exception must be met initially and on an ongoing basis. Obtaining the normal purchases and normal sales exclusion is an election and is not automatic as the contract must be specifically designated and documented as meeting the normal purchases and normal sales exclusion. However, any derivative contract which is not initially designated as a normal purchases and normal sales may meet the exclusion on a prospective basis once all criteria for obtaining the exclusion, including documentation, is met. However, once a contract is documented and designated as a normal purchases and normal sales, it is the Company's

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\* See definition under "Key Terms"

## Derivative Instruments and Hedging Activities Policy

policy that the contract may not be electively de-designated (the contract could be de-designated as a normal purchases and normal sales by failing to meet the criteria for such designation—see below under “De-designation of the Normal Purchases and Normal Sales Exception for Cause”).

### *De-designation of the Normal Purchases and Normal Sales Exception for Cause:*

If contracts cease to meet the normal purchases and normal sales exception, the fair value of the contracts shall be recognized on the Consolidated Balance Sheets and the contracts shall be accounted for using the MTM method unless immediately designated as a cash flow or fair value hedge (accrual method of accounting). Thus, once a normal purchases and normal sales contract has been de-designated for cause, the MTM of the derivative is immediately recorded to earnings and “hedge” accounting can be obtained on a prospective basis. The initial MTM of a contract coming off of the normal purchases and normal sales exception will always impact earnings, unless the entity holding the derivative is subject to SFAS No. 71.

### *Hedge Accounting*

Qualifying energy commodity and other derivatives may be designated as either a hedge of a forecasted transaction or future cash flows (cash flow hedge) or a hedge of a firm commitment, a recognized asset or liability (fair value hedge). For all hedge contracts, Duke Energy shall provide formal documentation of the hedge in accordance with SFAS No. 133. In addition, at inception and on a quarterly basis Duke Energy shall formally assess whether the hedge contract is highly effective in offsetting changes in cash flows or fair values of hedged items. Duke Energy shall document hedging activity by transaction type (futures/swaps) and risk management strategy (commodity price risk /interest rate risk/foreign currency risk).

The effective portion of changes in the fair value of a derivative designated and qualified as a cash flow hedge shall be included in the Consolidated Statements of Common Stockholders' Equity and Comprehensive Income (Loss) as AOCI until earnings are affected by the hedged item. Duke Energy shall discontinue hedge accounting prospectively when it has determined that a derivative no longer qualifies as an effective hedge, the Company electively removes the hedge designation, or when it is no longer probable that the hedged forecasted transaction will occur. When hedge accounting is discontinued because the derivative no longer qualifies as an effective hedge or the Company elects to discontinue hedge accounting, the derivative shall be subject to the MTM accounting method prospectively. Gains and losses related to discontinued hedges that were previously accumulated in AOCI shall remain in AOCI until the underlying hedged forecasted transaction is reflected in earnings. However, if it is probable that the hedged forecasted transaction will not occur by the end of the originally specified time period as documented or within an additional 2 months (assuming no extenuating circumstances), the amount in AOCI should be reclassified to earnings immediately. (Refer to paragraph 33 of SFAS No. 133.)

For derivatives designated as fair value hedges, Duke Energy shall recognize the gain or loss on the derivative instrument, including any hedge ineffectiveness, as well as the offsetting loss or gain on the hedged item in earnings in the current period.

All derivatives designated and accounted for as hedges shall be classified in the same category as the item being hedged in the Consolidated Statements of Cash Flows. However, if a derivative contains an other-than-insignificant financing element, other than a financing element inherently included in an at-the-market derivative with no prepayments (that is, the forward points in an at-the-money forward contract), then the borrower shall report all cash inflows and outflows associated with that derivative in a manner consistent with financing activities as described in paragraphs 18-20 of SFAS No. 95, “Statement of Cash Flows.” A derivative that at its inception includes off-market terms or requires an up-front cash payment, or both often contains a financing element. Identifying a financing element within a derivative is a matter of judgment that depends on the facts and circumstances.

In addition, all components of each derivative gain or loss shall be included in the assessment of hedge effectiveness, unless otherwise noted.

## Derivative Instruments and Hedging Activities Policy

A derivative held for trading purposes may be designated as a hedging instrument, prospectively, if all of the applicable criteria in SFAS No. 133 have been met.

In order to obtain hedge accounting, at inception of the hedge, there shall be formal documentation of the hedging relationship and the risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value (fair value hedge) or in hedging the exposure to the hedged transaction's variability in cash flows (cash flow hedge) attributable to the hedged risk will be assessed.

Hedge accounting shall be discontinued prospectively for an existing hedge if any *one* of the following occurs: i) the hedging relationship is no longer expected to be highly effective in achieving offsetting cash flows (offsetting changes in fair value for a fair value hedge) attributable to the hedged risk during the period that the hedge is designated; ii) the derivative expires or is sold, terminated, or exercised; iii) if any of the criteria for cash flow or fair value hedge accounting are no longer met; or iv) the Company removes the designation of the hedge.

### *Hedge Effectiveness*

Under SFAS No. 133, a derivative designated as a hedging instrument will qualify for cash flow or fair value hedge accounting so long as the hedging relationship can be shown to be "highly effective" (see discussion under "Initial Assessment" below) in offsetting cash flows (changes in fair value) attributable to the hedged risk. To demonstrate this relationship, an effectiveness assessment is required prior to the inception of the hedge and ongoing effectiveness shall be assessed at least every three months thereafter. There shall be a reasonable basis for how the business or corporate unit plans to assess the hedging instrument's effectiveness. The assessment of hedge effectiveness for a particular hedging relationship shall be consistent with the originally documented risk management strategy for that particular hedging relationship and clearly documented at the inception of the hedging relationship. At the inception of the hedge, the entity shall define and document the method it will use to assess hedge effectiveness, both prospectively and retrospectively. The methods for prospective considerations and retrospective considerations may be the same or different, but only one method may be used for evaluating each consideration. This method must be used consistently throughout the term of the hedging relationship. Methods shall not be changed from one period to the next unless the hedge designation is terminated and a new hedge is put in place.

If the critical terms of the hedging instrument and of the entire hedged asset or liability (as opposed to selected cash flows) or hedged forecasted transaction are the same, it could be concluded that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis (i.e., no ineffectiveness).

An assumption of no ineffectiveness is especially important in a hedging relationship involving an interest bearing financial instrument and an interest rate swap because it significantly simplifies the computations necessary to make the accounting entries (referred to as the shortcut method). No ineffectiveness in a hedging relationship of interest rate risk involving a recognized interest bearing asset or liability and an interest rate swap may be assumed if certain conditions are met. Please refer to paragraph 68 of SFAS No. 133 for a discussion of the conditions that are required to be met to apply the shortcut method and paragraphs 114 and 132 of SFAS No. 133 for guidance to apply the shortcut method to fair value hedges and cash flow hedges, respectively. The SEC Staff<sup>3</sup> addressed accounting for hedges at the 2006 AICPA National Conference on Current SEC and PCAOB Developments in December 2006 the SEC Staff emphasized that it is important to thoroughly analyze and document all sources of ineffectiveness when applying hedge accounting. The SEC Staff cautioned that documentation must analyze preferably quantitatively all mismatches in terms in order to show that the mismatch is indeed immaterial. When the hedge documentation fails to do so, the SEC believes this has the same accounting result as not electing hedge accounting. One either documented a hedge or one did not document a hedge. As a result, the evaluation of an error in

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<sup>3</sup> Mr. Timothy S. Kviz, Professional Accounting Fellow, Office of the Chief Accountant, SEC

## Derivative Instruments and Hedging Activities Policy

previously issued financial statements is equal to the entire mark-to-market on the derivative designated as a hedge and not just the overlooked ineffective portion of the hedge. The SEC Staff's position effectively increases significantly the possibility of a restatement as the error is more likely to be material to results. There are several methods for documenting and assessing hedge ineffectiveness. In addition to the 'long-haul' approach, other simplified methods include the 'shortcut', 'critical terms match', the 'hypothetical derivative' and 'variable cash flows' method. Some companies have been compelled to restate their financial statements as a result of failure to properly follow the requirements for these methods of assessing ineffectiveness. Many of the problems identified have involved the use of the 'shortcut' or 'critical terms match' method for interest rate swaps.

- Initial Assessment:

The initial assessment is a prospective consideration made prior to or simultaneous with initiating a hedge relationship and its applicability shall be evaluated on an ongoing basis. This analysis shall be able to justify the expectation that the hedge will be highly effective over the period being hedged (the hedged period) in achieving offsetting changes in the cash flows or offsetting changes in fair value of the hedged item. For purposes of SFAS No. 133, the condition of "highly effective" is achieved when the change in the fair value or cash flows of the hedging instrument offsets 80% - 125% of the change in the fair value or cash flows of the hedged item. It is common practice at Duke Energy to elect to use regression for the initial assessment of hedge effectiveness (although other methods may be acceptable). In order to conclude that the hedging relationship is highly effective using a regression analysis, the regression examines the relationship between *changes* in the value of the derivative and the hedged item, at least 30 data points should be used in the analysis,  $R^2$  should be equal to or greater than 0.8, the slope should be between a negative 0.8 and 1.25, and the t and F statistics should be evaluated at a 95 percent confidence level in accordance with guidance provided by the SEC staff.  $R^2$  measures the ability of the independent variable to explain the variation in the dependent variable.  $R^2$  can vary between 0 and 1. The higher the value the higher the indication that the independent variable can explain variation in the dependent variable. The t and F statistics are used to indicate correlation or a linear relationship between independent and dependent variables. A high t statistic generally indicates that correlation or a linear relationship exists between the independent and dependent variables. To achieve a 95% confidence level, the significance of F should be less than 5%. If the significance of F is less than 5% there is less than 5% probability that no linear relationship is present. The initial assessment need not be performed for each and every hedge but only when a new hedge strategy is proposed. However, the data used in the regression shall be updated at least on a quarterly basis (as new hedges are entered into). In addition, the initial assessment of effectiveness for a particular hedge strategy shall be evaluated if the ongoing assessment for a particular relationship, as discussed below, repeatedly indicates an ineffective hedge. Certain contracts may have a high correlation for a particular forward month while similar contracts for other forward months may not have a high correlation. The assessment both initially and ongoing should be undertaken on a forward month by forward month basis.

- Ongoing Assessment

Ongoing assessment is a retrospective assessment made at least on a quarterly basis to determine if a specific hedge relationship has been highly effective in having achieved offsetting changes in cash flows or the hedged item's fair value throughout the particular period being assessed (on a historical basis). The assessment may be based on cumulative dollar offset, regression or other statistical analysis of past changes in cash flows or fair value or other relevant information. If the relationship does not fall within the overall change effective range ( $R^2 \geq 0.8$ ), then hedge accounting for the period shall not be applied (all changes in fair value of the derivative during the period are recorded immediately in earnings). Failure of the 'ongoing assessment' test does not necessarily prevent the derivative in question from being considered as an ongoing hedge so long as the initial assessment continues to indicate a highly effective relationship. For cash flow hedges, if in subsequent periods, the relationship comes back into the highly effective range, by virtue of the ongoing regression analysis, the "ineffective" portion of

## Derivative Instruments and Hedging Activities Policy

gain or loss recorded in earnings in prior periods (or some part thereof) may be recaptured and recorded in current period OCI. For fair value hedges, if the relationship returns to the highly effective range, the hedged item (i.e., unrecognized firm commitment or recognized asset or liability) shall resume hedge accounting on a prospective basis along with the hedging instrument. For internal reporting, the ongoing assessment shall be performed at least quarterly.

Additionally, in assessing ineffectiveness, the likelihood of counterparty default should be considered. If the likelihood that the counterparty will not default ceases to be probable, the Company would be unable to conclude that the hedging relationship is expected to be highly effective and hedge accounting should be discontinued prospectively.

### *Ineffectiveness*

SFAS No. 133 requires for any changes in fair value of a derivative instrument related to hedge ineffectiveness to be immediately recorded in earnings. DIG Issue No. K4, "Miscellaneous: Income Statement Classification of Hedge Ineffectiveness and the Component of a Derivative's Gain or Loss Excluded from the Assessment of Hedge Effectiveness," has the following provisions related to the classification in the income statement of hedge ineffectiveness:

Statement 133 does not provide guidance on the required income statement classification of the amount of hedge ineffectiveness...While Statement 133 does not specify whether certain income statement categories are either permitted or appropriate, the Statement does contain specific disclosure requirements for those items.

Therefore, the Company should ensure that similar hedged items which result in periodic ineffectiveness are classified in the Statement of Operations in a consistent manner.

### *De-designation of a Hedge by Choice*

- Cash Flow Hedges

When de-designating or re-designating a cash flow hedge, that part of any change in fair value of the derivative that resides in AOCI shall remain in AOCI and shall not be immediately transferred to earnings until settlement of the original forecasted transaction that was being hedged. That part of the change in fair value of the derivative that was previously recorded in earnings (ineffectiveness, if any) shall remain in earnings. Prospectively, the derivative shall be MTM unless re-designated as another hedge.

- Fair Value Hedges

When de-designating a fair value hedge, changes in fair value of the hedged item shall no longer be recorded and the asset or liability reflecting the fair value as of the date of de-designation shall remain on the balance sheet until the hedged item affects earnings. The hedging instrument, which is now a freestanding derivative, shall be MTM. The Company, at its discretion, may re-designate the derivative as another fair value or cash flow hedge at which time hedge accounting will commence, prospectively, if the requirements for hedge accounting under SFAS No. 133 are met.

### *De-designation of a Hedge for Cause*

- Cash Flow Hedges

If it becomes probable that a forecasted transaction in a cash flow hedge will NOT occur within the originally specified time period or within an additional two-month period of time thereafter, then the hedge shall be terminated and the net gain or loss in AOCI shall be immediately reclassified into earnings. There is one exception to this rule. In rare cases, the existence of extenuating circumstances that are related to the nature of the forecasted transaction and are outside of the control or influence of the reporting entity may cause the forecasted transaction to be probable on a date beyond the additional two-month period of time. In such a case, the original hedge must be terminated but the related derivative gain or loss in AOCI shall continue to remain in AOCI until the forecasted transaction occurs. A pattern of determining that hedged forecasted transactions are NOT

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probable of occurring shall call into question the ability to accurately predict forecasted transactions and the propriety of applying hedge accounting for similar forecasted transactions in the future.

- Fair Value Hedges

If it becomes probable that a firm commitment that is being hedged in a fair value hedge relationship will NOT occur, then the hedge relationship shall be terminated. This will result in the hedged item being accounted for as if the contract was not in a hedge relationship subsequent to the termination of the hedge relationship. Any asset or liability previously recognized as an adjustment to the carrying amount of the firm commitment shall be immediately derecognized with a gain or loss being recognized in earnings.

If the fair value hedge is no longer expected to be "highly effective" in achieving offsetting changes in fair value to the hedged risk, adjustments to the carrying amount of the firm commitment shall not be recognized subsequent to the last date on which the hedge was considered "highly effective," unless a specific event or change in circumstances can be identified which caused the hedge to no longer be "highly effective" whereby the date of the specific event or change in circumstances will be utilized to prospectively discontinue hedge accounting.

### *Service Contracts*

Most service contracts are not considered derivatives under SFAS No. 133 due to the scope exclusion in paragraph 10(e)(2). A service does not involve the delivery of a fungible asset and, therefore, is not readily convertible to cash as defined in paragraph 83(a) of FASB Concepts Statement No. 5, "Recognition and Measurement in Financial Statements of Business Enterprises." Paragraph 10(e)(2) of SFAS No. 133 excludes from its scope any contract which is not exchange-traded as long as the underlying is the price or value of a nonfinancial asset which is not readily convertible to cash.

### *Embedded Derivative Instruments*

Contracts that do not in their entirety meet the definition of a derivative instrument or contracts excluded from the scope of SFAS No. 133, may contain embedded derivative instruments. An embedded derivative typically includes implicit or explicit terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument (i.e., some or all of the cash flows will be modified based on one or more underlyings). For example, although lease agreements are excluded from the scope of SFAS No. 133, a lease agreement may contain an embedded derivative such that the embedded derivative instrument will be subject to the requirements of SFAS No. 133.

An embedded derivative instrument shall be separated from the host contract (e.g., lease contract, debt contract, etc.) and accounted for as a derivative instrument per SFAS No. 133 if all the following occur: i) the economic characteristics and risks of the embedded derivative instrument are not *clearly and closely related* to the economic characteristics and risks of the host contract; ii) the contract ("*the hybrid instrument*") that embodies both the embedded derivative instrument and the host contract is not remeasured at fair value with changes in value recorded in earnings as they occur (under otherwise applicable generally accepted accounting principles); and iii) a separate instrument with the same terms as the embedded derivative instrument would meet the three characteristics to qualify as a derivative instrument as discussed above. Please refer to the guidance in paragraph 61 of SFAS No. 133 in determining whether the economic characteristics and risks of an embedded derivative are clearly and closely related to the economic characteristics and risks of the host contract.

### *Foreign Currency Derivatives*

Duke Energy may use foreign currency derivatives to manage its risk related to foreign currency fluctuations. A derivative instrument can be designated as hedging the changes in the fair value of an

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\* See definition under "Key Terms"

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unrecognized firm commitment, a recognized asset or liability (or a specific portion thereof), or an available-for-sale debt security for which a foreign currency transaction gain or loss, attributable to foreign currency exchange rates, is recognized in earnings, per SFAS No. 52, "Foreign Currency Translation" ("SFAS No. 52"). As such, fair value hedge accounting as discussed above may be available for these types of derivative instruments for which a foreign currency transaction gain or loss is recorded in earnings. An available-for-sale equity security can be hedged for changes in the fair value attributable to changes in foreign currency exchange rates and qualify for fair value hedge accounting only if the fair value hedge criteria per SFAS No. 133 are met and the following two conditions are satisfied: i) the security is not traded on an exchange (or other established marketplace) on which trades are denominated in the investor's functional currency, and ii) dividends or other cash flows to holders of the security are all denominated in the same foreign currency as the currency expected to be received upon sale of the security. Per paragraph 38 of SFAS No. 133, the change in fair value of the hedged available-for-sale equity security attributable to foreign exchange risk shall be reported in earnings and not in AOCI.

Cash flow hedge accounting, as discussed above, may be available for a derivative instrument designated as hedging the foreign currency exposure to variability in the functional-currency-equivalent cash flows associated with a forecasted transaction (for example, a forecasted export sale to an unaffiliated entity with the price to be denominated in a foreign currency), a recognized asset or liability, an unrecognized firm commitment, or a forecasted intercompany transaction (for example, a forecasted sale to a foreign subsidiary or a forecasted royalty from a foreign subsidiary). The specific requirements are addressed in paragraph 40 of SFAS No. 133.

A derivative instrument or a nonderivative financial instrument that may give rise to a foreign currency transaction gain or loss per SFAS No. 52 can be designated as hedging the foreign currency exposure of a net investment in a foreign operation. The gain or loss on a hedging derivative instrument (or the foreign currency transaction gain or loss on the nonderivative hedging instrument) that is designated as, and is effective as, an economic hedge of the net investment in a foreign operation shall be reported in the same manner as a translation adjustment to the extent it is effective as a hedge. The hedged net investment shall be accounted for consistent with SFAS No. 52; the provisions of SFAS No. 133 for recognizing the gain or loss on assets designated as being hedged in a fair value hedge do not apply to the hedge of a net investment in a foreign operation. The translation results for a hedge of a net investment in a foreign operation shall remain in AOCI until the foreign operation is sold or liquidated. Note that the determination of whether a "foreign operation has been sold or liquidated" is a judgmental analysis that should also consider any remaining interests in that foreign jurisdiction -- consultation with the Corporate Accounting Research Group should be made when determining whether net investment OCI amounts should be released. The notional amount of the derivative instruments should not exceed the amount of the net investment in the foreign operation.

If the above transactions qualify for hedge accounting, the respective hedge accounting documentation requirements discussed above shall be applied consistently.

### *Federal Energy Regulatory Commission ("FERC") Order 627 (Regulated Entities)*

FERC Order 627, "Accounting and Reporting of Financial Instruments, Comprehensive Income, Derivatives and Hedging Activities," provides guidance to entities under FERC jurisdiction related to the accounting and reporting of certain types of financial instruments and hedging activities. Entities subject to FERC guidelines should consider the provisions of FERC Order 627 when accounting for their risk management and hedging activities.

### *Valuation*

All derivative instruments not designated and qualifying for the normal purchases and normal sales exception under SFAS No. 133, shall be recorded on the Consolidated Balance Sheets at their **fair value** at each reporting period as "Unrealized Gains or Unrealized Losses on Mark-to-Market and Hedging Transactions." Fair value accounting is applied within the context of an overall valuation framework. All new and existing transactions shall be valued using approved valuation techniques

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and market data, including reserves for liquidity and counterparty credit and discounted using an appropriate discount rate.

*Note:* SFAS No. 157 was issued in September 2006 and was effective for Duke Energy, as it relates to valuations of derivative instruments and hedging activities, beginning on January 1, 2008. For additional information and guidance with respect to the application of SFAS No. 157 to derivative instruments, refer to Duke Energy Accounting Policy Statement, "Fair Value Measurements Used in Accounting."

Validation of a contract's calculated fair value shall be performed by the Corporate and/or Business Unit Risk Management Group. This group performs pricing model validation, back testing and stress testing of valuation techniques, prices and other variables. Validation of a contract's fair value may be done by comparison to actual market activity and negotiation of collateral requirements with third parties.

### *Inception or "Day One" Gains*

An inception gain or loss may exist if the transaction price (an entry price) does not represent fair value (an exit price). Paragraph 17 of SFAS No. 157 states that "[i]n many cases, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, the reporting entity shall consider factors specific to the transaction and the asset or liability." Paragraph 17 of SFAS No. 157 provides examples of where the transaction price may not represent fair value. Paragraph C16 of SFAS No. 157 indicates that "the fair value measurement objectives in this Statement should apply for fair value measurements at initial recognition under Statement 133 (an exit price objective). Consistent with that objective, this Statement clarifies that the measurement should be adjusted for risk, that is, the amount market participants would demand because of the risk (uncertainty) inherent in a particular valuation technique used to measure fair value (such as a pricing model) and/or the risk inherent in the inputs to the valuation technique (a risk premium notion). Accordingly, a measurement (for example, a "mark-to-model" measurement) that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one in pricing the related asset or liability." For additional information and guidance with respect to the application of SFAS No. 157 to derivative instruments, refer to Duke Energy Accounting Policy Statement, "Fair Value Measurements."

### *Reserves to Calculated Values for Derivative Instruments*

The following reserves, as appropriate, shall be used to adjust calculated values to arrive at estimates of fair value used to record derivative instruments (as a reminder, for additional information and guidance with respect to the application of SFAS No. 157, refer to the Duke Energy accounting policy entitled, "Fair Value Measurements Used in Accounting"):

- 1) Credit (Non-Performance) Reserves - costs associated with probable, future counterparty defaults. This category of reserves should be calculated based on current credit exposures with each respective counterparty that has an overall asset position.
- 2) Present Value (Discount) Reserve - costs associated with discounting future cash flows in accordance with time-value of money valuation principles. Note that the discount reserve is only required when all or a portion of the fair value of the derivative instrument are derived based upon cash flows.
- 3) Liquidity (Bid-Ask) Reserve – the cost of closing out a position relative to the overall market. At times, a discount will be required in order for the market to readily absorb certain positions. A reserve should be established for liquidity factors that are present in all markets.
- 4) Other Contractually-Specific Reserves – Each business unit may identify additional risk categories for which reserves to calculated values should be established. While the above specific reserves are well documented as to their purpose and methodology, it must be



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understood additional risks may exist (e.g., legal/enforceability risk, etc.) which are not captured by one or more of the reserves indicated above.

### *Netting Arrangements*

For reasons including reducing credit exposure, Duke Energy often seeks to enter into payment netting agreements with counterparties that permit Duke Energy to offset receivables and payables with such counterparties. Where Duke Energy's derivative instruments are subject to a master netting agreement and the criteria of FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts" ("FIN 39"), are met, Duke Energy shall present its derivative assets and liabilities, and accompanying receivables and payables, on a net basis (by counterparty) in the Consolidated Balance Sheets. Effective January 1, 2008, consistent with FASB Staff Position No. FIN 39-1, "Amendment of FASB Interpretation No. 39," it is also appropriate to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting arrangement that have been offset in accordance with paragraph 10 of FIN 39. Refer to the accounting policy entitled "Fair Value Measurements Used in Accounting" for the appropriate method to apply in netting cash collateral amounts against the various balance sheet accounts.

### *All-In-One Hedging*

Under the provisions of DIG Issue No. G2, an entity may designate a derivative instrument (which will result in gross settlement) as the hedging instrument in a cash flow hedge, which is referred to as an "all-in-one" hedge. For example, a forward purchase contract of a commodity (if the purchase contract meets the definition of a derivative under SFAS No. 133) could be designated as the hedging instrument in a cash flow hedge of the variability of amounts to be paid under the forecasted transaction or the commodity purchase. Contracts which are subject to net settlement (e.g., "bookout") cannot be designated as an "all-in-one" hedge.

As another example, some Duke Energy subsidiaries may be exposed to market fluctuations in the prices of emission allowances ("EAs") that can impact the future cash flows to be generated from forecasted sales of EAs (forecasted sales of EAs typically represent the excess of allocated EAs over the forecasted generation emission levels for a vintage year). Duke Energy closely monitors the potential impacts of EA price changes and, where appropriate, may enter into firm commitment sales contracts to protect margins for a portion of forecasted sales. In situations where we will actually deliver the EAs under a forward sale commitment and receive the full, gross revenue from the buyer under the forward contract, the forecasted transaction and the hedge instrument are deemed to be the same instrument and will be perfectly correlated, provided the creditworthiness of the counterparty does not deteriorate to an extent that performance by the counterparty is jeopardized. DIG Issue No. G2 addresses the accounting for hedged transactions that arise from gross settlement of a derivative. Forward sales (firm commitments) of EAs can qualify as all-in-one cash flow hedges if the contract requires delivery of a non-financial asset (e.g., EAs) in exchange for cash and the forecasted transaction and the derivative used to hedge it are the same contract. The assessment of hedge effectiveness should be determined based on changes in the entire fair value of the derivative instrument (i.e., the contract). We believe the hedging relationship will be 100% effective at the inception and throughout the term of the hedging relationship, provided the creditworthiness of the counterparty does not deteriorate to an extent that performance by the counterparty is jeopardized. To prove out the hedging relationship is perfectly effective, it should be documented each quarter until delivery of the EAs that a) counterparty creditworthiness has not deteriorated to an extent that performance (payment) by the counterparty is jeopardized and b) the forecast of excess EAs is greater than the amount of forward sales contracts for EAs at a high confidence level. Once a firm commitment forward sales contract is entered into, the fair value of the firm commitment should be measured and recorded within AOCI each reporting period until the transaction occurs, at which time AOCI should be recognized in the income statement. Until such time a firm commitment forward sales contract is entered into, nothing is to be recorded for the forecasted forward sales.

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### *Impairment Considerations*

SFAS No. 133 contains impairment considerations for both fair value and cash flow hedges. Paragraph 27 of SFAS No. 133 has impairment provisions for the asset or liability which is designated as the hedged item (e.g., a fixed-rate asset):

27. An asset or liability that has been designated as being hedged and accounted for pursuant to paragraphs 22–24 remains subject to the applicable requirements in generally accepted accounting principles for assessing impairment for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 22 of this Statement. Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment requirements to the hedged asset or liability.

DIG Issue No. F4, “Fair Value Hedges: Interaction of Statement 133 and Statement 114” (SFAS No. 114, “Accounting by Creditors for Impairment of a Loan”), has interpretative guidance on impairment considerations for fair value hedges and supports including the adjusted carrying amount of the hedged item in the impairment considerations of the hedged item.

Paragraphs 34 and 35 of SFAS No. 133 contain the following impairment provisions for cash flow hedges:

34. Existing requirements in generally accepted accounting principles for assessing asset impairment or recognizing an increased obligation apply to an asset or liability that gives rise to variable cash flows (such as a variable-rate financial instrument), for which the variable cash flows (the forecasted transactions) have been designated as being hedged and accounted for pursuant to paragraphs 30 and 31. Those impairment requirements shall be applied each period after hedge accounting has been applied for the period, pursuant to paragraphs 30 and 31 of this Statement. The fair value or expected cash flows of a hedging instrument shall not be considered in applying those requirements. The gain or loss on the hedging instrument in accumulated other comprehensive income shall, however, be accounted for as discussed in paragraph 31.

35. If, under existing requirements in generally accepted accounting principles, an impairment loss is recognized on an asset or an additional obligation is recognized on a liability to which a hedged forecasted transaction relates, any offsetting net gain related to that transaction in accumulated other comprehensive income shall be reclassified immediately into earnings. Similarly, if a recovery is recognized on the asset or liability to which the forecasted transaction relates, any offsetting net loss that has been accumulated in other comprehensive income shall be reclassified immediately into earnings.

Therefore, as paragraph 34 of SFAS No. 133 prohibits the fair value or expected cash flows from the hedging instrument in being considered in impairment considerations for other assets, the cash flows utilized for SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”), recoverability purposes (for long-lived assets such as property, plant & equipment) should exclude cash flows related to hedging activities. However, if an asset or liability to which a hedged forecasted transaction relates is impaired under the provisions of SFAS No. 144 or other applicable GAAP and an impairment charge is recorded in earnings, any net gain deferred in AOCI related to cash flow hedges for the impaired asset or liability would be recognized in earnings. The amount of such net gain recognized is limited to the greater of the impairment charge recognized or the net gain deferred in AOCI.

### *Financial Statement Presentation and Disclosures*

#### Balance Sheet Classification

Derivative instruments should be recorded at their fair value and classified as either current or noncurrent in accordance with the provisions of Accounting Research Bulletin (“ARB”) No. 43, “Restatement and Revision of Accounting Research Bulletins,” as follows:

*Current Assets*...are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business...[w]here a particular business has no clearly defined operating cycle, the one year rule should govern.

*Current Liabilities*...obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities.

Therefore, derivative instruments which do not meet the above criteria to be classified as a current asset or liability should be classified as a noncurrent asset or liability in the balance sheet.

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Classification of a derivative instrument between current and noncurrent should be based primarily upon the rights and obligations of the derivative instrument as well as the contractual maturity date of the derivative instrument. As an example, the fair value of an interest rate swap should be split between current and non-current consistent with the timing of the fair value of the expected cash flows under the swap.

Income Statement Classification

Effective January 1, 2003, in connection with the implementation of the remaining provisions of EITF Issue No. 02-3, Duke Energy designated all energy commodity derivatives as either trading or non-trading. For each of the Duke Energy's derivatives, the accounting method and presentation of gains and losses, or revenue and expense in the Consolidated Statements of Operations is shown below. See definition of "mark-to-market" and "accrual" methods earlier in this policy under **Accounting for Types of Instruments by Activity**.

Classification of Contract	Accounting Method	Presentation of Gains & Losses or Revenue & Expense
<b>Trading derivatives</b>	Mark-to-market	Net basis in Operating Revenues – Non-regulated electric, natural gas, and other
<b>Non-trading derivatives:</b>		
Cash flow hedge	Accrual	Gross basis in the same income statement category as the related hedged item
Fair value hedge	Accrual	Gross basis in the same income statement category as the related hedged item
Normal purchase or normal sale	Accrual	Gross basis upon settlement in the corresponding income statement category based on commodity type
Undesignated	Mark-to-market	Net basis in the related income statement category for interest rate, currency and commodity derivative.

Disclosures

Note: Beginning with the 1<sup>st</sup> quarter 2009 Form 10-Q, additional disclosures will be required under SFAS No. 161.

For derivative instruments and hedging activities, the following items are required to be reported at each quarterly or annual reporting period:

- Disclose the objectives for holding derivative instruments and hedging instruments, and the risk management strategy for achieving those objectives (annual disclosure requirement only).
  - Distinguish between cash flow hedges, fair value hedges, foreign currency exposure hedges.
  - Describe the Company's risk management policy for each type of hedge and those risks hedged.
- Derivative instruments designated and qualified as fair value hedges:
  - the net gain or loss recognized in earnings during the reporting period representing (a) the amount of the hedges' ineffectiveness and (b) the component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness, and a description of where the net gain or loss is reported in the Consolidated Statement of Operations.
  - the amount of net gain or loss recognized in earnings when a hedged firm commitment no longer qualifies as a fair value hedge.
- Derivative instruments designated and qualified as cash flow hedges:

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- the net gain or loss recognized in earnings during the reporting period representing (a) the amount of the hedges' ineffectiveness and (b) the component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness, and a description of where the net gain or loss is reported in the statement of income or other statement of financial performance
- a description of the transactions or other events that will result in the reclassification into earnings of gains and losses that are reported in AOCI, and the estimated net amount of the existing gains or losses at the reporting date that is expected to be reclassified into earnings within the next 12 months.
- the maximum length of time over which the entity is hedging its exposure to the variability in future cash flows for forecasted transactions excluding those forecasted transactions related to the payment of variable interest on existing financial instruments.
- the amount of gains and losses reclassified into earnings as a result of the discontinuance of cash flow hedges because it is probable that the original forecasted transactions will not occur by the end of the originally specified time period or within the additional period of time.
- Derivative instruments designated and qualified as hedges of the foreign currency exposure of a net investment in a foreign operation:
  - the net amount of gains or losses included in the cumulative translation adjustment during the reporting period
- The fair value of trading contracts outstanding at the end of the period.
- Reference is made to the accounting policy entitled "Fair Value Measurements Used in Accounting." Effective in the 1<sup>st</sup> quarter of 2008, additional disclosures are required with respect to fair value measurements of derivative assets and liabilities, including the fair value hierarchy of such measurements (e.g., Level 1, 2, and 3 disclosures).
- Provide quantitative information about market risk as of the end of the latest fiscal year,
  - categorize market risk sensitive instruments into instruments entered into for trading purposes and instruments entered into for purposes other than trading purposes
  - Within both the trading and other than trading portfolios, separate quantitative information shall be presented, to the extent material, for each market risk exposure category (i.e., interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market risks, such as equity price risk).
- For energy trading activities, *all* of the following shall be disclosed, in accordance with EITF Issue No. 02-3:
  - a. The applicability of EITF Issue No. 98-10
  - b. The types of contracts that are accounted for as energy trading contracts
  - c. The fair values of its energy trading contracts, aggregated by source or method of estimating fair value and by maturity dates of the contracts
  - d. A description of the methods and significant assumptions used to estimate the fair value of its various classes of energy trading contracts
  - e. A reconciliation of the beginning and ending carrying values of its energy trading contracts, aggregated by source or method of estimating fair value, showing separately the changes attributable to (1) unrealized gains and losses recognized at inception of a contract, (2) unrealized gains and losses recognized as a result of changes in valuation techniques and assumptions, (3) other unrealized gains and losses recognized during the period, and (4) realized gains and losses recognized during the period
  - f. The sensitivity of its estimates to changes in the near term.<sup>1</sup>
    - <sup>1</sup> Paragraph 14 of SOP 94-6 provides that "the disclosure should indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term" (footnote references omitted).
  - g. An entity should disclose the gross transaction volumes for those energy trading contracts that are physically settled.

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### Related Links:

- [Accounting for Regulated Entities \(SFAS No. 71\)](#)
- [Asset Impairments Reviews for Long-lived Assets \(excluding Goodwill\) and Equity Method Investments, Assets Held for Sale and Discontinued Operations \(SFAS No. 144 and APB No. 18\)](#)
- [Fair Value Measurements used in Accounting](#)
- [Revenue Recognition](#)
- [Commodity Risk Management](#)
- [PPA Contract Review Accounting Checklist](#)
- [Reclassification of Realized Income Statement Activity in Consolidation – Net vs. Gross](#)
- [Other Comprehensive Income Accounting Procedures](#)

### Key Terms

#### *Capacity Contract<sup>4</sup>*

An agreement by an owner of capacity to sell the right to that capacity to another party so that it can satisfy its obligations. For example, in the electric industry, capacity (sometimes referred to as installed capacity) is the capability to deliver electric power to the electric transmission system of an operating control area. A control area is a portion of the electric grid that schedules, dispatches, and controls generating resources to serve area load (ultimate users of electricity) and coordinates scheduling of the flow of electric power over the transmission system to neighboring control areas. A control area requires entities that serve load within the control area to demonstrate ownership or contractual rights to capacity sufficient to serve that load at time of peak demand and to provide a reserve margin to protect the integrity of the system against potential generating unit outages in the control area.

#### *Clearly and Closely Related*

"The phrase *not clearly and closely related* in paragraph 10(b) with respect to the normal purchases and normal sales scope exception is used to convey a different meaning than in paragraphs 12(a) and 60 of SFAS No. 133 with respect to the relationship between an embedded derivative and the host contract in which it is embedded. For purposes of determining whether a contract qualifies for the normal purchases and normal sales scope exception, the application of the phrase *not clearly and closely related to the asset being sold or purchased* should involve an analysis of both qualitative and quantitative considerations. The analysis is specific to the contract being considered for the normal purchases and normal sales scope exception and may include identification of the components of the asset being sold or purchased. The underlying in a price adjustment incorporated into a contract that otherwise satisfies the requirements for the normal purchases and normal sales exception would be considered to be *not clearly and closely related to the asset being sold or purchased* in any of the following three circumstances:

1. The underlying is extraneous (that is, irrelevant and not pertinent) to both the changes in the cost and the changes in the fair value of the asset being sold or purchased, including being extraneous to an ingredient or direct factor in the customary or specific production of that asset.
2. If the underlying is not extraneous as discussed in (1) above, the magnitude and direction of the impact of the price adjustment is not consistent with the relevancy of the underlying. That is, the magnitude of the price adjustment based on the underlying is significantly disproportionate to the impact of the underlying on the fair value or cost of the asset being purchased or sold (or of an ingredient or direct factor, as appropriate).
3. The underlying is a currency exchange rate involving a foreign currency that meets none of the criteria in paragraphs 15(a)-15(d) of Statement 133 (as amended) for that reporting entity.

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<sup>4</sup> Paragraph 540, Appendix F, SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities."

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(The inclusion of this circumstance is consistent with the portion of paragraph 10(b) that states, "contracts that...are denominated in a foreign currency that meets none of the criteria in paragraphs 15(a)-15(d) shall not be considered normal purchases and normal sales.") [DIG Issue No. C20]

"The test mandated by Question C20 for determining whether changes in the underlying are not irrelevant to changes in the fair value of the asset being purchased or sold under the contract is that there be an expectation that the price adjustment feature will impact the final sales price in line with market changes. Accordingly, a price adjustment feature based on a broad market index would be clearly and closely related to the item being sold under the contract assuming the impact of the price adjustment would be comparable to the actual market value changes of that item (or components of the item being sold or purchased)." [From Aspen Publishing's (CCH) Accounting Research Manager Interpretation 10b-4]

For embedded derivatives, paragraph 12 of SFAS No. 133 focuses on whether the economic characteristics and risks of the embedded derivative are clearly and closely related to the economic characteristics and risks of the host contract. If the host contract encompasses a residual interest in an entity, then its economic characteristics and risks should be considered that of an equity instrument and an embedded derivative would need to possess principally equity characteristics (related to the same entity) to be considered clearly and closely related to the host contract. However, most commonly, a financial instrument host contract will not embody a claim to the residual interest in an entity and, thus, the economic characteristics and risks of the host contract should be considered that of a debt instrument.

### *Fair value*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

*Note:* Effective January 1, 2008, the definition of fair value was amended under the guidance of SFAS No. 157, "Fair Value Measurements." For additional information and guidance with respect to the definition of fair value and the application of SFAS No. 157, refer to Duke Energy Accounting Policy Statement, "Fair Value Measurements Used in Accounting."

### *Financial instrument*

Cash, evidence of an ownership interest in an entity, or a contract that both:

a. Imposes on one entity a contractual obligation\* (1) to deliver cash or another financial instrument to a second entity or (2) to exchange other financial instruments on potentially unfavorable terms with the second entity

\* *Contractual obligations* encompass both those that are conditioned on the occurrence of a specified event and those that are not. All contractual obligations that are financial instruments meet the definition of *liability* set forth in Concepts Statement 6, although some may not be recognized as liabilities in financial statements - may be "off-balance-sheet" - because they fail to meet some other criterion for recognition. For some financial instruments, the obligation is owed to or by a group of entities rather than a single entity.

b. Conveys to that second entity a contractual right† (1) to receive cash or another financial instrument from the first entity or (2) to exchange other financial instruments on potentially favorable terms with the first entity.

† *Contractual rights* encompass both those that are conditioned on the occurrence of a specified event and those that are not. All contractual rights that are financial instruments meet the definition of *asset* set forth in Concepts Statement 6, although some may not be recognized as assets in financial statements - may be "off-balance-sheet" - because they fail to meet some other criterion for recognition. For some financial instruments, the right is held by or the obligation is due from a group of entities rather than a single entity.

### *Firm commitment*

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An agreement with an unrelated party, binding on both parties and usually legally enforceable, with the following characteristics:

- a. The agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction. The fixed price may be expressed as a specified amount of an entity's functional currency or of a foreign currency. It may also be expressed as a specified interest rate or specified effective yield.
- b. The agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable.

*Forecasted transaction*

A transaction that is expected to occur for which there is no firm commitment. Because no transaction or event has yet occurred and the transaction or event when it occurs will be at the prevailing market price, a forecasted transaction does not give an entity any present rights to future benefits or a present obligation for future sacrifices.

## APPENDIX A

### Application and Practice: Conclusions Reached Around Accounting for Derivative Instruments and Hedging Activities

#### *Determination of Whether a Contract Contains a Notional*

The determination as to whether a contract contains a notional under the provisions of SFAS No. 133 often requires significant judgment and interpretation of the accounting standards and is often based upon the facts and circumstances in each individual contract. However, the Company has developed certain interpretations related to the determination of a notional, which are discussed below.

1. "System Firm" Provisions – Many electricity contracts have "system firm" provisions whereby the seller's obligations to sell under the contract are subject to the availability of the system. "System firm" indicates that if electricity does not flow when called upon under a contract due to the fact that the transmission system is down, there are no damage or other payments as a result of such failure to perform. Therefore, the quantities deliverable under the contract could potentially be reduced to zero during the contractual term without the selling party incurring any penalties for nonperformance. This is an indicator that a notional does not exist, even though there may be a very low probability that such event would occur. However, partly due to the low probability of such failure to perform, it is the Company's policy to not solely base the notional conclusion on whether the contract contains "system firm" provisions.
2. Force Majeure Provisions – Most contracts have standard force majeure provisions, which are somewhat similar to the "system firm" provisions discussed above in that the seller's obligations under the contract are excused under unusual circumstances, such as fire, flood, and earthquakes, which prohibit the seller from being able to meet its obligations under the contract. Under these provisions, the seller does not owe any damages to the buyer due to failure to perform if such failure to perform is due to force majeure. Therefore, the quantities deliverable under the contract could potentially be reduced to zero during the contractual term without the selling party incurring any penalties for nonperformance. This is an indicator that a notional does not exist, even though there may be a very low probability that such event would occur. However, similar to the conclusion noted above for "system firm" provisions, it is the Company's policy to not solely base the notional conclusion on whether the contract contains force majeure provisions.
3. Ability to "Economically Exercise" – Economic exercise is the ability to buy or take delivery of amounts under the contract solely based upon the contract being "in the money". This concept is in contrast to contracts which are only utilized to satisfy a buyer's own actual needs and excess amounts cannot be purchased in order to take advantage of an "in the money" situation whereby the contractual price is lower than the current market price. The ability to economically exercise a contract usually results in a determinable notional. However, if a contract is only available to meet an entity's own actual needs, whether or not there is a notional will depend upon other contractual provisions (such as liquidating damage and termination provisions, as discussed below).
4. Contract Liquidating Damages Provisions and Termination Provisions – Under the guidance given in DIG Issue No. A6 (requirements contracts or contracts that cannot be economically exercised), the existence of liquidating damage and/or termination provisions under a contract may result in the contract having a notional. Normally, any liquidating damage or termination provision which requires the payment of a penalty based upon a determinable amount tied to the estimated volumes to be delivered under the contract will result in a determinable notional. Such liquidating damage or termination amounts paid can be either fixed or based upon a market-based formula. Additionally, contracts with a determinable minimum volume to be delivered have a notional equal to that minimum and contracts with a



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determinable maximum but no stated minimum volume to be delivered do not have a notional. If quantities deliverable under the contract can be reduced to zero without the seller or buyer incurring penalties for non-performance, there is not a determinable notional.

### *Determination of Whether a Contract Contains an Initial Net Investment*

The determination as to whether a contract involves an initial net investment involves a level of judgment as there is no specific threshold specified in the accounting standards for when there is considered to be an initial net investment. If a contract is not fully prepaid by more than a minor amount (after adjustment for the time value of money), the contract is considered to have this characteristic of a derivative.

### *Determination of Whether a Contract Contains Net Settlement*

The determination as to whether a contract contains net settlement under the provisions of SFAS No. 133 often requires significant judgment and interpretation of the accounting standards and is often based upon facts and circumstances related to the commodity or asset being purchased. However, the Company has developed certain interpretations related to the determination of net settlement, which are discussed below.

1. Explicit or implicit net cash settlement (paragraph 9(a) of SFAS No. 133) -- As discussed in DIG Issue No. A8, "Definition of a Derivative: Asymmetrical Default Provisions," asymmetrical default provisions in a contract do not result in net cash settlement under paragraph 9(a) of SFAS No. 133. An asymmetrical default provision is one in which the defaulting party has an obligation to compensate the counterparty's loss but the defaulting party does not have the right to demand any gain from the counterparty. Symmetrical default provisions may also not result in a conclusion that the contract is a derivative if the provision does not grant a party the unilateral right to net settle. For a contract to be net settled under paragraph 9(a), the defaulting counterparty must have the ability to default and as a result compel the other counterparty to make payment to the defaulting counterparty of the fair value of the contract. If the non-defaulting counterparty can choose whether or not to enforce the net payment provision, the contract does not have net settlement under paragraph 9(a).
2. Market mechanisms facilitate net settlement (paragraph 9(b) of SFAS No. 133) -- In order to be considered net settlement under paragraph 9(b), there must be the ability for either party to the contract to be fully relieved of all of its rights and obligations under the contract (including credit risk under the contract). An exchange, such as the NYMEX exchange, often gives the ability for a party to be fully relieved of all its rights and obligations under the contract. If a market mechanism exists, the assignment provisions of the contract must be examined pursuant to the guidance given in DIG Issue No. A7, "Definition of a Derivative: Effect of Contractual Provisions on the Existence of a Market Mechanism That Facilitates Net Settlement." If a contract is assignable only if approval of the counterparty is obtained, the probability of obtaining such consent from the counterparty must be assessed when determining whether there truly is net settlement under paragraph 9(b) of SFAS No. 133.
3. Readily convertible to cash (paragraph 9(c) of SFAS No. 133) -- the asset deliverable under the contract (such as a commodity) must be readily convertible to cash in order to obtain net settlement under SFAS No. 133. The asset deliverable under the contract must be evaluated as to whether it is readily convertible to cash at the contractual delivery point (e.g., plant location, grid location, Hub location, etc). If the asset is not readily convertible to cash at the contractual delivery point, the Company must evaluate which location is the most cost effective to transport the commodity from the contractual delivery point to where the asset would be considered readily convertible to cash. DIG Issue No. A10, clarifies that the cost to transport the asset from the contractual delivery point to the point of delivery where the asset is readily convertible to cash must be less than 10% of the sales price of the asset (at the readily convertible to cash delivery point) in order to consider the asset readily convertible to cash. Likewise, if the cost to transport the asset is equal to or greater than 10% of the sales price of the asset, the asset is not considered readily convertible to cash. For the seller,

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whether or not an asset deliverable under a contract is considered readily convertible to cash is not impacted by the buyer's ability to resell the underlying asset or commodity. The significance of the conversion costs should be performed only at inception of the contract or when a contract subsequently meets the definition of a derivative for reasons other than the level of transaction costs.

Electricity, both off-peak and on-peak, is typically considered readily convertible cash ("RCC"). Also, as an example, electricity delivered inside the Duke Energy Carolinas' border may be considered not RCC depending on the relationship between transmission costs and the price of electricity. Depending on the size of the contract (number of MWs), electricity delivered at the Duke Energy Carolinas' border may not be considered RCC. Electricity delivered to or within a Regional Transmission Organization ("RTO") or Independent System Operator ("ISO") is typically considered readily convertible to cash.

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## APPENDIX B

### CONTRACT TYPE ANALYSIS: DERIVATIVE VS. NON-DERIVATIVE

The following is a brief summary of certain transactions encountered by Duke Energy in the normal course of business and discussion of the assessments that have been made regarding whether or not these transactions are usually considered derivatives pursuant to SFAS No. 133. Note that the discussion below is meant to be a guide and should not be used as a substitute for performing a detailed SFAS No. 133 analysis on a contract-by-contract basis (as contracts can contain unique provisions which may result in a different conclusion than as discussed below):

#### **Power Purchase Agreements**

Duke Energy in the normal course of business enters in to power purchase agreements (PPAs), as either a buyer or seller of power. The number of these transactions is growing, especially in U.S. territories where the use of renewable energy sources is increasing and wind assets come on line. While PPAs are considered to be ordinary course of business contracts, the accounting for PPAs is often complex, as the authoritative literature requires an analysis of lease, derivative, and consolidation accounting for the underlying power producing fixed assets.

A PPA checklist has been created as a document that the Controller's Department believes will enhance internal controls around the accounting for PPAs. This checklist should be thoroughly considered when determining the appropriate accounting for all new and modified PPAs. Effective, October 1, 2008, the completion of the checklist is a mandatory SOX control for all new and modified PPAs.

#### **Tolling Agreement**

"Tolling" contracts provide the holder the right, but not the obligation, to call on the power generation owner to provide a service to convert natural gas to electricity at a predefined heat conversion rate. An energy trader or risk manager may enter into a power tolling contract with a power generation owner in a geographical area where the energy trader has no power delivery commitments to take advantage of any market opportunity and to provide the power generation owner commodity price risk protection. The owner of the power generation plant owns, operates, and dispatches the facilities under the terms of the agreement. The tolling contract provides the energy trader with the ability to convert natural gas to electricity in exchange for a monthly capacity payment or fixed fee from the energy trader (sometimes referred to as the capacity or demand charge). The terms of the contract require the power generation owner to deliver power to the energy trader at a predefined delivery point and may provide for alternative delivery points with applicable basis adjustments.

Tolling agreements should first be assessed to determine if they represent leases under EITF Issue No. 01-8 and SFAS No. 13. If they are not leases, most tolling agreements generally meet certain characteristics of a SFAS No. 133 derivative. Specifically, a tolling agreement is likely to have 1) an underlying, which is the price for fuel and/or electricity; 2) no initial net investment as the capacity payment is paid monthly throughout the term of the contract and 3) net settlement since the commodity delivered (i.e., power) is generally considered to have a spot market and thus would be readily convertible to cash in accordance with DIG Issue No. A19. It is the buyer's ability to turn the power into cash that constitutes de facto net settlement for SFAS No. 133 purposes. However, the remaining characteristic of a derivative - a notional or fixed payment provision - may not be present in all tolling agreements. Whether or not a toll contains a notional will be based partially upon whether or not the parties to the transaction can "economically exercise" (refer to definition in Appendix A) their rights under the contract and what the liquidating damages ("LD") and/or termination provisions are under the guidance given in DIG Issue No. A6.

Tolling agreements should also be considered for analysis under FIN 46 (revised December 2003), "Consolidation of Variable Interest Entities."

**Tolling Agreements – Firm Liquidated Damages ("LD") Products**

Certain tolling agreements are firm products whereby the buyer of the toll is protected from any and all risks associated with physical operations of a plant. The seller of the toll has effectively guaranteed 100% availability of the contracted power along with a fixed, guaranteed heat rate. For example, if the plant experiences an unplanned outage when the buyer has called upon the power, the seller must buy power in the market to cover the buyer's call order or pay market-based replacement value for any losses incurred by the buyer to keep the buyer whole for their short position created by the seller's default. These tolls behave very similar to financial options because the buyer assumes no unit contingent/operational plant risk. For these types of tolling agreements, a notional exists since the liquidating damages provision calls for a variable payment that is expected to reimburse the harmed party for market price movements (see DIG Issue No. A6 discussion). In other words, the contract provides for the delivery of either power or market-based liquidating damages that are not substantially different. Thus, this type of toll would most likely be classified as a derivative.

**Tolling Agreements – Unit Contingent Products**

Other tolling agreements require the buyer to take on some level of plant-specific risk. These tolling agreements are viewed commonly in the industry as "unit contingent" products. They are structured similarly to the firm LD products mentioned above, with the exception that the buyer is assuming availability risk, heat rate risk, and/or other types of risk that is associated with owning, controlling, or operating a power generation facility. The operational risk assumed by the buyer may or may not ultimately be more than that inherent in firm LD products that are characterized similar to financial options. It is the uniqueness of unit contingent tolling agreements that necessitates a facts-and-circumstances analysis to determine whether such agreement is or is not a derivative.

An example of this type of unit contingent tolling agreement (which, as noted above, would first need to be assessed to determine if it is a lease) includes a contract whereby the seller has guaranteed a heat rate and the plant availability is guaranteed for 90% of the year, except for scheduled maintenance in which the buyer is notified prior that the plant will not be available. This structure is very common for unit contingent tolling agreements. In this example, there may be a 100MW plant whereby a minimum notional of 788,400 MWh (computed based on 90% of 100 MW capacity multiplied by 24 hours times 365 days) may be computed. However, this minimum notional may be challenged and overcome if certain factors regarding the liquidating damages provisions and force majeure provisions are met.

Specifically, tolling agreements address what compensation the buyer is to receive in the event of non-performance. This compensation may be in the form of replacement energy (i.e., market-based liquidating damages), formulaic (non-market based) reduction to the overall capacity payment, no compensation, or some variation thereof. Generally, if a unit contingent toll contains a provision for replacement cost (market based) liquidating damages, the contract is deemed to be a derivative because the contract would be analogous to the firm liquidated damages toll described above. However, if the liquidating damages are non-existent or not market-based and are not deemed to be significant, the existence of the minimum notional may be successfully challenged and the contract deemed not a derivative. Consideration may also need to be given to the buyer's ability to "economically exercise" (refer to definition in Appendix A) their rights under the contract.

In addition to the liquidating damages provisions, broad force majeure provisions evident in the tolling agreements may indicate that no notional exists. Force majeure clauses generally bear

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certain characteristics such as acts of God, war, etc. However, if the force majeure provision contained in the tolling agreement is overly broad to the extent that it includes operational provisions, such as labor or material shortages, and either liquidating damages are not required during the force majeure period or the liquidating damages are not significant, the contract may be deemed to not have a notional and hence not be a derivative.

The determination as to whether a tolling agreement is a derivative is inherently based partially on the subjective judgment of the evaluator. While the determination of "significant" liquidating damages and "broad" force majeure clauses may vary from individual to individual, Duke Energy will maintain documentation at the appropriate business unit on the analysis of all tolls to ensure that consistent application of these definitions are applied, especially within a business unit. While we have segregated certain general types of tolling agreements in this document to help facilitate the definition of a derivative, we will continue to evaluate whether any tolling agreement is a derivative on a contract-by-contract basis.

### Transportation Contracts

Transportation or pipeline capacity contracts provide the holders of the capacity the opportunity, but not the obligation, to transport physical quantities of gas from one location to another on a daily basis. The holder of the capacity has the choice as to whether to ship and use the capacity, or not, based upon various factors relevant to its operations, including gas usage estimates for its operations or its customers, as well as the difference between the price of gas at the pipeline receipt and delivery points. The payment or settlement with the pipeline company by the capacity holder has a fixed and a variable component. The fixed payments, known as demand charges, are made to the pipeline company each month, whether or not the holder uses the capacity. The variable component is paid to the pipeline owner for capacity actually used by the holder during the month.

In 1992, FERC Order 636 implemented restructuring of interstate pipeline operations, and the 2000 FERC Order 637 further deregulated the natural gas industry by refining the remaining pipeline regulations to address inefficiencies in the capacity release market. The effects of Order 636 allowed the development of natural gas commodities. Order 636 required pipeline companies to unbundle, or separate, natural gas sales operations from pipeline transportation activities and set up separate transportation and trading affiliates. This supported the development of natural gas marketing, which was deregulated and opened to competition. In addition, Order 636 led to the development of the secondary transportation market, where shippers can purchase pipeline capacity from other shippers that temporarily or permanently spare capacity. The secondary market, known as the capacity release market, required each pipeline to set up an electronic bulletin board and institute rules by which holders of unwanted transport capacity may take bids from others who wish to lease or buy it. Order 636 was followed by a series of measures by the FERC that were designed to promote competition in the natural gas market and increase flexibility in pipeline transportation. In Order No. 637, issued February 9, 2000, the Commission (a) suspended until September 30, 2002 the operation of the price caps on capacity release sales of less than one year, and (b) authorized certain other policy changes in the pipeline ratemaking area.

As of January 1, 2003, a transportation contract does not meet the definition of a derivative because there is no provision for net settlement (all other defining characteristics are met). For the period Order No. 637 was effective, certain industry experts have indicated that there existed a market mechanism for natural gas transportation contracts because the lifting of the price cap and the posting and bidding process required by the bulletin boards facilitated a free market that was evidenced by the Electronic Bulletin Board. However, these same industry experts now believe that since the effective period for Order No. 637 expired on September 30, 2002, such market mechanism has been eliminated, as a party does not have the ability to relieve itself of all rights and obligations through a "market".

While we would agree that there is no market mechanism to facilitate net settlement, Duke Energy also believes that transportation contracts do not require delivery of an asset that is readily convertible to cash. The readily-convertible-to-cash criterion is not satisfied, as there are no quoted prices available in an active market that can rapidly absorb the quantity held by the entity without

## Derivative Instruments and Hedging Activities Policy

significantly affecting the price. Because the underlying on which contract settlement is based (the price or value of the right to receive transportation) is a non-financial asset (see definition of "financial asset" under "Key Terms" above) that is not readily convertible to cash, paragraph 10(e) of SFAS No. 133 provides that the contract is not subject to the requirements of SFAS No. 133. Further, in the discussions and deliberations of EITF Issue No. 02-3, the Task Force discussed that transportation contracts may not meet the definition of a derivative due to the significant service element included in the contract as well as the contract not being readily convertible to cash. Although the pricing of these contracts may be very similar to the pricing of a basis swap, the service element is pervasive and, therefore, transportation contracts are considered to be executory contracts.

### **Freight Contracts**

Due to the significant service element involved, railroad contracts (usually used for coal deliveries) are not considered to be derivatives. Likewise, trucking contracts are not considered to be derivatives.

### **Full or Supplemental Requirements Contracts and Load-following arrangements**

Full requirements contracts are contracts whereby the seller agrees to provide all of the commodity needs of a buyer. For example, Company A enters into a forward contract with Company B to provide as much electricity at a contract price (as opposed to a current market price) that is required by Company B to satisfy their needs during the next twelve-month period. Similar to a full requirements contract, a supplemental requirements contract provides for the seller to supply the excess requirements over the available resources of the buyer. Certain contracts for Duke Energy's wholesale electric customers are supplemental requirements contracts. A load-following contract is a type of requirements contract in which the company agrees to follow the load shape of the counterparty with predefined limits to enable one counterparty to buy or sell power in order to instantaneously match supply and demand.

Commodity contracts generally specify a fixed number of units of a commodity to be purchased or sold under a contract. However, some contracts, such as requirements contracts, do not specify a fixed number of units to be exchanged and, instead, specify either a maximum number of units, minimum number of units, or range of units to be purchased or sold during a specified period. DIG Issue No. A6, provides that a requirements contract has a notional amount only if a reliable means to determine such a quantity exists.

DIG Issue No. A6 further states that in many contracts, even though the notional amount is not specified, it can be reliably determined based on other provisions within the contract or within agreements contemporaneous to the contract. One technique to quantify and validate the notional amount in a requirements contract is to base the estimated volumes on the contract's settlement and default provisions. Often the default provisions of requirements contracts will specifically refer to anticipated quantities to utilize in the calculation of penalty amounts in the event of nonperformance. Other default provisions stipulate penalty amounts in the event of nonperformance based on average historical usage quantities of the buyer. If those amounts are determinable, they should be considered the notional amount of the contract.

The identification of a requirements contract's notional amount may require consideration of volumes or formulas contained in attachments or appendices to the contract or other legally binding side agreements. The determination of a requirements contract's notional amount must be performed over the life of the contract and could result in the fluctuation of the notional amount if, for instance, the default provisions reference a rolling cumulative average of historical usage.

In circumstances where the notional amount is not determinable, making the quantification of such an amount highly subjective and relatively unreliable (for example, if a contract does not contain settlement and default provisions that explicitly reference quantities or provide a formula based on historical usage), such contracts are considered not to contain a notional amount as that term is used in SFAS No. 133.

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The determination as to whether a full or supplemental requirements or load-following agreement has a notional will be made on a contract-by-contract basis. Certain requirements contracts and load-following contracts at the Company do not provide the buyer the ability to take quantities in excess of its need and resale these excess quantities and do not contain a stated minimum, default or other provisions in them that indicate the presence of a notional amount and thus are not SFAS No. 133 derivatives.

### **Electricity Capacity Contracts**

Capacity contracts, (for electric power), typically allow the buyer to take as much power as needed, up to the contract maximum. Unless the contract is a lease, whereby the seller allows the buyer to control a specific generation facility, the contract may require SFAS No. 133 derivative treatment. Capacity contracts are generally considered to be derivatives, due to the existence of a notional. The buyer is not normally restricted from selling their excess capacity on the open market if the price is right. Accordingly, such contracts are deemed to have a notional since they are economically exercisable. However, if the buyer is restricted from selling excess capacity on the open market (can only purchase power to meet its own needs), the termination and liquidating damage provisions of the contract need to be examined to determine whether a notional exists, under the guidance given in DIG Issue No. A6. Seller capacity or demand charges as well as energy charges are normally not prepaid at the inception of the contract; therefore, these contracts normally have no initial net investment. Since electricity is generally considered to be readily convertible to cash, these contracts have net settlement, assuming transmissions costs from the delivery point to an active market are less than 10%.

Derivative capacity contracts customarily qualify for the normal purchase normal sale exemption under paragraph 10(b)(4) of SFAS No. 133. The rules in paragraph 58(b) of SFAS No. 133 and DIG Issue No. C15, allow power producers selling from a specific plant to end users to qualify for the exemption.

### **Electric Transmission and Ancillary Services**

Electric transmission and ancillary services are services necessary to deliver power from the generation source to the end user as well as the other services necessary to maintain the operational security and the integrity of the electric grid. These are generally negotiated between principals and carry significant operational risk. These contracts are non-standard and are not traded actively. These contracts are not SFAS 133 derivatives, as they do not meet any of the requirements for net settlement. These contracts are considered "service contracts" and are, therefore, excluded from the scope of SFAS No. 133 under paragraph 10(e)(2).

The development and participation in RTOs or ISOs may change the conclusion on whether or not a contract is a derivative for certain types of ancillary services contracts.

Financial Transmission Rights (FTRs) in MISO and PJM (both the initial value and any changes in the initial value), whether granted or purchased, are considered derivatives and should be carried at fair value in accordance with SFAS No. 133.

Duke Energy's accounting for FTRs (and related ARRs) is documented in separate memoranda. Contact a representative of the Corporate Accounting Research Group for additional information.

### **Other Energy Related Contracts**

From time to time, the Company may enter into other energy related contracts not described above. While these contracts generally do not meet the definition of a derivative due to the lack of net settlement, any energy related contract executed that is not specifically provided for herein will be reviewed individually to determine if such contract meets the definition of a derivative.

## Derivative Instruments and Hedging Activities Policy

### DERIVATIVE ONLY CONTRACT TYPES

#### Forward-Based Derivatives

**Forward contracts.** The simplest derivative is the forward contract. A forward contract obligates one counterparty to buy, and the other to sell, a specific underlying at a specific price, amounts (i.e., notional) and date in the future. The change in the value of a forward contract is roughly proportional to the change in the value of its underlying. Typically, no net investment is required. Forward contracts are customized with terms and conditions tailored to fit the particular business, financial, or risk management objectives of the counterparties. Negotiations often take place with respect to contract size, delivery locations, delivery dates, and credit terms. Forwards, in other words, are not standardized. Some forward contracts for power and gas are traded in the over-the-counter ("OTC") market, which is mature enough to facilitate net settlement, as the underlying commodities are readily convertible to cash, especially for short-term contracts. (Other forward contracts are bilateral contracts which are not traded in the OTC market.) Longer term contracts may lack liquidity; however, subject to DIG Issue No. A19, Duke Energy's forward contracts in the power or gas markets are usually deemed to net settle as there is a current spot market for these commodities and the market is presumed to perpetuate. Forward contracts typically meet all of the requirements of a SFAS 133 derivative.

**Swap Transactions.** As the name implies, a swap transaction obligates the two parties to the contract to exchange a series of cash flows or a commodity, such as gas or power, that is readily convertible to cash at specified intervals or a single date (e.g., a swap is a series of forward contracts with different tenors combined into one contract). The cash flows of a swap are either fixed, or calculated for each settlement date by multiplying the quantity of the underlying (notional amount) by specified reference rates or prices. The notional amount is only used to calculate the payment stream, but it is not exchanged. Payments are generally netted, with the difference being paid by one party to the other. As described in paragraph 9(a), swap contracts have an explicit net settlement provision – e.g., neither party is required to deliver an asset that is associated with the underlying, only net price change differences. Therefore, similar to forward contracts, swap transactions meet the requirements of a SFAS 133 derivative.

**Futures contracts.** The basic form of a futures contract is similar to that of a forward contract. A futures contract obligates its owner to buy a specified underlying at a specified price on the contract maturity date (or settle the value for cash). Despite the similarity in payoff profiles, important economic differences distinguish futures from forwards and swaps. The contract terms of futures describing the quantity and quality of the underlying, the time and place of delivery, and the method of payment are fully standardized. Price is the only variable left to be determined. This full standardization leads to fungibility—that is, contracts of the same maturity are perfect substitutes. These characteristics are designed to facilitate anonymous trading in an active and liquid exchange market. Futures differ from forwards and swaps in that the contractual obligations under the futures contracts are entered into directly with the exchange clearinghouse and are generally satisfied through offset – the cancellation of an existing futures position through the acquisition of an equal but opposite position. Because of the existence of an actual exchange, as described by paragraph 9(b), futures contracts have a market mechanism. Futures contracts meet all of the requirements of a SFAS 133 derivative.

#### Option-Based Derivatives

**Option transactions.** In exchange for payment of a premium (a small net investment), an option contract (excluding electricity capacity contracts which are discussed in a separate section of this policy) gives the option holder the right but not the obligation to buy or sell the underlying (or settle the value for cash) at a price, called the strike price, during a period or on a specific date. Thus, the owner of the option can choose not to exercise the option and let it expire. The buyer benefits from favorable movements in the price of the underlying but is not exposed to corresponding losses. Option contracts are another building block of derivatives. Options contain a notional, require a small net investment and are net settled, as the underlying commodities, typically gas or power, are typically readily convertible to cash. Duke Energy holds that generally all options and subcategories



## Derivative Instruments and Hedging Activities Policy

of options, such as the following contract types meet the requirements of a SFAS 133 derivative unless specifically exempted. Paragraphs 20(c) and 28(c) of SFAS No. 133 give certain restrictions for obtaining hedge accounting for a written option.

***Caps, Floors and Collars.*** Just as forwards can be bundled to create swaps, options can be bundled to create other option-based contracts called, caps, floors, and collars. The buyer of the cap pays a premium, normally at inception. At each payment date, the seller must pay the buyer an amount based on the difference, if positive, between the reference and strike rate (cap). A cap therefore protects a floating-rate borrower against a rise in prices above the cap. A floor contract is the opposite of a cap in that payment is made only if the difference is negative. A floor therefore protects an index price investor against a decline in prices below the floor. Buying a collar is equivalent to buying a cap and selling a floor.

***Swaptions.*** A swaption (or swap option) is an option on a swap. It gives the buyer the right, but not the obligation, to enter into a specified swap contract at a future date. In this case, the asset underlying the option contract is another derivative transactions (i.e., a swap). A swaption is usually considered a written option for the holder of the swap.



Duke Energy Accounting Policy Statement

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## Accounting for Goodwill

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<b>Applicability:</b>	Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller
<b>Approval Date:</b>	December 9, 2004
<b>Effective Date:</b>	December 1, 2004
<b>Reissue Date:</b>	December 31, 2008

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### Statement of Purpose and Philosophy

The purpose of this policy is to provide guidelines related to the financial accounting and reporting for goodwill under the provisions of FASB Statement No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). Duke Energy is committed to preparing and providing financial information with the utmost integrity. To facilitate this corporate value, the Corporate Controller's Department will approve policies to ensure the accuracy of books and records (as detailed in the Code of Business Ethics).

### Policy Expectations and Scope

The intent of this policy is to communicate the financial accounting and reporting for goodwill under the provisions of SFAS No. 142. SFAS No. 142 addresses how goodwill should be accounted for after it has been initially recognized in the financial statements, including requiring goodwill to be tested for impairment at least annually, and not allowing goodwill to be amortized. This policy contains a high-level summary of the key requirements of U. S. GAAP as it applies to Duke Energy, including any significant interpretations or policy elections made by Duke Energy, but is not intended to be a substitute for the detail requirements of authoritative GAAP literature for specific issues or matters that may arise. This policy does not address the application of purchase accounting under FASB Statement No. 141, "Business Combinations," or the initial recognition of goodwill.

This policy is applicable to all business/corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company"), and should help ensure consistent application of the accounting for goodwill across the consolidated Duke Energy group.

### Materiality

FASB Statements note that "The provisions of this Statement need not be applied to immaterial items." Accordingly, materiality should be considered when applying this policy. However, materiality must be assessed at the consolidated Duke Energy Corporation level (as well as being assessed at the SEC sub-registrant level), and involves consideration of both quantitative as well as qualitative factors. Any questions regarding materiality should be directed to the Corporate Controller's Department.

## Accountability: Roles and Responsibilities

### Corporate Controller's Department -

- Maintain an accounting policy for goodwill available on the Duke Energy Portal to help ensure that business/corporate units are aware of how to account for goodwill, and when goodwill is to be tested for impairment.
- Establish and communicate the reporting timetable for goodwill information needed for SEC filings, and accumulate the information reported by the business/corporate units for periodic reporting and disclosure purposes (e.g. Form 10-K, Form 10-Q, etc.).
- Determine the financial statement presentation of goodwill and any goodwill impairment loss at each reporting period.
- Coordinate with the business/corporate units to ensure that proper documentation exists to support the level of operations identified as constituting a reporting unit.
- Provide guidance/assistance to business/corporate units on when goodwill should be tested for impairment under certain circumstances, and how goodwill should be tested for impairment.
- Provide guidance to business/corporate units on the allocation of goodwill to a reporting unit upon acquisition or disposition of a business and, as appropriate, assist in the impairment tests of any goodwill.
- Provide guidance on the consideration of materiality as may be requested by the business/corporate units.
- Coordinate with the business/corporate units to assess the need to file a Form 8-K for any material goodwill impairments.

### Business/Corporate Unit -

- Ensure all reporting requirements of goodwill and any goodwill impairment loss are accumulated and reported to the Corporate Controller's Department in accordance with the established reporting timetable.
- Coordinate with the Corporate Controller's Department to ensure that proper documentation exists to support the level of operations identified as constituting a reporting unit.
- Ensure proper support/documentation exists for the determination of estimated fair value of the reporting unit (or portion of a reporting unit, if the business/corporate unit is a portion of a reporting unit) that was evaluated for goodwill impairment, including determination of the appropriate discount rate to be used if a discounted cash flow approach is used to estimate fair value.
- Ensure proper support/documentation exists for the recording of any goodwill impairment loss.
- Ensure proper support/documentation exists if no new impairment assessment was performed at the annual testing date for the respective reporting unit (or portion of a reporting unit, if the business/corporate unit is a portion of a reporting unit).
- Monitor for any triggering events that would warrant a goodwill impairment assessment between annual testing dates.
- Notify the Corporate Controller's Department upon determining that any goodwill impairment exists and coordinate with the Corporate Controller's Department to assess the need to file a Form 8-K for any material goodwill impairments.

## Standards/Requirements

*[NOTE: In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value in US GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements; however SFAS No. 157 amends some of the accounting pronouncements discussed in this policy and therefore, the application of SFAS No. 157 may change Duke Energy's current practice for determining fair values for the areas of accounting covered by this policy. For Duke Energy, SFAS No. 157 was originally effective as of January 1, 2008. However, in February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS No. 157 for nonfinancial assets and*

*nonfinancial liabilities, until the 1<sup>st</sup> quarter of 2009. This version of this accounting policy does not reflect the provisions of SFAS No. 157 since the reissue date of this policy predates the 1<sup>st</sup> quarter 2009 effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities.]*

*Additionally, SFAS No. 141 (revised 2007), "Business Combinations" (SFAS No. 141R) was issued by the FASB in December 2007. SFAS No. 141R replaces SFAS No. 141, "Business Combinations." SFAS No. 141R retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and that an acquirer be identified for each business combination. This statement also establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling (minority) interests in an acquiree, and any goodwill acquired in a business combination or gain recognized from a bargain purchase. For Duke Energy, SFAS No. 141R must be applied prospectively to business combinations for which the acquisition date occurs on or after January 1, 2009. SFAS No. 141R changes the accounting for income taxes related to prior business combinations, such as Duke Energy's merger with Cinergy. Subsequent to the effective date of SFAS No. 141R, the resolution of tax contingencies relating to Cinergy that existed as of the date of the merger will be required to be reflected in the Consolidated Statements of Operations instead of being reflected as an adjustment to the purchase price via an adjustment to goodwill.*

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, which superseded the previous guidance for intangible assets prescribed in APB Opinion No. 17, "Intangible Assets". Duke Energy adopted SFAS No. 142 effective January 1, 2002. SFAS No. 142 requires goodwill to be tested for impairment at least annually, and does not allow goodwill to be amortized.

### **Supporting Guidance**

This section primarily contains references to, and excerpts from, the most significant or applicable GAAP authoritative literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

#### *Goodwill Definition and Recognition:*

Goodwill is defined in SFAS No. 142 as follows:

"The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The amount recognized as goodwill includes acquired intangible assets that do not meet the criteria in FASB Statement No. 141, "Business Combinations," for recognition as an asset apart from goodwill."

As noted in the definition, goodwill for accounting purposes represents the residual value paid in a business combination over the amounts assigned to individual assets acquired and liabilities assumed. Accordingly, no amount should be recorded for any goodwill that is generated internally from ongoing business operations.

#### *When to Test Goodwill for Impairment:*

Goodwill shall be tested for impairment at the reporting unit (see [Appendix A](#) for guidance on determination of a reporting unit) level on at least an annual basis. The impairment test is a two-step process. The first step involves comparing the fair value (see [Appendix B](#) for definition of fair value and guidance on measuring fair value (prior to the adoption of SFAS No. 157, which, as discussed above, will be adopted no earlier than the 1<sup>st</sup> quarter of 2009) and the discussion of the valuation considerations in EITF Issue No. 02-13 in the "Deferred Income Taxes" section below) of the reporting unit to its carrying value, including goodwill. If carrying value exceeds fair value, step two of the test is required. Step two involves a hypothetical purchase price allocation, to determine the "implied fair value" of goodwill, (i.e. the amount of goodwill that would result in a purchase business combination as of the date the impairment test is being performed). Step two involves allocating the fair value of the reporting unit to all tangible and intangible assets and liabilities, with any remaining

unallocated fair value representing the implied fair value of goodwill. If this implied fair value of goodwill is less than book value, then an impairment loss is recognized for the difference.

Paragraphs 19-22 of SFAS No. 142 discuss the use of the two-step method in the recognition and measurement of a goodwill impairment loss.

The date of the annual goodwill impairment test can differ for reporting units, and the annual impairment test can be performed at any time during the year provided that it is performed at the same time each year. Goodwill shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Examples of such events or circumstances include (paragraph 28, SFAS No. 142):

- A significant adverse change in legal factors or in the business climate.
- An adverse action or assessment by a regulator.
- Unanticipated competition.
- A loss of key personnel.
- A more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of. This trigger could occur at an SEC sub-registrant level for intercompany transfers (e.g., a common control transfer of net assets out of one SEC sub-registrant to another consolidated subsidiary of Duke Energy Corporation).
- The testing for recoverability under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," of a significant asset group within a reporting unit.
- Recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

In addition, goodwill must be tested for impairment after a portion of goodwill has been allocated to a portion of a reporting unit to be disposed of.

Following an acquisition, initial annual goodwill impairment testing should be performed within 12 months of the acquisition date. SFAS No. 142, paragraph 26 requires impairment testing to be performed annually, irrespective of the acquisition date. In other words, the initial impairment test for newly recorded goodwill should not be more than 12 months from the acquisition date. For example, Duke Energy's annual goodwill impairment testing is August 31. If an acquisition closes in September, the first goodwill impairment test would occur in the following year on August 31, as long as impairment indicators did not appear prior to that date.

Per paragraph 27 of SFAS No. 142, a detailed determination of the fair value of a reporting unit may be carried forward from one year to the next if all of the following criteria have been met:

- a. "The assets and liabilities that make up the reporting unit have not changed significantly since the most recent fair value determination. (A recent significant acquisition or a reorganization of an entity's segment reporting structure is an example of an event that might significantly change the composition of a reporting unit.)
- b. The most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin.
- c. Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote."

If goodwill and another asset (or asset group) of a reporting unit are tested for impairment at the same time, the other asset (or asset group) shall be tested for impairment before goodwill. For example, if a significant asset group is to be tested for impairment under SFAS No. 144 (thus potentially requiring a goodwill impairment test), the impairment test for the significant asset group would be performed before the goodwill impairment test. If the asset group was impaired, the

impairment loss would be recognized prior to goodwill being tested for impairment. (paragraph 29, SFAS No. 142)

*Goodwill Impairment Testing by a Subsidiary:*

Paragraph 37 of SFAS No. 142 notes that subsidiary goodwill shall be tested for impairment at the subsidiary level using the subsidiary's reporting units. If a goodwill impairment loss is recognized at the subsidiary level, goodwill of the reporting unit or units (at the higher consolidated level) in which the subsidiary's reporting unit with impaired goodwill resides must be tested for impairment if the event that gave rise to the loss at the subsidiary level would more likely than not reduce the fair value of the reporting unit (at the higher consolidated level) below its carrying amount. Only if goodwill of that higher-level reporting unit is impaired would a goodwill impairment loss be recognized at the consolidated level.

*Goodwill Impairment Testing When a Noncontrolling Interest Exists:*

Paragraph 38 of SFAS No. 142 discusses goodwill impairment testing when a noncontrolling interest exists (a noncontrolling interest is sometimes referred to as a minority interest). Goodwill arising from a business combination with a continuing noncontrolling interest shall be tested for impairment using an approach consistent with the approach used to measure the noncontrolling interest at the acquisition date. For example, if goodwill is initially recognized based only on the controlling interest of the parent, the fair value of the reporting unit used in the impairment test should be based on that controlling interest and should not reflect the portion of fair value attributable to the noncontrolling interest. Similarly, the implied fair value of goodwill that is determined in the second step of the impairment test and used to measure the impairment loss should reflect only the parent company's interest in that goodwill.

Note: In December 2007, the FASB issued SFAS No. 141R, which replaces SFAS No. 141, "Business Combinations." SFAS No. 141R retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and that an acquirer be identified for each business combination. This statement also establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling (minority) interests in an acquiree, and any goodwill acquired in a business combination.

After the adoption of SFAS 141(R), noncontrolling interests are recognized in an initial consolidation by an acquirer and measured at acquisition-date fair value. In contrast, under SFAS No. 141 (i.e., prior to revision), any minority (noncontrolling) interests were recognized based on the minority shareholders' interests in the predecessor cost basis of the assets acquired and liabilities assumed.

In a partial acquisition accounted for in accordance with SFAS 141R, an acquirer recognizes and consolidates assets acquired, liabilities assumed, and any noncontrolling interests at 100% of their fair values as of that date (regardless of the acquirer's percentage ownership in the acquiree). As goodwill is calculated as a residual, all goodwill of the acquired business, not just the acquirer's share, is recognized under this "full-goodwill" approach.

Recognized goodwill is allocated between the controlling and noncontrolling interest. Although this allocation is not presented separately on the acquirer's balance sheet, it is necessary so that a goodwill impairment charge recognized in a period following the business combination by an acquirer is appropriately allocated between controlling and noncontrolling interests. The portion of the goodwill initially allocated to the controlling and noncontrolling interests may not be equal to the total recognized goodwill multiplied by the respective ownership percentages in the acquiree (e.g., when the acquirer pays a premium to acquire the controlling interest in the subsidiary).

*Disposal of All or a Portion of a Reporting Unit:*

When a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit shall be included in the carrying amount of the reporting unit in determining the gain or loss on disposal. When

a portion of a reporting unit that constitutes a business is to be disposed of, goodwill associated with that business shall be included in the carrying amount of the business in determining the gain or loss on disposal (a "business" is defined as "a self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors, consisting of (a) inputs, (b) processes applied to those inputs, and (c) resulting outputs that are used to generate revenues"(from paragraph 6, EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business")). The amount of goodwill to be included in that carrying amount shall be based on the relative fair values of the business to be disposed of and the portion of the reporting unit that will be retained. For example, if a business is being sold for \$100 and the fair value of the reporting unit excluding the business being sold is \$300, 25 percent of the goodwill residing in the reporting unit would be included in the carrying amount of the business to be sold.

However, if the business to be disposed of was never integrated into the reporting unit after its acquisition and thus the benefits of the acquired goodwill were never realized by the rest of the reporting unit, the current carrying amount of that acquired goodwill shall be included in the carrying amount of the business to be disposed of. That situation might occur when the acquired business is operated as a stand-alone entity or when the business is to be disposed of shortly after it is acquired. When only a portion of goodwill is allocated to a business to be disposed of, the goodwill remaining in the portion of the reporting unit to be retained shall be tested for impairment in accordance with paragraphs 19–22 (using its adjusted carrying amount). (paragraph 39, SFAS No. 142)

*Equity Method Investments:*

Per paragraph 40 of SFAS No. 142, goodwill recognized on an equity method investment (i.e. the portion of the difference between the cost of an investment and the amount of underlying equity in net assets of an equity method investee) shall not be amortized. However, equity method goodwill shall not be reviewed for impairment in accordance with SFAS No. 142. Equity method investments shall continue to be reviewed for impairment in accordance with paragraph 19(h) of APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." (Refer to Duke Energy's accounting policy titled "Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments, Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)")

*Assigning Goodwill to Reporting Units:*

Paragraphs 34 and 35 of SFAS No. 142 address assigning goodwill to reporting units.

"34. For the purpose of testing goodwill for impairment, *all* goodwill acquired in a business combination shall be assigned to one or more reporting units as of the acquisition date. Goodwill shall be assigned to reporting units of the acquiring entity that are expected to benefit from the synergies of the combination even though other assets or liabilities of the acquired entity may not be assigned to that reporting unit. The total amount of acquired goodwill may be divided among a number of reporting units. The methodology used to determine the amount of goodwill to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. In addition, that methodology shall be consistent with the objectives of the process of assigning goodwill to reporting units described in paragraph 35.

35. In concept, the amount of goodwill assigned to a reporting unit would be determined in a manner similar to how the amount of goodwill recognized in a business combination is determined. An entity would determine the fair value of the acquired business (or portion thereof) to be included in a reporting unit—in essence a "purchase price" for that business. The entity would then allocate that purchase price to the individual assets acquired and liabilities assumed related to that acquired business (or portion thereof). Any excess purchase price is the amount of goodwill assigned to that reporting unit. However, if goodwill is to be assigned to a reporting unit that has not been assigned any of the assets

acquired or liabilities assumed in that acquisition, the amount of goodwill to be assigned to that unit might be determined by applying a "with and without" computation. That is, the difference between the fair value of that reporting unit before the acquisition and its fair value after the acquisition represents the amount of goodwill to be assigned to that reporting unit."

*Deferred Income Taxes:*

Paragraph 30 of SFAS No. 109, "Accounting for Income Taxes," states that deferred income taxes are not recognized for any portion of goodwill for which amortization is not deductible for income tax purposes. Paragraphs 261 and 262 of SFAS No. 109 provide additional guidance for recognition of deferred income taxes related to goodwill when amortization of goodwill is deductible for tax purposes. (paragraph 41, SFAS No. 142)

EITF Issue No. 02-13, "Deferred Income Tax Considerations in Applying the Goodwill Impairment Test in FASB Statement No. 142," reached a consensus on several issues related to deferred income taxes and goodwill impairment. First, when deciding whether to estimate the fair value of a reporting unit based on a purchase or sale in a taxable or nontaxable transaction, it is a matter of judgment that depends on relevant facts and circumstances and must be evaluated carefully on a case-by-case basis. Consideration should be given to assumptions that marketplace participants would incorporate into their estimates of fair value, the feasibility of the assumed structure (including whether the reporting unit could be sold in a nontaxable transaction and whether there are any laws or regulations that could impact the ability to treat the sale as nontaxable) and whether the assumed structure results in the highest economic value to the seller for the reporting unit, including consideration of related tax implications. Second, the issue decided that deferred income taxes should be included in the carrying value of the reporting unit, regardless of whether the fair value of the reporting unit will be determined assuming it would be bought or sold in a taxable or nontaxable transaction. Finally, when estimating the fair value of the reporting unit in Step 1 of the impairment test, the issue determined that an entity should use its existing income tax bases if the assumed structure used to estimate the fair value of the reporting unit was a nontaxable transaction, and it should use new income tax bases if the assumed structure was a taxable transaction.

*Disclosure Requirements:*

The disclosure requirements for the carrying amount of goodwill and for any goodwill impairment loss recognized are as follows (paragraphs 45-47 of SFAS No. 142):

- The changes in the carrying amount of goodwill during the period including:
  - (1) The aggregate amount of goodwill acquired
  - (2) The aggregate amount of impairment losses recognized
  - (3) The amount of goodwill included in the gain or loss on disposal of all or a portion of a reporting unit.
  
- Entities that report segment information in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," shall provide the above information about goodwill in total and for each reportable segment and shall disclose any significant changes in the allocation of goodwill by reportable segment. If any portion of goodwill has not yet been allocated to a reporting unit at the date the financial statements are issued, that unallocated amount and the reasons for not allocating that amount shall be disclosed.
  
- For each goodwill impairment loss recognized, the following information shall be disclosed in the notes to the financial statements that include the period in which the impairment loss is recognized:
  - A description of the facts and circumstances leading to the impairment
  - The amount of the impairment loss and the method of determining the fair value of the associated reporting unit (whether based on quoted market prices, prices of comparable businesses, a present value or other valuation technique, or a combination thereof)



- If a recognized impairment loss is an estimate that has not yet been finalized, that fact and the reasons therefore and, in subsequent periods, the nature and amount of any significant adjustments made to the initial estimate of the impairment loss.

Unless related to a component of an entity that is being presented as a discontinued operation, a goodwill impairment loss shall be included in income from continuing operations before income taxes, and also reflected in operating income if such a subtotal is presented in the Statement of Operations.

*SEC Form 8-K Reporting Requirements:*

In August 2004, the SEC expanded the number of events that are reportable on Form 8-K to include "material impairments." See the separate Duke Energy policy statement entitled "Form 8-K Requirements and Filing Procedure" for further discussion of this matter.

**Accounting Policy**

Duke Energy evaluates goodwill for potential impairment under the guidance of SFAS No. 142, Goodwill and Other Intangible Assets" (SFAS No. 142). Under this provision, goodwill is subject to an annual test for impairment. Duke Energy has designated August 31 as the date it performs the annual review for impairment for its reporting units. Under the provisions of SFAS No. 142, Duke Energy performs the annual review for goodwill impairment at the reporting unit level, which Duke Energy has determined to be an operating segment or one level below. (See Appendix A for guidance on determining reporting units.) Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Goodwill of a reporting unit shall be tested for impairment at an interim date if the events or circumstances, described in paragraph 28 of SFAS No. 142 (described above) exist. If none of these above certain circumstances or events have occurred, and the three requirements in paragraph 27 of SFAS No. 142 are met, no new impairment assessment need be performed. The business unit shall document that there were no triggering events during the current year and that the requirements of paragraph 27 of SFAS No. 142 were met. This documentation shall be provided in accordance with the established annual testing timetable for the respective reporting unit.

*Recognition and Measurement of an Impairment Loss:*

Impairment testing of goodwill consists of a two-step process. The first step involves a comparison of the determined fair value of a reporting unit with its carrying amount. If the carrying amount of the reporting unit exceeds its fair value, the second step of the process involves a comparison of the fair value and carrying value of the goodwill of that reporting unit. If the carrying value of the goodwill of a reporting unit exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess. Additional impairment tests are performed between the annual reviews if events or changes in circumstances make it more likely than not that the fair value of a reporting unit is below its carrying amount.

See Appendix B for guidance on measuring fair value and the discussion of the valuation considerations in EITF Issue No. 02-13 in the "Deferred Income Taxes" section above. Duke Energy primarily uses a discounted cash flow analysis to determine fair value of a reporting unit. Key assumptions in the determination of fair value include the use of an appropriate discount rate, estimated future cash flows and estimated run rates of operation, maintenance, and general and administrative costs. In estimating cash flows, Duke Energy incorporates expected growth rates, regulatory stability and ability to renew contracts or business franchises as well as other factors into its revenue and expense forecasts.

When a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit shall be included in the carrying amount of the reporting unit in determining the gain or loss on disposal. When a portion of a reporting unit is to be disposed of, a determination shall be made on whether that portion of the reporting unit constitutes a business. If it does constitute a business, the goodwill associated with that business (based on the relative fair values of the business to be disposed of and

the portion of the reporting unit that will be retained) shall be included in the carrying amount of the business in determining the gain or loss on disposal. If however the business to be disposed of was never integrated into the reporting unit after its acquisition and thus the benefits of the acquired goodwill were never realized by the rest of the reporting unit, the current carrying amount of that acquired goodwill shall be included in the carrying amount of the business to be disposed of.

Equity method goodwill shall not be reviewed for impairment in accordance with SFAS No. 142. Equity method investments shall be reviewed for impairment in accordance with paragraph 19(h) of APB Opinion 18, which states that a loss in value of an investment which is other than a temporary decline should be recognized. (Refer to Duke Energy's accounting policy titled "Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments, Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)")

#### *Allocation of Corporate Goodwill to Reporting Units:*

Goodwill shall be assigned to reporting units of the acquiring entity that are expected to benefit from the synergies of the combination even though other assets or liabilities of the acquired entity may not be assigned to that reporting unit. The total amount of acquired goodwill may be divided among a number of reporting units. The methodology used to determine the amount of goodwill to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. In addition, that methodology shall be consistent with the objectives of the process of assigning goodwill to reporting units as determined in a purchase price allocation (purchase business combination).

#### Reporting Requirements – At each quarterly and annual reporting period:

- The aggregate amount of goodwill shall be presented as a separate line item in the balance sheet.
- The aggregate amount of goodwill impairment losses shall be presented as a separate line item in the income statement as part of *income from continuing operations*. A goodwill impairment loss associated with a discontinued operation shall be included (on a net-of-tax basis) within the results of discontinued operations.
- See above for disclosure requirements for the carrying amount of goodwill and for any goodwill impairment loss recognized.

#### Key Terms

Fair value – see discussion in [Appendix B](#) for details around fair value.

Reporting unit – see discussion in [Appendix A](#) for details around reporting unit.

#### Related Links:

[Asset Impairments Reviews for Long-lived Assets \(excluding Goodwill\) and Equity Method Investments, Assets Held for Sale and Discontinued Operations \(SFAS No. 144 and APB No. 18\)](#)

[Form 8-K Requirements and Filing Procedure](#)

[Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters](#)

[Appendix A](#)

[Appendix B](#)



## Duke Energy Accounting Policy Statement

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### Accounting for Intercompany Transactions Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller

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<b>Effective Date:</b>	07/31/2004
<b>Revision Date:</b>	05/15/2009
<b>Reissue Date:</b>	03/31/2008

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#### Outline

- I. Policy Intent/Philosophy
- II. Policy Expectations
- III. Policy Definitions
- IV. Policy Requirements
  - A. Timing
  - B. Dispute Resolution
  - C. Methods for Recording Intercompany Transactions
    - Auto-generating
    - Manual Balancing
    - Automated Crossbill
  - D. Settlements
    - Settlement of Wholly Owned Affiliate Transactions
    - Settlement of Non Wholly Owned Affiliate Transactions
  - E. Accounting for Non-Routine Transactions
  - F. Consolidations/Eliminations
  - G. Account Reconciliations
- V. Roles and Responsibilities
  - A. Corporate Controller
  - B. Business Unit Controllers
  - C. Enterprise Intercompany Process Owner
  - D. Business Unit Intercompany Process Owners
  - E. Seller/Sender and Purchaser/Receiver
- VI. Appendices

#### I. Policy Intent/Philosophy

The Accounting for Intercompany Transactions Policy ("the Policy") was established to define the accounting standards for ensuring the timely, accurate and consistent reconciliation, recording and elimination of intercompany transactions in accordance with U.S. Generally Accepted Accounting Principles ("USGAAP"), including defining:

- roles and responsibilities
- process for dispute resolution
- process for non-routine transactions

For the purpose of this Policy, intercompany transactions are defined as both intra-business unit transactions (transactions within a consolidated business unit) and inter-business unit transactions (transactions between consolidated business units).

Intercompany transactions for the purposes of this Policy include, but are not limited to, the recording of actuals, estimates, accruals, expense/revenue reimbursements, loans, and allocations.

This Policy is applicable to all business units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company").

This Policy is not applicable for investments in unconsolidated domestic and international affiliates that are not controlled by Duke Energy, which are accounted for using the equity method.

## **II. Policy Expectations**

All Business Unit Accounting personnel of Duke Energy involved with the recording of intercompany transactions shall:

- Ensure compliance with the Policy including all appendices and all related policies, standards or procedures referenced in the Policy;
- Make every effort to minimize the possibility of disputes arising from transactions between affiliates by properly documenting all intercompany transactions per the Code of Business Ethics - Accuracy of Books & Records and Reporting Information and Contract Authorization ("COBE").

## **III. Policy Definitions**

**Corporate Controller or his/her designee "Corp Controller"** - defined as the person who is in the role of Controller for Duke Energy Corporation or his/her designee.

**"BU Controller" or his/her designee** - defined as the person(s) who is a Direct Report to the Corporate Controller and is responsible for the accounting of each of the reportable segments of Duke Energy Corporation.

**Enterprise Intercompany Process Owner "Enterprise IPO"** - defined as the person who is in the role of Intercompany Process Owner for all of Duke Energy Corporation and its consolidated subsidiaries.

**Business Unit Intercompany Process Owner "BU IPO"** - defined as the person who is in the role of Intercompany Process Owner for each of the reportable segments of Duke Energy Corporation.

**Seller/Sender Corporate or Business Unit "Seller/Sender"** - defined as the corporate or business unit who is selling the product/service or sending the charge. For intercompany cash sweeps or other cash-related transactions between Duke Energy Corp and any other business unit,

the Corporate Accounting Department will be responsible for all journal entries and all Seller/Sender activities no matter whether Duke Energy Corp is sending or receiving cash.

**Purchaser/Receiver Corporate or Business Unit "Purchaser/Receiver"** - defined as the corporate or business unit who is purchasing the product/service or receiving the charge.

**Monthly and Quarterly Close Calendar "the Calendar"** - defined as the monthly and quarterly schedule of all close related due dates and deadlines distributed by the Corporate Controller's Office of Duke Energy Corporation.

#### **IV. Policy Requirements**

##### **A. Timing**

In accordance with the dates established by the Corporate Controller and distributed in the Calendar,

- o All intercompany transactions shall be recorded
- o All intercompany account balances shall be reconciled and eliminated
- o All intercompany discrepancies shall be resolved

Any intercompany transaction that is not completed in accordance with the dates distributed in the Calendar shall be reported to the Enterprise IPO.

##### **B. Dispute Resolution**

Every effort shall be made to resolve disputed items directly between the Seller/Sender and the Purchaser/Receiver prior to the deadline for recording intercompany transactions distributed in the Calendar. In the event that "actual" transaction amounts cannot be mutually agreed upon (i.e., disputes over quantity and/or pricing), prior to this deadline, the Seller's/Sender's supporting documentation shall be used to record the transaction by both parties in the financial system in order to meet this deadline.

Disputed transactions between affiliates not resolved during the current accounting period shall not be recorded to a deferred account or any other account on the balance sheet or income statement, nor shall the balance be offset against 3rd party balances. These disputed balances (i.e., the difference between the amount recorded to the general ledger by the Seller/Sender and the amount the Purchaser/Receiver believes to be the correct amount billed/received), shall be properly documented in the Intercompany Schedule of Disputed Items and shall be resolved before workday 1 of the following accounting period. (Refer to attached Appendix A- the Intercompany Dispute Resolution Procedure for more details).

Sound business judgment shall be used when resolving disputes. For example, where a third-party statement is the source and is available, it shall be used as the defining document for resolution. If a third-party statement is not available, the parties shall refer to contractual documentation or tariffs as a means for resolution. In cases where one party did not record one side of the transaction, the other party shall provide the supporting documentation for issue resolution.

Intercompany transactions in dispute shall not preclude cash settlement, where required, in accordance with related contractual documentation or tariffs. To reduce time spent processing and reconciling intercompany transactions, the relative value and materiality of the disputed transaction should be considered.

#### C. **Methods for Recording Intercompany Transactions**

When recording intercompany transactions to the general ledger, designated intercompany accounts and one of the following methods shall be used. Also any subsequent reclass entries (for analysis and/or regulatory requirements) shall be recorded using contra accounts. (Refer to attached Appendix B for flowcharts of each method and Appendix C regarding general ledger accounts). Any exceptions to use of the designated intercompany or contra accounts must be approved by the Enterprise IPO prior to recording any entries to the general ledger.

- **Auto-generating**

All intercompany transactions required for recording loans, cash sweeps, or that generate the booking of revenue and generation of a receivable where both affiliates are on the enterprise PeopleSoft ledger may be recorded using the Auto-generating Method. The Auto-generating Method only handles US Dollar denominated transactions; any non US Dollar denominated transactions shall be exempt from using this method. This method automatically generates the Purchaser/Receiver transaction based on the Seller/Sender transaction and is available to all business units within the enterprise PeopleSoft general ledger.

- **Manual Balancing**

Although manual balancing is not the preferred method for recording inter-business unit transactions, manual balancing can be used when deemed necessary. Examples include: intercompany transactions that are required for recording investment/equity, intercompany derivatives, non-U.S. dollar denominated transactions or, in the case where the transaction is with an affiliate who is not on the enterprise-wide PeopleSoft sourced general ledger.

Prior to recording inter-business unit transactions using the manual balancing method, both the Seller/Sender and Purchaser/Receiver must submit a request for approval to the Enterprise IPO. The request shall include the reason for using this method and documentation of the mitigating controls in place to ensure compliance with the Policy. (Refer to attached Appendix D for Manual Balancing Approval Request Form).

- **Automated Crossbill**

All intercompany transactions that are required for recording allocations or expense/revenue transfers between corporate/business units shall be recorded using the Automated Crossbill Method. Allocations or expense/revenue transactions recorded using this method may be recorded to 3rd party accounts rather than designated intercompany accounts as long as individuals responsible for the transaction ensure the propriety of the effect to the consolidated financial statement line items. The PeopleSoft system automatically generates the related receivable or payable to intercompany accounts.

#### D. **Settlements**

All intercompany transactions between affiliates that do not cross country borders, except federal and state taxes payable, shall be settled at least once per quarter (in advance of quarter close), unless otherwise provided in accordance with related contractual

documentation or tariffs. The settlement shall occur either through cash settlement, reclassification to intercompany advances, intercompany notes receivable or payable or reclassification to equity.

All intercompany transactions between affiliates that do cross country borders, must be in cash and shall occur at least once per month, unless otherwise provided in accordance with related contractual documentation or tariffs.

In order to reduce costs associated with transferring cash, intercompany accounts receivable and accounts payable balances shall be netted prior to settling with cash, unless otherwise restricted in related contractual documentation or tariffs or unless previously agreed by both affiliates to settle in gross to facilitate account reconciliation.

- **Settlement of Wholly Owned Affiliate Transactions**

Transactions between affiliates that are **wholly owned** by Duke Energy, and do not cross country borders, are generally not settled in cash unless there is a specific business reason, or contractual obligation to do so. All wholly owned intercompany balances not settled in cash shall be reclassified to the intercompany advance account by the Enterprise IPO, or his/her designee (i.e., prior month balances are reclassified during the current month), except for federal and state taxes payable which shall be reclassified to the intercompany advance account annually. At least once per quarter, the Enterprise IPO will be responsible for reviewing the intercompany advance account of any SEC registrant of Duke Energy to determine whether any of the balances should be converted to a note or equity. The Enterprise IPO shall consult with the BU Controller, Corporate Treasurer's Department, and the Tax Department to evaluate the impacts, if any (i.e., debt/equity ratio, tax, etc.) and will coordinate with the appropriate subject matter experts prior to reclassifying any of the balances. Refer to the Intercompany Funding Policy and Business Unit Capitalization Protocol documentation for additional information.

- **Settlement of Non Wholly Owned Affiliate Transactions**

Where the intercompany transaction is with an affiliate that is not wholly owned by Duke Energy, unless otherwise provided in related contractual documentation or tariff, the transaction shall be settled in cash on a monthly basis. The Enterprise IPO and the BU IPO's will be responsible for monitoring these transactions to determine that settlement has occurred timely and in accordance with related contractual documentation or tariffs and/or the Calendar as appropriate.

**E. Accounting for Non-Routine Transactions**

From time to time the Company may be involved in accounting for major transactions, new accounting guidelines/pronouncements/issues, and significant, non-recurring transactions (e.g. sale of a business). When these situations arise, the BU Controller will be responsible for ensuring the accounting for intercompany transactions is considered and that any identified affiliate transactions are accurately recorded and eliminated during the consolidations processing. Refer to the Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters for additional information.

**F. Consolidations/Eliminations**

All intercompany transactions shall be eliminated within the consolidated financial

statements of Duke Energy in accordance with USGAAP. In order to ensure accurate and timely elimination of all designated intercompany account balances and elimination of intercompany profit, the Intercompany Process Owners will be responsible for reviewing the Intercompany Out of Balance Report and other reports as deemed necessary to ensure the propriety of intercompany balances and the effect of the eliminations on consolidated financial statement line items, and submitting reports to the Corporate and BU Controllers for final review and sign off. (Refer to attached Appendix E for the Eliminations Procedures for more details).

**G. Account Reconciliations**

Account analysis and reconciliations of intercompany accounts shall be performed in accordance with the Account Analysis and Reconciliation Policy. During the reconciliation process, account owners should coordinate with affiliate account owners to ensure accurate account balances.

**V. Roles and Responsibilities**

**A. Corporate Controller**

- Ensure by policy, procedure, review and sign off that all business units are recording intercompany transactions on a timely, accurate and consistent basis;
- Designate an individual who will serve as Enterprise Intercompany Process Owner;
- Establish and enforce a cutoff date for each accounting period for recording, reconciling and eliminating intercompany transactions and resolving any out of balances which will be distributed in the Calendar;
- Address disputed intercompany transactions between business units that remain unresolved after close of workday 1 of the following accounting period and is ultimately responsible for ensuring resolution;
- Perform final review and sign off of monthly Intercompany Schedule of Disputed Balances, Intercompany Out of Balance Report and other reports as deemed necessary to ensure the propriety of intercompany balances and the effect of the eliminations on consolidated financial statement line items;
- Perform general administration of the Policy, including periodic review and update for changes in accounting standards, business conditions and other factors;
- When accounting for non-routine transactions, ensure the accounting for intercompany transactions is considered and that any identified affiliate transactions are accurately recorded and eliminated during the consolidations processing.

**B. Business Unit Controllers**

- Ensure assigned business units are recording intercompany transactions on a timely, accurate and consistent basis and are in compliance with the Policy and all related policies and procedures;
- Designate an individual who will serve as Intercompany Process Owner for assigned business units;
- Understand the legal entity structure for assigned business units and ensure accounting entries are consistent with the legal hierarchy. Refer to the Creation, Dissolution, or Restructuring of Legal Entities & Subsidiaries Policy;
- Ensure disputed intercompany transactions between business units and/or corporate are resolved. If necessary work with the affiliate BU Controller to reach a resolution and record proper transactions by the deadline distributed in the Calendar;



- Perform final review and sign off of monthly Intercompany Schedule of Disputed Balances, Intercompany Out of Balance Report and other reports as deemed necessary to ensure the propriety of intercompany balances and the effect of the eliminations on consolidated financial statement line items for assigned business units;
- When accounting for non-routine transactions, ensure the accounting for intercompany transactions is considered and that any identified affiliate transactions are accurately recorded and eliminated during the consolidations processing.

**C. Enterprise Intercompany Process Owner**

- Ensure each of the BU IPO's are in compliance with the Policy;
- Ensure all disputed balances between affiliates are resolved by maintaining the Intercompany Schedule of Disputed Items and administering the Dispute Resolution Procedure (Refer to attached Appendix A for the Dispute Resolution Procedure);
- Ensure all intercompany balances are accurately and timely eliminated during the consolidations processing by monitoring the Intercompany Out of Balance Report, reviewing other reports as deemed necessary to ensure the propriety of intercompany balances and the effect of the eliminations on consolidated financial statement line items and administering the Eliminations Procedures (Refer to attached Appendix E for the Eliminations Procedures);
- Ensure the BU IPO's facilitate the accurate and timely settlement of all Duke Energy affiliate transactions in accordance with related contractual documentation or tariffs, either through cash settlement, reclassification to intercompany advances, intercompany notes receivable or payable or reclassification to equity;
- Provide training of the Policy to all business unit personnel involved in the recording of intercompany transactions.

**D. Business Unit Intercompany Process Owners**

- Ensure assigned business units are in compliance with the Policy;
- Maintain the Intercompany Schedule of Disputed Items for assigned corporate/business unit and ensure that all disputed items are resolved per the Policy;
- Ensure all intercompany balances are accurately and timely eliminated during the consolidations processing by monitoring the Intercompany Out of Balance Report, reviewing other reports as deemed necessary to ensure the propriety of intercompany balances and the effect of the eliminations on consolidated financial statement line items and administering the Eliminations Procedures for assigned business/corporate units (Refer to attached Appendix E for the Eliminations Procedures);
- Ensure the accurate and timely settlement of all assigned Duke Energy affiliate transactions in accordance with related contractual documentation or tariffs, either through cash settlement, reclassification to intercompany advances, intercompany notes receivable or payable or reclassification to equity.
- Notify the BU IPO of the Seller/Sender business unit and the Enterprise IPO when the Purchaser/Receiver business unit is capitalizing any intercompany transactions

**E. Seller/Sender and Purchaser/Receiver**

- Seller/Sender is responsible for contacting the Purchaser/Receiver by phone, email or any other reasonable method prior to recording intercompany transactions to verify the accuracy and mutual agreement of all charges, volumes, values, and the account chartfields and shall make every effort to resolve any discrepancies prior to recording intercompany transactions to the general ledger. Exceptions by the Seller/Sender in contacting the Purchaser/Receiver prior to recording intercompany transactions may be granted for routine transactions (e.g. allocations) and must be approved in advance by the Enterprise IPO;
- Seller/Sender shall record all intercompany transactions by the deadline as distributed in the Calendar;

- Seller/Sender is responsible for properly documenting all transactions prior to recording journal entries in accordance with The Journal Entry Creation and Approval Requirements for Non-System Generated Journals Policy, which encompasses the Create/ Review guidelines;
  - For intercompany cash sweeps or other cash-related transactions between Duke Energy Corp and any other business unit, the Corporate Accounting Department will be responsible for all journal entries and all Seller/Sender activities no matter whether Duke Energy is sending or receiving cash;
  - Purchaser/Receiver is responsible for reviewing and verifying all charges received and notifying the Seller/Sender of any charges that were not recorded as previously agreed;
  - Purchaser/Receiver is responsible for updating the Intercompany Schedule of Disputed Items and working with the Seller/Sender to ensure all disputed items are resolved by close of workday 1 of the following accounting period.

#### **VI. Appendices:**

- Appendix A - Intercompany Dispute Resolution Procedure
- Appendix B - Methods for Recording Intercompany Transactions
- Appendix C - Intercompany Accounts and Definitions
- Appendix D - Manual Balancing Approval Request Form
- Appendix E - Eliminations and Out of Balance Materiality Procedures
- Appendix F - Investment and Equity Transactions Procedures

#### **Related Links:**

- Intercompany Funding Policy
- Business Unit Capitalization Protocol
- Roles and Responsibilities for Consultation on and Documentation of Significant Accounting Policies
- Account Analysis and Reconciliation Policy
- Creation, Dissolution, or Restructuring of Legal Entities & Subsidiaries Policy
- Journal Entry Creation and Approval Requirements for Non-System Generated Journals Policy
- Reclassification of Realized Income Statement Activity in Consolidation – Net vs. Gross Policy



Duke Energy Accounting Policy Statement

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## Accounting for Loss Contingencies

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<b>Applicability:</b>	Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller
<b>Approval Date:</b>	December 17, 2007
<b>Effective Date:</b>	December 17, 2007
<b>Reissue Date:</b>	December 31, 2008

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### Statement of Purpose and Philosophy

The purpose of this policy is to provide guidelines related to the accounting and disclosure of loss contingencies. Duke Energy is committed to preparing and providing financial information with the utmost integrity. To facilitate this corporate value, the Corporate Controller's Department will approve policies to ensure the accuracy of books and records (as detailed in the Code of Business Ethics).

### Policy Expectations and Scope

All business/corporate units should understand the requirements for accounting and disclosing loss contingencies under U.S. generally accepted accounting principles ("GAAP") and SEC requirements and ensure that these requirements are applied appropriately per this policy. This policy contains a high-level summary of the key requirements of U. S. GAAP as it applies to Duke Energy, including any significant interpretations or policy elections made by Duke Energy, but is not intended to be a substitute for the detail requirements of authoritative GAAP literature for specific issues or matters that may arise. This policy does not address the accounting for income tax contingencies.

This policy does not address the accounting for gain contingencies or insurance recoveries. However, it should be noted that contingent gains generally are not recorded until all uncertainty as to the possible gain is resolved. Contact the Corporate Controller Department if you have any questions regarding contingent gains.

The question of whether it is appropriate to write down the carrying amount of operating assets also is not addressed by this accounting policy. Refer to the accounting policy entitled "Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments, Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)" for accounting guidance related to loss contingencies associated with asset impairments.

This policy is applicable to all business/corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company"). This policy should help ensure consistent application of the accounting for and disclosure of loss contingencies across the consolidated Duke Energy group.

### Materiality

FASB Statements note that, "The provisions of this Statement need not be applied to immaterial items." Accordingly, materiality should be considered when applying this policy. However, materiality must be assessed at the consolidated Duke Energy Corporation level (as well as being assessed at the SEC sub-registrant level), and involves consideration of both quantitative as well as qualitative factors. Any questions regarding materiality should be directed to the Corporate Controller Department.

### **Accountability: Roles and Responsibilities**

#### **Corporate Controller's Department -**

- Maintain an accounting policy for loss contingencies available on the Duke Energy Portal to help ensure that business/corporate units are aware of the criteria for accounting for and disclosure of loss contingencies.
- Accumulate the information necessary to fulfill the Company's periodic reporting obligations (e.g., SEC Forms 10-K and 10-Q).
- Ensure that all necessary disclosures are made in the Company's consolidated financial statements with respect to the policies for accounting for loss contingencies, including any necessary discussion in critical accounting policies.
- As requested, or as the accounting literature changes, provide guidance/assistance to business/corporate units on accounting for loss contingencies.
- Provide guidance on the consideration of materiality as may be requested by the business/corporate units.

#### **Business/Corporate Unit -**

- Communicate, on at least a quarterly basis, with operational management, legal counsel, human resources and others to identify and update the status of contingencies.
- Ensure that contingencies are identified and tracked to support proper accounting treatment and accurate reporting to the Corporate Controller Department. Loss contingencies should be classified in terms of the likelihood of occurrence of the future events that will confirm the loss as probable, reasonably possible, or remote (as defined below).
- Ensure that the accounting for loss contingencies is in accordance with this policy.
- Ensure that discussion in the Company's consolidated financial statements and SEC filings appropriately address the significant loss contingencies disclosed.

### **Standards/Requirements**

This section contains discussion of the following topics:

- Background
- Supporting Guidance
- Accounting Policy:
  - General Principles
  - Other considerations common to Duke Energy
  - Regulatory Considerations
  - Disclosure Requirements

#### **Background**

For accounting purposes, a loss contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to loss (the term *loss* is used for convenience to include many charges against income that are commonly referred to as *expenses* and others that are commonly referred to as *losses*) that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the loss or the incurrence of a liability.

If there is nothing uncertain about the fact that a loss has occurred or a liability has been incurred, there is no loss contingency, and the loss should therefore be recorded.

Examples of loss contingencies that are the subject of this accounting policy include:

- Obligations related to product warranties and product defects
- Pending or threatened litigation
- Actual or possible claims and assessments, including 3<sup>rd</sup> party damages arising from contractual disputes and environmental remediation claims

The primary purposes of this accounting policy is to address the application of the provisions of SFAS No. 5, "Accounting for Loss Contingencies" ("SFAS No. 5"). In addition to contingencies accounted for under SFAS No. 5, the accounting for certain contingencies is governed by other accounting pronouncements, including the following:

Guarantees - At inception of a guarantee (including indemnification), the Company is required to recognize in its balance sheet a liability equal to the fair value for that guarantee irrespective of the likelihood of loss. FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB interpretation No. 34" addresses the accounting for guarantees.

Asset Retirement Obligations ("ARO") - SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143") and FIN 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FAS 143" ("FIN 47") require an entity to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The term *conditional asset retirement obligation* as used in SFAS 143 and FIN 47 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event.

The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. SFAS 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation.

Refer to the accounting policy entitled "Accounting for Regulated Entities (SFAS No. 71)" and related support documents for additional information regarding the accounting for asset retirement obligations.

In addition, separate policies exist for income tax contingencies – see the policies entitled "Accounting for Income Taxes" and "Tax Reserves Policy."

#### Supporting Guidance

This section primarily contains references to, and excerpts from, the most significant or applicable GAAP authoritative literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

The below excerpts from SFAS No. 5 and FASB Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss – An Interpretation of FASB Statement No. 5" ("FIN 14") provide the relevant accounting literature for the accounting for loss contingencies.

SFAS No. 5 contains the following provisions:

For the purpose of this Statement, a contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (hereinafter a "gain contingency") or loss (hereinafter a "loss contingency") to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the

uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability.

An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if BOTH of the following conditions are met: [paragraph 8]

a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.

b. The amount of loss can be reasonably estimated.

#### Disclosure of Loss Contingencies

9. Disclosure of the nature of an accrual made pursuant to the provisions of paragraph 8, and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading.

10. If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.

11. After the date of an enterprise's financial statements but before those financial statements are issued, information may become available indicating that an asset was impaired or a liability was incurred after the date of the financial statements or that there is at least a reasonable possibility that an asset was impaired or a liability was incurred after that date. The information may relate to a loss contingency that existed at the date of the financial statements, e.g., an asset that was not insured at the date of the financial statements. On the other hand, the information may relate to a loss contingency that did not exist at the date of the financial statements, e.g., threat of expropriation of assets after the date of the financial statements or the filing for bankruptcy by an enterprise whose debt was guaranteed after the date of the financial statements. In none of the cases cited in this paragraph was an asset impaired or a liability incurred at the date of the financial statements, and the condition for accrual in paragraph 8(a) is, therefore, not met. Disclosure of those kinds of losses or loss contingencies may be necessary, however, to keep the financial statements from being misleading. If disclosure is deemed necessary, the financial statements shall indicate the nature of the loss or loss contingency and give an estimate of the amount or range of loss or possible loss or state that such an estimate cannot be made. Occasionally, in the case of a loss arising after the date of the financial statements where the amount of asset impairment or liability incurrence can be reasonably estimated, disclosure may best be made by supplementing the historical financial statements with pro forma financial data giving effect to the loss as if it had occurred at the date of the financial statements. It may be desirable to present pro forma statements, usually a balance sheet only, in columnar form on the face of the historical financial statements.

FIN 14 has the following interpretation of the provisions of paragraph 8 of SFAS No. 5:

When condition (a) in paragraph 8 [of SFAS No. 5] is met with respect to a particular loss contingency and the reasonable estimate of the loss is a range, condition (b) in paragraph 8 is met and an amount shall be accrued for the loss. When some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.<sup>4</sup> In addition, paragraph 9 of the Statement may require disclosure of the nature and, in some circumstances, the amount accrued, and paragraph 10 requires disclosure of the nature of the contingency and the additional exposure to loss if there is at least a reasonable possibility of loss in excess of the amount accrued.

<sup>4</sup> Even though the minimum amount in the range is not necessarily the amount of loss that will be ultimately determined, it is not likely that the ultimate loss will be less than the minimum amount.

SEC Staff Accounting Bulletin No. 92, "Accounting and Disclosures Relating to Loss Contingencies" ("SAB 92") provides the following accounting and disclosure guidance:

#### F. Presentation of Liabilities for Environmental Costs

*Facts:* A public utility company determines that it is obligated to pay material amounts as a result of an environmental liability. These amounts may relate to, for example, damages attributed to clean-up of hazardous wastes, reclamation costs, fines, and litigation costs.

*Question 1:* May a rate-regulated enterprise present on its balance sheet the amount of its estimated liability for environmental costs net of probable future revenue resulting from the inclusion of such costs in allowable costs for rate-making purposes?

*Interpretive Response:* No. *Statement of Financial Accounting Standards No. 71*, "Accounting for the Effects of Certain Types of Regulation," ("SFAS 71") specifies the conditions under which rate actions of a regulator can provide reasonable assurance of the existence of an asset. The staff believes that environmental costs meeting the criteria of paragraph 9 of SFAS 71 should be presented on the balance sheet as an asset and should not be offset against the liability. Contingent recoveries through rates that do not meet the criteria of paragraph 9 should not be recognized either as an asset or as a reduction of the probable liability.

*Question 2:* May a rate-regulated enterprise delay recognition of a probable and estimable liability for environmental costs which it has incurred at the date of the latest balance sheet until the regulator's deliberations have proceeded to a point enabling management to determine whether this cost is likely to be included in allowable costs for rate-making purposes?

*Interpretive Response:* No. *SFAS No. 5*, "Accounting for Contingencies," states that an estimated loss from a loss contingency shall be accrued by a charge to income if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. The staff believes that actions of a regulator can affect whether an incurred cost is capitalized or expensed pursuant to SFAS 71, but the regulator's actions cannot affect the timing of the recognition of the liability.

AICPA Statement of Position 96-1, "Environmental Remediation Liabilities" ("SOP 96-1") contains accounting and disclosure guidance for accounting for environmental contingent liabilities.

Finally, in preparing loss contingencies disclosures, it is important to consider the guidance in the SEC Staff Accounting Bulletin Topic 5.Y., "Miscellaneous Accounting - Accounting and Disclosures Relating to Loss Contingencies."

See below for further discussion.

## **Accounting Policy**

### **General principles**

In determining whether an accrual is required for a loss contingency, it is first necessary to assess the outcome of the contingency in terms of the likelihood of occurrence of the future event or events that will confirm the loss. SFAS No. 5 uses three terms in discussing the likelihood of occurrence:

- Probable – the future event or events are likely to occur.
- Reasonably possible – the chance of the future event or events occurring is more than remote but less than likely.
- Remote – the chance of the future event or events occurring is slight.

If (a) it is probable that a loss will result from a contingency, and (b) the amount of the loss can be reasonably estimated, the estimated loss is accrued by a charge to income, absent regulatory accounting treatment. Both conditions must be met if a loss contingency is to be accrued.

If the above condition (a) is met with respect to a particular loss contingency and the reasonable estimate of the loss is a range, then condition (b) is also met and an amount shall be accrued for the loss. If some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. However, if no amount within the range is a better estimate than any other amount, the minimum amount in the range shall be accrued.

### **Probability of Loss Contingencies**

To determine the probability of loss contingencies, each identified contingency is classified as probable, reasonably possible, or remote. Duke Energy has historically used a threshold of approximately 70-80% to represent "probable." No specific percentage thresholds have been used for "remote," but such percentage would likely be at or below a 10% threshold. Because

management judgment is extremely important to this decision, loss contingencies are often discussed with operational management. The assessment of the probabilities of contingencies should be performed, supported and approved on a quarterly basis (at a minimum).

Many contingencies (e.g., legal, environmental, asbestos exposure) require the involvement of non-financial personnel who focus on, or specialize in, the applicable area. Periodic communication of significant matters with the appropriate representatives of the Corporate Controller Department is required. In addition, as appropriate, input should be provided by the Corporate Controller's Department regarding the appropriate application and interpretation of GAAP to such contingencies.

#### Amount of Range for Each Contingency

In many instances, the amount of the contingency is relatively easy to determine; for example, a commitment for a certain amount has been made or a legal action has been taken seeking a certain amount. In other instances, a single amount cannot be estimated, but a range of amounts can be determined; for instance, a settlement is being negotiated and management believes the liability will be at least one amount but could reach anywhere up to a higher amount. The estimate of the exposures for contingencies should be performed in conjunction with the probability review prescribed in the preceding section.

#### Consideration of Potential Law Changes

Future laws or changes in laws should not be anticipated for purposes of accruing a liability in accordance with SFAS No. 5. Prior to enactment of a law, uncertainty exists as to the specific content of the final law. Substantive changes to the law may materially impact the nature, timing, and extent of resources a company will be required to expend. Liabilities should be accounted for based on the provisions of enacted laws on a country-by-country basis.

#### Recording and Disclosure of Loss Contingencies

If a loss contingency is probable and the amount can be reasonably estimated, then a contingent liability must be recorded. If it is probable that an unasserted claim or assessment will be made and probable that the outcome will be unfavorable, accrual is necessary if the amount can be reasonably estimated, just as with an asserted claim. When some amount within a range appears to be a better estimate than any other amount within the range, that amount shall be accrued. Otherwise, the minimum amount of that range should be accrued (even though the minimum amount in the range is not necessarily the amount of loss that will be ultimately determined, it is not likely that the ultimate loss will be less than the minimum amount).

If the likelihood of occurrence of a loss contingency is reasonably possible, then certain financial disclosures must be made, even though the amount is not recorded.

#### Accounting for Legal Fees

In making a determination of the amount to accrue for a loss contingency involving litigation, a question arises as to whether expected legal fees related to the litigation should be accrued when the loss contingency is initially recorded, or when the legal services are actually provided. Currently, there is no authoritative accounting guidance with respect to this question. The SEC staff has not codified guidance as to which method, accrue in advance for future legal fees or expense legal fees as incurred, is required, but rather has indicated its expectation of disclosure and consistent application of an entity's historical policy.

As indicated in our financial statement disclosure of significant accounting policies, Duke Energy expenses legal costs related to the defense of loss contingencies as incurred.

#### Subsequent Events



If the conditions for accrual of a loss contingency are satisfied on the basis of information which becomes available subsequent to the date of the financial statements, but before issuance of such statements, the charge to income should be recorded in the period covered by the yet-to-be-released financial statements. With respect to loss contingencies, a distinction is made between two types of subsequent events:

1. Should be accrued at the balance sheet date: The first type of subsequent events consists of those events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.
2. Should not be accrued at the balance sheet date: The second type of subsequent events consists of those events that provide evidence with respect to conditions that did not exist at the date of the balance sheet being reported on but arose subsequent to that date. These events should not result in adjustment of the financial statements. Some of these events, however, may be of such a nature that disclosure of them is required to keep the financial statements from being misleading.

#### Discounting of Contingent Liabilities

When a contingent liability or recovery is recognized, settlement of the liability or receipt of the recovery may not be expected to occur within one year. In those situations, it may be appropriate to consider whether the contingent liability or recovery should be discounted to reflect its present value.

Authoritative guidance surrounding appropriate circumstances in which payables can be discounted is found in APB Opinion No. 21, "Interest on Receivables and Payables" ("APB 21"). Principles discussed in APB 21 are "applicable to...payables which represent...contractual obligations to pay money on fixed or determinable dates, whether or not there is any stated provision for interest." However, specifically exempted from present-value techniques are those payables arising from transactions with customers or suppliers in the normal course of business that are due in accordance with customary trade terms, not exceeding approximately one year. Further, APB 21 does not specifically address discounting of liabilities related to loss contingencies.

While SOP 96-1 specifically addresses environmental remediation liabilities, its guidance also is useful in evaluating whether discounting is appropriate for similar loss contingencies. Paragraph 132 of SOP 96-1 states, in part:

The measurement of the liability, or of a component of the liability, may be discounted to reflect the time value of money if the aggregate amount of the liability or component and the amount and timing of cash payments for the liability or component are fixed or reliably determinable.

The SEC has provided guidance with respect to discounting claims liabilities related to short-duration insurance contracts, noting in SEC Staff Accounting Bulletin Topic 5.N., "Discounting by Property-Casualty Insurance Companies" that:

The staff is aware of efforts by the accounting profession to assess the circumstances under which discounting may be appropriate in financial statements. Pending authoritative guidance resulting from those efforts however, the staff will raise no objection if a registrant follows a policy for GAAP reporting purposes of discounting liabilities with respect to settled claims under the following circumstances:

- The payment pattern and ultimate cost are fixed and determinable on an individual claim basis, and
- The discount rate used is reasonable on the facts and circumstances applicable to the registrant at the time the claims are settled.

By analogy to the above guidance, discounting of a contingent liability is permitted, but not required, if both the timing and amounts of future cash flows are fixed or reliably determinable. Achievement of the "reliably determinable" threshold is based on objective and verifiable information. It is often difficult to meet the criteria for discounting, as the measurement of many contingent liabilities is

inherently subjective. This is especially true in the early phases of litigation and environmental remediation efforts.

Generally, an entity is not required to discount its contingent liabilities. As such, whether an entity discounts its contingent liabilities is a matter of accounting policy, assuming certain conditions are met. Our accounting policy is to not discount contingent liabilities to reflect the time value of money, except under the following circumstances:

- The effects of estimated future inflation are recognized,
- The timing of payments is fixed or reasonably estimable, and
- The computation of the gross liability is objective and verifiable.

#### Use of Recorded Contingent Liabilities

Once a contingent liability is recorded, it should only be used for expenditures for which it was originally recognized.

#### Environmental Remediation Costs

Like other contingent liabilities, costs for environmental assessment and remediation are to be accrued when such costs are probable and reasonably estimable. However, due to extensive regulations and inherent uncertainties in this area, specific accounting principles have been developed and are found in SOP 96-1. A summary of the key principles for accounting for environmental remediation liabilities is provided below.

The guidance in SFAS No. 5 provides the framework for determining when an environmental liability should be recognized. SFAS No. 5 requires accrual of a loss contingency when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. An entity's liability for environmental remediation generally is not fixed nor is an actual amount determinable at a specific point in time. Rather, the existence and amount of the liability become known over a continuum of events and activities that help frame, define, verify, and quantify the liability.

According to SOP 96-1, the probability criterion in SFAS No. 5 is met for environmental liabilities if both of the following conditions have occurred on or before the date the financial statements are issued:

- Litigation, a claim, or an assessment has been asserted, or is probable of being asserted.
- It is probable that the outcome of such litigation, claim, or assessment will be unfavorable.

With respect to environmental remediation liabilities, there is a presumption that the outcome will be unfavorable if litigation, a claim, or an assessment has been asserted (e.g., the entity has been named as a Potentially Responsible Party or "PRP"), or is probable of assertion, and if the entity is associated with the site (e.g., by virtue of being a current or past owner or operator or a transporter of hazardous waste to the site). Assuming that both of the above conditions are met, the entity would need to accrue at least the minimum amount that can reasonably be estimated as an environmental remediation liability.

Once it has determined that it is probable that a liability has been incurred, the remediation liability should be estimated based on available information and recognition of some amount of liability, if estimable, is likely to be required. This would include the allocable share of an environmental remediation liability when there are several PRPs and its share of amounts related to the site that will not be paid by other PRPs or the government. Recoveries of environmental remediation costs to be paid may be claimed from several different parties, including insurers, other PRPs, and governmental or third-party funds. An asset relating to recoveries only can be recognized when realization of the claim for recovery is deemed probable. According to SOP 96-1, if a claim for recovery is the subject of litigation, a rebuttable presumption exists that realization of the claim is not probable. An environmental liability should be evaluated independently from any potential claim for recovery.

Discounting an insurance claim is not required in determining the value of the recovery when the related liability is not discounted and the timing of the recovery is dependent on the timing of the payment of the liability.

### **Regulatory Considerations**

In SFAS No. 71, paragraph 9, the FASB put forth certain requirements for regulated entities, which if met, results in the recognition of a regulatory asset.

9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred costs that would otherwise be charged to expense if both of the following criteria are met (<sup>6</sup> An *incurred cost* is "a cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for"):
- a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
  - b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

If at any time the incurred cost no longer meets the above criteria, that cost shall be charged to earnings.

Thus, in certain instances in which a contingent loss is recorded related to Duke Energy's regulated operations (e.g., Duke Energy Carolinas), it may be appropriate for a regulatory asset to be recognized pursuant to SFAS No. 71. For further guidance, refer to the accounting policy entitled "Accounting for Regulated Entities (SFAS No. 71)."

### **Disclosure Requirements**

#### Accrued Loss Contingencies

For an accrued loss contingency, disclosure of the following may be necessary for the financial statements not to be misleading:

1. The nature of the accrual, and
2. In some circumstances, the amount of the accrual.

#### Loss Contingencies Not Accrued

For a loss contingency that is not accrued because one or both conditions for accrual are not met, or if an exposure to loss exists in excess of the amount accrued, the following disclosures are required when there is at least a reasonable possibility that a loss or an additional loss may have been incurred:

1. The nature of the contingency, and
2. An estimate of the possible loss or range of loss, or a statement that an estimate cannot be made.

An unasserted claim or assessment need not be disclosed when there has not been any manifestation by a potential claimant of an awareness of a possible claim or assessment unless (a) it is considered probable that a claim will be asserted and (b) there is a reasonable possibility of an unfavorable outcome.

Finally, in preparing loss contingencies disclosures, it is important to consider the guidance in the SEC Staff Accounting Bulletin Topic 5.Y., "Miscellaneous Accounting - Accounting and Disclosures Relating to Loss Contingencies."

Disclosure requirements for guarantees and commitments are not addressed in the policy.

**Related Links:**

Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters

Accounting for Derivative Instruments and Hedging Activities

Accounting for Regulated Entities (SFAS No. 71)

Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments, Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)

Accounting for Income Taxes

Tax Reserves Policy



## Duke Energy Accounting Policy Statement

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### Accounting for Regulated Entities (SFAS No. 71)

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller

<b>Effective Date:</b>	12/01/2004
<b>Revision Date:</b>	12/09/2004
<b>Reissue Date:</b>	12/31/2008

### Index

### **Statement of Purpose and Philosophy**

The purpose of this policy is to provide guidelines related to the accounting and disclosures of regulated entities under SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," ("SFAS No. 71") and other related accounting pronouncements. Duke Energy is committed to preparing and providing financial information with the utmost integrity. To facilitate this corporate value, the Corporate Controller's Department will approve policies to ensure the accuracy of books and records (as detailed in the Code of Business Ethics).

Accounting references have been provided for much of the Accounting Policy discussion. For additional accounting references including interpretations, see [Accounting Policy Support](#).

### **Policy Expectations and Scope**

This policy is applicable to all business/corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company") which have cost-based regulated operations. This policy contains a high-level summary of the key requirements of U. S. generally accepted accounting principles ("GAAP") as it applies to Duke Energy, including any significant interpretations or policy elections made by Duke Energy, but is not intended to be a substitute for consulting with the detail requirements of authoritative GAAP literature for specific issues or matters that may arise. This policy should help ensure consistent application of the accounting rules for regulated entities across the consolidated Duke Energy group.

### **Materiality**

FASB Statements note that "The provisions of this Statement need not be applied to immaterial items." Accordingly, materiality should be considered when applying this policy. However, materiality must be assessed at the consolidated Duke Energy Corporation level (as well as being assessed at the SEC sub-registrant level), and involves consideration of both quantitative as well as qualitative factors. Any questions regarding materiality should be directed to the Corporate Controller's Department.

### **Accountability: Roles and Responsibilities**

#### Corporate Controller's Department –

- Maintain an accounting policy for accounting for regulated entities available on the Duke Energy portal to help ensure that business/corporate units are aware of the criteria/applicability of applying the provisions of SFAS No. 71 and other related accounting pronouncements for cost-based rate regulated entities.
- Provide guidance/assistance to business units/regulatory accounting on the application of SFAS No. 71 and related authoritative literature.
- Establish and communicate the reporting timetable for regulatory accounting information needed for SEC filings and accumulate the information reported by the applicable regulated entities for periodic reporting and disclosure purposes (e.g., Form 10-K, Form 10-Q, etc.).

## Accounting for Regulated Entities (SFAS No. 71)

- Provide guidance on the consideration of materiality as may be requested by the business/corporate units.

### Business Unit/Regulatory Accounting –

- Ensure all reporting requirements for regulated entities are accumulated and reported to the Corporate Controller's Department in accordance with the established reporting timetable.
- Ensure proper support/documentation exists for all regulatory assets/liabilities.
- Ensure proper support exists for continued application of SFAS No. 71 at each balance sheet date, if applicable.
- Document discontinuance of SFAS No. 71 when it is appropriate for any portion of their business.
- In periods subsequent to the discontinuance of SFAS No. 71, monitor legislative and regulatory actions to determine if SFAS No. 71 should be reapplied.
- Monitor all regulatory assets for recoverability.
- Monitor all regulatory liabilities for continued propriety under SFAS No. 71.
- Ensure proper calculation of the Allowance for Funds Used During Construction ("AFUDC").

### Standards/Requirements/Background Information

This section primarily contains references to, and excerpts from, the most significant or applicable GAAP authoritative literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

#### Standards

Guidance on accounting for regulated entities is provided primarily but not exclusively by the following:

- SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation"
- SFAS No. 90, "Regulated Enterprises – Accounting for Abandonments and Disallowance of Plant Costs – An Amendment of FASB Statement No. 71"
- SFAS No. 92, "Regulated Enterprises – Accounting for Phase-in Plans – An Amendment of FASB Statement No 71"
- SFAS No. 101, "Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No. 71"
- SFAS No, 109, "Accounting for Income Taxes"
- EITF 90-8, "Capitalization of Costs to Treat Environmental Contamination"
- EITF 92-07, "Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue programs"
- EITF 93-4, "Accounting for Regulatory Assets"
- EITF 97-04, "Deregulation of the Pricing of Electricity – Issues Related to the Application of FASB Statement No. 71 and No. 101"
- SEC Staff Accounting Bulletin ("SAB") Topic 10, "Utility Companies"
- Current Text Section Re6, "Regulated Operations"

#### Background–

Per SFAS No. 101, "Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No. 71":

41. .... The application of Statement 71, as amended, is not optional. An enterprise's operations that meet the criteria for application of Statement 71 are required to be reported consistent with Statement 71, and an enterprise whose operations cease to meet the criteria for application of Statement 71 is required to discontinue application of Statement 71 as prescribed in this Statement.

In December 1982, the Financial Accounting Standards Board (FASB) issued SFAS No. 71. Per SFAS No. 71,

#### Summary –

## Accounting for Regulated Entities (SFAS No. 71)

In general, the type of regulation covered permits rates (prices) charged to customers to be set at levels intended to recover the estimated costs of providing regulated services or products, including the cost of capital (i.e., interest costs and a provision for earnings on shareholders' investments).

For a number of reasons, revenues intended to cover some costs may be collected through rates either before or after the costs are actually incurred. If regulation provides assurance that incurred costs will be recovered in the future, this Statement requires entities to capitalize those costs. If current recovery is provided for costs that are expected to be incurred in the future, this Statement requires entities to recognize those current receipts as liabilities.

### Introduction –

1. Regulation of an enterprise's prices (hereinafter referred to as *rates*) is sometimes based on the enterprise's costs. Regulators use a variety of mechanisms to estimate a regulated enterprise's allowable costs,<sup>1</sup> and they allow the enterprise to charge rates that are intended to produce revenue approximately equal to those allowable costs. Specific costs that are allowable for rate-making purposes result in revenue approximately equal to the costs.

<sup>1</sup> The term *allowable costs* is used throughout this Statement to refer to all costs for which revenue is intended to provide recovery. Those costs can be actual or estimated. In that context, allowable costs include interest cost and amounts provided for earnings on shareholders' investments.

2. In most cases, allowable costs are used as a means of estimating costs of the period during which the rates will be in effect, and there is no intent to permit recovery of specific prior costs. The process is a way of setting prices—the results of the process are reported in general-purpose financial statements in accordance with the same accounting principles that are used by unregulated enterprises.

3. Regulators sometimes include costs in allowable costs in a period other than the period in which the costs would be charged to expense by an unregulated enterprise. That procedure can create assets (future cash inflows that will result from the rate-making process), reduce assets (reductions of future cash inflows that will result from the rate-making process), or create liabilities (future cash outflows that will result from the rate-making process) for the regulated enterprise. For general-purpose financial reporting, an incurred cost for which a regulator permits recovery in a future period is accounted for like an incurred cost that is reimbursable under a cost-reimbursement-type contract.

4. Accounting requirements that are not directly related to the economic effects of rate actions may be imposed on regulated businesses by orders of regulatory authorities and occasionally by court decisions or statutes. This does not necessarily mean that those accounting requirements conform with generally accepted accounting principles. For example, a regulatory authority may order an enterprise to capitalize<sup>2</sup> and amortize a cost that would be charged to income currently by an unregulated enterprise. Unless capitalization of that cost is appropriate under this Statement, generally accepted accounting principles require the regulated enterprise to charge the cost to income currently.

<sup>2</sup> *Capitalize* is used in this Statement to indicate that the cost would be recorded as the cost of an asset. That procedure is often referred to as "deferring a cost," and the resulting asset is sometimes described as a "deferred cost."

### Scope –

5. This Statement applies to general-purpose external financial statements of an enterprise that has regulated operations that meet all of the following criteria:

a. The enterprise's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.<sup>3</sup>

<sup>3</sup> (footnote omitted)

b. The regulated rates are designed to recover the specific enterprise's costs of providing the regulated services or products.

## Accounting for Regulated Entities (SFAS No. 71)

c. In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the enterprise's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs.

6. If some of an enterprise's operations are regulated and meet the criteria of paragraph 5, this Statement shall be applied to only that portion of the enterprise's operations.

7. Authoritative accounting pronouncements that apply to enterprises in general also apply to regulated enterprises. However, enterprises subject to this Statement shall apply it instead of any conflicting provisions of standards in other authoritative pronouncements.<sup>4</sup>

<sup>4</sup> For example, a regulator might authorize a regulated enterprise to incur a major research and development cost because the cost is expected to benefit future customers. The regulator might also direct that cost to be capitalized and amortized as an allowable cost over the period of expected benefit. If the criteria of paragraph 9 of this Statement were met, the enterprise would capitalize that cost even though FASB Statement No. 2, *Accounting for Research and Development Costs*, requires such costs to be charged to income currently. Statement 2 would still apply to accounting for other research and development costs of the regulated enterprise, as would the disclosure requirements of Statement 2.

### General Standards of Accounting for the Effects of Regulation –

9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset.<sup>4a</sup> An enterprise shall capitalize all or part of an incurred cost<sup>5</sup> that would otherwise be charged to expense if both of the following criteria are met:

<sup>4a</sup> Costs of abandoned plants shall be accounted for in accordance with paragraphs 3-6 of FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs*. Phase-in plans shall be accounted for in accordance with FASB Statement No. 92, *Regulated Enterprises—Accounting for Phase-in Plans*.

<sup>5</sup> An *incurred cost* is "a cost arising from cash paid out or obligation to pay for an acquired asset or service, a loss from any cause that has been sustained and has been or must be paid for" (Eric L. Kohler, *A Dictionary for Accountants*, 5th ed. [Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1975], p. 253).

a. It is probable<sup>6</sup> that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

<sup>6</sup> The term *probable* is used in this Statement consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*. Statement 5 defines *probable* as an area within a range of the likelihood that a future event or events will occur. That range is from probable to remote, as follows:

*Probable.* The future event or events are likely to occur.

*Reasonably possible.* The chance of the future event or events occurring is more than remote but less than likely.

*Remote.* The chance of the future event or events occurring is slight.

b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

If at any time the incurred cost no longer meets the above criteria, that cost shall be charged to earnings.

10. Rate actions of a regulator can reduce or eliminate the value of an asset. If a regulator excludes all or part of a cost from allowable costs, the carrying amount of any asset recognized pursuant to paragraph 9 of this Statement shall be reduced to the extent of the excluded cost. Whether other assets have been impaired shall be judged the same as for enterprises in general<sup>6a</sup> and FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* shall apply.

<sup>6a</sup> Disallowances of costs of recently completed plants, whether direct or indirect, shall be accounted for in accordance with paragraph 7 of Statement 90.



## Accounting for Regulated Entities (SFAS No. 71)

10A. If a regulator allows recovery through rates of costs previously excluded from allowable costs, that action shall result in recognition of a new asset. The classification of that asset shall be consistent with the classification that would have resulted had those costs been initially included in allowable costs.

11. Rate actions of a regulator can impose a liability on a regulated enterprise. Such liabilities are usually obligations to the enterprise's customers. The following are the usual ways in which liabilities can be imposed and the resulting accounting:

a. A regulator may require refunds to customers.<sup>7</sup> Refunds that meet the criteria of paragraph 8 (accrual of loss contingencies) of FASB Statement No. 5, *Accounting for Contingencies*, shall be recorded as liabilities and as reductions of revenue or as expenses of the regulated enterprise.

<sup>7</sup> Refunds can be paid to the customers who paid the amounts being refunded; however, they are usually provided to current customers by reducing current charges.

b. A regulator can provide current rates intended to recover costs that are expected to be incurred in the future with the understanding that if those costs are not incurred future rates will be reduced by corresponding amounts. If current rates are intended to recover such costs and the regulator requires the enterprise to remain accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose,<sup>8</sup> the enterprise shall not recognize as revenues amounts charged pursuant to such rates. Those amounts shall be recognized as liabilities and taken to income only when the associated costs are incurred.

<sup>8</sup> The usual mechanism used by regulators for this purpose is to require the regulated enterprise to record the anticipated cost as a liability in its regulatory accounting records.

c. A regulator can require that a gain or other reduction of net allowable costs be given to customers over future periods. That would be accomplished, for rate-making purposes, by amortizing the gain or other reduction of net allowable costs over those future periods and reducing rates to reduce revenues in approximately the amount of the amortization. If a gain or other reduction of net allowable costs is to be amortized over future periods for rate-making purposes, the regulated enterprise shall not recognize that gain or other reduction of net allowable costs in income of the current period. Instead, it shall record it as a liability for future reductions of charges to customers that are expected to result.

12. Actions of a regulator can eliminate a liability only if the liability was imposed by actions of the regulator.

78. If rates are designed to be adjusted automatically for changes in operating expenses (e.g., costs of purchased fuel), the regulator's intent could be either to permit recovery of the incurred cost or merely to provide for recovery of similar future costs. Normal operating expenses such as fuel costs usually are provided for in current rates. In that case, the presumption is that the rate increase is intended to permit recovery of similar future costs. That presumption, which would preclude capitalizing the incurred cost, can be overcome only if it is clear that the regulator's intent is to provide recovery of the incurred cost.

79. Rate actions of a regulator can also impose a liability on a regulated enterprise in the following ways:

a. A regulator can order a regulated enterprise to refund previously collected revenues.

b. A regulator can provide rates intended to recover costs that are expected to be incurred in the future. Paragraphs 38 and 39 illustrate that possibility. The resulting increased charges to customers are liabilities and not revenues for the enterprise—the enterprise undertakes to provide the services for which the increased charges were collected, and it is obligated to return those increased charges if the future cost does not occur. The obligation will be fulfilled either by refunding the increased charges through future rate reductions or by paying the future costs with no corresponding effect on future rates. The resulting increases in charges to customers are unearned revenues until they are earned by their use for the intended purpose.

c. For rate-making purposes, a regulator can recognize a gain or other reduction of overall allowable costs over a period of time. Paragraphs 35-37 illustrate that possibility. By that action, the regulator obligates the enterprise to give the gain or other reduction of overall allowable costs to customers by reducing future rates. Accordingly, the amount of the gain or cost reduction is the appropriate measure of the obligation.

## Accounting for Regulated Entities (SFAS No. 71)

### Accounting Policy

The following topics are discussed in this section

1. Abandonments (SFAS No. 90 "Regulated Enterprises – Accounting for Abandonments and Disallowance of Plant Costs – An Amendment of FASB Statement No. 71")
2. Accrued Compensated Absences (e.g. Vacation)
3. Allowance for Funds Used During Construction or "AFUDC"
4. Asset Retirement Obligations (ARO)
5. Current Assets and Current Liabilities
6. Debt issuance costs
7. Disallowances of Plant Costs
8. Discontinuation of Application of SFAS No. 71
9. Emission Allowances
10. Impairments
11. Income Taxes and Investment Tax Credit for Regulated Entities
12. Incurred Costs vs. Allowable Costs
13. Intercompany Profit
14. Mark-to-market results for certain derivative instruments under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"
15. Major Maintenance
16. Net Regulatory Asset Related to Income Taxes
17. Net Revenues - ISO-RTOs
18. Nuclear property and liability reserves
19. Nuclear decommissioning trust fund
20. Pensions and Other Postretirement Benefits
21. Phase-In Plans (SFAS No. 92)
22. Property, Plant and Equipment
23. Rate Changes
24. Reapplication of SFAS No. 71
25. Regulatory Accounting vs. U. S. GAAP
26. Regulatory Assets
27. Regulatory Liabilities
28. Removal Costs
29. Reporting and Disclosure Requirements
30. Unbilled Fuel
31. Unbilled Revenues (meters not read)

#### 1. Abandonments

From SFAS No. 90, "Regulated Enterprises – Accounting for Abandonments and Disallowance of Plant Costs – An Amendment of FASB Statement No. 71");

3. When it becomes probable<sup>1</sup> that an operating asset or an asset under construction will be abandoned, the cost of that asset shall be removed from construction work-in-process or plant-in-service. The enterprise shall determine whether recovery of any allowed cost is likely to be provided with (a) full return on investment during the period from the time when abandonment becomes probable to the time when recovery is completed or (b) partial or no return on investment during that period. That determination should focus on the facts and circumstances related to the specific abandonment and should also consider the past practice and current policies of the applicable regulatory jurisdiction on abandonment situations. Based on that determination, the enterprise shall account for the cost of the abandoned plant as follows:

<sup>1</sup> The term probable is used in this Statement consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*, to mean that a transaction or event is likely to occur.

a. *Full return on investment is likely to be provided.* Any disallowance of all or part of the cost of the abandoned plant that is both *probable* and *reasonably estimable*, as those terms are used in FASB Statement No. 5, *Accounting for Contingencies*, and the related FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, shall be recognized as a loss, and the carrying basis of the recorded asset shall be correspondingly reduced. The remainder of the cost of the abandoned plant shall be reported as a separate new asset.

## Accounting for Regulated Entities (SFAS No. 71)

b. *Partial or no return on investment is likely to be provided.* Any disallowance of all or part of the cost of the abandoned plant that is both *probable* and *reasonably estimable*, as those terms are used in Statement 5 and Interpretation 14, shall be recognized as a loss. The present value of the future revenues expected to be provided to recover the allowable cost of that abandoned plant and return on investment, if any, shall be reported as a separate new asset. Any excess of the remainder of the cost of the abandoned plant over that present value also shall be recognized as a loss. The discount rate used to compute the present value shall be the enterprise's incremental borrowing rate, that is, the rate that the enterprise would have to pay to borrow an equivalent amount for a period equal to the expected recovery period. In determining the present value of expected future revenues, the enterprise shall consider such matters as (1) the probable time period before such recovery is expected to begin and (2) the probable time period over which recovery is expected to be provided. If the estimate of either period is a range, the guidance of Interpretation 14 shall be applied to determine the loss to be recognized. Accordingly, the most likely period within that range shall be used to compute the present value. If no period within that range is a better estimate than any other, the present value shall be based on the minimum time period within that range.

The following discussion is a brief summary of paragraphs 3 of SFAS No. 90. When it becomes probable that an operating plant or plant under construction will be abandoned, the associated cost should be removed from plant-in-service or construction work in progress. A separate, new asset should be established. No loss should be recognized unless it is probable and estimable. Losses should be estimated based on the present value using the incremental borrowing rate of the future revenue stream, if any. Further guidance on accounting for an abandonment can be found in paragraphs 6 and 42-53 of SFAS No. 90 and FASB Technical Bulletin No. 87-2, "Computation of a Loss on an Abandonment".

This accounting should include any plant asset balances related to asset retirement costs recorded under SFAS No. 143, "Accounting for Asset Retirement Obligations".

### 2. Accrued Compensated Absences (e.g. Vacation)

Per SFAS No. 71;

48. Statement 43 specifies criteria for accrual of a liability for employees' compensation for future absences. For rate-making purposes, compensation for employees' absences may be included in allowable costs when the compensation is paid.

49. The liability, if any, would be accrued in accordance with Statement 43 because rate actions of the regulator cannot eliminate obligations that were not imposed by the regulator (paragraph 12). By including the accrued compensation in future allowable costs on an as-paid basis, the regulator provides reasonable assurance of the existence of an asset. The asset is the probable future benefit (increased revenue) that will result from the regulatory treatment of the subsequent payment of the liability (paragraph 9). Accordingly, the enterprise also would record the asset that results from the regulator's actions.

Any liability accrued for compensated absences (e.g. vacation) under SFAS No. 43 related to regulated entities are recorded as a regulatory asset if the requirements of paragraph 9 of SFAS No. 71 are met.

All vacation days that employees are entitled to in the coming year, including personal holidays and unused vacation eligible to be carried over, should be accrued as a liability as of the end of the current year. This policy is consistent with the fact that an employee can come to work on the first day of the calendar, then take time off for their full year's worth of vacation, then return to work and terminate employment without having to reimburse the company for that time off. The recorded liability should include fringe benefits and payroll taxes at the expected loading percentage for the following year.

To the extent the liability is for either the regulated operations of U.S. Franchised Electric & Gas ("USFEG") or for the portion of the service companies that are allocable to the regulated operations, these costs should be deferred in a regulatory asset account. The regulatory asset should reside on the same balance sheet as the associated liability for vacation. Thus, the regulatory asset for the portion of the service company's vacation accrual allocable to regulated operations should reside on the service company's balance sheet.

The regulatory asset for vacation costs should be reported as a current asset. The vacation accrual should be reported as a current liability.

## Accounting for Regulated Entities (SFAS No. 71)

### 3. Allowance for Funds Used During Construction or "AFUDC"

Per SFAS No. 71;

15. In some cases, a regulator requires an enterprise subject to its authority to capitalize, as part of the cost of plant and equipment, the cost of financing construction as financed partially by borrowings and partially by equity. A computed interest cost and a designated cost of equity funds are capitalized, and net income for the current period is increased by a corresponding amount. After the construction is completed, the resulting capitalized cost is the basis for depreciation and unrecovered investment for rate-making purposes. In such cases, the amounts capitalized for rate-making purposes as part of the cost of acquiring the assets shall be capitalized for financial reporting purposes instead of the amount of interest that would be capitalized in accordance with FASB Statement No. 34, *Capitalization of Interest Cost*.<sup>9</sup> Those amounts shall be capitalized only if their subsequent inclusion in allowable costs for rate-making purposes is probable. The income statement shall include an item of other income, a reduction of interest expense, or both, in a manner that indicates the basis for the amount capitalized.

<sup>9</sup> Statement 34 requires capitalization of interest cost on certain qualifying assets. The amount capitalized is the portion of the interest cost incurred during the period that theoretically could have been avoided if the expenditures had not been made.

Per SFAS No. 92;

8. If specified criteria are met, paragraph 9 of Statement 71 requires capitalization of an incurred cost that would otherwise be charged to expense. An allowance for earnings on shareholders' investment<sup>4</sup> is not "an incurred cost that would otherwise be charged to expense." Accordingly, such an allowance shall not be capitalized pursuant to paragraph 9 of Statement 71.

<sup>4</sup> The phrase "an allowance for earnings on shareholders' investment," as used in this Statement, is intended to have the same meaning as the phrase "a designated cost of equity funds," used in paragraph 15 of Statement 71.

9. In specified circumstances, paragraph 15 of Statement 71 requires capitalization of an allowance for earnings on shareholders' investment (a designated cost of equity funds) during construction. Paragraph 5 of this Statement requires capitalization of an allowance for earnings on shareholders' investment for qualifying phase-in plans. If an allowance for earnings on shareholders' investment is capitalized for rate-making purposes other than during construction or as part of a phase-in plan, the amount capitalized for rate-making purposes shall not be capitalized for financial reporting.

67. An AICPA Issues Paper, *Application of Concepts in FASB Statement of Financial Accounting Standards No. 71 to Emerging Issues in the Public Utility Industry*, received by the Board in November 1984, recommended that the Board amend paragraph 9 of Statement 71 to require capitalization of any allowable cost when the criteria of that paragraph are met. Many respondents to the Exposure Draft made the same recommendation. Paragraph 9 requires capitalization only of "an incurred cost that would otherwise be charged to expense." Thus, paragraph 9 does not permit capitalization of an allowance for earnings on shareholders' investment—an allowable cost but not an incurred cost that would otherwise be charged to expense. An allowance for earnings on shareholders' investment provided by a regulator is an imputed cost. Capitalization of that cost would increase currently reported income, a result which some Board members believe is inappropriate. The Board believes that income related to an allowance for earnings on shareholders' investment generally should result from revenue realization, not from capitalization.

Where the regulator allows for such cost inclusion and recovery, AFUDC is generally comprised of two components, commonly referred to as AFUDC borrowed or AFUDC debt and AFUDC equity. Total AFUDC (debt and equity) replaces capitalized interest as determined by SFAS No. 34, "Capitalization of Interest Cost" (see paragraph 9 of SFAS No. 71). AFUDC equity is only allowed to be accrued for GAAP financial statements in the following circumstances: (paragraphs 15 and 82-84 of SFAS No. 71, paragraphs 8, and 64-68 of SFAS No. 90 and paragraphs 8-9, 55-56 and 67-69 of SFAS No. 92)

1. Plant, including nuclear fuel, while under construction (if not included in rate base) NOTE: to the extent plant while under construction is included in rate base, that amount of plant does not accrue AFUDC.

## Accounting for Regulated Entities (SFAS No. 71)

2. As part of a qualifying phase-in plan (see the discussion of "Phase-In Plans" below; this is a highly unlikely circumstance for Duke Energy)

Because the interest component of AFUDC represents an actual cash expense in the form of interest payments, it is included in capital expenditures in the external GAAP Statement of Cash Flows. Although equity returns are eventually converted into payments of cash in the form of dividends, there is no actual cash expense associated with AFUDC equity (the "non-cash" entry to record AFUDC equity is essentially to debit assets and credit income). Therefore, AFUDC equity is not included in capital expenditures in the Statement of Cash Flows. As a non-cash component of income, the equity component of AFUDC is subtracted from net income in arriving at cash flows from operations.

AFUDC equity is an after-tax calculation, and is recorded in the "Other income and expenses, net," in the consolidated statement of operations. The recording of AFUDC Equity in the consolidated statement of operations does not result in the recording of deferred tax expense (resulting in a lowering of the overall effective tax rate for book purposes as there is no income tax expense recorded against the GAAP AFUDC income).

However, deferred tax liability balances (also referred to as accumulated deferred income taxes (ADIT)) will result from book-tax differences. The entry recording ADIT on the component of AFUDC equity that is capitalized is balanced by an equal and offsetting entry to regulatory asset such that the amount of AFUDC equity capitalized as plant plus the associated regulatory asset times the deferred tax rate equals the ADIT recorded.

In the year that the plant including capitalized AFUDC equity is depreciated or amortized, the corresponding depreciation expense of the amortized AFUDC equity does not result in a tax deduction and no deferred tax expense is recorded. Instead, a 'balance sheet' amortization of the ADIT and regulatory asset is recorded. This balance sheet amortization maintains the relationship between plant, regulatory asset and ADIT as previously discussed. As a result, the overall effective tax rate for book purposes is higher than the statutory income tax rate.

AFUDC debt is recorded gross of income tax expense. As a result, deferred tax expense is recorded on the income statement. The amortization of AFUDC debt and equity is presented within depreciation expense or for nuclear fuel, within fuel expense. The amortization of AFUDC debt is presented before tax with an offsetting credit to income (deferred) tax expense.

If the commission has so ordered and the costs are required to be refunded, an AFUDC rate may be applied to regulatory liabilities (instead of an accrual of interest). The accrual of AFUDC also requires a calculation of deferred taxes.

If the commission has so ordered, Duke Energy may accrue AFUDC on other assets for regulatory purposes. For GAAP financial statement purposes, the AFUDC equity component is not recognized. (Revenues billed will include a component for the recovery of AFUDC equity.) If so, the GAAP financial statements will show less income during the initial period of accrual of AFUDC equity than for regulatory purposes and more income during the subsequent period of recovery than for regulatory purposes of the previously accrued AFUDC equity.

If Duke Energy wishes to record AFUDC equity and AFUDC debt after the time the interest expense was initially incurred, confirmation from the regulators of their agreement that such costs are still recoverable is required prior to recording a catch-up entry.

### 4. Asset Retirement Obligations (ARO)

Substantially all the AROs established at the implementation of SFAS No. 143, "Accounting for Asset Retirement Obligations", were for Duke Energy Carolinas's nuclear plants. For rate-making for Duke Energy Carolinas, a component of depreciation expense is recorded for the decommissioning of the contaminated portion of the nuclear plants. The decommissioning of the contaminated portion of the nuclear plants meets the definition of an ARO and therefore a regulatory asset for ARO costs is recorded. The regulatory asset for ARO represents the additional expense that otherwise would have been recorded under SFAS No. 143, "Accounting for Asset Retirement Obligations." Duke Energy Carolinas has received commission orders in NC and SC allowing the Company to set up a regulatory asset.

## Accounting for Regulated Entities (SFAS No. 71)

The company has also accrued AROs for the removal of gas mains, for remediation of landfills at various sites and for Asbestos removal. These AROs are deferred as regulatory assets or regulatory liabilities.

See also the section on Removal Costs.

### 5. Current Assets and Current Liabilities

From Current Text Section B05, "Balance Sheet Classification: Current Assets and Current Liabilities:"

.105 For accounting purposes, the term *current assets* ..... comprehends in general such resources as .... trade accounts, notes, and acceptances receivable; .... installment or deferred accounts and notes receivable if they conform generally to normal trade practices and terms within the business ..... and prepaid expenses such as insurance, interest, rents, taxes, unused royalties, current paid advertising service not yet received, and operating supplies.

.108 The term *current liabilities* is ..... intended to include obligations for items ..... such as payables incurred ..... in providing services to be offered for sale; collections received in advance of the delivery of goods or performance of services".

Current assets and current liabilities, in general, are those assets and liabilities due in one year. However, no portion of regulatory assets or liabilities that are associated with plant (such as the net regulatory assets related to income taxes or the regulatory liability on the gross-up on investment tax credits) are booked as current assets or liabilities.

Within the appropriate line item on the balance sheet, the balances of regulatory assets and liabilities should be grouped by jurisdiction and business unit. Netting should not be done between either jurisdictions or business units. (For example, for a business unit, unbilled fuel can be an asset in one jurisdiction and a liability in another jurisdiction. It would be inappropriate to offset these balances. Likewise, it would be inappropriate to offset a debit and a credit balance for two different business units operating in the same jurisdiction unless the netting requirements of FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts – An Interpretation of APB Opinion No. 10 and FASB Statement No. 105" ("FIN 39") are met.)

Regulatory assets and liabilities for unbilled fuel and the regulatory asset for vacation accrual are recorded as current assets or liabilities.

Refer to the section entitled "Emissions Allowances" for discussion of the appropriate balance sheet classification for certain intangible assets.

### 6. Debt issuance costs

Per SFAS No. 71,

#### **Early Extinguishment of Debt**

35. Opinion 26 requires recognition in income of a gain or loss on an early extinguishment of debt in the period in which the debt is extinguished. For rate-making purposes, the difference between the enterprise's net carrying amount of the extinguished debt and the reacquisition price may be amortized as an adjustment of interest expense over some future period.

36. If the debt is reacquired for an amount in excess of the enterprise's net carrying amount, the regulator's decision to increase future rates by amortizing the difference for rate-making purposes provides reasonable assurance of the existence of an asset (paragraph 9). Accordingly, the regulated enterprise would capitalize the excess cost and amortize it over the period during which it will be allowed for rate-making purposes.

37. If the debt is reacquired for an amount that is less than the enterprise's net carrying amount, the regulator's decision to reduce future rates by amortizing the difference for rate-making purposes imposes a liability on the regulated enterprise (paragraph 11(c)). Accordingly, the enterprise would record the difference as a liability and amortize it over the period during which permitted rates will be reduced.

Under U.S. GAAP, unamortized debt issuance costs are immediately expensed for retired debt and modified debt arrangements which are considered "substantially different" under the provisions of EITF Issue No. 96-19,

## Accounting for Regulated Entities (SFAS No. 71)

"Debtor's Accounting for a Modification or Exchange of Debt Instruments". However, if the conditions in paragraphs 9 and 35 to 37 of SFAS No. 71 are met, debt issuance costs related to regulated entities which would be expensed under U.S. GAAP should be deferred as a regulatory asset and amortized. Because the requirements for SFAS No. 71 have been met, for Duke Energy Carolinas, the period of amortization is the life of the replacement debt if the debt has been replaced. If the debt has not been replaced, the amortization period is the remaining original life of the extinguished debt. The amortization period should be reviewed in conjunction with any guidance provided by the relevant commission.

The costs of extinguishment include the costs of any associated interest rate swaps that are cancelled when the debt is extinguished.

### 7. Disallowances of Plant Costs

Per SFAS No. 90,

7. When it becomes probable that part of the cost of a recently completed plant will be disallowed for rate-making purposes and a reasonable estimate of the amount of the disallowance can be made,<sup>2</sup> the estimated amount of the probable disallowance shall be deducted from the reported cost of the plant and recognized as a loss. If part of the cost is explicitly, but indirectly, disallowed (for example, by an explicit disallowance of return on investment on a portion of the plant), an equivalent amount of cost shall be deducted from the reported cost of the plant and recognized as a loss.

<sup>2</sup> footnote omitted

When a direct disallowance of a recently completed plant is probable and estimable, a loss should be recorded, dollar for dollar, for the disallowed amount. This accounting can be different than the requirement under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" where an undiscounted cash flow approach is used to determine if impairment exists, and, if so impairment loss is measured by comparing the carrying value of a long-lived asset to its fair value. Future depreciation charges should be based on the written down asset basis. Refer to the accounting policy entitled "Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments, Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)" for additional guidelines.

When there is an explicit but indirect disallowance, the present value of the future revenue stream allowed by the regulator should be determined by discounting the expected future revenues using the last allowed rate of return. This amount should be compared to the recorded plant amount and the deficit, if any, recorded as a loss. An explicit but indirect disallowance occurs when, in certain circumstances, no return or a reduced return is permitted on all or a portion of the new plant for an extended period of time.

See also paragraphs 7, 26-34 and 54-63 of SFAS No. 90.

Where costs were previously disallowed and written off in accordance with SFAS No. 90, but subsequently allowed in ratemaking, the costs should be restored as plant. If an impairment was recorded pursuant to SFAS No. 144, and the regulator allows recovery, then a regulatory asset should be recognized.

### 8. Discontinuation of Application of SFAS No. 71

SFAS No. 101, "Regulated Enterprises — Accounting for the Discontinuation of Application of FASB Statement No. 71" addresses situations which may cause an enterprise to no longer meet the criteria for applying SFAS No. 71. Per SFAS No. 101;

4. Failure of an enterprise's operations to continue to meet the criteria in paragraph 5 of Statement 71 can result from different causes. Examples include the following:
  - a. Deregulation
  - b. A change in the regulator's approach to setting rates from cost-based rate making to another form of regulation

## Accounting for Regulated Entities (SFAS No. 71)

c. Increasing competition that limits the enterprise's ability to sell utility services or products at rates that will recover costs

d. Regulatory actions resulting from resistance to rate increases that limit the enterprise's ability to sell utility services or products at rates that will recover costs if the enterprise is unable to obtain (or chooses not to seek) relief from prior regulatory actions through appeals to the regulator or the courts.

5. When an enterprise determines that its operations in a regulatory jurisdiction no longer meet the criteria for application of Statement 71, that enterprise shall discontinue application of that Statement to its operations in that jurisdiction. If a separable portion of the enterprise's operations within a regulatory jurisdiction ceases to meet the criteria for application of Statement 71, application of that Statement to that separable portion shall be discontinued. That situation creates a presumption that application of Statement 71 shall be discontinued for all of the enterprise's operations within that regulatory jurisdiction. That presumption can be overcome by establishing that the enterprise's other operations within that jurisdiction continue to meet the criteria for application of Statement 71.

6. When an enterprise discontinues application of Statement 71 to all or part of its operations, that enterprise shall eliminate from its statement of financial position prepared for general-purpose external financial reporting the effects of any actions of regulators that had been recognized as assets and liabilities pursuant to Statement 71 but would not have been recognized as assets and liabilities by enterprises in general, and FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, shall apply, except for the provisions for income statement reporting in paragraphs 25 and 26 of that Statement. However, the carrying amounts of plant, equipment, and inventory measured and reported pursuant to Statement 71<sup>1</sup> shall not be adjusted unless those assets are impaired, in which case the carrying amounts of those assets shall be reduced to reflect that impairment. Whether those assets have been impaired shall be judged in the same manner as for enterprises in general. The net effect of the adjustments required by this Statement shall be included in income of the period in which the discontinuation occurs and shall be classified as an extraordinary item.

<sup>1</sup> The carrying amounts of plant, equipment, and inventory for enterprises applying Statement 71 differ from those for enterprises in general only because of the allowance for funds used during construction, intercompany profit, and disallowances of costs of recently completed plants. If any other amounts that would not be includable in the carrying amounts of plant, equipment, or inventory by enterprises in general (such as postconstruction operating costs capitalized pursuant to paragraph 9 of Statement 71) are included in or netted against the carrying amounts of plant, equipment, or inventory, those amounts shall be accounted for as this Statement prescribes for the effects of actions of a regulator.

7. An enterprise that discontinues application of Statement 71 shall no longer recognize the effects of actions of a regulator as assets or liabilities unless the right to receive payment or the obligation to pay exists as a result of past events or transactions and regardless of future transactions.

SFAS No. 71 can be discontinued for a variety of reasons. Factors to consider may include a persistent and significant under-earning of the allowed rate of return for an extended period of time, legislation deregulating some portion (typically generation or production) of the business, a rate structure based on long term rate freezes, cost caps or market based regulation of rates.

With respect to rate freezes, as long as that portion of the business continues to be subject to the jurisdiction of the regulator as evidenced by routine reporting of results to the regulator and as long as that portion of the business continues to earn a reasonable rate of return, then SFAS No. 71 should be continued.

Once SFAS No. 71 is no longer applicable, the balance sheet effects of any actions of regulators that had been recognized as regulatory assets and regulatory liabilities pursuant to SFAS No. 71 should be eliminated. However, the carrying amounts of plant, equipment, and inventory measured and reported pursuant to SFAS No. 71 reflecting AFUDC, intercompany profit and disallowances of costs of recently completed plants should not be adjusted unless those assets are impaired (under SFAS No. 144 or other authoritative literature). If impaired, the carrying amounts of those assets should be reduced to reflect that impairment. The net effect of the above adjustments should be recorded in the period of the change and classified as an extraordinary item in the income statement. (SFAS No. 101, paragraph 6).

If the discontinuance of SFAS No. 71 is due to deregulatory legislation, typically a portion of the business is deregulated and the remaining portion is regulated. Sometimes, the remaining portion is entitled to cash flows related to the deregulated portion of the business. In that case, the elimination of the regulatory assets and



## Accounting for Regulated Entities (SFAS No. 71)

liabilities for that portion of the business that is deregulated should not be written off until 1) they are recovered through the collection of regulated cash flows (in the case of assets) or settled (in the case of liabilities), 2) they are individually impaired or the regulator eliminates the obligation or 3) the separable portion of the business from which regulated cash flows are derived no longer meets the criteria for SFAS 71. (EITF Issue No. 97-04 "Deregulation of the Pricing of Electricity – Issues Related to the Application of FASB Statement No. 71 and No. 101")

### 9. Emission Allowances

Emission allowances are accounted for as intangible assets by Duke Energy. All amounts should be reflected within non-current assets (i.e., reclassifying the amount of the coming year's amortization of an intangible asset to current assets is inappropriate).

Vintage swaps (exchanges of one vintage year for another vintage of the same type of allowance) require the recognition of a gain or loss under SFAS No. 153, "Exchange of Nonmonetary Assets," unless the gain or loss should be deferred as a regulatory asset or liability. If the gain or loss is deferred, the gain or loss is recorded as an adjustment to intangible assets with an offsetting adjustment to regulatory assets or liabilities.

Proceeds from the EPA's auction of emission allowances may also be deferred as a regulatory liability depending on the applicable state regulatory jurisdiction's rate making.

### 10. Impairments

A rate-regulated enterprise has four primary categories of long-lived assets, each of which is analyzed in a slightly different fashion for the purpose of determining an impairment: 1) Regulatory assets, 2) disallowances of recently completed plants, 3) abandonments and 4) other assets.

Regulatory assets are covered by SFAS 71, while abandonments and disallowances are covered by SFAS 90. SFAS 144 applies to impairment reviews of definite-lived long-lived assets (e.g., PP&E, emission allowances, etc.), while SFAS 142 applies to impairment reviews of goodwill and other indefinite-lived intangibles. Other assets are covered by other areas of GAAP depending upon the specific nature of the asset – e.g., equity method investments are covered by APB 18, other investments are covered by SFAS 115 and EITF Issue 03-1, notes receivable are covered by SFAS 114, etc. Also refer to the accounting policy entitled "Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments, Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)" for additional guidelines.

### 11. Income Taxes and Investment Tax Credit for Regulated Entities

Per SFAS No. 109, "Accounting for Income Taxes";

29. Regulated enterprises that meet the criteria for application of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, are not exempt from the requirements of this Statement. Specifically, this Statement:

- a. Prohibits net-of-tax accounting and reporting
- b. Requires recognition of a deferred tax liability (1) for tax benefits that are flowed through to customers when temporary differences originate and (2) for the equity component of the allowance for funds used during construction
- c. Requires adjustment of a deferred tax liability or asset for an enacted change in tax laws or rates.

If, as a result of an action by a regulator, it is probable that the future increase or decrease in taxes payable for items (b) and (c) above will be recovered from or returned to customers through future rates, an asset or liability is recognized for that probable future revenue or reduction in future revenue pursuant to paragraphs 9-11 of Statement 71. That asset or liability also is a temporary difference for which a deferred tax liability or asset shall be recognized.

## Accounting for Regulated Entities (SFAS No. 71)

Duke Energy presents regulatory assets and liabilities and AFUDC equity on a "gross-of-tax" basis on the balance sheet. "Gross-of-tax" usually means that the regulatory asset or liability is a temporary difference on which deferred taxes are provided. However, some regulatory assets (the AFUDC equity component of plant, for example) and some regulatory liabilities (tax rate reductions or deferred investment tax credits, for example) must be grossed up to reflect the taxation of the revenue required to recover the asset or settle the liability. A regulatory asset for the gross up of AFUDC Equity (AFUDC Equity is included in property, plant and equipment) is booked with the tax effect in the balance sheet account accumulated deferred income taxes ("ADIT"). The ADIT represents both the deferred taxes on the AFUDC Equity in PP&E and the deferred taxes on the regulatory asset for the gross up. See also SFAS No. 109, paragraphs 57-58 and 252-255.

Duke Energy does a balance sheet amortization of "Net Regulatory Asset Related to Income Taxes" and ADIT (see discussion below in section captioned "Net Regulatory Asset Related to Income Taxes"). The result is that AFUDC equity income and the depreciation or amortization of AFUDC equity is presented net of tax on the income statement and are reconciling items in the statutory to effective tax rate reconciliation.

Per SFAS No. 101;

116. The requirements for accounting for investment tax credits are contained in Opinions 2 and 4. In Opinion 2, the Accounting Principles Board (APB) concluded that:

- a. The investment tax credit reduces the cost of the related asset, and for that reason, it should be deferred and amortized over the productive life of the related asset.
- c. Display of the deferral as deferred income is also permitted provided that the investment tax credit is accounted for as a reduction of the cost of the asset, that is, amortized over the productive life of the asset.

For electric operations, investment tax credits are deferred and reported as a credit on the balance sheet rather than a reduction in PP&E. Investment tax credits are amortized as a component of income tax expense over the life of the associated plant. This amortization impacts the Company's reported effective tax rate.

A regulatory liability for the gross up of investment tax credits on the balance sheet is booked with an offsetting amount in ADIT. The offsetting ADIT represents the deferred taxes on the Investment Tax Credit and the deferred taxes on the regulatory liability for the gross up.

Per SFAS No. 109;

18. The objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realized.

ADIT balances should reflect the enacted tax rates expected to apply to taxable income. If a change in tax rates (or allocations of income between state jurisdictions for state income taxes) occurs, ADIT should be adjusted to the new tax rate. The change in the ADIT balance should be evaluated to determine if a regulatory asset or liability for the change in tax rates should be recorded. If a regulatory asset or liability is recorded, it should be grossed up to a before tax amount and ADIT on the regulatory asset or liability should be recorded at the new tax rate. Further guidance on tax rates can be found in SFAS No. 109 paragraphs 18, 27, 89-91, 233-237 and 252-255.

Duke Energy has deferred changes in tax rates on 'protected' property and utilized either the South Georgia or the average rate assumption methodology ("ARAM") to amortize the excess taxes into income. The resulting amortization impacts the Company's reported effective tax rate.

The regulated Duke Energy companies have entered into a tax sharing agreement. As a result, income taxes for regulated utilities, even if their form of organization is an 'LLC', should reflect income tax expense and income tax liabilities. However, income tax payments as determined by the tax sharing agreement should not be assumed to be the same as GAAP income tax expense. Any difference should be accounted for as a capital transaction between the parent and the subsidiary.

On an SEC sub-registrant level, the accounting for income taxes essentially represents the income taxes that each sub-registrant would incur if each sub-registrant were a separate company filing its own tax return as a C-Corporation.

## Accounting for Regulated Entities (SFAS No. 71)

As it relates to taxes, Duke Energy records interest expense, within the interest expense line item of the income statement, and interest income and penalties within the "Other Income and Expenses, net", line item of the income statement. Income tax accruals for unrecognized tax benefits on regulated operations are recorded as a regulatory asset if the requirements of paragraph 9 of SFAS No. 71 are met.

### 12. Incurred Costs vs. Allowable Costs

"Incurred" costs (e.g., as discussed in paragraph 9 of SFAS No. 71) only include those costs that would otherwise be charged to expense. Incurred costs do not include an AFUDC equity return or a reduction in revenue. For example, a one-year reduction in rates would likely not represent an "incurred" cost and therefore not qualify for recording as a regulatory asset, even if the regulator allowed multi-year amortization for regulatory reporting purposes. Likewise, the accrual of AFUDC equity on a regulatory asset would not likely represent an "incurred" cost. See section above entitled "Allowance for Funds Used During Construction or AFUDC" for guidance on accruals related to equity returns.

In the context of SFAS 71, "allowed" costs is a broader concept of costs than "incurred" costs. Allowed costs include all costs from which (regulated) revenue is intended to provide recovery (see SFAS 71, paragraph 1). Regulators often defer allowed costs for ratemaking purposes with the intent that revenues from regulated operations cover these allowed costs in a later time period. A deferral for regulatory purposes does not necessarily equate to a change in rates. Instead, a deferral may mean that costs are deferred for the purpose of assessing earned rates of returns in regulatory reports.

### 13. Intercompany Profit

Per SFAS No. 71;

#### **Intercompany Profit**<sup>10</sup>

<sup>10</sup> The term *intercompany profit* is used in this Statement to include both profits on sales from one company to another within a consolidated or affiliated group and profits on sales from one operation of a company to another operation of the same company.

16. Profit on sales to regulated affiliates shall not be eliminated in general-purpose financial statements<sup>11</sup> if both of the following criteria are met:

<sup>11</sup> ARB No. 51, *Consolidated Financial Statements*, requires that profit on sales of assets remaining in the consolidated group be eliminated in consolidated financial statements. APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, effectively extends that requirement to affiliated entities reported on the equity method.

a. The sales price is reasonable.

b. It is probable that, through the rate-making process, future revenue approximately equal to the sales price will result from the regulated affiliate's use of the products.

Profits on intercompany sales to regulated affiliates should not be eliminated in consolidated results if the requirements of paragraph 16 of SFAS No. 71 are met.

Intercompany profit on sales from a regulated entity (under SFAS No. 71) to an unregulated affiliate should be eliminated in consolidated results. See also SFAS 71, paragraph 17 and 85-86.

### 14. Mark-to-market results for certain derivative instruments under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"

Changes in the fair value of derivative instruments designated as cash flow hedges are recorded in Accumulated Other Comprehensive Income (AOCI), a separate component of shareholders' equity on the balance sheet, while changes in the fair value of derivative instruments not designated as cash flow hedges or fair value hedges are recorded immediately in earnings ("mark-to-market" derivatives) absent regulatory accounting.

## Accounting for Regulated Entities (SFAS No. 71)

For derivative instruments related to regulated entities, the changes in fair value of "mark-to-market" commodity derivatives and cash flow hedges that would otherwise flow through the income statement should be recorded as a regulatory asset or liability, rather than AOCI or earnings, as long as the criteria in paragraphs 9 or 11 of SFAS No. 71, as applicable, are met. Depending upon the specific facts and circumstances, a formal "rate order" may not be required in order to meet the criteria of SFAS No. 71 to classify the balance as either a regulatory asset or liability.

Refer to the accounting policy entitled "Accounting for Derivative Instruments and Hedging Activities" for additional guidelines related to the accounting for derivative instruments.

### 15. Major Maintenance of Plant

The cost of repairs, replacements and major maintenance projects which do not extend the useful life or increase the expected output of property, plant and equipments, is expensed as it incurred. Extending the useful life refers to the life of the property as it was originally constructed or acquired. Restoring serviceability, maintaining, or preserving the life as originally constructed does not 'extend the useful life'.

Significant refurbishment or other expenditures deemed to be "life extending" may be capitalized if the original components have been refurbished, repaired, rebuilt, re-generated, or substantially replaced such that the unit of property has been returned to its original operating capability with an estimated life as if new. Indicators of "life extension" treatment include the cost of the work being 50% or more of the original cost of the property and manufacturer rewarranty and/or re-certification being provided.

Work performed at regular intervals (months or years, number of hours in operation, miles driven, cold starts, etc.) per manufacturer specifications or other available guidance, it should be considered normal repair and maintenance and therefore expensed.

All maintenance costs except those that extend the life, increase the output or in some other way constitute a substantial betterment or substantial addition to the asset should be expensed. Work performed specifically for the purpose of preventing failure, restoring serviceability or maintaining life of plant, rearranging or changing the location should be expensed. The magnitude of the costs does not change what would otherwise be a current period expense into an asset.

Major maintenance activities may involve tasks which support both capital tasks (e.g., replacement of retirement units) and expense tasks (e.g., inspections, machining of parts). For instance, a turbine inspection will require disassembly and reassembly of the turbine in order to perform replacements, inspections, machining of parts, etc. When generic tasks, such as disassembly and reassembly, are required in order to perform both capital and expense tasks, the cost associated with the generic task shall be allocated to capital and expense using the labor cost of the capital and expense tasks as the basis for allocation.

See also Plant Property and Equipment.

### 16. Net Regulatory Asset Related to Income Taxes

AFUDC Equity is capitalized to Property, Plant, and Equipment including Nuclear Fuel (PP&E) on an after tax basis (See section above entitled "Allowance for Funds Used During Construction or "AFUDC"" for a discussion of AFUDC Equity). Capitalized AFUDC Equity is considered to be a temporary difference because it is recognized as income in one period and recognized in later periods as depreciation or amortization expense. Duke's policy is to take the amount of undepreciated AFUDC Equity in PP&E and gross it up to a before tax amount. The gross-up is presented as net regulatory asset related to income taxes, which is a temporary difference. An equal and offsetting amount is credited to Accumulated Deferred Income Taxes (ADIT) on the balance sheet. This ADIT represents ADIT on the undepreciated AFUDC Equity remaining in PP&E plus the ADIT on the net regulatory asset related to income taxes. The result is that the AFUDC Equity in PP&E is effectively converted from a net of tax amount to a before tax amount. For example, if there is \$100 of undepreciated AFUDC Equity in PP&E and the tax rate is 40%, Duke Energy debits net regulatory asset related to income taxes for \$67 and credits ADIT for \$67. ADIT of \$67 represents ADIT on AFUDC in PP&E of \$40 (40% of \$100) and ADIT on net regulatory asset related to income taxes of \$27 (40% of \$67). See SFAS No. 109, paragraph 253. Also see section above entitled "Income taxes and Investment Tax Credit for Regulated Entities" for further discussion of accounting for income taxes in a rate-regulated environment.

## Accounting for Regulated Entities (SFAS No. 71)

### 17. Net Revenue - ISO/RTOs

Sales to an independent system operator ("ISO") or RTO (Independent System Operator and Regional Transmission Organization) and purchases from an ISO or RTO in the day-ahead market for the same hour should be netted. Likewise, sales to an ISO/RTO and purchases from an ISO/RTO in the real-time market should also be netted.

If the net result is the sale of megawatt hours ("mWhs"), the net dollars should be reported as revenue, even if a net payment results. If the net result is the purchase of mWhs, the net dollars should be reported as expense, even if net income results. If the net result is zero mWhs, gains should be reported as revenue and losses as expense.

### 18. Nuclear property and liability reserves

As a result of prior rate-making, Duke Energy Carolinas has reserves set aside for property damage and for liability under the Price-Anderson Act, and is required to be accountable to the regulatory commissions for these amounts. Since a nuclear accident is a remote possibility as defined by SFAS No. 5, these amounts represent regulatory liabilities under SFAS 71, paragraph 11(b).

### 19. Nuclear decommissioning trust fund

In accordance with regulatory requirements, Duke Energy has established an external trust fund that holds investments, including debt and equity securities, designated to cover costs to decommission Duke Energy Carolinas' nuclear plants when the operating licenses ultimately expire. Decommissioning of the non-contaminated portion is a removal cost (see separate section below entitled "Removal Costs"). Decommissioning of the contaminated portion is an ARO under SFAS No. 143 because it represents a legal obligation, while decommissioning of the non-contaminated portion is not a legal obligation and therefore not an ARO under SFAS No. 143.

In accordance with regulatory requirements, Duke Energy has outsourced the management of the investments in the trust to one or more third parties. Under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", investments in marketable securities, such as debt and equity securities, are classified as trading, held-to-maturity, or available-for-sale. With respect to the nuclear decommissioning trust fund, all the marketable securities held in the trust are classified as available-for-sale. Duke Energy management does not have the ability to hold the securities to maturity, due to the outsourcing of the investment management procedures, nor do the securities qualify for the trading designation as they are not bought and held principally for selling them in the near term. Consequently, under the guidance in SFAS No. 115, the investments are carried at fair value in the consolidated balance sheets.

Net realized and unrealized earnings of the decommissioning fund set aside for contaminated costs are recorded as a regulatory asset (debit/credit nuclear decommissioning trust fund, credit/debit regulatory asset). The reason the amount is recorded as a regulatory asset is that at this time, the ARO costs (decommissioning expense) allowed for setting rates is less than the cumulative amount of asset retirement costs expensed for GAAP purposes.

Realized and unrealized earnings/losses of the decommissioning fund set aside for clean costs are recorded as a regulatory liability (debit/credit nuclear decommissioning trust fund, credit/debit regulatory asset). The company has a liability to its customers related to the costs that are booked for setting rates versus the cost of removal which is not a GAAP recognized cost until incurred.

### 20. Pensions and Other Postretirement Benefits

The accrual of the net pension asset, net pension liability and other post retirement benefits liability (i.e., the "funded status") on the balance sheet pursuant to SFAS No. 158 is offset by an entry to regulatory asset or liability to the extent allocable to Duke's regulated operations rather than accumulated other comprehensive income ("Accumulated Other Comprehensive Income (AOCI)"). The regulatory asset or liability recorded pursuant to SFAS

## Accounting for Regulated Entities (SFAS No. 71)

No. 158 should be on the books of the same company where the associated net pension asset, net pension liability or other post retirement benefits liability is recorded.

The regulatory asset for other post retirement benefits net of deferred taxes, is equal to the other post retirement liability, net of deferred taxes, allocated to Duke's regulated operations. The before tax regulatory asset for other post retirement benefits does not equal the before tax net liability for other post retirement benefits as a component of the before tax net liability represents a permanent difference. The reason the before tax amount for the regulatory asset does not equal the before tax amount for the post retirement benefit liability is that there is a non-taxable component of the benefit liability represented by the non-taxable funding by the federal government for medical costs.

Refer to the accounting policy entitled "Accounting for Defined Benefit Pension and Other Post-Retirement Benefit Plans" for additional guidelines.

### 21. Phase-In Plans (SFAS No. 92)

From SFAS No. 92:

3. The term *phase-in* is used in this Statement to refer to any method of recognition of allowable costs (footnote omitted) in rates that meets all of the following criteria:

- a. The method was adopted by the regulator in connection with a major, newly completed plant of the utility or one of its suppliers or a major plant scheduled for completion in the future (hereinafter referred to as a "plant").
- b. The method defers the rates intended to recover allowable costs beyond the period in which those allowable costs would be charged to expense under GAAP applicable to enterprises in general.
- c. The method defers the rates intended to recover allowable costs beyond the period in which those rates would have been ordered under ratemaking methods routinely used prior to 1982 by that regulator for similar allowable costs of that regulated enterprise.

4. If a phase-in plan is ordered by a regulator in connection with a plant on which no substantial physical construction had been performed before January 1, 1988, none of the allowable costs that are deferred for future recovery by the regulator under the plan<sup>2</sup> for rate-making purposes shall be capitalized for general-purpose financial reporting purposes (hereinafter referred to as "financial reporting").

<sup>2</sup> "Allowable costs that are deferred for future recovery by the regulator under the plan" consist of all allowable costs deferred for rate-making purposes under the plan beyond the period in which those allowable costs would be charged to expense under generally accepted accounting principles applicable to enterprises in general.

Since it is unlikely that Duke will have a phase-in on a plant constructed prior to January 1, 1988, Duke Energy should not be deferring any costs as a result of phase-in plans.

Phase-in plans do not include the deferral of costs between the commercial operation date of a major new plant and a change in rates to reflect commercial operation of that plant. Such incurred costs can be deferred provided they meet the requirements of SFAS No. 71 paragraph 9 and do not include an amount for AFUDC equity. (See paragraphs 38-41 of SFAS No. 92)

### 22. Property, Plant and Equipment

In accordance with the FERC Uniform System of Accounts ("USA"), Duke Energy uses composite depreciation to depreciate its utility plant for both FERC and GAAP purposes. Composite depreciation is a method whereby one depreciation rate is applied to the entire asset group. For example, the foundation and structure of a building may last 50 years, whereas the electrical and plumbing components may have lives of 20 years. These component assets would be grouped together, and a composite depreciation rate of approximately 33 1/3 years, as an example, may be used for the entire asset group. When Duke Energy retires its regulated property, plant and equipment, it charges the original cost plus the cost of retirement, less salvage value, to accumulated depreciation and amortization. When it sells entire regulated operating units, or retires or sells non-regulated properties, the cost is removed from the property account and the related accumulated depreciation and

## Accounting for Regulated Entities (SFAS No. 71)

amortization accounts are reduced. Any resulting gain or loss is recorded in earnings, unless otherwise required by the applicable regulatory body.

Duke capitalizes Contributions in Aid of Construction ("CIAC") as reductions in utility plant in accordance with the FERC Uniform System of Accounts and prevalent industry practice for GAAP reporting purposes. Prepayments of extra facilities fees are treated as deferred revenue and not as CIAC.

Preliminary survey and development costs that meet the requirements of paragraph 9 of SFAS No. 71 are recorded as a regulatory asset until a decision has been made to either start or abandon the project. If a decision has been made to start the project, the costs are transferred to construction work in progress. Otherwise, the costs are expensed unless the costs continue to meet the requirements of paragraph 9 of SFAS No. 71.

Investment tax credits, for electric plant, are recorded as deferred credits instead of as reductions in PP&E (See section above entitled "Income Taxes and Investment Tax Credit for Regulated Entities"). Duke Energy does not record any regulatory assets or regulatory liabilities as PP&E. (See section above entitled "Allowance for Funds Used During Construction or 'AFUDC'".) The cost of removal component of depreciation is reported on the GAAP balance sheet as a regulatory liability although for regulatory purposes, this liability is credited to Accumulated Depreciation. (See section below on Removal Costs.)

The income statement effects of SFAS No. 143 "Accounting for Retirement Obligations", are deferred into a regulatory asset or regulatory liability. (See section on Asset Retirement Obligations.)

Changes in Units of Property are a change in an accounting estimate effected by a change in accounting principle as defined by SFAS No. 154, "Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 29."

Per SFAS 154, "Accounting Changes and Error Corrections":

22..... If a change in estimate does not have a material effect in the period of change but is reasonably certain to have a material effect in later periods, a description of that change in estimate shall be disclosed whenever the financial statements of the period of change are presented.

Per SAB Topic 1 M "Materiality", materiality considerations include an effect that increases management's compensation.

A retirement is the removal from service, sale, abandonment or other withdrawal from service. Refurbishing a piece of property and then returning it to service in the same location is not a retirement. Returning the item to service after refurbishment in a different location is not a retirement because the item has not been removed from service.

A piece of plant that is removed from service should not be placed in inventory (for GAAP accounting) if it has been classified as a capital spare part. Such spare parts do not meet the definition of inventory. If the spare parts are essential for emergency needs, are associated with specific plant-in-service, and are not subject to use as normal periodic replacements, they may be recorded in the depreciable plant-in-service accounts. Spare parts which are subject to use as normal periodic replacements (such as meters and transformers) should be recorded as inventory.

All property will be considered as consisting of either property units or minor items of property. If not identified as a property unit, the item is considered a minor item.

- If a property unit is added, the cost is capitalized.
- If a property unit is replaced with new property unit, the old unit is retired and the new unit is capitalized.
- If a minor item of property is added to a property unit, costs are expensed unless there is a "substantial addition" to the property unit,
- If a minor item of property is replaced independently of the property unit of which it is a part, the cost is expensed, unless there is a "substantial betterment" of the property unit.
- All remaining expenditures are expensed.

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**Substantial Addition** - The new minor item being added to the property unit must cost at least 25% of the current price for that unit, or, using an appropriate and reasonable functional metric, there must be at least a 25% addition.

**Substantial Betterment** - Improvement to a property unit through replacement of a minor item of property that makes the unit more useful or more efficient or that increases capacity. Capitalize only the portion that adds at least 25% betterment. (Subtract the current cost of the original minor item from the betterment.)

A trade-in/salvage arrangement with a vendor where pre-arrangements exist for the repurchase of the same or previously-owned refurbished Duke Energy property will not change the accounting treatment from expense to capital.

The repair/refurbishment/overhaul of existing equipment where the company has purchased an additional item to insert in its place while the work is ongoing shall be accounted for as follows:

1. Purchase of the additional property unit(s) shall be recorded in materials inventory at cost.
2. When work begins the property unit(s) are issued out of materials inventory and charged to the appropriate capital project.
3. The existing property unit(s) are removed, retired from plant-in-service, and placed in materials inventory at original cost (trended to the appropriate vintage date). This occurs whether the unit(s) are kept on-site or shipped to a vendor. If shipped to a vendor, appropriate supporting documentation noting the physical location of the units must be maintained.
4. Refurbishment costs incurred are expensed currently unless the refurbishment results in a substantial betterment or economic life extension of the unit of property.

Costs that "have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted." Capitalization is only appropriate when such costs are specifically identifiable with a particular project and are identifiable in the accounting records. Indirect costs capitalized should be incremental (costs that would not have been incurred had the project not been developed.)

The following is a summary of costs for overhead departments which if not feasible to be direct charged, can be included in a cost pool that may be used for capitalization. Overhead cost pools include employee fringe and benefit allocations. Direct costs to a capital project also include employee fringe and benefit allocations.

**Accounting: (Asset, Controller, Accounting Support):** Only Asset Accounting departmental costs are eligible for capitalization. No other costs are eligible for capitalization unless direct charged.

**Executive:** No costs are eligible for capitalization unless direct charged.

**Information Technology: (mainframe, server, workstation, data center and support services):** eligible for capitalization.

**Human Resources:** No costs are eligible for capitalization unless direct charged.

**Facilities: real estate and project management:** No costs are eligible for capitalization unless direct charged.

**Finance: (treasury, insurance claims, budgeting, reporting):** No costs are eligible for capitalization unless direct charged.

Based on the available guidance, the presumption is that these costs are to be expensed unless there is a direct or very close indirect relationship to the construction project. FERC states only costs that "have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted." GAAP states capitalization is only appropriate when such costs are specifically identifiable with a particular project and are identifiable in the accounting records. GAAP also states indirect costs capitalized should be incremental (costs that would not have been incurred had the project not been developed.)

The burden of proof is on the Company to support costs are directly identifiable with the construction project. Identified costs are based on what activities are performed in support of construction projects, and not simply based on what department personnel are associated with. In defining these costs the following factors should be considered:

- a. Specific information should be available (such as timecards) to support the allocation of overhead costs to specific projects.



## Accounting for Regulated Entities (SFAS No. 71)

- b. The costs incurred should be incremental costs. That is, in the absence of the project or projects under development or construction, these costs would not be incurred.
- c. The impact of capitalization of such indirect costs on the results of operations should be consistent with the pervasive principle of matching costs with related revenue.

Payroll timesheets and/or special studies of where personnel spend their time are methods which could provide acceptable support.

For additional guidance, see: [USFEG Capitalization Guidelines](#)

### 23. Rate Changes

Per SFAS No. 71;

79. Rate actions of a regulator can also impose a liability on a regulated enterprise in the following ways:

- a. A regulator can order a regulated enterprise to refund previously collected revenues.
- b. A regulator can provide rates intended to recover costs that are expected to be incurred in the future. Paragraphs 38 and 39 illustrate that possibility. The resulting increased charges to customers are liabilities and not revenues for the enterprise—the enterprise undertakes to provide the services for which the increased charges were collected, and it is obligated to return those increased charges if the future cost does not occur. The obligation will be fulfilled either by refunding the increased charges through future rate reductions or by paying the future costs with no corresponding effect on future rates. The resulting increases in charges to customers are unearned revenues until they are earned by their use for the intended purpose.

Rate reductions for previously collected revenue (refunds) should be accrued as regulatory liabilities in accordance with SFAS No. 71, paragraph 11(a). Other rate reductions should likely not be accrued.

Rate changes for cost tracked items (such as a fuel or purchased power expense) are booked as revenue as billed (typically monthly). The mismatch between fuel or purchased power revenue and the associated expense is booked as an adjustment to revenue or expense.

The effects of regulatory-ordered future rate reductions that do not qualify as regulatory liabilities under FAS 71, par. 11 should not be accrued in advance but rather should be recognized as reduced revenue in future periods.

### 24. Reapplication of SFAS No. 71

Reapplication of SFAS No. 71 as a result of reregulation is the result of a change in accounting principle as a result of a changed circumstance. The effect of such a change is recognized in current earnings and is not a cumulative effect of a change in accounting principle. Caution should be applied to avoid the recognition of regulatory assets before they are considered probable of recovery. Reapplication of SFAS No. 71 may be considered an "extraordinary item" for income statement classification purposes depending on facts and circumstances.

### 25. Regulatory Accounting vs. U. S. GAAP

Per SFAS No. 111, "Rescission of FASB Statement No. 32 and Technical Corrections"

25. The chart below summarizes the GAAP hierarchy for financial statements of nongovernmental entities under SAS 69, "The Meaning of *Present Fairly in Conformity With Generally Accepted Accounting Principles*."

#### **Established Accounting Principles**

Category (a)-FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Research Bulletins

Category (b)-FASB Technical Bulletins, cleared <sup>5</sup> AICPA Industry Audit and Accounting Guides, and cleared AICPA Statements of Position

## Accounting for Regulated Entities (SFAS No. 71)

Category (c)-Consensus positions of the FASB Emerging Issues Task Force and cleared AICPA AcSEC Practice Bulletins

Category (d)-AICPA Accounting Interpretations, FASB Implementation Guides (Q&As), and widely recognized and prevalent industry practices

### Other Accounting Literature

Other accounting literature, including FASB Concepts Statements; APB Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; GASB Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles.

Regulatory accounting pronouncements (e.g., accounting from regulatory bodies such as FERC or state public utility commissions) should not be assumed to comply with U.S. GAAP reporting requirements (SFAS 71, paragraphs 4 & 54). However, per the excerpts from SFAS No. 111 above, pronouncements of regulatory agencies and prevalent industry practice represent lower level GAAP. Therefore, the

- FERC Uniform System of Accounts,
- FERC Accounting Interpretations, Releases and Rulemakings,
- State Commission Accounting Orders, Rate Orders or other pronouncements and
- prevalent industry practice

provide GAAP guidance as long as they are consistent with SFAS No. 71 and are not in conflict with any higher level GAAP. Industry practice cannot take precedence over authoritative literature.

SFAS No. 71 applies to most of the operations of the USFEG business segment. However, there are some exceptions. For example, the regulated operations exclude all of the wholesale operations, as the rates for the wholesale operations are not under cost-based regulation, with the exception of the transmission operations which continue to be rate regulated.

Note that the FASB has recently issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS No. 162) which states, "The Board does not expect that this Statement will result in a change in current practice. However, transition provisions have been provided in the unusual circumstance that the application of the provisions of this Statement results in a change in practice.." Below is the GAAP hierarchy as outlined in SFAS No. 162, and we believe the aforementioned use policy guidance remains applicable.

#### The GAAP Hierarchy

3. The sources of accounting principles<sup>1</sup> that are generally accepted are categorized in descending order of authority as follows:
  - a. FASB Statements of Financial Accounting Standards and Interpretations, FASB Statement 133 Implementation Issues, FASB Staff Positions, and American Institute of Certified Public Accountants (AICPA) Accounting Research Bulletins and Accounting Principles Board Opinions that are not superseded by actions of the FASB
  - b. FASB Technical Bulletins and, if cleared<sup>2</sup> by the FASB, AICPA Industry Audit and Accounting Guides and Statements of Position
  - c. AICPA Accounting Standards Executive Committee Practice Bulletins that have been cleared by the FASB, consensus positions of the FASB Emerging Issues Task Force (EITF), and the Topics discussed in Appendix D of *EITF Abstracts* (EITF D-Topics)<sup>3</sup>
  - d. Implementation guides (Q&As) published by the FASB staff, AICPA Accounting Interpretations, AICPA Industry Audit and Accounting Guides and Statements of Position not cleared by the FASB, and practices that are widely recognized and prevalent either generally or in the industry.
4. If the accounting treatment for a transaction or event is not specified by a pronouncement in category (a), an entity shall consider whether the accounting treatment is specified by an accounting principle from a source in another category. In such cases, if categories (b)-(d) contain accounting principles that specify accounting treatments for a transaction or event, then the entity shall follow the accounting treatment specified by the accounting principle from the source in the highest category—for example, follow category (b) treatment over category (c) treatment.

## Accounting for Regulated Entities (SFAS No. 71)

### 26. Regulatory Assets

Regulatory assets should be amortized over future periods consistent with the related recovery through customer revenues or reductions in the related deferred taxes. Regulatory assets should not be netted against a corresponding GAAP liability unless the netting requirements of FIN 39 are met. Regulatory assets should not be included as a part of plant, property and equipment including nuclear fuel (PP&E) or inventory. (See discussion on AFUDC, Intercompany profit and Disallowances for further guidance.)

Evidence should be maintained for all regulatory assets supporting that the asset is both probable of recovery and estimable and that the cost being deferred is a specific cost and not a provision for similar future costs.

An incurred cost that does not meet the asset recognition criteria in paragraph 9 at the date the cost is incurred should be subsequently recognized as a regulatory asset if it meets those criteria at a later date.

Items which meet the requirements of paragraph 9 of SFAS No. 71 and would otherwise be recorded as accumulated other comprehensive income ("Accumulated Other Comprehensive Income (AOCI)") (see pensions and other post retirement benefits for example) are recorded as regulatory assets.

### 27. Regulatory Liabilities

Regulatory liabilities should be amortized over future periods consistent with the related decrease in customer revenues, increase in expense to which the regulatory liability was originally created, or reductions in the related deferred taxes. Regulatory liabilities should not be netted against a corresponding GAAP asset unless the netting requirements of FIN 39 are met. Regulatory liabilities should not be included as a part of plant, property and equipment including nuclear fuel (PP&E) or inventory. (See the sections above on AFUDC and Disallowances of Plant Costs for further guidance.)

Regulatory liabilities are usually created when the criteria of paragraph 11 (a), (b) or (c) are met.

Items which meet the requirements of SFAS No. 71 and would otherwise be recorded as AOCI are recorded as regulatory liabilities (see pensions and other post retirement benefits for example).

### 28. Removal Costs

For certain regulated Duke entities, the depreciation component of rates includes an estimate for costs of removal. Costs of removal may include both the "non-legal" retirement obligations, such as estimated costs for non-nuclear facilities and the non-contaminated portion for decommissioning nuclear power plants as well as certain costs associated with retirement of gas pipeline systems. Under SFAS No. 143, these costs cannot be accrued as retirement obligations until incurred because they do not represent legally-obligated costs. (The contaminated portion for decommissioning Duke's nuclear power facilities is an ARO liability.) Therefore, pursuant to SFAS No. 71, paragraph 11(b), the balance for these non-legal costs is recorded as a regulatory liability for GAAP reporting although regulated financial statements may be required, in some cases, to classify these credits within accumulated depreciation.

### 29. Reporting and Disclosure Requirements

Per SFAS No. 71;

19. For refunds that are recognized in a period other than the period in which the related revenue was recognized and that have a material effect on net income, the enterprise shall disclose the effect on net income and indicate the years in which the related revenue was recognized. Such effect may be disclosed by including it, net of related income taxes, as a line item in the income statement. However, that item shall not be presented as an extraordinary item.

Significant refunds that are recognized in a period other than the period in which the related revenue was recognized and that have a material effect on net income should be disclosed. The years for which the related revenue was recognized should be indicated. The effect may be disclosed, net of related income taxes, as a line item in the income statement. However, it should not be presented as an extraordinary item.

## Accounting for Regulated Entities (SFAS No. 71)

The amount of any revenue adjustments resulting from rate-making processes related to prior interim periods should be disclosed under the following circumstances.

From SFAS No. 16, "Prior Period Adjustments", paragraph 13:

- a. The effect of the adjustment or settlement is material in relation to income from continuing operations of the current fiscal year or in relation to the trend of income from continuing operations or is material by other appropriate criteria, and
- b. All or part of the adjustment or settlement can be specifically identified with and is directly related to business activities of specific prior interim periods of the current fiscal year, and
- c. The amount of the adjustment or settlement could not be reasonably estimated prior to the current interim period but becomes reasonably estimable in the current interim period.

If the revenue adjustment occurs in *other than the first quarter*, prior interim periods of the current year should be restated to include the portion of the revenue adjustment. The portion of the refund that is directly related to business activities during prior years will be included in the first quarter of the current year. Disclosures will be made of both a) the change in income and b) the income on

- continuing operations,
- net income and
- related per share amounts

See also, SFAS No. 16, paragraphs 14-15.

Losses recorded related to abandonments or disallowances should not be reported as extraordinary items.

Per SFAS No. 101;

6. When an enterprise discontinues application of Statement 71 to all or part of its operations, .....  
The net effect of the adjustments required by this Statement shall be included in income of the period in which the discontinuation occurs and shall be classified as an extraordinary item.
8. For the period in which an enterprise reflects the discontinuation of application of Statement 71 to all or a separable portion of its operations, the enterprise shall disclose the reasons for the discontinuation and identify the portion of its operations to which the application of Statement 71 is being discontinued.

If SFAS No. 71 is discontinued for any portion of the regulated business, the reason for the discontinuance and the portion of the operations for which SFAS No. 71 is discontinued should be disclosed. The discontinuance should be treated as an extraordinary item.

Duke Energy discloses in a separate financial statement note all regulatory assets and liabilities. Regulatory assets and liabilities exclude AFUDC (borrowed and equity) capitalized as part of plant, property and equipment including nuclear fuel, intercompany profit in PP&E or inventory or disallowances. Disclosures include:

- the nature of the cost deferred,
- the amount deferred,
- where each item is presented on the balance sheet,
- the recovery period and
- whether a return is being provided.

The SEC's SAB Topic 10C, "Jointly Owned Electric Utility Plants," requires a utility participating in a jointly owned power station to disclose the extent of its interests in such plant(s). Disclosure should include a table showing separately for each interest the amount of utility plant in service, accumulated depreciation, the amount of plant under construction and the proportionate share. Amounts presented for plant in service maybe further subdivided into subcategories such as production, transmission and distribution. Information concerning two or more generating plants on the same site may be combined if appropriate.

Disclosure should address the participant's share of direct expenses included in operating expenses on the income statement (fuel, maintenance and other operating). If the share of direct expenses is all charged to

## Accounting for Regulated Entities (SFAS No. 71)

purchased power, then disclosure of this amount, as well as the proportionate amounts related to specific operating expenses in the joint plant records, should be indicated.

The following is a comment from the SEC, along with the Company's response, from a comment letter received in 2007 from the SEC's review of the 2006 form 10-K of Duke Energy Carolinas:

**"Please revise future disclosure to indicate the amount of unbilled revenues recorded at period end. To the extent applicable, please explain any material differences in amounts recorded between periods."**

The Company will revise future disclosure to indicate the amount of unbilled revenues recorded at period end. To the extent applicable, the Company will explain any material differences in amounts recorded between periods."

Accordingly, these disclosures should be made in all future SEC filings for all Duke Energy SEC registrants.

Long term purchase power contracts are disclosed in MD&A as a component of the table of contractual obligations.

### 30. Unbilled Fuel

The adjustment made to match billed fuel revenue and fuel expense is reported as an adjustment to revenue or fuel expense in order to match billed fuel revenue and fuel expense. Fuel expense is defined by each regulatory jurisdiction and may include portions of purchased power expense or exclude components of fuel expense as reported in the GAAP financial statements. The matching of fuel revenue and fuel expense ignores the fuel component of Unbilled Revenues (meters not read). Depending on the jurisdictional balance, the balance sheet amount is recorded as either a current (regulatory) asset or a current (regulatory) liability.

### 31. Unbilled Revenue (meters not read)

An amount for electricity or gas delivered but not yet billed is accrued each month based on estimates of the amounts delivered since the last meter reading date to the end of the reporting period. Revenue is recognized as the only activities before conversion into cash are meter reading, billing and cash collection. The revenue recognized is gross of meter reading, billing and cash collection costs due to the immateriality of such items.

The accrual of a receivable for unbilled revenue includes the amount recoverable through the fuel clause or the purchased gas clause. Unbilled revenue for each jurisdiction is recorded as a current asset.

### **Related Links:**

[Accounting for Derivative Instruments and Hedging Activities](#)

[Asset Impairments Reviews for Long-lived Assets \(excluding Goodwill\) and Equity Method Investments, Assets Held for Sale and Discontinued Operations \(SFAS No. 144 and APB No. 18\)](#)

[Revenue Recognition](#)

[Other Comprehensive Income Accounting Procedures](#)

[Accounting for Defined Benefit Pension and Other Post-Retirement Benefit Plans](#)

[Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters](#)

- For all accruals impacting customer billings, the appropriate account should be used
- For capital accruals, the appropriate resource type, 35000 – Direct Mat/Purchases Accrual, should be used. For regulated enterprises, the appropriate resource type for a capital accrual will prevent Allowance for Funds Used During Construction (AFUDC) from calculating on those accrued charges. Use of resource type is optional for expense accruals
- Appropriate documentation should be attached to each journal to substantiate that the entries follow proper accrual guidelines (i.e. that liabilities/assets have been incurred in current period). To assist with the account reconciliations, the documentation should include a short explanation as to the nature of the accrual: 1) the projected date(s) for its reversal and 2) an indication of whether the accrual is for one specific item or for a group of smaller items.

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#### Support for the Policy:

Statement of Financial Accounting Concepts No. 6: Elements of Financial Statements

35. Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

PROBABLE is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in Statement 5, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved. Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain (pars. 44 - 48)

OBLIGATIONS in the definition is broader than LEGAL OBLIGATIONS. It is used with its usual general meaning to refer to duties imposed legally or socially; to that which one is bound to do by contract, promise, moral responsibility, and so forth. It includes equitable and constructive obligations as well as legal obligations (pars. 37 - 40).

#### CHARACTERISTICS OF LIABILITIES

36. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. Liabilities commonly have other features that help identify them -- for example, most liabilities require the obligated entity to pay cash to one or more identified other entities and are legally enforceable. However, those features are not essential characteristics of liabilities. Their absence, by itself, is not sufficient to preclude an item's qualifying as a liability. That is, liabilities may not require an entity to pay cash but to convey other assets, to provide or stand ready to provide services, or to use assets and the identity of the recipient need not be known to the obligated entity before the time of settlement. Similarly, although most liabilities rest generally on a foundation of legal rights and duties, existence of a legally enforceable claim is not a prerequisite for an obligation to qualify as a liability if for other reasons the entity has the duty or responsibility to pay cash, to transfer other assets, or to provide services to another entity.



## Duke Energy Accounting Policy Statement

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### Accrual Guidelines

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller – Corporate Accounting, FE&G Accounting, DEI Accounting & Non-Regulated Accounting
<b>Approval:</b>	Corporate Controller

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<b>Effective Date:</b>	March 31, 2003
<b>Revision Date:</b>	May 15, 2009
<b>Reissue Date:</b>	March 31, 2008

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### Statement of Purpose and Philosophy

To ensure that obligations incurred in a given period are reflected on the financial statements for that period in accordance with generally accepted accounting principles (GAAP).

### Policy Expectations

#### General Policy:

The guidelines below will help identify when costs should be accrued:

- Purchases of Goods, Equipment and Assets: Payables for the purchase of assets should be recorded when the risks of ownership have passed. For goods or equipment purchased, this generally takes place when title passes, typically the date the items are received or, if the terms are F.O.B. shipping point, the date shipped. However, if title or possession is retained by the seller for security reasons or for the convenience of the buyer, the payable should nevertheless be recorded if the substantive risks of ownership have passed. Payables for items received subject to testing or installation should also be recorded unless it is probable that the items will not be accepted or installed. On the other hand, no liability should be recorded for items received on consignment until title passes or on bailment.
- Services: Payables for services should be recorded as the services are performed.
- Activities/Fees: Payables for other activities/fees should be recorded when the associated benefits are received.
- Products/Services Provided to Customers: Receivables for work performed but not yet billed should be recorded only when products/services are rendered consistent with the Revenue Recognition policy for the enterprise.
- Exempt and Non-exempt Employee Compensation: Payables for labor should be recorded as work is performed.

Detailed analysis of accruals will be completed on a quarterly basis for the months ended March 31, June 30, September 30, and December 31. This detailed analysis would include a pursuit for all items greater than or equal to \$50,000 which meet the guidelines above (Note: for accruals impacting Duke Energy Kentucky, the threshold is reduced to \$25,000 or greater). Departments may choose to pursue items under this threshold as long as the same level is used consistently each period. In any month, departments should accrue any material items they are aware of that meet the guidelines above and are reasonably estimable without any additional detailed analysis – especially any material expense items and any material items related to any major construction projects. Accruals should be reversed in the month(s) that the associated invoices are processed.

#### Accountability, Roles and Responsibilities:

- Journal entries should be prepared for capital vs. expense items on or before day 3 of the close cycle.
- Expenditure accruals should be charged to the appropriate expense/capital account and accounts payable account. If you have questions about the appropriate accounting, contact your business unit accounting representative.



Duke Energy Accounting Policy Statement

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## Asset Impairments Reviews for Long-lived Assets (excluding Goodwill) and Equity Method Investments, Assets Held for Sale and Discontinued Operations (SFAS No. 144 and APB No. 18)

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<b>Applicability:</b>	Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller
<b>Approval Date:</b>	December 9, 2004
<b>Effective Date:</b>	December 1, 2004
<b>Reissue Date</b>	December 31, 2008

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### **Statement of Purpose and Philosophy**

The purpose of this policy is to provide guidelines related to the accounting and disclosure of asset impairments and assets held for sale as well as the presentation of discontinued operations for long-lived assets under the provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), and for investments accounted for using the equity method under the provisions of Accounting Principles Board ("APB") Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock" ("APB No. 18"). Duke Energy is committed to preparing and providing financial information with the utmost integrity. To facilitate this corporate value, the Corporate Controller's Department will approve policies to ensure the accuracy of books and records (as detailed in the Code of Business Ethics).

### **Policy Expectations and Scope**

The intent of this policy is to communicate the financial accounting and reporting for impairments, assets held for sale and discontinued operations under SFAS No. 144 and APB No. 18. This policy contains a high-level summary of the key requirements of U. S. GAAP as it applies to Duke Energy, including any significant interpretations or policy elections made by Duke Energy, but is not intended to be a substitute for the detailed requirements of authoritative GAAP literature for specific issues or matters that may arise.

Except for equity method investments, this policy does not apply to assets that are scoped out of SFAS No. 144 (e.g., goodwill; investments in debt and equity securities accounted for under the cost method under SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," or SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities;" or instruments accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS No. 133")). Furthermore, reference is made to the accounting policy entitled "Accounting for Regulated Entities," ("SFAS No. 71") which provides additional guidance for monitoring regulatory assets for recoverability.



Examples of assets subject to the accounting and reporting requirements of SFAS No. 144 include:

- Property, plant and equipment
- Assets under capital leases of lessees
- Long-lived assets of lessors subject to operating leases
- Intangibles subject to amortization
- Long-term prepaid assets

This policy is applicable to all business/corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company"), and should help ensure consistent application of the accounting rules for asset impairments, assets held for sale, and discontinued operations classification across the consolidated Duke Energy group.

### **Materiality**

FASB Statements note that "The provisions of this Statement need not be applied to immaterial items." Accordingly, materiality should be considered when applying this policy. However, materiality must be assessed at the consolidated Duke Energy Corporation level (as well as being assessed at the SEC sub-registrant level), and involves consideration of both quantitative as well as qualitative factors. Any questions regarding materiality should be directed to the Corporate Controller's Department.

### **Accountability: Roles and Responsibilities**

#### **Corporate Controller's Department -**

- Maintain an accounting policy available on the Duke Energy portal to help ensure by policy that business/corporate units are aware of the criteria in order to record impairments, classify an asset as held for sale and record discontinued operations.
- Establish and communicate the reporting timetable for information needed for SEC filings regarding SFAS No. 144 and APB No. 18 and accumulate the information reported by the business/corporate units for periodic reporting and disclosure purposes (e.g. Form 10-K, Form 10-Q, etc.).
- Determine the presentation of assets held for sale at each reporting period.
- Provide guidance/assistance to business/corporate units on the classification and disclosure of assets held for sale and discontinued operations.
- Provide guidance on the consideration of materiality as may be requested by the business/corporate units.
- Coordinate with the business/corporate units to assess the need to file a Form 8-K for any material asset impairments.

#### **Business/Corporate Unit -**

- Monitor for impairment indicators.
- Ensure that any required recoverability/impairment analyses for assets to be held and used and any investments accounted for using the equity method are performed in a timely manner and that the appropriate support/documentation is prepared and retained for the analyses.
- Ensure all reporting requirements of assets held for sale are accumulated and reported to the Corporate Controller's Department in accordance with the established reporting timetable.
- Ensure proper support/documentation exists for the six criteria which must be met in order to classify assets as held for sale.
- Ensure proper support/documentation exists for the determination of fair value of the assets classified as held for sale, including support for the discount rate used if a discounted cash flow approach is used to determine fair value.
- Ensure that appropriate consideration is given to discontinued operations presentation when assets are disposed of or classified as held for sale.
- Notify the Corporate Controller's Department upon determining that any asset impairment exists and coordinate with the Corporate Controller's Department to assess the need to file a Form 8-K for any material asset impairments.

### Standards/Requirements/Background Information

*[NOTE: In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value in US GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements; however SFAS No. 157 amends some of the accounting pronouncements discussed in this policy and therefore, the application of SFAS No. 157 may change Duke Energy's current practice for determining fair values for the areas of accounting covered by this policy. For Duke Energy, SFAS No. 157 is effective as of January 1, 2008 for fair value measurements of equity method investees (as they are deemed to be financial assets) whereas fair value measurements for non-financial assets (such as PP&E) are not subject to the guidance under SFAS No. 157 until 2009, at the earliest. For additional information and guidance with respect to the application of SFAS No. 157, refer to policy entitled Fair Value Measurements Used in Accounting.]*

This section primarily contains references to, and excerpts from, the most significant or applicable GAAP authoritative literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

#### Background

In August 2001, the FASB issued SFAS No. 144, which superseded the previous asset impairment provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS No. 121"), and the discontinued operations classification provisions of APB Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". SFAS No. 144 requires a long-lived asset to be periodically evaluated for impairment under a held and used model. An asset (asset group) which meets certain criteria to be classified as held for sale is measured at the lower of its carrying amount or fair value less cost to sell and depreciation (amortization) of the asset is ceased. Additionally, subject to meeting certain criteria, a *component of an entity* (as defined – see "Discontinued Operations Presentation" section below), which has been sold or classified as held for sale, is presented as discontinued operations in the Statement of Operations.

The guidance on accounting for equity method investments is included in APB No. 18, which has been in effect since 1971.

#### Supporting Guidance

This section contains discussions of the following topics:

- Long-Lived Assets to be Held and Used
- Long-Lived Assets to be Disposed Of Other Than by Sale
- Long-Lived Assets to be Disposed Of by Sale
- Equity Method Investments
- Discontinued Operations Presentation
- SEC Form 8-K Reporting Requirements

This section primarily contains references to, and excerpts from, the most significant or applicable GAAP authoritative literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

#### Long-Lived Assets to be Held and Used

A long-lived asset held and used (asset group) shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such events or changes in circumstances which may require an asset (asset group) to be tested for recoverability (note that the following are only examples and is not an "all inclusive"

listing of circumstances) (paragraph 8 of SFAS No. 144):

- a. A significant decrease in the market price of a long-lived asset (asset group)
- b. A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition
- c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
- d. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)
- e. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
- f. A current expectation that, *more likely than not*,<sup>1</sup> a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

<sup>1</sup> The term *more likely than not* refers to a level of likelihood that is more than 50 percent.

A long-lived asset (asset group) is not recoverable if its carrying amount (book value) exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset (asset group). If a long-lived asset (asset group) is not recoverable, it is impaired and an impairment loss shall be recognized only if the carrying amount (book value) of the asset (asset group) exceeds its fair value. Such impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset (asset group) exceeds its fair value (paragraph 7 of SFAS No. 144). An impairment loss recognized for a long-lived asset (asset group) to be held and used shall be included in income from continuing operations before income taxes, and also reflected in operating income if such a subtotal is presented in the Statement of Operations.

*Grouping of Assets for Recognition and Measurement of Impairment (Asset Group) (paragraphs 10-14 of SFAS No. 144)*

For purposes of recognition and measurement of an impairment loss, a long-lived asset or assets shall be grouped with other assets and liabilities (an asset group) at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. However, an impairment loss, if any, that results from applying SFAS No. 144 shall reduce only the carrying amount of a long-lived asset or assets of the group, on a pro-rata basis using the relative carrying amounts of those assets. SFAS No. 144 prohibits entities from reversing impairment losses should facts and circumstances change in the future. In addition, future depreciation would be based on the asset's new cost basis.

In limited circumstances, a long-lived asset (for example, a corporate headquarters facility) may not have identifiable cash flows that are largely independent of the cash flows of other assets and liabilities and of other asset groups. In those circumstances, the asset group for that long-lived asset shall include all assets and liabilities of the entity.

When the asset group is at a level below the entire entity, which is often the case, corporate overhead expenses that can be specifically identified or attributed to specific assets should still be included in the asset group's cash flow projection. For example, advertising expense for a specific business unit recorded by corporate headquarters. Accordingly, it may be appropriate to include those specific advertising costs in the cash flow projection. However, if an overhead expense is incidental to the operations of a particular store (e.g., the Chief Executive Officer's salary or rent on the headquarters building), generally it should be excluded from the cash flow projection.

Goodwill shall be included in an asset group to be tested for impairment only if the asset group is or includes a reporting unit (the term "reporting unit" is defined in SFAS No. 142, "Goodwill and Other Intangible Assets ("SFAS No. 142")," as the same level as or one level below an operating segment (as that term is defined in paragraph 10 of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information"). SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level)). Goodwill shall not be included in a lower-level asset group that includes only part of a reporting unit. Estimates of future cash flows used to test that lower-level asset group for recoverability shall not be adjusted for the effect of excluding goodwill from the group.

Regarding goodwill, paragraph 29 of SFAS No. 142 notes the following regarding the proper sequencing when goodwill and another asset are being assessed for impairment at the same time:

"29. If goodwill and another asset (or asset group) of a reporting unit are tested for impairment at the same time, the other asset (or asset group) shall be tested for impairment before goodwill. For example, if a significant asset group is to be tested for impairment under Statement 144 (thus potentially requiring a goodwill impairment test), the impairment test for the significant asset group would be performed before the goodwill impairment test. If the asset group was impaired, the impairment loss would be recognized prior to goodwill being tested for impairment."

Other than goodwill, the carrying amounts of any assets (such as accounts receivable and inventory) and liabilities (such as accounts payable, long-term debt, and asset retirement obligations) not covered by SFAS No. 144 that are included in an asset group shall be adjusted in accordance with other applicable generally accepted accounting principles prior to testing the asset group for recoverability.

#### *Estimates of Future Cash Flows for Recoverability (paragraphs 16-18 of SFAS No. 144)*

Estimates of future cash flows used to test the recoverability of a long-lived asset (asset group) shall include only the future cash flows (cash inflows less associated cash outflows) that are directly associated with and that are expected to arise as a direct result of the use and eventual disposition of the asset (asset group).

Estimates of future cash flows used to test the recoverability of a long-lived asset (asset group) shall incorporate the entity's own assumptions about its use of the asset (asset group) and shall consider all available evidence. If alternative courses of action to recover the carrying amount of a long-lived asset (asset group) are under consideration or if a range is estimated for the amount of possible future cash flows associated with the likely course of action, the likelihood of those possible outcomes shall be considered. A probability-weighted approach may be useful in considering the likelihood of those possible outcomes. Such future cash flows used to test the recoverability of a long-lived asset (asset group) to be held and used are undiscounted.

#### *Practicable Considerations in Preparing Estimates of Future Cash Flows for Recoverability*

- General Considerations - the assumptions used in estimating future cash inflows should be reasonable in relation to the assumptions used in developing other information used for comparable periods, such as internal budgets and projections and accruals related to incentive compensation plans.
- Cash Flow Estimation Period - The cash flow estimation period should be based upon the long-lived asset's remaining useful life to the entity. Thus, the process of estimating a long-lived asset's remaining useful life is very important because it directly impacts the number of periods over which operating cash flows are to be estimated in performing a recoverability test. When long-lived assets are grouped for purposes of performing the recoverability test, the remaining useful life of the asset group should be based upon the useful life of the "primary asset." The "primary asset" is defined as the principal long-lived tangible asset being depreciated or identifiable intangible asset being amortized that is the most significant component asset from which the group derives its cash-flow-generating capacity. A primary

asset of an asset group therefore cannot be land or an intangible asset not being amortized. Factors that an entity should consider in determining whether a long-lived asset is the primary asset are: a) whether other assets of the group would have been acquired by the entity without the asset, b) the level of investment that would be required to replace the asset, and c) the remaining useful life of the asset relative to other assets of the group.

- Asset-Related Expenditures - For a long-lived asset (group) that is "held and used," estimates of future cash flows used to test for recoverability shall be based on the existing service potential (i.e., "as is") of the "primary asset" on the date it is tested. Therefore, estimates of future cash flows used in that test should exclude the cash flows associated with asset-related expenditures that would enhance the existing service potential of the "primary asset" that is in use. The cash flow estimates would include cash flows (including estimated salvage values) associated with future expenditures necessary to maintain the existing service potential, including those that replace the service potential of component parts of a long-lived asset or component assets (other than the primary asset) of an asset group.
- Debt - Generally, debt (including project level debt) should not be included in an asset group because the lowest level of identifiable cash flows will typically not include cash flows associated with debt (i.e., the principal payments associated with the debt). However, in rare instances, if the lowest level of identifiable cash flows includes cash flows associated with debt principal payments and it is not practical to eliminate those cash flows (which would be more likely to occur when the asset group is a business or reporting unit), then the debt should be included in the asset group (i.e., netted with the carrying amounts of the assets of the group) so as to maintain an appropriate comparison. This basis adjustment provides the same result as if the debt principal payments have been excluded (e.g., debt with a carrying value of \$100, would have undiscounted cash flows of \$100).
- Interest expense - SFAS No. 144 prohibits the inclusion of interest expense in assessing the recoverability of long-lived assets. However, Paragraph 20 of SFAS No. 144 notes that for assets under development, estimates of future cash flows developed to test a long-lived asset for recoverability shall include interest payments that will be capitalized as part of the cost of the asset.
- Inventory and other assets related to the asset group - Other than goodwill, the carrying amounts of any assets and liabilities not covered by SFAS No. 144 that are included in an asset group shall be adjusted in accordance with other generally accepted accounting principles prior to testing the asset group for recoverability. For example, inventory and accounts receivable should be adjusted in accordance with generally accepted accounting principles prior to performing a recoverability test, if those assets are included in an asset group being tested for recoverability. For example, inventory is reported at the lower of cost or market in accordance with ARB No. 43.
- End of Estimation Period Cash Flows - because a long-lived asset's value is not necessarily fully depleted over its depreciable life, assuming proceeds on sale in cash flow estimates is appropriate.

SFAS No. 144 does not contain specific guidance on whether the expected undiscounted cash flows should include or exclude income taxes. The following guidance on estimates of future cash flows is contained in SFAS No. 144:

"Estimates of future cash flows used to test the recoverability of a long-lived asset (asset group) shall include only the future cash flows (cash inflows less associated cash outflows) that are directly associated with and that are expected to arise as a direct result of the use and eventual disposition of the asset (asset group). Those estimates shall exclude interest charges that will be recognized as an expense when incurred."

The following interpretation of this issue is from KPMG:

"QIIB10. Should an entity perform the recoverability test using pre-tax or after-tax cash flows?"

In Statement 144, as in Statement 121, the Board did not address the issue of whether estimates of future cash flows used to test recoverability of an asset should include or exclude income taxes. Generally, an entity performs the recoverability testing using pre-tax cash flows because the carrying amounts of the tested long-lived assets are pre-tax. That is, any tax-related

consequences of the asset are included in the entity's deferred tax assets and liabilities. Deferred tax amounts related to a long-lived asset generally are not included in the carrying amount of the asset when testing that asset for recoverability under Statement 144.

We believe that an entity should make an accounting policy election to use either pre-tax or after-tax cash flows when testing its long-lived assets for recoverability. In some situations, an exception to a policy to use pre-tax cash flows may be appropriate. For example, we believe that an entity should use after-tax cash flows to test the recoverability of an asset if the asset's tax characteristics strongly influenced the entity's decision to invest in that asset. An example of an asset with that type of tax characteristic is a direct investment in affordable housing (the investor's return depends significantly on income tax credits generated by the investment)."

Additionally, Aspen Publishing's (CCH) Accounting Research Manager has a similar interpretation:

**"7-6. Inclusion of Income Taxes in Statement 144 Analyses**

**(a) Inclusion of Income Taxes in Undiscounted Cash Flows**

**Question:** Statement 144 is silent on the issue of income taxes. Should income taxes be considered in the future cash flows of an asset for purposes of determining whether the carrying amount of an asset is recoverable?

**Response:** Even though Statement 144 does not require income taxes to be considered in an entity's estimate of expected future cash flows for purposes of the undiscounted recoverability test, the test would normally yield a similar result regardless of whether income taxes are included or excluded as demonstrated below.

The following example demonstrates that the undiscounted cash flow recoverability test for Asset Z results in the same answer on both a pretax and after-tax basis. Three scenarios are used in the example where the pretax undiscounted cash flows are varied to be more than the carrying amount of the asset (Scenario A), equal to the carrying amount of the asset (Scenario B), or less than the carrying amount of the asset (Scenario C).

<b>Assumptions:</b>	Scenario A	Scenario B	Scenario C
Book carrying amount of Asset Z (a)	10,000	10,000	10,000
Tax basis of Asset Z (e)	<u>6,000</u>	<u>6,000</u>	<u>6,000</u>
Temporary difference	<u>4,000</u>	<u>4,000</u>	<u>4,000</u>
Deferred tax liability (assuming 40% tax rate)	1,600	1,600	1,600
(b)			
Pretax undiscounted cash flows (c)	11,000	10,000	9,700
<b>Pretax Comparison:</b>			
Pretax undiscounted cash flows	11,000	10,000	9,700
Book carrying amount	10,000	10,000	10,000
<b>Impairment?</b>	<b>No</b>	<b>No</b>	<b>Yes</b>
<b>After-tax Comparison:</b>			
Pretax undiscounted cash flows (c)	11,000	10,000	9,700
Future taxes payable (see (d) below)	<u>2,000</u>	<u>1,600</u>	<u>1,480</u>
After-tax cash flows [(c) – (d)]	9,000	8,400	8,220
Book carrying amount less deferred tax liability [(a) – (b)]	8,400	8,400	8,400
<b>Impairment?</b>	<b>No</b>	<b>No</b>	<b>Yes</b>
Calculation of future taxes payable:			
Pretax undiscounted cash flows (c)	11,000	10,000	9,700

Depreciation deductions (e)	<u>6,000</u>	<u>6,000</u>	<u>6,000</u>
Future taxable income	<u>5,000</u>	<u>4,000</u>	<u>3,700</u>
Income taxes payable (assuming 40% tax rate) (d)	<u>2,000</u>	<u>1,600</u>	<u>1,480</u>

Note that when performing the after-tax comparison, the book carrying amount must be reduced by the deferred tax liability to arrive at the appropriate amount to compare to the after-tax cash flows."

The above example applies to a taxable entity (e.g., a C corporation). Consideration of the specific facts and circumstances would need to be given for a non-taxable entity (e.g., a limited liability corporation or a partnership). For example, a non-taxable entity that is not a party to any tax sharing agreement and does not provide for income taxes in its financial statements should likely perform the impairment assessment without regard to income tax implications. On the other hand, the implications for a non-taxable entity that is a party to a tax sharing agreement and therefore provides for income taxes in its financial statements would likely be similar to those for a taxable entity.

*Determination of Fair Value (paragraph 22 and 23 of SFAS No. 144)*

*Note – as discussed on page 3 above, the following excerpts do not reflect amendments by SFAS No. 157 which are effective for fair value measurements of equity investees beginning January 1, 2008. Refer to the separate policy entitled “Fair Value Measurements Used in Accounting.”*

The fair value of an asset (liability) is the amount at which that asset (liability) could be bought (incurred) or sold (settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The fair value of an asset group or a disposal group refers to the amount at which the group as a whole could be bought or sold in a current single transaction. Therefore, the fair value of the group would not necessarily equate to the sum of the fair values of the individual assets and liabilities of the group.

Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the fair value measurement, if available. However, in many instances, quoted market prices in active markets will not be available for the long-lived assets (asset groups) covered by SFAS No. 144. In those instances, the estimate of fair value shall be based on the best information available, including prices for similar assets (groups) and the results of using other valuation techniques.

A present value technique is often the best available valuation technique with which to estimate the fair value of a long-lived asset (asset group). FASB Concepts Statement No. 7, “Using Cash Flow Information and Present Value in Accounting Measurements,” discusses the use of two present value techniques to measure the fair value of an asset (liability). The first is expected present value, in which multiple cash flow scenarios that reflect the range of possible outcomes and a risk-free rate are used to estimate fair value. The second is traditional present value, in which a single set of estimated cash flows and a single interest rate (a rate commensurate with the risk) are used to estimate fair value. Either present value technique can be used for a fair value measurement. However, for long-lived assets (asset groups) that have uncertainties both in timing and amount, an expected present value technique will often be the appropriate technique.

Whether or not cash flows from derivative instruments designated in qualifying cash flow hedges under SFAS No. 133, should be considered in determining whether the carrying value of a long-lived asset is recoverable under SFAS No. 144 has been addressed in the following interpretation included in Aspen Publishing’s (CCH) Accounting Research Manager:

**“7-13. Interaction Between Statement 133 and Statement 144**

**Question:** May cash flows from derivative instruments designated in qualifying cash flow hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, be considered in determining whether the carrying value of a long-lived asset is recoverable under paragraph 7 of SFAS No. 144?

**Response:** No. Paragraph 34 of SFAS No. 133 requires that companies apply impairment provisions of generally accepted accounting principles each period after applying hedge accounting for the period. Paragraph 34 of SFAS No. 133 prohibits a company from considering the fair value or expected cash flows of a hedging instrument in applying impairment provisions of other GAAP.

Under SFAS No. 144, certain circumstances may require a company to estimate the future cash flows it expects from an asset's use and its eventual disposition. Companies should not consider cash flows from derivative instruments designated in qualifying cash flow hedges under SFAS No. 133 when performing the recoverability test under paragraph 7 of SFAS No. 144. For example, when applying the test to an oil and gas property, the oil and gas producer's estimate of future cash flows should not include cash flows of derivative instruments designated in qualifying cash flow hedges of oil and gas sales related to the property.

However, if a company recognizes an impairment loss in accordance with Statement 144 for an asset to which hedged forecasted transactions relate, paragraph 35 of Statement 133



requires the company to reclassify into earnings any offsetting net gain from accumulated other comprehensive income."

Therefore, cash flows from recognized derivative instruments under SFAS No. 133 should not be included in determining whether the carrying value of a long-lived asset (asset group) is recoverable under SFAS No. 144. However, unrecognized derivative instruments (such as instruments being accounted for under the Normal Purchase and Normal Sale exception in SFAS No. 133) should be evaluated on a facts and circumstances basis as to whether cash flows from such unrecognized derivative instruments should be included in the undiscounted cash flows utilized to test the asset (asset group) for recoverability under SFAS No. 144.

*Revision of Depreciation or Amortization Estimates (paragraph 9 of SFAS No. 144)*

When a long-lived asset (asset group) is tested for recoverability under SFAS No. 144, it also may be necessary to review depreciation estimates or amortization periods for the long-lived asset (asset group). Any revision to the remaining useful life of a long-lived asset resulting from that review also shall be considered in developing estimates of future cash flows used to test the asset (asset group) for recoverability. However, any change in the accounting method (e.g., the depreciation method being used) for the asset resulting from that review shall be made only after applying the provisions of SFAS No. 144.

*Disclosure Requirements (paragraph 26 of SFAS No. 144)*

The following information shall be disclosed in the notes to the financial statements that include the period in which an impairment loss is recognized:

- a. A description of the impaired long-lived asset (asset group) and the facts and circumstances leading to the impairment;
- b. If not separately presented on the face of the statement, the amount of the impairment loss and the caption in the income statement or the statement of activities that includes that loss;
- c. The method or methods for determining fair value; and,
- d. If applicable, the segment in which the impaired long-lived asset (asset group) is reported under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information."

*Long-Lived Assets to be Disposed Of Other Than by Sale (paragraphs 27-29 of SFAS No. 144)*

A long-lived asset to be disposed of other than by sale (for example, by abandonment, in an exchange for a similar productive long-lived asset, or in a distribution to owners in a spinoff) shall continue to be classified as held and used until it is disposed of. If an asset (asset group) that is to be exchanged for a similar productive long-lived asset (asset group) or distributed to owners in a spinoff is tested for recoverability while it is classified as held and used, the estimates of future cash flows used in that test shall be based on the use of the asset for its remaining useful life, assuming that the disposal transaction will not occur.

*Long-Lived Assets to be Distributed in to Owners in a Spinoff*

Long-lived assets (groups) to be exchanged or distributed to owners in a spinoff are considered disposed of when they are exchanged or distributed. Prior to the exchange or distribution, if the assets are tested for recoverability on a "held and used" basis, the undiscounted cash flows would be based on the use of the asset for its remaining useful life, assuming the disposal transaction will not occur. For example, if an entity has committed to a plan to distribute a long-lived asset (group) to owners in a spinoff but the distribution will not occur for several months and impairment indicators trigger a recoverability test, the cash flow estimates used in that test should assume the long-lived asset will be used over its remaining useful life (even though the distribution of the long-lived asset (group) is expected to occur in the near future).

Long-Lived Assets to be Disposed Of by Sale

A long-lived asset (disposal group) classified as held for sale shall be measured at the lower of its carrying amount or fair value less estimated costs to sell. Costs to sell are the incremental direct costs to transact a sale, that is, the costs that result directly from and are essential to a sale transaction and that would not have been incurred by the entity had the decision to sell not been made, including broker commissions, legal and title transfer fees, and closing costs that must be incurred before legal title can be transferred. Additionally, a long-lived asset shall not be depreciated (amortized) while it is classified as held for sale.

The carrying amounts of any assets that are not covered by SFAS No. 144, including goodwill, that are included in a disposal group classified as held for sale shall be adjusted in accordance with other applicable generally accepted accounting principles prior to measuring the fair value less cost to sell of the disposal group.

Certain assets are specifically scoped out of SFAS No. 144 (including equity method investments, as discussed below). As there is no evidence that presentation of the assets scoped out of SFAS No. 144 to be sold was specifically contemplated, separate presentation of such assets on the face of the balance sheet (as held for sale), while not required, would not be prohibited. Duke Energy's position on this matter is addressed in the "Accounting Policy" section below.

*Criteria for Classification as Held for Sale*

A long-lived asset is only classified as held for sale in the period in which **all** of the following six criteria (paragraph 30 of SFAS No. 144) are met (commentary on meeting certain of the criteria has been added in *italics* below):

1. Management, having the authority to approve the action, commits to a plan to sell the asset (or group of assets, referred to as "disposal group").
  - *Management must be of the proper level and have the proper authority to be able to commit the entity to a plan to sell.*
  - *If Board approval is required, or management seeks such approval, in order to sell an asset, the entity has not committed to a plan to sell the asset until Board approval is granted (this position is consistent with that previously expressed by the SEC in Staff Accounting Bulletin Topic 5.P.1 (from SAB 100, which was ultimately deleted by SAB 103)). Executive management or Board approval of an overall budget or forecast that includes information on potential asset dispositions does not constitute approval for the purposes of this item if subsequent more detailed approval (e.g. individual asset dispositions) will be required. However, explicit Board approval to proceed with the sales of assets may constitute the requisite level of approval, depending upon the specific facts and circumstances, even if subsequent Board approval will be required under the Company's delegation of authority policy to execute a specific transaction.*
  - *Public announcements concerning an entity's consideration of selling do not meet the definition of "committing to a plan to sell the asset" if subsequent approval is required (such as from an executive committee or board of directors).*
2. The asset (disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (disposal groups).
  - *Any requirement the Company may have to hold or operate the asset for a certain future period of time would not allow the asset to be available for immediate sale. As an example, if an entity did not intend to sell a property until certain renovations or improvements are completed (in order to increase the value), the asset would not be available for immediate sale until the renovations or improvements are completed. Additionally, any requirement of an entity to continue to operate an asset in order to*

*complete pending customer orders would not allow the asset to be available for immediate sale.*

- *Any third party requirements to hold or operate the facility for a certain period of time which are outside of the entity's control (such as pending regulatory approvals) would not preclude the asset from being available for immediate sale as long as it is expected the requirement or pending approval will not permanently delay the sale of the asset.*
3. An active program to locate a buyer and other actions required to complete the plan to sell the asset (disposal group) have been initiated.
- *This would include engagement of investment bankers, deploying of internal staff to market the long-lived asset for sale, etc.*
4. The sale of the asset (disposal group) is probable (i.e. "likely to occur") and transfer of the asset (disposal group) is expected to qualify for recognition as a completed sale, within one year, except as explained below:
- *The term "recognition as a completed sale" is interpreted to mean the transaction meets the requirements to be recognized as a sale under the accounting literature, such as SFAS No. 66, "Accounting for Sales of Real Estate", within a one year timeframe.*
  - *If delay beyond one-year is outside of the control of the company, held for sale classification may still be appropriate if any of the following conditions are met (the following are the specific items from paragraph 31 of SFAS No. 144):*
    - *If at the date an entity commits to a plan to sell a long-lived asset (disposal group) the entity reasonably expects that others (not a buyer) will impose conditions on the transfer of the asset (group) that will extend the period required to complete the sale and (1) actions necessary to respond to those conditions cannot be initiated until after a firm purchase commitment is obtained from the buyer and (2) a firm purchase commitment is probable within one year of the date an entity commits to a plan to sell the asset;*
    - *If an entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a long-lived asset (disposal group) previously classified as held for sale that will extend the period required to complete the sale and (1) actions necessary to respond to the conditions have been or will be timely initiated and (2) a favorable resolution of the delaying factors is expected; or,*
    - *If during the initial one-year period, circumstances arise that previously were considered unlikely and, as a result, a long-lived asset (disposal group) previously classified as held for sale is not sold by the end of that period and (1) during the initial one-year period the entity initiated actions necessary to respond to the change in circumstances, (2) the asset (group) is being actively marketed at a price that is reasonable given the change in circumstances, and (3) the six criteria for classification as held for sale are met.*
5. The asset (disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value.
- *"Reasonable sales price" is interpreted as no greater than an asset's fair value*
  - *"Actively marketed" means that the asset (disposal group) is being marketed for sale by the Company. This can be directly by the Company through an offering memorandum, through investment bankers or brokers, etc.*

6. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

If the above criteria in paragraph 30 of SFAS No. 144 are met after the balance sheet date but before issuance of the financial statements, a long-lived asset shall continue to be classified as held and used in those financial statements when issued (only classified as held for sale at the date the criteria above are met).

*Subsequent Measurement (paragraph 37 of SFAS No. 144)*

A loss shall be recognized for any initial or subsequent write-down to fair value less cost to sell. A gain shall be recognized for any subsequent increase in fair value less cost to sell, but not in excess of the cumulative loss previously recognized (for a write-down to fair value less cost to sell). The loss or gain shall adjust only the carrying amount of a long-lived asset, whether classified as held for sale individually or as part of a disposal group. A gain or loss not previously recognized that results from the sale of a long-lived asset (disposal group) shall be recognized at the date of sale.

*Changes to a Plan to Sale (paragraphs 38 and 39 of SFAS No. 144)*

If circumstances arise that previously were considered unlikely and, as a result, an entity decides not to sell a long-lived asset (disposal group) previously classified as held for sale, the asset (disposal group) shall be reclassified as held and used. A long-lived asset that is reclassified shall be measured individually at the lower of its (a) carrying amount before the asset (disposal group) was classified as held for sale, adjusted for any depreciation (amortization) expense that would have been recognized had the asset (disposal group) been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell.

Any required adjustment to the carrying amount of a long-lived asset that is reclassified as held and used shall be included in income from continuing operations in the period of the subsequent decision not to sell. That adjustment shall be reported in the same income statement caption used to report a loss.

*Long-Lived Assets Acquired in a Purchase Business Combination (paragraph B87 of SFAS No. 144)*

When long-lived assets newly acquired in a purchase business combination are classified as assets to be sold (disposal group), the purchase price allocation is to reflect this determination. SFAS No. 144 has the following discussion:

"A long-lived asset (disposal group) classified as held for sale shall be measured at the lower of its carrying amount or fair value less cost to sell, whether previously held and used or newly acquired. This Statement also requires that the results of operations of a disposal group classified as held for sale be recognized in the period in which those operations occur, whether reported in continuing operations or in discontinued operations."

Thus, the purchase price allocation would report the disposal group at the lower of its carrying amount or fair value less cost to sell. In the period the disposal group is sold (assuming it is a component of an entity), the respective results from operations would be reported in discontinued operations in the Statement of Operations.

*Disclosure Requirements (paragraphs 46-48 of SFAS No. 144)*

The disclosure requirements of an asset classified as held for sale are as follows:

- A long-lived asset classified as held for sale shall be presented separately in the balance sheet, if material. The assets and liabilities of a disposal group classified as held for sale shall be presented separately in the asset and liability sections, respectively, of the balance sheet, if material. Those assets and liabilities shall not be offset and presented as a single amount. The

major classes of assets and liabilities classified as held for sale shall be separately disclosed either on the face of the balance sheet or in the notes to financial statements. Additionally, classification of the assets and liabilities included in the disposal group should be considered between current and non-current.

- The following information shall be disclosed in the notes to the financial statements that cover the period in which a long-lived asset (disposal group) either has been sold or is classified as held for sale:
  - a. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face of the statement, the carrying amount(s) of the major classes of assets and liabilities included as part of a disposal group.
  - b. The gain or loss recognized and if not separately presented on the face of the income statement, the caption in the income statement that includes that gain or loss.
  - c. If applicable, amounts of revenue and pretax profit or loss reported in discontinued operations.
  - d. If applicable, the segment in which the long-lived asset (disposal group) is reported under Statement 131.

If an entity subsequently decides to change the plan to sell the long-lived asset (disposal group), a description of the facts and circumstances leading to the decision to change the plan and its effect on the results of operations for the period and any prior periods presented shall be disclosed in the notes to financial statements that include the period of that decision.

#### Equity Method Investments

##### *Impairment Assessment*

The guidance for assessing investments accounted for under the equity method for impairment is included in paragraph 19(h) of APB No. 18:

“A loss in value of an investment which is other than a temporary decline should be recognized. Evidence of a loss in value might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment. However, a decline in the quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is other than temporary. All are factors to be evaluated.”

*Note – as discussed on page 3 above, amendments by SFAS No. 157 are effective for fair value measurements of equity investees beginning January 1, 2008. Refer to the separate policy entitled “Fair Value Measurements Used in Accounting.”*

APB 18 does not provide any further guidance regarding how to assess a “loss in value.” However, the SEC has commented on this matter more than once. For example, at the December 2002 AICPA Conference on Current SEC Developments, the SEC presentation included the following slide:

#### “Other Hot Topics

##### Impairment of Equity Method Investments

- Guidance – See paragraph 19(h) of APB 18
- Undiscounted cash flow methodology is not an appropriate means of assessing whether an equity method investment is impaired
- Trigger is “other than temporary” loss in value”

The SEC also commented on this matter at the March 2004 EITF meeting – the following is an extract from the minutes to that meeting:

"The SEC Observer stated that registrants should continue to rigorously assess equity method investments for impairment and indicated that the SEC staff will continue to object to inappropriate impairment analyses for such investments, for example a Statement 144 undiscounted cash flow approach."

The accounting literature does not expressly define what constitutes an "other than temporary" decline in value. However, the SEC has provided some observations on this topic in SEC Staff Accounting Bulletin Topic 5.M., "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities" ("SAB Topic 5.M." or "SAB 59"). In SAB Topic 5.M., the SEC staff notes that "other than temporary" is not the same as "permanent" and provides the following guidance in assessing whether an impairment should be considered to be "other than temporary":

"There are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case. The staff believes that the following are only a few examples of the factors which, individually or in combination, indicate that a decline is other than temporary and that a write-down of the carrying value is required:

- a. The length of the time and the extent to which the market value has been less than cost;
- b. The financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; or
- c. The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

Unless evidence exists to support a realizable value equal to or greater than the carrying value of the investment, a write-down to fair value accounted for as a realized loss should be recorded."

SEC Accounting and Auditing Enforcement Release Nos. 309, 316, 370, and 422 provide factors to be evaluated in determining an other-than-temporary impairment in addition to those listed in SAB Topic 5.M, including:

- The condition and trend of the economic cycle,
- The issuer's financial performance and projections,
- Trends in the general market,
- The issuer's capital strength, and
- The issuer's dividend payment record.

Other specific adverse conditions at the investee level are further indicators of an other-than-temporary diminution in value, including:

- Known liquidity crisis.
- Bankruptcy proceedings.
- Going concern commentary in the auditor's report on the investee's most recent financial statements.

#### *Financial Statement Presentation and Classification*

As noted above, equity method investments are among the assets that are specifically scoped out of SFAS No. 144. APB No. 18 is silent regarding the presentation of any equity method investments to be disposed of. Paragraph 19(c) of APB No. 18 simply notes that the equity investments (e.g., investments in common stock) should be shown in the balance sheet as a single amount. As there is no evidence that presentation of an equity method investment to be sold was specifically contemplated, separate presentation of such assets on the face of the balance sheet (as held for sale), while not required, would not be prohibited. Duke Energy's position on this matter is addressed in the "Accounting Policy" section below.

See also the discussion of equity method investments in the "Discontinued Operations Presentation" section below.

### Discontinued Operations

The results of operations of a component of an entity that either has been disposed of or is classified as held for sale shall be reported in discontinued operations if both of the following conditions are met: (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. For these purposes, a component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

The following is a Q&A from KPMG regarding what constitutes a component of an entity:

"QV11. Can a disposal group that does not include assets within the scope of the impairment provisions of Statement 144 (because the impairment of those assets is addressed by other generally accepted accounting principles) be a component of an entity under paragraph 41?

A. Yes. Assets or groups otherwise outside the scope of Statement 144 for impairment recognition and measurement may represent a component of the entity and, if the asset or group meets the conditions in paragraph 42, qualify for discontinued operations display."

"Significant" continuing involvement is a lower hurdle or threshold than the concept of "substantial" continuing involvement contained in SFAS No. 66 to recognize a transaction as a sale. Therefore, it is possible that a transaction would meet the criteria to be recognized as a sale under SFAS No. 66 as the continuing involvement was not "substantial", but the criteria for classification as discontinued operations would not be met as the continuing involvement is considered "significant".

Additional operational guidance on the assessment of (1) the elimination of cash flows and (2) the significance of any continuing involvement is addressed in EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations ("EITF Issue 03-13")," for which a final consensus was reached in late 2004. In the consensus, the EITF concluded that classification of a disposed component as a discontinued operation is appropriate only if the ongoing entity (1) has no "continuing direct cash flows" (a term Issue 03-13 introduces to interpret paragraph 42(a) of SFAS No. 144), and (2) does not retain an interest, contract, or other arrangement sufficient to enable it to exert significant influence over the disposed component's operating and financial policies after the disposal transaction (an interpretation of paragraph 42(b) of SFAS No. 144).

Paragraphs 13-15 of EITF Issue 03-13 provide an assessment period in which to evaluate whether a disposed component should be classified as a discontinued operation. The assessment period includes the earlier of (i) the date at which the component meets the criteria to be classified as held for sale or (ii) is disposed of, and continues through one year after the disposal date. Those paragraphs from EITF Issue 03-13 are presented below:

#### **"Assessment Period**

13. The Task Force reached a consensus that the appropriate assessment period should include the point at which the component initially meets the criteria to be classified as held for sale or is disposed of through one year after the date the component is actually disposed of. The assessment should be based on all facts and circumstances, including management's intent and ability to (a) eliminate the cash flows of the disposed component from its operations and (b) not have significant continuing involvement in the operations of the disposed component. For one year after a component has been disposed of, an entity should reassess whether the criteria in paragraph 42 are expected to be met only when significant events or circumstances occur that may change its current assessment. If the occurrence of a significant event or circumstance at any time during the assessment period results in an expectation that the criteria in paragraph 42 will not be met by the end of the assessment period, the component's operations should not be presented as discontinued operations. If the occurrence of a significant event or circumstance at any time during the

assessment period results in an expectation that the criteria in paragraph 42 will be met by the end of the assessment period, the component's operations should be presented as discontinued operations. Reclassification into and out of discontinued operations for all periods presented may be required during the assessment period.

14. The assessment period may extend beyond one year after the component is actually disposed of in situations in which events or circumstances beyond an entity's control extend the period required to eliminate the direct cash flows of the disposed component or eliminate significant continuing involvement in the ongoing operations of the disposed component provided that the entity (a) takes the actions necessary to respond to those situations and (b) expects to eliminate the direct cash flows and the significant continuing involvement.

15. The evaluation of whether the criteria in paragraph 42 are expected to be met for a component that is either disposed of or classified as held for sale at the balance sheet date should include significant events or circumstances that occur after the balance sheet date but before the issuance of the financial statements. This evaluation is solely for the purposes of determining the presentation of discontinued operations pursuant to paragraph 42 of Statement 144 and does not apply to any other guidance in Statement 144."

The forward-looking considerations discussed in paragraph 13 of EITF Issue 03-13 include the need to assess any potential implications of any planned or potential purchases or acquisitions. For example, the Duke Energy North America ("DENA") discontinued operations assessment in the 3<sup>rd</sup> quarter of 2005 required the consideration of the potential implications of the trading operations intended following the proposed merger with Cinergy Corp. that was expected to close in the first half of 2006.

In a period in which a component of an entity either has been disposed of or is classified as held for sale, the income statement of a business enterprise (or statement of activities of a not-for-profit organization) for current and prior periods shall report the results of operations of the component, including any gain or loss recognized related to classification as held for sale, in discontinued operations. The results of operations of a component classified as held for sale shall be reported in discontinued operations in the period(s) in which they occur. The results of discontinued operations, less applicable income taxes (benefit), shall be reported as a separate component of income before extraordinary items and the cumulative effect of accounting changes (if applicable).

EITF Topic No. D-104, "Clarification of Transition Guidance in Paragraph 51 of FASB Statement No. 144," contains the following regarding the timing of discontinued operations presentation for a component of an entity to be liquidated or wound down:

"However, if, after Statement 144 is initially applied, a component of an entity will be abandoned through the liquidation or run-off of operations, that component should not be reported as a discontinued operation in accordance with Statement 144 until all operations, including run-off operations, cease."

Regarding significance, or materiality, assessments for discontinued operations presentation, in the basis for conclusions to SFAS No. 144 the FASB commented that one of the reasons for revising the guidance for accounting for discontinued operations was to broaden the disposal transactions presented as discontinued operations to include the results of operations of a component of an entity, as defined. The FASB concluded that the requirements for reporting discontinued operations should not focus on whether a component of an entity is significant or otherwise incorporate a quantitative criterion. Instead, those requirements should focus on whether a component of an entity has operations and cash flows that can be clearly distinguished from the rest of the entity, consistent with the stated objective of broadening the reporting of discontinued operations. Accordingly, the FASB likely anticipated that the materiality threshold for assessing presentation of discontinued operations would be relatively low.

If the disposal transaction or anticipated transaction meets the requirements for presentation as a discontinued operation before the balance sheet date, financial statements for prior periods must also be restated to reflect the discontinued operation. If a material disposal transaction or anticipated transaction meets the requirements for presentation as a discontinued operation after the balance sheet date, but prior to the issuance of the financial statements, the transaction should not be presented as a discontinued operation. Discontinued operations presentation is only appropriate in



historical financial statements covering the period during which the discontinued operations presentation requirements are met.

Once the threshold for reporting discontinued operations for a reporting period has been crossed, and the discontinued operations line item(s) are included in the Statement of Operations, any previous dispositions that occurred during the reporting period that were not shown as discontinued operations due to materiality should be reassessed to determine if discontinued operations presentation is now appropriate. Unless the impact is immaterial, it is possible that discontinued operations presentation for any such items will be appropriate.

If a registration statement is filed after the date that a transaction qualifies for discontinued operations presentation, but prior to the time such transaction has been presented as a discontinued operation in the historical financial statements (e.g. included in filed financial statements), pro forma financial statements pursuant to Article 11 of Regulation S-X would be required, for all periods presented in the registration statement, if the transaction exceeds the significance threshold in Article 11. While such Article 11 pro forma financial statements are not required in the historical periodic 1934 Act filings (e.g. SEC Forms 10-K and 10-Q), subsequent event disclosure of the transaction should be considered in those financial statements, if material. If a registration statement is filed after a current year transaction has been presented (included in filed financial statements with the SEC) as a discontinued operation, the historical financial statements for all periods included or incorporated by reference in the registration statement (e.g., three years plus any subsequent interim periods) would be required to be restated and reissued to reflect the transaction as a discontinued operation.

SFAS No. 144 specifically does not apply to investments in equity securities accounted for under the cost or equity method, and APB No. 18 does not address the topic of discontinued operations presentation. Additionally, it is unlikely that an investment accounted for under the cost or equity method, by itself, would qualify as a 'component of an entity', as prescribed by SFAS No. 144. Operations and cash flows of an equity method investment usually cannot be clearly distinguished, operationally and for financial reporting purposes from the rest of an entity (the investor), and thus would not qualify as a disposal group. As pointed out in Deloitte & Touche's interpretations of SFAS No. 144, in November of 2001 the FASB Board clarified that the disposal of an equity method investment, by itself, should not be reported as a discontinued operation under SFAS No. 144, as paragraph 5 excludes investments in equity securities accounted for by the equity method from the scope of SFAS No. 144. Accordingly, unless it is part of a larger disposal group that represents a component of an entity, sale of an equity method investment usually would not be reported as a discontinued operation in the Statement of Operations.

Cash flows relating to discontinued operations are not required to be set out separately in the statement of cash flows, but they may be if the enterprise desires to do so. Whether or not cash flows from discontinued operations are set out separately, the reconciliation of net income to net cash flows from operations should begin with net income, as required by paragraphs 28 and 29 of SFAS No. 95, "Statement of Cash Flows."

Extraordinary items and the cumulative effect of changes in accounting principles are not allocated between continuing and discontinued operations. Accordingly, to the extent that the Company has either an extraordinary item or a change in accounting principle that relate to an entity or operation accounted for as discontinued operations for any of the periods presented, these items should continue to be presented at their full amounts, net of the related income tax effects, in their appropriate locations in the income statement and not reclassified into discontinued operations. Neither accounting changes nor extraordinary items are part of the normal operations of an entity; therefore, their effects shall not be allocated between continuing operations and discontinued operations.

Operations to be presented as discontinued may contain intercompany transactions with other business or corporate units (e.g., purchases from, or sales to, other units that will continue to be owned). SFAS No. 144 does not expressly address the treatment of intercompany accounts, but the matter is addressed in the following Deloitte & Touche interpretation of SFAS No. 144:

## "INTERCOMPANY SALES TO A DISCONTINUED OPERATION

FASB 144: 43-5  
[Issued February 14, 2003]  
[Amended December 9, 2005]

### Question

Company N is a paper manufacturing company with plants around the country. N owns a distribution business, Company X, who buys paper from N and then sells the paper to outside customers. N is planning to discontinue the operations of X and sell X to another paper manufacturer. N has appropriately eliminated the intercompany sales between itself and X, and therefore, only recognizes the sales from X to the customers.

X will continue to purchase paper from N to sell to outside customers. Therefore, N will continue to have sales to X that will not be eliminated once it is no longer a related party. N has analyzed the significance of the continuing cash flows pursuant to EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations," and has concluded that the continuing cash flows are not significant. Therefore, X will be classified as discontinued operation in the second quarter financial statements.

May the intercompany sales between N and X that have not been passed on to outside customers remain in continuing operations?

### Answer

Yes, the sales from N to X that have not been passed on to outside customers should be shown in the continuing operations of N.

For example: N sells paper to X for \$6 with a cost of \$4. N's profit is \$2. X sells paper to outside customers for \$7 with a cost (X's purchase price from N) of \$6. X's profit is \$1. In the consolidated financial statements of N, the intercompany sales of \$6 will be eliminated along with the \$6 cost of sales, leaving a profit of \$3. The \$3 margin will come through as \$2 in continuing operations (representing the sales from N to X) and \$1 in discontinued operations (representing the sales from X to the outside customers). Next year (assuming the same facts) when N sells paper to X, it will have the same \$6 sale, \$4 cost of sale and \$2 profit in its continuing operations (and will not have the additional \$1 profit from sales to the outside customers).

The company should record sales from continuing operations of \$6, cost of sales of \$4, a profit of \$2, and \$1 of profit in discontinued operations."

The appropriate presentation of amounts resulting from intercompany transaction will depend on the particular facts and circumstances of each transaction.

### SEC Form 8-K Reporting Requirements

In August 2004, the SEC expanded the number of events that are reportable on Form 8-K to include "material impairments." See the separate Duke Energy policy statement entitled "Form 8-K Requirements and Filing Procedure" for further discussion of this matter.

### Accounting Policy

A long-lived asset (asset group) classified as "Held and Used" is evaluated periodically for impairment when certain events or changes in circumstances indicate the long-lived asset may not be recoverable. If the long-lived asset is considered impaired, the impairment loss recognized is measured as the difference between the long-lived asset's carrying value and its fair value. Impairment losses are recorded as a component of income from continuing operations before income taxes.

As discussed under "Estimates of Future Cash Flows for Recoverability" above, SFAS No. 144 is silent regarding the consideration of income taxes when assessing undiscounted cash flows to determine the recoverability of an asset (asset group). Since the undiscounted recoverability test is expected to normally yield a similar result regardless of whether income taxes are included or excluded, for simplicity purposes, Duke Energy's preferred method, no matter the form of legal entity (C-Corp, LLC, etc.) is not to consider the impact of income taxes. However, in the event that factors indicate that the outcome of the test would differ if income taxes were considered (e.g., a non-conventional fuel source property in which the decision to invest was based in part on receiving special income tax credits), the test should be performed after giving consideration to income taxes.

An asset (asset group) is classified as held for sale and measured at the lower of carrying value or fair value less costs to sell in the period when all of the six criteria in paragraph 30 of SFAS No. 144 are met. Once classified as held for sale, depreciation (or amortization) of the long-lived asset is ceased. If at any time the criteria for classification as held for sale are no longer met, a long-lived asset (disposal group) classified as held for sale shall be reclassified as held and used and measured individually at the lower of its (a) carrying amount before the asset (disposal group) was classified as held for sale, adjusted for any depreciation (amortization) expense that would have been recognized had the asset (disposal group) been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell (in accordance with paragraph 38 of SFAS No. 144).

The guidance in SFAS No. 144 does not specify whether assets and liabilities held-for-sale should be classified as current or noncurrent in the statement of financial position. Paragraph B120 of SFAS No. 144 indicates, "The Board concluded that because requirements for classifying assets and liabilities as current or noncurrent are provided by other accounting pronouncements, including ARB No. 43, Chapter 3, "Working Capital," further guidance in this Statement is not needed." ARB No. 43 indicates that current classification applies to those assets that an entity will realize in cash, sell, or consume within one year and those liabilities an entity will discharge by use of current assets or the creation of other current liabilities within one year. Therefore, all assets and liabilities classified as held-for-sale will need to be evaluated for classification as current or non-current. Normally, those assets and liabilities will retain their previous current or noncurrent classification (as held and used) and will be disclosed under the provisions of paragraph 46 of SFAS No. 144.

As noted above there is no authoritative literature that addresses the balance sheet presentation for assets that are intended to be sold but are outside the scope of SFAS No. 144. Accordingly, Duke Energy's policy for presentation is that these assets, including any equity method investments being held for sale, should usually continue to retain their previous presentation and therefore not be presented as "assets held for sale." An exception to this presentation might be made if, for example, a significant operation was being disposed of that included some assets that were within the scope of SFAS No. 144 and some that were outside its scope (e.g., for the substantial exit of DENA announced in September 2005, substantially all of the assets to be disposed of were within the scope of SFAS No. 144, so all, including some contracts not under SFAS No. 144, were presented as assets held for sale, as this was determined to be the most useful presentation to a user of Duke Energy's financial statements).

Regarding any intercompany accounts that may accompany assets being sold (e.g., an intercompany liability to be assumed by a buyer), such intercompany accounts must continue to be eliminated in consolidation until the transaction closes and the accounts cease to represent intercompany transactions. Accordingly, in assessing balance sheet presentation of any such intercompany balances related to assets to be sold, appropriate coordination with the business or corporate unit on the other end of the transaction should occur to ensure that the balances continue to be eliminated in consolidation. Consistent with the treatment of other items that are outside the scope of SFAS No. 144, the normal practice should be to not reclassify intercompany amounts to "assets held for sale" or "liabilities associated with assets held for sale." As discussed under the "Discontinued Operations Presentation" section above, the determination of the appropriate presentation of amounts for intercompany transactions will be dependent on the facts and circumstances surrounding each transaction.

Additionally, the business/corporate unit will be responsible for reporting to the Corporate Controller's Department all the disclosure requirements in accordance with SFAS No. 144 and APB No. 18 (see

"Reporting Requirements" below). All asset impairments and assets classified as held for sale shall be reported by each business/corporate unit to the Corporate Controller's Department regardless of any materiality thresholds, as discussed below.

If assets classified as held for sale exceed five percent of total assets on a consolidated basis at the reporting date, they must be separately disclosed on the face of the balance sheet in accordance with SEC Regulation S-X, Rule 5-02. For all other instances, classification as held for sale on a consolidated basis will be determined by the Corporate Controller's Department.

If some, but not all, of the six criteria in SFAS No. 144 are met and the asset is classified as held and used, the potential impact of the following other accounting requirements should be considered:

- The potential need to adjust the remaining depreciable life of the asset. If a loss is anticipated on the ultimate sale of the asset, depreciation expense should be adjusted based upon the remaining period of time the entity expects to use the asset and the expected proceeds from the asset's sale (if less than the historical depreciation expense amount); and
- The potential need to assess the asset for impairment under an "asset to be held and used" scenario, with appropriate probability weighting of the various potential uses of the asset, as discussed in paragraph 17 of SFAS No. 144.

Equity method investments should be assessed for impairment when conditions exist that indicate that the fair value of the investment is less than book value. If the decline in value is considered to be other than temporary, the investment should be written down to its estimated fair value, which establishes a new cost basis in the investment. This new cost basis cannot subsequently be written up to a higher value as a result of increases in fair value, nor can the write-down be reversed over time by amortization of the basis difference (the difference between the carrying value of the investment and the investor's underlying equity in the net assets of the investee) caused by the write-down. Any subsequent increases in the value of the investment should not be recognized until realized.

#### Reporting and Disclosure Requirements

In financial statements containing a period in which an impairment loss is recognized, the following are required to be disclosed:

- A description of the impaired long-lived asset (asset group) and the facts and circumstances leading to the impairment;
- If not separately presented on the face of the statement, the amount of the impairment loss and the caption in the income statement or the statement of activities that includes that loss;
- The method or methods for determining fair value (whether based on a quoted market price, prices for similar assets, or another valuation technique); and,
- If applicable, the segment in which the impaired long-lived asset (asset group) is reported under SFAS No. 131.

For each asset (disposal group) a business/corporate unit has classified as held for sale, the following items are required to be reported at each quarterly or annual reporting period until the asset is sold or is no longer classified as held for sale:

- Carrying amount of the asset (disposal group) at the reporting balance sheet date
- The account balance the carrying amount of the asset is included within
- The amount of any loss recorded and the classification of the loss in the income statement
- The expected manner and timing of the sale transaction
- The methodology utilized to determine fair value (e.g. appraisals, quoted market prices, comp sales, etc.)

### Presentation of Discontinued Operations

Assets sold or classified as "held for sale" must be assessed for presentation as a discontinued operations in accordance with the provisions of SFAS No. 144.

- As a general rule, revenues are required in order to qualify for discontinued operations presentation. For example, the sale of equipment that was never placed into use or partially-completed power plants would likely not qualify for discontinued operations presentation because there were never any revenues generated by these assets.
- A component of an entity may qualify for discontinued operations presentation even if it does not include conventional long-lived assets, such as power plants. For example, a component that represents a trading and marketing operation may qualify for discontinued operations presentation.
- Equity method investments do not qualify for discontinued operations presentation unless they are part of a larger disposal group that represents a component of an entity. This also applies for any investments for which the accounting has changed (e.g., from equity method to consolidation) during the period covered by the financial statements. For example, if an investment is being sold that was consolidated in the most recent year, but accounted for under the equity method in prior years, only the period that the investment was consolidated would be eligible for discontinued operations presentation (unless they are part of a larger disposal group that represents a component of an entity). The results for the investment for the prior years when it was accounted for using the equity method should remain in continuing operations.
- Discontinued operations are presented at the bottom of the income statement following income from continuing operations
- Discontinued operations presentation is appropriate, subject to materiality considerations, if both of the following conditions are met:
  - The operations and cash flows related to the asset will be eliminated from ongoing operations following the sale; and
  - The Company will not have any significant continuing involvement with the operations of the asset following the sale.

Note that the assessment period in which to evaluate whether a disposed component should be classified as a discontinued operation includes the date at which the component meets the criteria to be classified as held for sale or is disposed of, and continues through one year after the disposal date. Once the threshold for reporting discontinued operations for a reporting period has been crossed, and the discontinued operations line item(s) are included in the Statement of Operations, any previous dispositions that occurred during the reporting period that were not shown as discontinued operations due to materiality should be reassessed to determine if discontinued operations presentation is now appropriate. Unless the impact is immaterial, it is possible that discontinued operations presentation for any such items will be appropriate (management judgment should be applied, and in the event of uncertainty contact the Corporate Controller's Department).

### **Related Links:**

- [Accounting for Regulated Entities \(SFAS No. 71\)](#)
- [Accounting for Derivative Instruments and Hedging Activities](#)
- [Accounting for Goodwill](#)
- [Fair Value Measurements Used In Accounting](#)
- [Form 8-K Requirements and Filing Procedure](#)
- [Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters](#)



## Duke Energy Accounting Policy Statement

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### Fair Value Measurements Used in Accounting

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller

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<b>Effective Date:</b>	01/01/2008
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<b>Issuance Date:</b>	12/31/2008
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*[Index to Accounting Policy](#)*

### **Statement of Purpose and Philosophy**

The purpose of this policy is to provide guidelines related to the accounting and disclosures for fair value accounting measurements, under SFAS No. 157, "Fair Value Measurements," ("SFAS No. 157") and other related accounting pronouncements. Duke Energy is committed to preparing and providing financial information with the utmost integrity. To facilitate this corporate value, the Corporate Controller's Department will approve policies to ensure the accuracy of books and records (as detailed in the Code of Business Ethics).

On January 1, 2008, Duke Energy adopted SFAS No. 157. As discussed further below, Duke Energy's adoption of SFAS No. 157 is currently limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. 157-2, which delayed the effective date of SFAS No. 157 for one year for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis.

Accounting references have been provided for much of the Accounting Policy discussion. For additional accounting references including interpretations, see Accounting [Policy Support - Fair Value](#).

### **Policy Expectations and Scope**

This policy is applicable to all business/corporate units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company") which utilize fair value measurements in accounting. This policy contains a high-level summary of the key requirements of U. S. generally accepted accounting principles ("GAAP") as it applies to Duke Energy, including any significant interpretations or policy elections made by Duke Energy, but is not intended to be a substitute for consulting with the detail requirements of authoritative GAAP literature for specific issues or matters that may arise. This policy should help ensure consistent application of fair value measurements in accounting across the consolidated Duke Energy group.

### **Materiality**

FASB Statements note that "The provisions of this Statement need not be applied to immaterial items." Accordingly, materiality should be considered when applying this policy. However, materiality must be assessed at the consolidated Duke Energy Corporation level (as well as being assessed at the SEC sub-registrant level), and involves consideration of both quantitative as well as qualitative factors. Any questions regarding materiality should be directed to the Corporate Controller's Department.

### **Accountability: Roles and Responsibilities**

#### Business Units/Corporate Areas

- Ensure appropriate business/corporate unit personnel understand the fair value measurement technique requirements of SFAS 157 and apply all material aspects of such requirements to the period end measurements.

## Fair Value Measurements (SFAS No. 157)

- Maintain supporting documentation of the appropriateness of the fair value techniques employed to demonstrate compliance with SFAS 157's measurement requirements.
- Ensure business/corporate unit personnel with appropriate level of experience complete the data request forms that will be used in the preparation of the SFAS 157 disclosures in Form 10-Qs and Form 10-Ks.
- Work with the Corporate Controller's Department - CARG to address any identified cases of noncompliance with or inconsistencies in the application of SFAS 157.
- Provide assistance to the External Reporting Group ("ERG") in completing the SFAS 157 disclosures within Form 10-Q and Form 10-K by answering questions from the ERG and providing supporting documentation, if applicable.
- Ensure all reporting requirements are accumulated and reported to the Corporate Controller's Department in accordance with the established reporting timetable.

### Corporate Controller's Department

- ERG and CARG will maintain data request forms outlining the needed information for financial assets and liabilities measured at fair value.
- CARG will be available to answer questions from business/corporate units with respect to the application of SFAS 157 to their fair value measurements and will coordinate as necessary with the company's external auditors in resolving complex matters.
- Address any instances of noncompliance with SFAS 157 or any inconsistencies and review and approve final results with the Corporate Controller.
- Maintain an accounting policy for Fair Value accounting available on the Duke Energy portal to help ensure that business/corporate units are aware of the criteria/applicability of applying the provisions of SFAS No. 157 and other related accounting pronouncements.
- Establish and communicate the reporting timetable for Fair Value accounting information needed for SEC filings and accumulate the information reported by the applicable entities for periodic reporting and disclosure purposes (e.g., Form 10-K, Form 10-Q, etc.).
- Provide guidance on the consideration of materiality as may be requested by the business/corporate units.
- Determine Accounting Policy decisions with respect to the use of Fair Value Measurements.
- Approve changes in valuation techniques.

### Risk Management –

- Develop and maintain valuation techniques for commodity derivatives that comply with this accounting policy and assist business unit and corporate accountants with obtaining other market-based valuation inputs for other valuations, as requested.

### Treasury –

- Value interest rate swaps consistent with this policy and assist business unit and corporate accountants with obtaining other market-based valuation inputs for other valuations, as requested.

### **Standards/Requirements/Background Information**

This section primarily contains references to, and excerpts from, the most significant or applicable GAAP authoritative literature. Matters specific or unique to Duke Energy are primarily discussed in the "Accounting Policy" section below.

#### Standards

Guidance on accounting and disclosures for fair value measurements is provided primarily but not exclusively by the following:

- SFAS No. 107, "Disclosures about Fair Value of Financial Instruments"
- SFAS No. 157, "Fair Value Measurements"
- SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities"
- FIN 39, "Offsetting of Amounts Related to Certain Contracts"

## Fair Value Measurements (SFAS No. 157)

- FSP FIN 39-1, "FASB Staff Position: Amendment of FASB Interpretation No. 39"
- FSP FIN FAS 157-1, "FASB Staff Position: Application of FASB Statement No. 157 to GASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13"
- FSP FIN FAS 157-2, "FASB Staff Position: Effective Date of FASB Statement No. 157"

### Background-

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157. Per SFAS No. 157,

### Summary -

The definition of fair value retains the exchange price notion in earlier definitions of fair value. This Statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price).

This Statement emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, this Statement establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The notion of unobservable inputs is intended to allow for situations in which there is little, if any, market activity for the asset or liability at the measurement date. In those situations, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity must not ignore information about market participant assumptions that is reasonably available without undue cost and effort.

This Statement clarifies that market participant assumptions include assumptions about risk, for example, the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and/or the risk inherent in the inputs to the valuation technique. A fair value measurement should include an adjustment for risk if market participants would include one in pricing the related asset or liability, even if the adjustment is difficult to determine. Therefore, a measurement (for example, a "mark-to-model" measurement) that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one in pricing the related asset or liability.

This Statement clarifies that market participant assumptions also include assumptions about the effect of a restriction on the sale or use of an asset. A fair value measurement for a restricted asset should consider the effect of the restriction if market participants would consider the effect of the restriction in pricing the asset. That guidance applies for stock with restrictions on sale that terminate within one year that is measured at fair value under FASB Statements No. 115, Accounting for Certain Investments in Debt and Equity Securities, and No. 124, Accounting for Certain Investments Held by Not-for-Profit Organizations .

This Statement clarifies that a fair value measurement for a liability reflects its nonperformance risk (the risk that the obligation will not be fulfilled). Because nonperformance risk includes the reporting entity's credit risk, the reporting entity should consider the effect of its credit risk (credit standing) on the fair value of the liability in all periods in which the liability is measured at fair value under other accounting pronouncements, including FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities .

This Statement affirms the requirement of other FASB Statements that the fair value of a position in a financial instrument (including a block) that trades in an active market should be measured as the product of the quoted price for the individual instrument times the quantity held (within Level 1 of the fair value hierarchy). The quoted price should not be adjusted because of the size of the position relative to trading volume (blockage factor). This Statement extends that requirement to broker-dealers and investment companies within the scope of the AICPA Audit and Accounting Guides for those industries.



## Fair Value Measurements (SFAS No. 157)

This Statement expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value and for recurring fair value measurements using significant unobservable inputs (within Level 3 of the fair value hierarchy), the effect of the measurements on earnings (or changes in net assets) for the period. This Statement encourages entities to combine the fair value information disclosed under this Statement with the fair value information disclosed under other accounting pronouncements, including FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, where practicable.

The guidance in this Statement applies for derivatives and other financial instruments measured at fair value under Statement 133 at initial recognition and in all subsequent periods. Therefore, this Statement nullifies the guidance in footnote 3 of EITF Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities." This Statement also amends Statement 133 to remove the similar guidance to that in Issue 02-3, which was added by FASB Statement No. 155, Accounting for Certain Hybrid Financial Instruments .

### Scope -

2. This Statement applies under other accounting pronouncements<sup>1</sup> that require or permit fair value measurements, except as follows:

- a. This Statement does not apply under accounting pronouncements that address share-based payment transactions: FASB Statement No. 123 (revised 2004), Share-Based Payment, and its related interpretive accounting pronouncements that address share-based payment transactions.
- b. This Statement does not eliminate the practicability exceptions to fair value measurements in accounting pronouncements within the scope of this Statement.
- c. This Statement does not apply under FASB Statement No. 13, Accounting for Leases, and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. This scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under Statement 141 or Statement 141(R), regardless of whether those assets and liabilities are related to leases.

<sup>1</sup> Footnote omitted

3. This Statement does not apply under accounting pronouncements that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including the following:

- a. Accounting pronouncements that permit measurements that are based on, or otherwise use, vendor-specific objective evidence of fair value
- b. ARB No. 43, Chapter 4, "Inventory Pricing."

### Definition of Fair Value -

5. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

.....

9. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs.<sup>5</sup> Transaction costs represent the incremental direct costs to sell the asset or transfer the liability in the principal (or most advantageous) market for the asset or liability.<sup>6</sup> Transaction costs are not an attribute of the asset or liability; rather, they are specific to the transaction and will differ depending on how the reporting entity transacts. However, transaction costs do not include the costs that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market. If location is an attribute of the asset or liability (as might be the case for a commodity), the price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall be adjusted for the costs, if any, that would be incurred to transport the asset or liability to (or from) its principal (or most advantageous) market.

## Fair Value Measurements (SFAS No. 157)

<sup>5</sup> Transaction costs should be accounted for in accordance with the provisions of other accounting pronouncements.

### Fair Value Hierarchy

22. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3) [Note: Underline formatting added by Duke Energy author to add emphasis]. In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

### Level 1 Inputs

24. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available, except as discussed in paragraphs 25 and 26.

25. If the reporting entity holds a large number of similar assets or liabilities (for example, debt securities) that are required to be measured at fair value, a quoted price in an active market might be available but not readily accessible for each of those assets or liabilities individually. In that case, fair value may be measured using an alternative pricing method that does not rely exclusively on quoted prices (for example, matrix pricing) as a practical expedient. However, the use of an alternative pricing method renders the fair value measurement a lower level measurement.

26. In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades, or announcements) occur after the close of a market but before the measurement date. The reporting entity should establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment renders the fair value measurement a lower level measurement.

### Level 2 Inputs

28. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- a. Quoted prices for similar assets or liabilities in active markets
- b. Quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers (for example, some brokered markets), or in which little information is released publicly (for example, a principal-to-principal market)
- c. Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)
- d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

29. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition and/or location of the asset or liability, the extent to which the inputs relate to

## Fair Value Measurements (SFAS No. 157)

items that are comparable to the asset or liability, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

### Level 3 Inputs

30. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions. [Note: Underline formatting added by Duke Energy author to add emphasis]

### Disclosures

32. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition (for example, trading securities), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements and for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To meet that objective, the reporting entity shall disclose the following information for each interim and annual period (except as otherwise specified) separately for each major category of assets and liabilities:

- a. The fair value measurements at the reporting date
- b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
- c. For fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:<sup>12</sup>
  - (1) Total gains or losses for the period (realized and unrealized), segregating those gains or losses included in earnings (or changes in net assets), and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities)
  - (2) Purchases, sales, issuances, and settlements (net)
  - (3) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)
- d. The amount of the total gains or losses for the period in subparagraph (c)(1) above included in earnings (or changes in net assets) that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at the reporting date and a description of where those unrealized gains or losses are reported in the statement of income (or activities)

<sup>12</sup> For derivative assets and liabilities, the reconciliation disclosure required by paragraph 32(c) may be presented net.

## Fair Value Measurements (SFAS No. 157)

e. In annual periods only, the valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques, if any, during the period.

D1. This appendix lists APB and FASB pronouncements existing at the date of this Statement that refer to fair value. Those pronouncements that are amended by this Statement are indicated by an asterisk. (See Appendix E.)

### *Appendix D: Pronouncement Title*

NOTE: This is a partial list designed to identify the APB, FASB and FIN's that are most applicable to Duke Energy.

Opinion 18	The Equity Method of Accounting for Investments in Common Stock
Opinion 21	Interest on Receivables and Payables
Opinion 28	Interim Financial Reporting
Opinion 29	Accounting for Nonmonetary Transactions
Statement 35	Accounting and Reporting by Defined Benefit Pension Plans
Statement 66	Accounting for Sales of Real Estate
Statement 87	Employers' Accounting for Pensions
Statement 106	Employers' Accounting for Postretirement Benefits Other Than Pensions
Statement 107	Disclosures about Fair Value of Financial Instruments
Statement 115	Accounting for Certain Investments in Debt and Equity Securities
Statement 133	Accounting for Derivative Instruments and Hedging Activities
Statement 141*	Business Combinations
Statement 142*	Goodwill and Other Intangible Assets
Statement 143*	Accounting for Asset Retirement Obligations
Statement 144*	Accounting for the Impairment or Disposal of Long-Lived Assets
Statement 146*	Accounting for Costs Associated with Exit or Disposal Activities
Statement 150	Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity
Statement 153	Exchanges of Nonmonetary Assets
Interpretation 45	Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others
Interpretation 46 (revised December 2003)	Consolidation of Variable Interest Entities
Interpretation 47*	Accounting for Conditional Asset Retirement Obligations

**\* - These statements are generally not impacted by SFAS No. 157 in 2008. Duke Energy's adoption of SFAS No. 157 is currently limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. 157-2, which delayed the effective date of SFAS No. 157 for one year for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis.**

## Fair Value Measurements (SFAS No. 157)

### **Accounting Policy**

The following topics are discussed in this section

1. Accrued Interest, Dividends and Interest rate swap payments
2. Active Market
3. Asset Retirement Obligations
4. Auction Revenue Rights
5. Bid-Ask Spreads
6. Broker Quotes
7. Cash and Cash Equivalents
8. Cash Collateral
9. Cost of Service
10. Classification by Level
11. Credit Risk
12. Debt and Equity Investments accounted for at Fair Value
13. Deferred Compensation
14. Derivatives: Commodity
15. Disclosures: FSP FAS 157-2
16. Derivatives: Interest Rate Swaps
17. Disclosures: Non-Recurring
18. Disclosures: Other
19. Disclosures: Recurring
20. Equity Method Investments
21. Estimated (or Stale) Values
22. Fair Value Election (Policy on Interest income/expense)
23. Financial Transmission Rights
24. Goodwill, Intangibles, and Property, Plant and Equipment
25. Impairments
26. Inactive Markets Impact to the Fair Value of Financial Assets
27. IVC
28. Level 3
29. Level 3 Rollforward
30. Liabilities
31. Life Insurance
32. Net Asset Values (NAV)
33. Non-Performance Risk
34. Nuclear Decommissioning Trust Fund
35. Observable Inputs
36. Other Items in Trust Fund Balances not reported at Fair Value
37. Pension and OPEB Assets
38. Portfolio level reserves
39. Post-Market Adjustments
40. Practical Expedients
41. Present Value
42. Principal Market
43. Probability of default
44. Regulatory Assets and Liabilities
45. Reserves
46. SFAS No. 115 disclosures
47. Significant
48. Stock Based Compensation
49. Transaction Costs
50. Unit of Account
51. Valuation Premise

1. Accrued Interest, Dividends and interest rate swap payments

For net-cash-settled derivatives (e.g., fixed-for-floating interest rate swaps), there may be no separately recorded accrued receivable or payable line item. Instead, the fair value of the derivative may include an accrual component. Such an accrual component may exist in the fair value of a net-cash-settled derivative

## Fair Value Measurements (SFAS No. 157)

because it is common for a time lag to exist between the date on which the floating price of the contract is set and the date on which cash settlement occurs (e.g., the contract settlement amount is based on the price of an index established on March 31 even though the contract does not cash-settle until April 3). The fact that the recorded fair value of a net-cash-settled derivative contains an accrual component does not affect an entity's ability to offset contracts carried at fair value. The accrual component is not separately reported from its related derivative. It still may be possible to offset separately recorded accrued receivables and payables against similar separately recorded payables or receivables held by the same counterparty, if all the conditions in paragraphs 5 and 8 of Interpretation 39 are satisfied. Note, however, that paragraph 8 states that "amounts recognized as accrued receivables should not be offset against amounts recognized as accrued payables unless a right of setoff exists."

The market convention for bond investments is that they are typically quoted excluding accrued interest. Duke Energy excludes accrued interest (accrued dividends in the case of investments in preferred and common stock) but does include the accrued payment on a fixed-floating interest rate swap as an item measured at fair value in the recurring Fair Value disclosures.

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### 2. Active Market

An active market includes markets such as NYMEX, NYSE, NASDAQ, Pink Sheets (a daily list of over-the-counter stocks not traded on NASDAQ and the broker/dealers making markets in them.) and Chicago Board of Trade as long as transactions for the particular instrument in question have taken place on an on-going basis during the last month. Transaction volume is not usually a factor in determining whether or not a market is active.

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### 3. Asset Retirement Obligations

The application of SFAS No. 157 at Duke Energy for non-financial measurements excluding derivatives has been delayed until 1/1/2009 as a result of FSP FAS 157-2. We anticipate adding additional guidance to this policy as it applies to this item in the future. See also [Disclosures: FSP FAS 157-2](#).

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### 4. Auction Revenue Rights

Auction Revenue Rights (ARRs) in PJM and MISO are not considered derivatives. See also the discussion on [Financial Transmission Rights](#). ARR are not carried at Fair Value and are not included in the recurring or non-recurring Fair Value disclosures.

Duke Energy's accounting for ARR and FTR is documented in separate memoranda. Contact a representative of the Corporate Accounting Research Group for additional information.

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### 5. Bid-Ask Spreads

From SFAS No. 157:

31. If an input used to measure fair value is based on bid and ask prices (for example, in a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where in the fair value hierarchy the input falls (Level 1, 2, or 3). This Statement does not preclude the use of mid-market pricing or other pricing conventions as a practical expedient for fair value measurements within a bid-ask spread.

Investments which are traded on a bid-ask spread are reported using the latest closing price.

Commodity derivatives are priced by adjusting the mid-market price for liquidity. Liquidity is calculated by taking one quarter of the difference between the bid-ask spread under the assumption that the fair value

## Fair Value Measurements (SFAS No. 157)

will typically settle somewhere within the bid-ask spread but not necessarily at mid-market. Within the observable window, long positions are fair valued by subtracting the liquidity adjustment. Short positions are recorded by adding the liquidity adjustment.

For derivatives which are settled outside an observable window, an adjustment is also required to reflect a bid-ask spread. This adjustment should reflect the full spread required to move the price to either the "bid", if the position is a long position, or the "ask" if the position is a short position.

In the context of the above discussion, a 'long position' is a position which benefits from price increases. For example, if you own a contract to buy a mWh of on-peak electricity at \$50/mWh, price increases are to your advantage. A price increase means you will be able to sell the electricity for a profit or at worst, a price increase means you will be able to sell for less of a loss. Conversely, a price decrease means you will sell at a loss or at less of a profit.

A 'short position' benefits from price decreases and is therefore, the opposite of a long position. ...

'Bid Ask' is from the perspective of the market, or a third party. A 'bid' price is the price which the market is 'bidding', that is, what the market will pay you for what you have to sell. An 'ask' price is the price which the market is "asking", that is what price the market will sell something to you. Thus, the 'bid' price is lower than the 'ask' price.

For interest rate swaps, Duke is typically a price-taker. When Duke is 'long' interest rates (receives the variable interest rate), swaps will be priced at the "bid". When Duke is 'short' interest rates (pays the variable interest rate), swaps will be priced at the 'ask'.

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### 6. Broker Quotes

Indicative Broker Quotes which are defined as broker quotes where the broker does not agree to trade on the price quoted are not considered observable inputs. Broker quotes are considered level 3 inputs. Multiple broker quotes do not change broker quotes to a level 2 input.

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### 7. Cash and Cash Equivalents

Cash equivalents are investments with a maturity when acquired of 3 months or less. In general, these investments are held at carrying cost and therefore, are not considered Fair Value measurements when classified as current assets. As a result, cash and cash equivalents held as current assets will not be included in the disclosures on Fair Value. Cash and cash equivalents include money market funds.

Cash equivalents held inside the NDTF or as funding for executive benefits are not reflected in the cash and cash equivalents line item on the balance sheet and are therefore subject to disclosure in the FAS 157 footnote. Any investment funding the executive benefits are reported as non-current assets since the corresponding liability is also reported as non-current.

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### 8. Cash Collateral

It is not appropriate to offset separately recorded accrued receivables or payables against the fair value amounts for derivative assets or liabilities and associated fair value amounts for cash collateral receivables or payables entered into with the same counterparty. Physically settled derivatives (e.g., forward contracts to purchase/sell commodities or bonds) require delivery of an asset. Upon delivery of the asset underlying the physically settled derivative, but before the cash payment, an entity will remove the derivative from its balance sheet and record separate inventory and accrued payable balances. For multiple delivery contracts, this often results in a current payable for the latest delivery and a derivative asset or liability for any remaining deliveries. Once a receivable or payable (other than for cash collateral) is reported separately from its related derivative, however, that receivable or payable no longer can be offset against derivative assets or liabilities and associated cash collateral receivables or payables carried at fair value.

## Fair Value Measurements (SFAS No. 157)

Effective with financial statements after December 31, 2007, cash collateral which approximates fair value will be netted against MTM derivatives on the balance sheet which are under a master netting agreement. Unless the master netting agreement provides for a different methodology, netting against MTM balance sheet positions on the balance sheet will use the following process:

- 1) Put all the positions that were used to determine the amount of collateral posted into five buckets:
  - a) On-Balance Sheet derivatives: Current
  - b) On-Balance Sheet derivatives: Non-Current
  - c) Off-Balance Sheet derivatives: Current
  - d) Off-balance Sheet derivatives: Non-Current
  - e) Accounts Receivable or Accounts Payable
- 2) If cash collateral is an Asset (i.e., Duke Energy has paid/posted collateral to a 3<sup>rd</sup> party as its derivative liability or contract position has tripped the requirement for such posting, and the posting effectively is a receivable back to Duke Energy upon the contractual settlement of the underlying position), add up only the net liabilities in the five buckets. (Leave out any bucket which is a net asset.) Allocate the Cash collateral accordingly.
  - a) Cash collateral allocated to Accounts Payable should not be netted against Accounts Payable.
  - b) Cash collateral allocated to the Off-balance sheet buckets should be reported as current accounts receivable and non-current other assets.
  - c) Cash collateral allocated to the On-Balance sheet buckets should be netted against the Current MTM liabilities and the non-current other liabilities.
- 3) If cash collateral is a Liability (i.e., Duke Energy has received collateral from a 3<sup>rd</sup> party as its derivative asset or contract position has tripped the requirement for such posting, and the cash collateral received effectively is a payable for Duke Energy that will be settled upon the contractual settlement of the underlying position), add up only the net assets in the five buckets. (Leave out any bucket which is a net liability.) Allocate the Cash collateral accordingly.
  - a) Cash collateral allocated to Accounts Receivable should not be netted against Accounts Receivable.
  - b) Cash collateral allocated to the Off-balance sheet buckets should be reported as current accounts payable and non-current other liabilities.
  - c) Cash collateral allocated to the On-Balance sheet buckets should be netted against the Current MTM assets and the non-current other assets.

The amounts put in each bucket are allocated based on the dollars in each bucket prior to the allocation of the collateral.

The above allocation guidance should be used on a recurring basis, unless amounts become significantly higher than historical levels (consultation with the GM of the Corporate Accounting Research Group should be made to determine if this additional process is necessary) and it is determined that the master netting arrangement dictates the level of collateral that must be provided for each contract covered by the agreement on the basis of a specified formula. In that situation, it will be advisable that the contractual formula should be used to determine the level of collateral associated with derivatives carried at fair value. Additionally, consideration should be made of whether the master netting arrangement provides some other means of ascertaining how the collateral would be allocated if a default occurred under the arrangement.

Whether or not cash collateral is at approximate Fair Value will be determined based on judgment which considers the following factors:

- a) anticipated date of repayment of the collateral,
- b) interest rate accrued on collateral,
- c) the market rate of interest for an equivalent credit risk,
- d) frequency of compounding and
- e) frequency of paying interest.

Unless the terms of the cash collateral are such that the present value of the collateral based on the market rate of interest for an equivalent credit risk differs significantly from the carrying value, cash collateral is assumed to approximate Fair Value.



## Fair Value Measurements (SFAS No. 157)

Balance sheet presentations after December 31, 2007 shall reflect the netting of cash collateral retrospectively for all periods presented.

Disclosure of the amount of Cash Collateral that is offset against fair value positions is required. In addition, disclosure of the amount of Cash Collateral that is not offset (for example, if the carrying value of the collateral does not approximate fair value or if cash collateral is allocated to NPNS off-balance sheet positions) is also required to be disclosed.

Disclosure of the amount of Cash Collateral offset against fair value positions can be shown as an additional column in the table of fair values by level.

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### 9. Cost of Service

Cost of service is a reserve that incorporates an estimate of accounting, billing, collecting, nomination and scheduling costs. A cost of service reserve is internally developed and is therefore a level 3 input.

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### 10. Classification by Level

Unadjusted quoted prices from NYSE, AMEX, NASDAQ, NYMEX, Chicago Board of Trade and Pink Sheets are considered to be Level 1 measurements.

The following are the 'default' levels for typical financial assets and commodity derivatives:

#### Level 1:

- a) Both 'On-the-Run' treasuries (the most recently issued U.S. Treasury bond or note of a particular maturity) and 'Off-the-run' treasuries are typically considered to be level 1 measurements.
- b) NYMEX commodity contracts (excluding options)
- c) Mutual funds with published and traded Net Asset Values.
- d) Listed Domestic and Foreign common stock, ETFs, exchange traded ADRs (American Depositary Receipt. A negotiable certificate issued by a U.S. bank representing a specific number of shares of a foreign stock traded on a U.S. stock exchange. ADRs make it easier for Americans to invest in foreign companies, due to the widespread availability of dollar-denominated price information, lower transaction costs, and timely dividend distributions).

#### Level 2:

- a) Commingled cash funds
- b) Corporate Bonds
- c) Municipal Bonds
- d) Swaps
- e) NYMEX commodity option contracts

#### Level 3:

- a) Illiquid Auction Rate Securities
- b) Commodity contracts with more than 10% of tenor outside of observable window

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### 11. Credit Risk

Credit risk is a reserve that incorporates the risk of default by a counterparty of Duke Energy. Credit risk involves a balance sheet asset of Duke or a Duke subsidiary. It is analogous to non-performance risk and reflects:

- a. probability of default,
- b. master netting agreements,
- c. credit enhancements such as guarantees from the parent, letters of credit or cash collateral posted,

## Fair Value Measurements (SFAS No. 157)

- d. timing of the expected payment(s),
- e. expected recovery in bankruptcy
- f. discount rate used to present value the expected payments and
- g. credit limits.

Exposures are netted and then bucketed by year and a credit reserve is calculated for each year.

Credit limits established are assumed to be effective so that the exposure for any year is limited to the total credit limit.

Letters of credit and guarantees are assumed to be credit enhancements for balance sheet derivatives as opposed to off balance sheet derivatives (NPNS).

Present value calculations of future payments often incorporate a component for credit risk (asset valuation) or non-performance risk (liability valuation). For example, a fixed floating interest rate swap is typically discounted at LIBOR. If so, the discounting already reflects a credit spread over the risk-free rate of interest. Theoretically, in the case of a liability valuation, the measurement of non-performance risk is the difference between the credit rating implicit in LIBOR and the credit rating of Duke or the Duke subsidiary. Due to the difficulty in and likely insignificance, Duke ignores any adjustment to reflect the difference between the risk-free rate and LIBOR (however, this decision should be reconsidered each reporting period based on significance – refer to the separate “Significance” section of this policy).

Derivative assets on the balance sheet will reflect a reserve for credit risk, when significant. For interest rate swaps which are assets, a credit risk reserve, if significant, is calculated based on the probability of default applied to the timing of the payments as bucketed by year.

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### *12. Debt and Equity Investments accounted for at Fair Value*

Non-current investments in debt and equity instruments are carried at fair value and therefore are included in the recurring Fair Value disclosures and subject to the fair value measurement principles outlined in this policy.

Current (short-term) debt investments are often reported at carrying value which approximates Fair Value due to the short time to maturity and the minimal risk of default. If there is a significant difference between Fair Value and carrying value, the carrying value is adjusted to Fair Value. Since all instruments with the same CUSIP number have the same fair value per unit, significance is determined relative to each investment. For example, for all investments with the same CUSIP number, the total fair value vs the total carrying value. Short term investments are also included in the recurring Fair Value disclosures.

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### *13. Deferred Compensation*

Deferred compensation plans, including the excess executive savings plans, are liabilities of Duke Energy. The liability is typically measured as an amount equal to the fair value of a set of investments which the executives have selected. As a result, these liabilities have the appearance of a Fair Value measurement.

However, the liability itself is not a Fair Value measure and therefore should not be included in the non-recurring or recurring Fair Value disclosures. Likewise, the liability is not adjusted to reflect non-performance risk.

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## Fair Value Measurements (SFAS No. 157)

### 14. Derivatives: Commodity

Commodity derivatives that are on the balance sheet are carried at Fair Value in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended and are included in the recurring Fair Value disclosures. Commodity derivatives which are exempted from SFAS No. 133 as a result of the Normal Purchase Normal Sale election (NPNS) are not included in the recurring Fair Value disclosures. Commodity derivatives include coal, electricity (on-peak or off-peak), electric capacity swaps, emission allowances (contracts on emission allowances but not emission allowances themselves), FTRs or Financial Transmission Rights and natural gas contracts.

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### 15. Disclosures: FSP FAS 157-2

FSP FAS 157-2 allows a one-year deferral of FAS 157 for non-financial assets and liabilities measured on a recurring (annual) basis. Disclosures required by FSP FAS 157-2 should state that:

- a) The provisions of FAS 157 has been partially applied (i.e., fully applied to financial assets and liabilities and non-financial derivatives but not applied to non-financial assets and liabilities) and
- b) The provisions have not been applied to Goodwill tests effective 3<sup>rd</sup> quarter 2008. (NOTE: Goodwill impairment testing is done annually as of August 31).

Any other non-financial asset and liability fair value measures not being done in accordance with FAS 157 should also be disclosed.

As a reminder, in 2008, SFAS No. 157 measurement principles need not be applied in the accounting for the following (however, pre-existing fair value guidance, such as that outlined in FASB Concept Statement CON 7, "Using Cash Flow Information and Present Value in Accounting Measurements", should continue to be applied):

- a. Acquisitions - nonfinancial assets and liabilities initially measured at fair value.
- b. Goodwill - reporting units measured at fair value in the 1<sup>st</sup> step of a GW impairment test.
- c. Goodwill impairment - **nonfinancial** assets and nonfinancial liabilities measured at fair value in the 2<sup>nd</sup> step of a goodwill impairment test as described in SFAS No. 142
- d. Plant, Property and Equipment measured at fair value for an impairment assessment under SFAS No. 144.
- e. ARO's initially measured at FV under SFAS 143, (nonrecurring fair value measurements)
- f. Liabilities for exit or disposal activities initially measured at fair value under SFAS 146.

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### 16. Derivatives: Interest Rate Swaps

Interest Rate Swaps are derivatives and carried at Fair Value in accordance with SFAS No. 133, as amended and included in the recurring Fair Value disclosures. The accrual component of an interest rate swap is not separately reported from its related derivative.

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### 17. Disclosures: Non-Recurring

The application of SFAS No. 157 at Duke Energy for non-financial measurements excluding derivatives has been delayed until 1/1/2009 as a result of FSP FAS 157-2. We anticipate adding additional guidance to this policy as it applies to this item in the future. See also [Disclosures: FSP FAS 157-2](#).

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### 18. Disclosures: Other

Other disclosures include a statement that the company does not typically adjust prices to reflect after-hours market activity. ([Post-Market Adjustments](#))

## Fair Value Measurements (SFAS No. 157)

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### 19. Disclosures: Recurring

Fair Value measurements are disclosed by Level 1, 2 and 3 and by Short Term Investments, Long Term Investments, NDTF, Derivative Assets and Derivative Liabilities, a total of 20 possible categories. For example:

Description	Balance	Level 1	Level 2	Level 3
Short Term Investments				
Long Term Investments				
NDTF				
Derivative Assets				
Total Assets				
Derivative Liabilities				
Net Assets				

If appropriate, further level of detail (additional line items) should be displayed. For example, due to the current illiquidity, Auction Rate Securities have been shown as a separate line item. Also, collateral offset against fair value measurements can be added as a column. Cash Collateral is not classified by level 1, 2 or 3 but can be shown separately to fulfill the requirements of FSP FIN 39-1.

At present, Long Term investments include the Indiana Grantor Trust, investments which 'fund' executive benefits and investments by Bison, Duke's captive insurance subsidiary.

Effective January 1, 2008, a rollforward of Level 3 measurements for the quarter and year to date is presented with the following line items (if applicable):

- a. beginning balance,
- b. realized and unrealized changes in value reflected in earnings,
- c. realized and unrealized changes in value reflected in OCI,
- d. realized and unrealized changes in value reflected on the balance sheet,
- e. purchases, sales, issuances and settlements,
- f. transfers in and out of Level 3 and
- g. ending balance.

Realized and unrealized changes in value reflected on the balance sheet (item d) are typically reflected in Regulatory Assets or Liabilities (for Duke Energy's USFEG segment) or in non-current liabilities (for executive compensation).

Another recurring disclosure is the disclosure required by SFAS No. 107, "Disclosures about Fair Value of Financial Instruments". Disclosures for SFAS No. 107 are required annually.

Disclosure of the valuation methods and any changes in those methods for the Fair Value measurements is required quarterly during 2008 and annually thereafter.

The Nuclear Decommissioning Trust Fund (NDTF) is a separate line on Duke's balance sheet. Since the amount reported in the footnote for the NDTF may not directly tie to the line item on Duke's balance sheet, the footnote will disclose the reconciling items, if any, (for example, accrued interest and dividends, cash including foreign currency and cash equivalents but not commingled cash) if significant. Alternatively, the External Reporting Group may determine that items within the NDTF not subject to SFAS No. 157 disclosure are insignificant to the NDTF in total and therefore include them in the disclosure in order to agree to the face of the balance sheet.

Some items (executive benefits) are currently accounted for on a month delay basis, if the difference from the actual reporting date balance is not material. However, it is expected that this timing lag will be reflected in the general ledger when immaterial and thus the balance in the disclosure will equal the amount in the general ledger. Thus, the amount of the difference is only considered for purposes of determining

## Fair Value Measurements (SFAS No. 157)

whether the recorded amount should be disclosed as a level 2 or level 3 measurement. There are two sources of variance from the actual quarter end balance; the price of each investment and the quantity of the investments and the mixture of the investments in the portfolio. The total variance for the portfolio can be viewed as a measurement 'error'. These investments will be viewed as either a level 2 or level 3 measurement depending on the magnitude of the variance between the numbers used in the GL and the correct numbers. If the variance is less than 10%, we will call the measurement a level 2 measure, otherwise a level 3 measure.

Other recurring disclosures include the [Level 3 rollforward](#).

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### 20. [Equity Method Investments](#)

SFAS No. 157 for non-financial measurements excluding derivatives has been delayed for Duke Energy until 1/1/2009 as a result of FSP FAS 157-2. We anticipate adding additional guidance to this policy as it applies to this item in the future. See also [Disclosures: FSP FAS 157-2](#).

A reporting entity is not required to provide fair value disclosures under either [FASB Statement No. 107, Disclosures About Fair Value of Financial Instruments](#), or SFAS No. 157 for an investment accounted for under the equity method in accordance with [APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock](#). However, a reporting entity must provide such disclosures if it either elects to carry its investment at fair value under the fair value option in [FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities](#).

Duke Energy has not elected to use the Fair Value Option of SFAS No. 159 for equity method investments.

If Duke Energy concludes an impairment of any of its equity method investments has occurred ("outside basis impairment"), then the equity method investment should be impaired down to its fair value. Fair value should be determined consistent with the guidance in this policy effective January 1, 2008 as equity investments are considered financial assets.

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### 21. [Estimated \(or stale\) Values](#)

Fair value measurements for debt and equity investments are made using actual data whenever practical. In valuing investments, in the event estimated data is used due to actual data being stale, and the variance between the estimated and actual fair value is [significant](#), the variance will be assessed as a nonobservable input. Nonobservable inputs are [level 3](#) inputs and will render the investment as a level 3 measure for disclosures purposes if [significant](#).

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### 22. [Fair Value Election \(Policy on Interest income/expense\)](#)

Duke Energy may elect the Fair Value option under SFAS No. 159 in lieu of using a) hedge accounting, b) SFAS No. 71 (for USFEG) for new issuances of fixed rate debt (after 1/1/2008) that are hedged with a pay floating, receive fixed rate interest swap or c) VRDN investments with an attached 'put' option. If so, documentation of the election must be approved by the Corporate Controller's department. The decision to make the Fair Value election is irrevocable as long as the debt instrument is outstanding. The election requires that the entire value of the debt is carried at Fair Value. Separate components of the debt, such as the benchmark rate or the credit spread cannot be elected to be carried at Fair Value.

At the time Duke first elects the Fair Value option, an accounting policy decision should be made that explains the allocation of changes in Fair Value to interest expense or interest income and on which line item(s) of the company's income statement, the changes in Fair Value will be presented.

Additional disclosures are required stating 1) that the company has elected the Fair Value option, 2) why the company has elected the Fair Value option for some debt or investments issuances but not for others and 3) explaining the company's accounting policy on reporting interest expense.

## Fair Value Measurements (SFAS No. 157)

At this time, Duke will not elect the Fair Value option for equity method investments or for cost method investments unless at least a level 2 measurement is expected to be consistently available for the investment.

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### 23. Financial Transmission Rights

Financial Transmission Rights (FTRs) in MISO and PJM (both the initial value and any changes in the initial value), whether granted or purchased, are considered derivatives and should be carried at fair value in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended and included in the [recurring Fair Value disclosures](#).

Duke Energy's accounting for ARRs and FTRs is documented in separate memoranda. Contact a representative of the Corporate Accounting Research Group for additional information.

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### 24. Goodwill, Intangibles, and Plant, Property and Equipment

The application of SFAS No. 157 at Duke Energy for non-financial measurements excluding derivatives has been delayed until 1/1/2009 as a result of FSP FAS 157-2. We anticipate adding additional guidance to this policy as it applies to this item in the future. See also [Disclosures: FSP FAS 157-2](#).

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### 25. Impairments

The application of SFAS No. 157 at Duke Energy for non-financial asset measurements excluding derivatives has been delayed until 1/1/2009 as a result of FSP FAS 157-2. We anticipate adding additional guidance to this policy as it applies to this item in the future. See also [Disclosures: FSP FAS 157-2](#).

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### 26. Inactive Markets Impacts to the Fair Value of Financial Assets

On October 10, 2008, the FASB issued Staff Position (FSP) FAS 157-3 to clarify the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. Duke Energy believes the practices outlined in this policy are consistent with this FSP, but encourages company accountants to analyze FSP FAS 157-3 when valuing financial assets in inactive markets.

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### 27. IVC

IVC or Implied Value Correction is an adjustment ([reserve](#)) that is made to the forward price curve developed by the front office based on indicative broker quotes. IVC reserves are considered Level 3 inputs if based on indicative [broker quotes](#).

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### 28. Level 3

A level 3 input is an unobservable input. Examples of unobservable inputs include indicative [broker quotes](#), valuations from interest rate swap counterparties and internally developed cash flow projections. However, valuations of commodity derivatives based on actual market data are level 2 inputs.

If a level 3 input is [significant](#) to the fair value measurement, then the measurement is a level 3 measurement and will be included in the rollforward analysis required for [recurring Fair Value disclosures](#).

## Fair Value Measurements (SFAS No. 157)

The term of the contract can also have an impact on the determination of whether or not the overall measure is considered a level 3 measure. For example, if the term of the contract that is unobservable is more than 10% of the total remaining term of the contract, then the measurement is a level 3 measurement.

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### 29. Level 3 Rollforward

A quarterly and a year to date rollforward of the level 3 measurements is required. Level 3 measurements in the beginning balance for the year to date which are realized during the year are reported at the Fair Value as of the beginning of the year and changes to that balance on a year to date basis are used as the building blocks for developing the quarterly schedule. The quarterly schedule will be 'built' such that the sum of the line items for each quarter equals the year to date.

The unrealized gain or loss for the level 3 fair value rollforward in the ending balance should be reported in the same level of detail as shown on the table for recurring disclosures except that Derivatives are presented net.

Cash income, such as interest or dividend payments from level 3 investments, is not a reconciling item in the rollforward as cash income is not a 'gain or loss'. Realized gains or losses from the sale of level 3 investments are reconciling items in the rollforward. Changes in the fair value of level 3 investments are also reconciling items in the rollforward.

The beginning balance of the rollforward in the year of adoption is the balance at year end 12/31/07 for fair value measurements which the company considers to be level 3 measurements.

To illustrate, assume a level 3 investment has a fair value of \$1,000 at the beginning of the period, pays interest of \$100 during the period, is sold for \$1,050 before the end of the period and the gain is reflected in earnings. The investment would be reflected in the rollforward as follows:

Beginning balance,	\$1,000
realized and unrealized changes in value reflected in earnings,	50
realized and unrealized changes in value reflected in OCI,	0
realized and unrealized changes in value reflected on the balance sheet,	0
Purchases, sales, issuances and settlements,	(1,050)
transfers in and out of Level 3	0
Ending balance.	\$0

As another example, a derivative electricity contract has a value of \$1,000 at the beginning of the period. The MTM value of that contract the month before physical delivery of the power is \$1,500. The rollforward would look as follows:

Beginning balance,	\$1,000
realized and unrealized changes in value reflected in earnings,	500
realized and unrealized changes in value reflected in OCI,	0
realized and unrealized changes in value reflected on the balance sheet,	0
Purchases, sales, issuances and settlements,	(1,500)
transfers in and out of Level 3	0
Ending balance.	\$0

As another illustration, assume an investment was level 3 at the beginning of the year and is a level 2 adjustment at the end of the first quarter. If there is not a discrete date which clearly indicates when the item went from level 2 to level 3, Duke will assume that a transfer to level 2 occurred after any changes in fair value are recorded. Likewise, assume that an investment was level 2 at the beginning of the year is a

## Fair Value Measurements (SFAS No. 157)

level 3 adjustment at the end of the first quarter. Duke will assume that a transfer to level 3 occurred at the beginning of the quarter.

For example, the date an auction for an auction rate security fails is a discrete date for identifying a change from level 2 to level 3.

In the instance where an item measured at fair value changes from level 2 to level 3, the change will be shown as a transfer in and not a purchase.

For level 3 measurement items still on the balance sheet at period end, Duke will disclose per paragraph 32 (d) the amount of the total gains or losses for the period that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at the reporting date.

Consider the following example. The derivative contract was signed in the 4<sup>th</sup> quarter of the previous year for the delivery of electricity in the 1<sup>st</sup> and 2<sup>nd</sup> quarter of the current year (as of the end of the 4<sup>th</sup> quarter, the fair value of the derivative contract was \$250). The MTM activity for the 1<sup>st</sup> quarter shows a gain of \$25 during the 1<sup>st</sup> quarter with \$10 of that gain attributable to the delivery made in the 1<sup>st</sup> quarter (total portion of contract settled of \$110) and \$15 attributable to the delivery to be made in the 2<sup>nd</sup> quarter (total remaining fair value of contract at end of the 1<sup>st</sup> quarter of \$165).

	Attributable to portion of contract settled in	Attributable to portion of contract to be settled in	Total Q1 Activity in the general ledger
	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	Total
Beginning Balance for the 1 <sup>st</sup> quarter	\$100	\$150	\$250
Gain or loss in earnings	10	15	25
Cash settlement	-110	0	-110
Ending Balance for the 1 <sup>st</sup> quarter	\$-	\$165	\$165

The disclosure for paragraph 32(d) (for level 3 measurement items still on the balance sheet at period end, the amount of the total gains or losses for the period that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at the reporting date) at the end of the 1<sup>st</sup> quarter should be \$15 or the MTM gain on the delivery for the 2<sup>nd</sup> quarter which was reported in the 1<sup>st</sup> quarter.

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### 30. *Liabilities*

Duke's MTM derivative liabilities that are recorded on the balance sheet will reflect a non-performance reserve adjustment, when significant to the measurement of the liability and when material to the financial statements of Duke Energy or is SEC sub-registrants.

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### 31. *Life Insurance*

Duke's Company Owned and Trust Owned Life Insurance policies are not Fair Value measurements unless held for the purpose of funding Pensions or Other Post Retirement Benefits (for interpretative guidance related to this topic, refer to the document entitled "[Accounting Policy Support - Fair Value.](#)")

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### 32. *Net Asset Value (NAV)*

The fair value (under SFAS No. 157) for an interest in an open-end mutual fund that allows entities to sell their ownership interest back to the fund at NAV on a daily basis is NAV.

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### 33. *Non-Performance Risk*



## Fair Value Measurements (SFAS No. 157)

Non-performance risk is the risk of default by Duke (parent) or a subsidiary of Duke. Non-performance risk involves a balance sheet liability of Duke or a Duke subsidiary. It is analogous to credit risk and reflects:

- a. probability of default,
- b. master netting agreements,
- c. credit enhancements such as guarantees from the parent, letters of credit or cash collateral posted,
- d. timing of the expected payment(s),
- e. expected recovery in bankruptcy,
- f. discount rate used to present value the expected payments and
- g. credit limits.

Exposures are netted and then bucketed by year and a non-performance reserve is calculated for each year.

Credit limits established are assumed to be effective so that the exposure for any year is limited to the total credit limit.

Credit enhancements in the form of letters of credit and guarantees are allocated between balance sheet derivatives, accounts payables or accounts assets and off balance sheet derivatives (NPNS).

Present value calculations of future payments often incorporate a component for non-performance risk. For example, a fixed floating interest rate swap is typically discounted at LIBOR. If so, the discounting already reflects a *credit spread over the risk-free rate of interest*. Theoretically, the measurement of non-performance risk is the difference between the credit rating implicit in LIBOR and the credit rating of Duke or the Duke subsidiary. Due to the difficulty in and likely insignificance, Duke ignores any adjustment to reflect the difference between the risk-free rate and LIBOR.

Derivative liabilities on the balance sheet will reflect a reserve for non-performance risk, when significant. For interest rate swaps which are liabilities, a non-performance risk reserve, if significant, is calculated based on the probability of default applied to the timing of the payments as bucketed by year.

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### 34. Nuclear Decommissioning Trust Fund

Investments in the Nuclear Decommissioning Trust Fund (NDTF) are carried at Fair Value and are included in the recurring Fair Value disclosures.

From FIN 39

50. Some respondents identified Statement 87 as an example in which plan assets are offset against the plan liabilities without meeting the criteria of the proposed Technical Bulletin. They indicated that other assets held in trust should be offset against the related liabilities in a manner similar to the reporting prescribed in Statement 87. Pension trusts are significantly different from most trusts and trustee assets supporting other liabilities. The accounting and reporting for pensions was specifically considered by the Board in Statement 87. However, trusts established for other specified purposes, such as for decommissioning of a nuclear generating plant, would have to meet the conditions for setoff specified in paragraph 5.

If not significant, liabilities of the NDTF can be netted against the line item on the balance sheet.

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### 35. Observable Inputs

An observable input is an input that is observable in the market. To be considered observable in the market, there must be evidence that the information can be used for trading.

With respect to prices, a price quote on the Intercontinental Exchange (ICE), is usually considered to be observable if the price is for a particular product and delivery location, has both a bid and an ask price and the difference between the two forward prices are not too great.

## Fair Value Measurements (SFAS No. 157)

Another example of an observable input is a price developed by the front office if the pricing is based on actual trading that has taken place during the last business day of the period for the particular forward month and location. If trading has not taken place, during the business day, the pricing will be considered a level 3 input.

Valuations of interest rate swaps by the counterparty to the swap which are verified from Bloomberg or similar sources are level 2 inputs.

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### *36. Other Items in Trust Fund Balances not reported at Fair Value*

Nuclear Decommissioning Trust Fund per the recurring Fair Value footnote will be reconciled to the balance shown on the balance sheet. Reconciling items may include accrued interest and dividends, cash in foreign currency and liabilities. As long as the liabilities are not significant to the total amount in the NDTF, they will be netted against the NDTF on the balance sheet. If the liabilities are significant, the NDTF will displayed on the balance sheet gross of liabilities. With respect to disclosures, the External Reporting Group may determine that items within the NDTF not subject to SFAS No. 157 disclosure are insignificant to the NDTF in total and therefore include them in the disclosure in order to agree to the face of the balance sheet.

The Indiana Grantor Trust also has similar items which are not fair value measurements.

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### *37. Pension and OPEB Assets*

Based on preliminary guidance from the FASB, it is anticipated that there are no Fair Value disclosure requirements for Pension and OPEB assets under SFAS No. 157 for the year ending December 31, 2008. However, it is also anticipated that a form of fair value disclosures will be required, no earlier than for the year ending December 31, 2009, as a result of a potential FASB staff position on FASB 132(R) for Pension and OPEB plan assets.

Pension assets and OPEB assets are required to be held at fair value less transaction costs, if transaction costs are significant. See discussion on [Transaction Costs](#).

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### *38. Portfolio level reserves*

If the calculation of a reserve is done at a portfolio level due to offsetting, the allocation of the reserve to the individual contract for the purpose of determining the level is done as follows. The allocation of all portfolio level reserves will be done on a gross basis (excluding all other portfolio level reserves). For a credit reserve, the allocation is pro-rated to just the contracts in the portfolio that are assets. For a non-performance reserve, the allocation is pro-rated to just the contracts in the portfolio that are liabilities.

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### *39. Post-Market Adjustments*

Duke has elected not to reflect adjustments to fair values that take place after the close of the market on the last business day of the month (but prior to the last day of the reporting period end) unless those changes are believed to be significant. Any adjustments made will change a level 1 measurement to a level 2 or level 3 measurement.

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### *40. Practical Expedients*

Fair Value measurements will reflect market observable data if practical to obtain. SFAS No. 157 does not eliminate the practicality expedients of SFAS No. 107 that allow the company to avoid developing Fair Value measures for disclosures of financial instruments when not practical.

## Fair Value Measurements (SFAS No. 157)

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### 41. Present Value

MTM analysis of derivatives or impairment calculations discount to the present, the expected cash flows or payments. Depending on the nature of the asset or liability being valued, discounting can be done utilizing a risk free rate of interest, LIBOR or a weighted average cost of capital (WACC). To the extent LIBOR or a WACC is used, there is an explicit or implicit adjustment for credit risk. Hence, there is a credit spread between the risk free rate of interest and LIBOR. Likewise, the WACC typically factors in an adjustment for credit risk.

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### 42. Principal Market

Where the company typically uses the Intercontinental Exchange (ICE) for derivative transactions, then ICE represents the principal market for Duke. Conversely, where the company's derivatives are not typically transacted in ICE, the ICE is not the principal market. Pricing that is not based on the principal market cannot be level 1 pricing.

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### 43. Probability of default

The probability of default (POD) is used in the calculation of credit risk and non-performance risk. When practical, the probability of default will be derived from a current market-based approach such as the credit default market or the credit spreads on rated debt relative to the risk free rate of interest. A credit default swap also takes into consideration the recovery in bankruptcy.

When not practical, the POD will be determined from historical analysis such as the S&P analysis of cumulative default probabilities. PODs take into consideration the timing of the expected payment such that the longer the tenor, the higher the POD.

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### 44. Regulatory Assets and Liabilities

For regulated operations, the other side of a balance sheet entry for a change in the fair value of a derivative can be a regulatory asset or liability. Although the regulatory asset or liability may be set equal to the fair value of the derivative, the regulatory asset or liability is not a fair value measure and therefore is not included in the non-recurring or recurring Fair Value disclosures. Likewise, a regulatory liability is not adjusted to reflect non-performance risk.

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### 45. Reserves

The measurement of commodity derivatives, other than NYMEX contracts, includes the following types of reserves:

- a. Credit or non-performance
- b. Present value
- c. Bid-Ask or Liquidity
- d. Cost of service
- e. IVC or Implied Value Correction

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### 46. SFAS No. 115 disclosures

The footnote disclosure of the amount reported for SFAS No. 115 disclosures as the Fair Values of Available for Sale investments will be the same values used in the SFAS No. 157 disclosures.

## Fair Value Measurements (SFAS No. 157)

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### 47. *Significant*

Significant is used in this policy for several purposes. A deviation from this policy is acceptable if the result is not significant to the Fair Value measurements. Level 3 inputs, if significant, result in a Fair Value measurement being classified as a Level 3 measurement. Pension Assets do not have to be adjusted for transaction costs if transaction costs are not significant to the Pension Assets (significance should be determined based on the nature of the potential adjusting entry - in the case of pension assets, any adjusting entry as of a year-end date would not affect the income statement). An unobservable window can be significant to a Fair Value measurement.

To determine if something is significant for measurement purposes, at a minimum, a 'back of the envelope' calculation is required in order to estimate the impact of the item in question at each reporting period. This estimate should be provided to Corporate Accounting who will accumulate and assess the materiality for financial reporting purposes.

Measurement is made by contract for derivatives. For example, level 3 inputs are considered significant to the measurement of a derivative contract reported at Fair Value on the balance sheet if the input represents 10% of the total Fair Value or 10% of the total tenor.

Measurement is typically made by investment for investments. For example, level 3 inputs are considered significant to the measurement of an investment reported at Fair Value on the balance sheet if the input represents 10% of the total Fair Value of the investment.

An exception to the measurement of significance by investment occurs if the unit of account is a portfolio. For example, sometimes a group of derivatives are may be valued as a single portfolio.

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### 48. *Stock Based Compensation*

Fair Value measurements for Stock Based Compensation covered by SFAS NO. 123R are not Fair Value measurements under this policy.

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### 49. *Transaction Costs*

Unlike other fair value measurements, the fair value measurement of investments held by a pension or other postretirement benefit plan should be reduced by the transaction costs involved to dispose of the asset.

Per SFAS No. 87; "Employers' Accounting for Pensions"

49. For purposes of applying the provisions of paragraph 35 and for purposes of the disclosures required by paragraphs 5 and 8 of FASB Statement No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits, plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date.<sup>12</sup>

<sup>12</sup> The fair value of an investment shall be reduced by reflect the brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell).

Per SFAS No. 106; "Employers' Accounting for Post Retirement Benefits Other than Pensions"

65. For purposes of the disclosures required by paragraphs 5 and 8 of FASB Statement No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date.<sup>21</sup> (Refer to paragraph 71.)

## Fair Value Measurements (SFAS No. 157)

<sup>21</sup> The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell).

Duke will reduce Pension Assets and Other Post Employment Assets by transaction costs if these costs are significant to the assets or the transaction cost is material to the line item on the balance sheet. See also the discussion on [significant](#).

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### 50. [Unit of Account](#)

The unit of account defines what is being measured for financial reporting purposes. It is an accounting concept that determines the level at which an asset or liability is aggregated or disaggregated for purposes of applying SFAS No. 157, as well as other accounting pronouncements. The identification of exactly what asset or liability is being measured, while basic, is fundamental to determining its fair value. It can be easy to confuse the concept of "unit of account" with that of "valuation premise" because both concepts deal with determining the appropriate aggregation or disaggregation of assets and liabilities. However, to appropriately apply SFAS No. 157, the distinction between these two concepts must be understood. Unit of account is an accounting concept that, as it pertains to the application of SFAS No.157, primarily drives the level of aggregation (or disaggregation) for presentation and disclosure purposes (e.g., whether disclosure requirements are made at the individual asset level or for a group of assets). Valuation premise is a valuation concept that determines how the asset or liability is measured (i.e., based on the value it derives on a standalone basis or the value it derives in conjunction with other assets and liabilities).

Unit of account for stock is a single share, for debt is each unit of the debt instrument, for a derivative, is the contract. Policy guidance with respect to the unit of account for a non-financial asset or liability will be provided upon the effective date for SFAS No. 157 for non-financial assets and liabilities.

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### 51. [Valuation premise](#)

Refer to the above section entitled "Unit of Account."

The valuation premise is value in exchange for investments and derivatives.

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### **Related Links:**

[Accounting for Derivative Instruments and Hedging Activities](#)

[Accounting for Defined Benefit Pension and Other Post-Retirement Benefit Plans](#)

[Asset Impairments Reviews for Long-lived Assets \(excluding Goodwill\) and Equity Method Investments, Assets Held for Sale and Discontinued Operations \(SFAS No. 144 and APB No. 18\)](#)

[Accounting for Regulated Entities \(SFAS No. 71\)](#)

[Roles and Responsibilities for the Documentation of and Consultation on Significant Accounting or Reporting Matters](#)



## Duke Energy Accounting Policy Statement

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### Financial Statement Disclosure of Related Party Transactions

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller

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<b>Effective Date:</b>	12/15/2004
<b>Revision Date:</b>	05/15/2009
<b>Reissue Date:</b>	03/31/2008

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#### **Statement of Purpose and Philosophy**

Transactions between related parties commonly occur in the normal course of business. These transactions include, but are not limited to, sales, purchases, loans, transfers, leasing arrangements, guarantees, and other commercial transactions. To assist investors in understanding the impact of these transactions on the financial statements, U.S. generally accepted accounting principles (GAAP), specifically Statement of Financial Accounting Standards ("SFAS") No. 57, *Related Party Disclosures*, and Securities and Exchange Commission (SEC) Regulation S-X Rule 4-08(k)(1), require the disclosure of certain control relationships and related party transactions. This policy provides guidance for identifying, appropriately accounting for, and reporting related party transactions.

#### **Policy Expectations**

This policy is designed to help ensure consistent application of the accounting rules and disclosure provisions for related party transactions across the consolidated Duke Energy group. All Business Units and Corporate Areas must follow U.S. GAAP with respect to accounting for and reporting related party transactions and maintain adequate internal processes to ensure compliance.

#### **Accountability: Roles and Responsibilities**

##### Business Units/Corporate Areas ("Units")

- Ensure appropriate unit personnel understand the definitions and requirements of the accounting for and reporting of related party transactions, as evidenced through unit communications, training of personnel, etc.
- Appropriately account for, based upon the economic substance, any known related party transactions in accordance with GAAP
- Report related party transactions in each quarter accordance with the instructions provided by the Corporate Controller's Department
- Review and update, as needed, enterprise list of related parties for Duke Energy Corporation (DEC) distributed by the Corporate Controller's Department each quarter
- Maintain enterprise list of related parties for any registrant that reports to the unit. Consult World Records database to find consolidated subsidiaries of DEC

### Corporate Controller's Department

- Provide interpretation of accounting guidance as to whether or not a person is considered a related party (Corporate Accounting Research) and whether or not a transaction is considered material (Internal/External Reporting)
- On a quarterly basis, obtain information about related parties and related party transactions from the DEC Business Units/Corporate areas through the distribution of the list of related parties to the Business Units/Corporate Areas and review of related party transaction summaries provided by the Business Units/Corporate Areas
- On an annual basis, obtain summary of Directors and Officers (D&O) questionnaire responses from Corporate Legal Department to determine if any disclosures are required (Internal/External Reporting)
- Report material related party transactions as appropriate in the periodic SEC filings (Internal/External Reporting )

### **Standards/Requirements**

#### Background and Related Accounting & Reporting Guidance

SFAS No. 57, *Related Party Disclosures*, and SEC Regulation S-X Rule 4-08(k)(1) require disclosure in the consolidated financial statements and periodic (e.g., quarterly) filings of certain relationships and transactions between an entity (or registrant) and its related parties, as appropriately defined, so that users of an entity's financial statements have a full and clear picture of the financial position and results of operations of that entity when making an investment and/or lending decision.

Based on the guidance in SFAS No. 57 and S-X Rule 1-02, related parties are generally understood to be one of the following (refer to Key Terms below for Duke Energy Corporation's guidance regarding these definitions):

1. *Affiliates* - an affiliate is a person that controls, is controlled by, or is under common control with another person. Control may be direct or indirect and may be exercised through one or more intermediaries
2. Related parties also include entities for which Duke Energy's investments in their equity securities are required to be accounted for by the equity method (for example, any entity in which Duke Energy owns 20% or more of its common stock).
3. Management- any person with responsibility for achieving objectives of the organization and requisite authority to make decisions that pursue those objectives. Management normally includes members of the board of directors, chief executive officers, chief operating officer, any vice president in charge of a principal business function (such as sales, administration, or finance), and any other individual who performs a similar policy making function
4. Principal owners - a person who owns more than 10% of any class of equity securities of an entity. Such ownership may be direct or indirect and includes beneficial ownership as well as ownership through one or more affiliates. Principal owners include owners, each of whose individual holdings is 10% or less of the voting interest but whose combined holdings are more than 10%, if such owners are acting in concert with respect to a transaction or transactions with the reporting entity
5. Promoter - a person who receives 10% or more of the stock of an entity in connection with its founding or organization
6. Immediate family members - family members whom a principal owner or member of management might control or influence or by whom they might be controlled or influenced because of the family relationship

The above items do not necessarily represent an all inclusive listing. The determination of whether a person or an entity is a related party to a reporting entity is generally a determination of fact. Such determination does, in certain cases, require the exercise of professional judgment. When certain persons (or person) have

the ability to exert significant influence over the terms of a transaction between two parties, those parties could be considered related. For example, if Entity A's Chief Executive Officer's (CEO) immediate family member is the owner of Entity B and those two entities enter into transactions with each other, those entities could be considered related parties, as significant influence is presumed to exist between the CEO and his/her immediate family member as to the price and other terms that would not be present between unrelated parties. In contrast, if the CEO's immediate family member is an employee of Entity B with no ability to exert any influence over the terms of the transaction(s), those parties would generally not be considered related. An additional example would be a situation in which a member of the board of directors of Entity A is the CEO of Entity B, transactions between Entity A and Entity B would be considered related party transactions to both entities, as that director/CEO is presumed to have the ability to exercise significant influence over the terms to those transactions.

Related party transactions are any direct or indirect transactions between the reporting entity and a related party, as defined above. Related party transactions generally include transactions between:

- A parent company and its subsidiaries (transactions eliminated in consolidation are not required to be disclosed under SFAS No. 57 as they are not included in the consolidated financial statements, but they remain related party transactions nonetheless)
- Subsidiaries of a common parent (e.g., Cinergy Corp. and Duke Energy Carolinas, LLC are under the common control of Duke Energy)

*The reporting entity and:*

- Other affiliated businesses
- Management (including directors and members of their immediate families), excluding compensation arrangements
- Principal owners (including members of their immediate families), excluding compensation arrangements
- Pension and profit-sharing trusts managed by or under the trusteeship of management
- Investees accounted for on the equity method of accounting (see below for guidance regarding equity method investees of a reporting entity's equity method investee)
- Promoters
- Other interests having the ability to exert significant influence (see above for examples)

As discussed above, the determination of whether a person or an entity is a related party to a reporting entity requires significant judgment. From the accounting guidance discussed above, it is clear that an equity method investee of a reporting entity is considered a related party. However, it is less clear as to whether an equity method investee of a reporting entity's equity method investee (referred to as a "second tier" equity investee) should be considered a related party. Such determination will depend upon the level of involvement the reporting entity has with the second tier equity investee. For example, the reporting entity may have a 50% owned equity investee (investee A) which has a 50% owned equity investee (investee B). Therefore, the reporting entity has an indirect ownership of 25% in investee B. Normally, direct ownership in an entity of 20% or greater results in a presumption that the investee should be accounted for under the equity method and, therefore, would be considered a related party. The determination as to whether or not the second tier equity investee is considered a related party to the reporting entity will depend upon such factors such as the level of influence over operating and financial decisions of investee B held by investee A and, indirectly, the reporting entity (such as board representation, contractual arrangements, etc).



Established accounting principles ordinarily do not require transactions with related parties to be accounted for on a different basis from that which would be appropriate if the parties were not related. Related party transactions should be considered satisfactorily accounted for when:

- The substance of the transaction is accounted for in conformity with existing authoritative accounting literature and the accounting principles selected are appropriate in the circumstances, and
- When the requisite disclosures (material transactions and relationships) are made in accordance with the requirements of SFAS No. 57 and S-X Rule 4-08

Disclosures required by paragraphs 2-4 of SFAS No. 57 include the following:

2. Financial statements shall include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. However, disclosure of transactions that are eliminated in the preparation of consolidated or combined financial statements is not required in those statements. The disclosures shall include:

- a. The nature of the relationship(s) involved
- b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements
- c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period
- d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement
- e. The information required by paragraph 49 of SFAS No. 109, *Accounting for Income Taxes* (see below)

3. Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated.

4. If the reporting enterprise and one or more other enterprises are under common ownership or management control and the existence of that control could result in operating results or financial position of the reporting enterprise significantly different from those that would have been obtained if the enterprises were autonomous, the nature of the control relationship shall be disclosed even though there are no transactions between the enterprises.

Paragraph 49 of SFAS No. 109, *Accounting for Income Taxes*, states the following:

49. An entity that is a member of a group that files a consolidated tax return shall disclose in its separately issued financial statements:

- a. The aggregate amount of current and deferred tax expense for each statement of earnings presented and the amount of any tax-related balances due to or from affiliates as of the date of each statement of financial position presented
- b. The principal provisions of the method by which the consolidated amount of current and deferred tax expense is allocated to members of the group and the nature and effect of any changes in that method (and in determining related balances to or from affiliates) during the years for which the disclosures in (a) above are presented.

Regulation S-X Rule 4-08(k) requires the following:

- (1) Related party transactions should be identified and the amounts stated on the face of the balance sheet, income statement, or statement of cash flows.
- (2) In cases where separate financial statements are presented for the registrant, certain investees, or subsidiaries, separate disclosure shall be made in such statements of the amounts in the related consolidated financial statements that are (i) eliminated and (ii) not eliminated. Also, any intercompany profits or losses resulting from transactions with related parties and not eliminated and the effects thereof shall be disclosed.

For purposes of applying the provisions of SFAS No. 57 and Regulation S-X Rule 4-08, only those transactions that are material need be disclosed. See Staff Accounting Bulletin ("SAB") No. 99 for guidance in determining materiality. Also, for stand-alone financial statements of Duke Energy subsidiaries (e.g., Duke Energy Carolinas, LLC, Duke Energy Ohio, Inc. and Duke Energy Indiana, Inc.), the guidance found in SAB, Topic 1B, should be followed with respect to the allocation of expenses from a parent to a subsidiary and the related required disclosures.

#### Procedure for Reporting Related Party Transactions

In order to appropriately account for and disclose related party transactions at the Duke Energy Corporation level, the following policy/procedure is to be followed at the Corporate/Business unit level

- Corporate Controller's Department will distribute DEC enterprise list of related parties to appropriate personnel within the Corporate/Business units quarterly
- Business Units/Corporate Areas will provide updates to the DEC enterprise list of related parties to the Corporate Controller's Department quarterly or when there are significant changes
- Business Units/Corporate Areas will report related party transactions in accordance with this policy and the instructions contained in the quarterly data request distributed by the Corporate Controller's Department. Related party transactions with one entity that are less than \$1 million in aggregate need not be reported to the Corporate Controller's Department. The units should consult with the Corporate Controller's Department (Internal/External Reporting) on questions of materiality.
- When developing the enterprise list of related parties for DEC's subsidiary registrants (such as Duke Energy Carolinas, LLC), the unit will need to consult the World Records database to identify consolidated entities of DEC which are not included in the subsidiary registrant's consolidated financial statements as these entities will not be on the DEC enterprise list of related parties. The

"ownership" tab in the World Records database will indicate the parent entity. The consolidated subsidiaries are eliminated in the DEC consolidation, but may not be eliminated in the consolidation of the subsidiary registrant.

### **Key Terms**

Compensation Arrangements - salary, bonus, deferred compensation, pension, profit sharing, stock options and awards, expense allowances, director fees, and other similar items that are paid or incurred in the ordinary course of business. Compensation arrangements also may include other items pursuant to company policy, such as providing low-cost financing for shares acquired through a stock option plan.

Control - the power to direct or cause the direction of the management and policies of a specified person. Control may be exercised directly or indirectly through ownership, contract, or by other means.

Enterprise - registrant

Immediate Family - a person's spouse; parent; child; sibling; parent-, child-, sibling-in-law; and anyone who shares a person's home in a non-employee capacity

Ordinary Course of Business - Paragraph 1 of SFAS No. 57 gives the following examples of items that are considered in the ordinary course of business:

Some examples of common types of transactions with related parties are: sales, purchases, and transfers of realty and personal property; services received or furnished, for example, accounting, management, engineering, and legal services; use of property and equipment by lease or otherwise; borrowings and lendings; guarantees; maintenance of bank balances as compensating balances for the benefit of another; intercompany billings based on allocations of common costs; and filings of consolidated tax returns.

Management - refers to management of the registrant (i.e., the board of directors and executive officers of the registrant)

Person - an individual, corporation (excluding 501(c)(3) tax-exempt organizations), partnership, association, joint-stock company, business trust, or unincorporated organization.

### **Related Links:**

[Code of Business Ethics](#)

have an understanding, appropriate to his or her role, as to whether the entry is reasonable, relevant, complete, complies with GAAP and properly referenced. The performance of the Reviewer responsibilities must not be a perfunctory exercise. An independent party should be able to conclude that the performance of these responsibilities is meaningful and appropriate.

The following section designates specific accountabilities of the roles associated with each journal:

#### **Creator**

- Prepares the journal entry, attaches the appropriate supporting documentation and references it to the journal entry, or if supporting documentation is filed separately, indicates the location. See Attachment A – Recommended Guidelines for Documenting a Journal Entry for journal entry referencing guidelines.
- Ensures information received from others is appropriate or is derived from someone with appropriate authority (see related Policy, "Preparing and Reviewing Schedules, Statements, or Reports").
- Completes the journal line description field.
- Prepares a written summary of the purpose of the journal on the face of the journal entry or separate page, referencing any applicable accounting literature or pronouncement (e.g., a FASB pronouncement, APB Opinion, FERC Code of Federal Regulations section, etc.).
- Ensures the journal is Valid.
- Loads the journal in the financial application via the appropriate mechanism.
- Acts as the steward during the journal entry process flow to ensure the timeliness and completion of journal entry responsibilities.

#### **Reviewer**

- Cannot organizationally report to the Creator of the journal entry.
- Ensures proper accounting for the journal entry.
- Verifies journal entry is being recorded to the appropriate accounting period.
- Checks or confirms calculations (e.g., foot/cross-foot, multiplication, division, etc.).
- Has the appropriate technical or functional expertise to perform the review responsibilities.
- Verifies adequate documentation is attached to the journal to substantiate the entry.
- Performs final verification that the journal does not require further review or approval by management - see "Roles and Responsibilities in Accounting for Major Transactions, New Accounting Issues, and Significant Non-recurring Entries" Policy.
- Approves the journal for posting.

Electronic date, time and signature stamps are the evidence of creation and review. Financial applications used to process journal entries are required to have a system-enforced segregation of duties which requires action from two individuals - journal entry Creator and Approver (to post). The Approver (to post) is required to be the Reviewer.

#### **Assembling the Journal**

The journal entry and supporting documents should be organized in a reasonable and appropriate manner and include the following:

- Journal Entry reports
- Written summary of the purpose of the journal entry
- Supporting documentation, appropriately referenced

### **Recurring Journal Entries**

"Recurring" journal entries are designated as such as part of the initial setup of these journal entries in the financial application. After initial set-up, the financial application automatically creates these journal entries each month. An appropriate individual must approve the journal entry to post.

Because recurring journal entries are created by the financial application and their review is maintained within the financial application, it is not required to maintain hard copy documentation of the Create and Approve process. Two steps are required to initially set up these journal entries, but only one step, posting, is required in subsequent months.

A journal entry which is manually initiated each month, while it may be regarded by the Business Unit/Corporate Area as recurring, is not considered a "Recurring" journal entry for purposes of this Policy since such designation is not maintained in the financial application. Accordingly, such manual journal entries are subject to this Policy.

### **Statistical Journal**

Statistical journals impacting the general ledger, or journals which impact rates used for allocations, loading factors for overheads, etc., must have two individuals perform the initial setup or change, but do not require monthly manual approval until a change is initiated.

### **Reporting Overrides**

An override represents any failure to comply with the requirements of this Policy. Overrides must be reported to Internal Controls, Corporate Controller's Department no later than 4 business days after "pencils down" of the close cycle. See [Attachment B - Journal Entry Create/Review Override Report](#) for the form to use to report overrides. If there are no overrides to report, indicate such positive affirmation to Internal Controls in the Corporate Controller's department no later than 4 business days after "pencils down."

### **Requesting an Exception to this Policy**

An exception to any aspect of this Policy is requested using the form shown in *Attachment C - Request for Ongoing Exception to Policy*. No exceptions to this Policy are authorized until approval from the Corporate Controller's Department is received. Any failure to comply with this Policy prior to receipt of an approved exception constitutes an override which must be reported.

### **Accountability: Roles and Responsibilities**

Creator and Reviewer:

- Process journal entry in compliance with this policy.
- Have appropriate expertise and understanding of the journal entry and supporting documentation.

Business Unit and Corporate Area Management:

- Ensure that the appropriate individuals in their respective Business Unit/Corporate Area are aware of and comply with the requirements of this Policy.
- Report Policy overrides to Internal Controls, Corporate Controller's Department.

0219029	OCI- Grantor Unreal GL	No	PSI Grantor Trust
0219030	OCI - Grantor Unreal GL Fed Tax	Yes	Tax effect of PSI Grantor Trust
0219031	OCI - Grantor Unreal GL St Tax	Yes	Tax effect of PSI Grantor Trust
0219032	OCI - Rabbi - Unreal GL	No	Rabbi Unreal GL
0219033	OCI - Rabbi - Unreal GL Fed Tax	Yes	Tax effect of Rabbi Trust
0219034	OCI - Rabbi - Unreal GL St Tax	Yes	Tax effect of Rabbi Trust
0219043	PTIS OCI Int Rate Hdg	No	Interest rate hedges
0219048	OCI - Treasury Lock	No	Treasury Lock
0219049	OCI - Treasury Lock - Fed Tax	Yes	Tax effect of Treasury Lock
0219050	OCI - Treasury Lock - St Tax	Yes	Tax effect of Treasury Lock
0219051	OCI - Fwd Start Swap	No	Interest rate hedges
0219054	OCI - CF Commod Hdg -St Tax	Yes	Tax effect of commodity hedges
0219058	OCI - St Tax Act G/L F112 OPRB	Yes	Tax effect of FAS 112
0219060	OCI - TCSR Actuarial GL Qual	No	Actuarial adjustments of qualified plans
0219061	OCI - TCSR Actuarial GL Qual Fed Tx	Yes	Tax effect of actuarial adjustments of qualified plans
0219062	OCI - TCSR Actuarial GL Qual St Tx	Yes	Tax effect of actuarial adjustments of qualified plans
0219063	FAS 106 TCSR Actuarial GL	No	FAS 106
0219064	FAS 106 TCSR Actuarial GL Fed Tx	Yes	Tax effect of FAS 106
0219065	FAS 106 TCSR Actuarial GL St Tx	Yes	Tax effect of FAS 106

**NOTES:**

- Specific accounts are available for tax-effect entries (i.e. - 0219004 should have the tax-effect for 0219002 and 0219012). The tax department has determined this to be the fewest accounts needed to facilitate their objectives. Should you encounter a situation requiring a new detail account to be added, you may use 0219001 as a temporary account until the new account is available.
- Consolidations will ensure that the Account EBIT Barrs tree is also set up for the new accounts.



## Duke Energy Accounting Policy Statement

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# Preparing and Reviewing Financial Schedules, Statements, or Reports

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller
<hr/>	
<b>Effective Date:</b>	03/31/2004
<b>Revision Date:</b>	02/01/2008
<b>Reissue Date:</b>	02/01/2008
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### Purpose

The intent of this Policy is to provide minimum standards expected for information prepared or supplied for use in financial statements or reports, including information supplied in support of a journal entry. Proper preparation, review and approval mitigates the risk of a material misstatement in Duke Energy's financial statements.

(Note: Create/Review process for manual journal entries is covered by the Journal Entry Creation and Approval Requirements for Non-System Generated Journals Policy.)

### Terms

**Finance Function** - Individuals or departments which are either direct reports or have a dotted-line relationship to the Duke Energy Chief Financial Officer.

### Expectations

All Business Units/Corporate Areas must comply with this Policy, including areas outside the Finance Function.

### Information Prepared Outside the Finance Function

- Information supplied to Finance personnel which is used to record a journal entry, prepare financial statements or be included in footnote disclosures is required to be appropriately verified and authorized by the provider. Verified includes confirming calculations and ensuring the data is accurate and complete. The information supplied is required to be from someone authorized, either from:
  - an individual with the appropriate level of authority; or
  - a designee, provided the individual with the appropriate level of authority is knowledgeable that the data is being supplied.
- When an individual in the Finance Function receives information or data used in preparing financial statements or journal entries from an individual outside the Finance Function, he/she is expected to verify that the information is appropriate and/or is provided from someone with the appropriate level of authority.

factors such as the credit standing of the buyer, age and location of the property, and adequacy of cash flow from the property.

If the buyer does not demonstrate a commitment to pay that is supported by substantial initial and continuing investments then profit recognition (i.e., revenue recognition) shall not occur.

As stated in paragraph 3, in other than retail land sales, the full accrual method is to be used. Profit shall not be recognized under the full accrual method until all of the following criteria are met as stated in paragraph 5 (further guidance):

- a. A sale is consummated (paragraph 6).
- b. The buyer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property (paragraphs 8-16).
- c. The seller's receivable is not subject to future subordination (paragraph 17).
- d. The seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property (paragraph 18).

If a real estate sales transaction does not satisfy the criteria in paragraphs 3-5 (with guidance contained in paragraphs 6-18) for recognition of profit by the full accrual method, the transaction shall generally be accounted for using the deposit, installment, percentage-of-completion, or the cost-recovery method, as appropriate.

*(Note: There are separate measurement and recognition criteria in SFAS No. 66 for "retail land sales", however, Duke Energy does not currently enter into such sales, which are defined in paragraph 100 of Appendix E to SFAS No. 66)*

#### Lease Revenue

SFAS No. 13, "Accounting for Leases", paragraphs 17 through 19 govern the accounting for revenue related to sales-type, direct financing and operating leases. The following discussion covers the recognition of revenue related to these types of leases; however, it is not intended to cover the determination of whether a lease will meet the criteria for treatment as such.

Revenue recognition related to leases would be as follows:

##### *Direct financing*

1. Amortization of unearned income and initial direct costs as interest income over the lease term so as to produce a constant periodic rate of return on the net investment in the lease.

##### *Sales-type leases*

1. Recognition of revenue from sales-type leases at the commencement date of the lease term. The amount recognized as sales revenue from a sales-type lease would exclude the present value of the unguaranteed residuals.
2. Amortization of unearned income as interest income over the lease term so as to produce a constant periodic rate of return on the net investment in the lease.

##### *Operating leases*

1. Rental revenue is recognized on a straight-line basis regardless of the lease provisions, unless another systematic and rational basis is more representative of the timing pattern in which use benefit from the leased property is diminished.

##### *Leases Involving Real Estate*



Paragraph 22(f) of SFAS No. 98, "Accounting for Leases, an amendment of FASB Statements No. 13, 66 and 91 and a Rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11," states the following with respect to the treatment of real estate leases:

The first two sentences of paragraph 8 and paragraph 8(a) [of SFAS No. 13] are superseded by the following:

From the standpoint of the lessor, a lease involving real estate shall be classified as a sales-type lease only if it meets the criterion in paragraph 7(a) as appropriate under paragraph 6(b)(i). Otherwise, if the lease at inception meets any one of the four criteria in paragraph 7 and in addition meets both of the following criteria, it shall be classified as a sales-type lease, a direct financing lease, a leveraged lease, or an operating lease as appropriate under paragraph 6(b). If the lease does not meet any of the criteria of paragraph 7 or both of the following criteria, the lease shall be classified as an operating lease.

- a. Collectibility of the minimum lease payments is reasonably predictable. A lessor shall not be precluded from classifying a lease as a sales-type lease, a direct financing lease, or a leveraged lease simply because the receivable is subject to an estimate of uncollectibility based on experience with groups of similar receivables.

#### Indefeasible Right to Use ("IRU's")

Duke Energy, through its wholly-owned subsidiary, DukeNet, sells capacity related to its fiber optic cable network to third parties as part of its core business. The indefeasible right to use such network capacity is often referred to as an "IRU". Pursuant to an IRU, an entity purchasing network capacity has the exclusive right to use a specified amount of capacity for a period of time. In determining when to recognize revenue related to an IRU, a network capacity provider must determine whether the IRU represents a lease or a service contract. If the IRU is in substance a lease, and it is determined to be a sales-type lease, the recognition provisions enumerated above would apply and likewise if it is an operating lease. If the IRU is a service contract then revenue would generally be recognized straight-line over the life of the contract (see above for further guidance related to revenue recognition with respect to services).

#### Long-Term Power Purchase Arrangements

In EITF Issue No. 91-6, the EITF issued guidance for "non-utility generators" ("NUGs") as to the appropriate recognition of revenue from certain long-term power sales arrangements, i.e., electricity sales contracts. EITF Issue 91-6 applies only to those entities that do not meet the criteria for application of SFAS No. 71. It is also important to note that long-term power supply contracts that would qualify for lease accounting pursuant to SFAS No. 13, including EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease," are also outside the scope of EITF Issue 91-6. Duke Energy's **PPA Contract Review Accounting Checklist** provides a guide for applying these accounting standards to power purchase agreements.

The issues identified by the EITF in determining revenue recognition from long-term power sales contracts are as follows:

1. Whether revenue on a power sales contract that contains scheduled price changes should be recognized based on the scheduled prices or ratably over the term of the contract
2. Whether the accounting prescribed in Issue 1 changes if the power sales contract provides that total revenues for the term of the contract are determined by a separate, formula-based pricing arrangement
3. Whether the accounting prescribed in Issue 1 changes if the power sales contract provides that total revenues for the term of the contract are limited by a separate, formula-based pricing arrangement.

The consensus reached on these issues is as follows:

The Task Force reached a consensus that a NUG should recognize as revenue the lesser of (1) the amount billable under the contract or (2) an amount determined by the kWhs made available during the period multiplied by the estimated average revenue per kWh over the term of the contract. The determination of the lesser amount should be made annually based on the cumulative amounts that would have been recognized had each method been consistently applied from the beginning of the contract term.

The Task Force reached a consensus on Issues 2 and 3 that a NUG should recognize revenue in each period determined under the separate, formula-based pricing arrangement if it determines or limits total revenues billed under the contract. The separate, formula-based pricing arrangement should not be used to recognize revenue if its only purpose is to establish liquidating damages. The Task Force indicated that the NUG should recognize a receivable only if the contract requires a payment to the NUG at the end of the contract term and such payment is probable of recovery. A receivable arises when amounts billed are less than the amount computed pursuant to the formula-based pricing arrangement.

However, the FASB in SFAS No. 133, as amended, partially nullified the consensus above as stated below in the status section of EITF Issue 91-6:

If a long-term power sales contract meets the definition of a derivative under Statement 133, then it would be marked to fair value through earnings, unless designated as a hedging instrument in certain types of hedging relationships. Otherwise, the consensus in Issue 91-6 would apply. Some long-term power sales contracts that meet the definition of a derivative may qualify for the normal purchases and normal sales scope exception contained in paragraph 10(b), in which case the long-term power sales contract would be accounted for under this consensus in Issue 91-6. Long-term power sales contracts that are accounted for as derivatives may possibly qualify as hedging instruments in all-in-one hedges (as described in Statement 133 Implementation Issue No. G2, "Hedged Transactions That Arise from Gross Settlement of a Derivative 'All in One Hedges'"). The guidance in Statement 133 Implementation Issue No. A6, "Notional Amounts of Commodity Contracts," may be relevant.

Additionally, in EITF Issue 96-17, the Task Force reached a consensus on how revenue should be recognized on a long-term power sales contract that contains separate, specified terms for (1) a fixed or scheduled price per kilowatt hour (kWh) for one period of time and (2) a variable price per kWh (based on market prices, actual avoided costs, or formula-based pricing arrangements) for a different period of time, where neither a tracker account nor any other form of adjustment determines or limits the total revenues to be billed under the contract over its entire period. The EITF reached a consensus that:

...the long-term power sales contracts covered by this Issue should be bifurcated and accounted for as follows:

1. The revenue associated with the fixed or scheduled price period of the contract should be recognized in accordance with the consensus reached for Issue 1 of Issue 91-6 (that is, the lesser of (a) the amount billable under the contract or (b) an amount determined by the kWhs made available during the period multiplied by the estimated average revenue per kWh over the term of the contract). The determination of the lesser amount should be made annually based on the cumulative amounts that would have been recognized had each method been consistently applied from the beginning of the contract term.
2. The revenue associated with the variable price period of the contract should be recognized as billed, in accordance with the provisions of the contract for that period.

The Task Force noted that if the contractual terms during the separate fixed and variable portions of the contract are not representative of the expected market rates at the inception of the contract, the revenue associated with the entire contract should be recognized in accordance with the consensus reached for Issue 1 of Issue 91-6.

The Task Force observed that the long-term power sales contract should be periodically reviewed to determine whether it is a loss contract in which the loss should be recognized immediately.

As with EITF Issue 91-6, SFAS No. 133, as amended, partially nullified the consensus in EITF Issue 96-17 as stated in its status section:

If a long-term power sales contract meets the definition of a derivative under Statement 133, then it would be marked to fair value through earnings, unless designated as a hedging instrument in certain types of hedging relationships. Otherwise, the consensus in Issue 96-17 would apply. Some long-term power sales contracts that meet the definition of a derivative may qualify for the normal purchases and normal sales scope exception contained in paragraph 10(b), in which case the long-term power sales contract would be accounted for under the consensus in Issue 96-17. Long-term power sales contracts that are accounted for as derivatives may possibly qualify as hedging instruments in all-in-one hedges. (Refer to Statement 133 Implementation Issues No. A6, "Notional Amounts of Commodity Contracts," and No. G2, "Hedged Transactions That Arise from Gross Settlement of a Derivative ('All in One' Hedges).")

## **Multiple element arrangements**

### Scope & Applicability

In EITF Issue 00-21, the Task Force addressed the identification of separate units of accounting in revenue arrangements with multiple deliverables. It is important to note that per EITF Issue 00-21 paragraph 3:

3. This Issue does not address when the criteria for revenue recognition are met or provide guidance on the appropriate revenue recognition convention for a given unit of accounting. For example, this Issue does not address when revenue attributable to a unit of accounting should be recognized based on proportional performance. The timing of revenue recognition for a given unit of accounting will depend on the nature of the deliverable(s) composing that unit of accounting (and the corresponding revenue recognition convention) and whether the general conditions for revenue recognition have been met.

Therefore, revenue should be recognized from those separate units of accounting, as identified or not, based upon the principles set forth above (specific literature or SAB Topic 13). In applying the provisions of EITF Issue 00-21, paragraph 2 states that "separate contracts with the same entity or

related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.”

There may be instances where higher level authoritative literature governs the allocation of consideration to multiple-element arrangements, such as SFAS Nos. 13, 45 and 66 (see paragraph 4a (i) and (ii)). Paragraph 4a (iii) states that:

iii. If higher-level literature provides no guidance regarding the separation of the deliverables within the scope of higher-level literature from those deliverables that are not or the allocation of arrangement consideration to deliverables within the scope of the higher-level literature and to those that are not, then the guidance in this Issue should be followed for purposes of such separation and allocation. In such circumstances, it is possible that a deliverable subject to the guidance of higher-level literature does not meet the criteria in paragraph 9 of this Issue to be considered a separate unit of accounting. In that event, the arrangement consideration allocable to such deliverable should be combined with the amount allocable to the other applicable undelivered item(s) within the arrangement. The appropriate recognition of revenue should then be determined for those combined deliverables as a single unit of accounting.

### Principles

EITF Issue 00-21 specifies certain general principles with respect to the accounting for multiple-element arrangements, they are:

1. Revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables in the arrangement meet the criteria in paragraph 9 of EITF Issue 00-21.
2. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values (or as otherwise provided in paragraph 12). The amount allocated to the delivered item(s) is limited as discussed in paragraph 14 of EITF Issue 00-21.
3. Applicable revenue recognition criteria should be considered separately for separate units of accounting.

Paragraph 9 states the following:

In an arrangement with multiple deliverables, the delivered item(s) should be considered a separate unit of accounting if all of the following criteria are met:

- a. The delivered item(s) has value to the customer on a standalone basis. That item(s) has value on a standalone basis if it is sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), the Task Force observed that this criterion does not require the existence of an observable market for that deliverable(s).
- b. There is objective and reliable evidence of the fair value of the undelivered item(s).
- c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the vendor.

### **Additional Regulatory Considerations**

In SFAS No. 71, paragraph 11, the FASB put forth certain instances in which a regulatory liability should be recognized. They include:

- a. A regulator may require refunds to customers. Refunds that meet the criteria of paragraph 8 (accrual of loss contingencies) of FASB Statement No. 5, *Accounting for Contingencies*, shall be recorded as liabilities and as reductions of revenue or as expenses of the regulated enterprise.
- b. A regulator can provide current rates intended to recover costs that are expected to be incurred in the future with the understanding that if those costs are not incurred future rates will be reduced by corresponding amounts. If current rates are intended to recover such costs and the regulator requires the enterprise to remain accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose, the enterprise shall not recognize as revenues amounts charged pursuant to such rates. Those amounts shall be recognized as liabilities and taken to income only when the associated costs are incurred.

c. A regulator can require that a gain or other reduction of net allowable costs be given to customers over future periods. That would be accomplished, for rate-making purposes, by amortizing the gain or other reduction of net allowable costs over those future periods and reducing rates to reduce revenues in approximately the amount of the amortization. If a gain or other reduction of net allowable costs is to be amortized over future periods for rate-making purposes, the regulated enterprise shall not recognize that gain or other reduction of net allowable costs in income of the current period. Instead, it shall record it as a liability for future reductions of charges to customers that are expected to result.

Thus, in certain instances in which revenue is or may be recognized related to the Company's regulated operations a regulatory liability may be required to be recognized under paragraph 11 of SFAS No. 71. See the separate Accounting for Regulated Entities (SFAS No. 71) for further guidance as to when such a liability should be recognized, and how it is to be accreted into income.

EITF Issue 92-7 addresses the timing of revenue recognition by "rate-regulated utilities" for billings under additional, alternative revenue programs. We have confirmed with our external auditors, Deloitte & Touche, that the reference in this Issue to rate-regulated utilities results in the guidance in EITF Issue 92-7 only being applicable to operations that are accounted for under SFAS No. 71. The types of "alternative revenue programs" addressed by EITF Issue 92-7 can generally be segregated into two categories, Type A and Type B. Type A programs adjust billings for the effects of weather abnormalities or broad external factors or to compensate the utility for demand-side management initiatives (for example, no-growth plans and similar conservation efforts). Type B programs provide for additional billings (incentive awards) if the utility achieves certain objectives, such as reducing costs, reaching specified milestones, or demonstratively improving customer service.

The Task Force reached a consensus on EITF Issue 92-7 that the additional revenues should be recognized when all of the following conditions have been met:

1. The program is established by an order from the utility's regulatory commission that allows for automatic adjustment of future rates. Verification of the adjustment to future rates by the regulator would not preclude the adjustment from being considered automatic.
2. The amount of additional revenues for the period is objectively determinable and is probable of recovery.
3. The additional revenues will be collected within 24 months following the end of the annual period in which they are recognized.

## **Reporting & Disclosure Requirements**

### Gross versus net presentation

In EITF Issue 99-19, the Task Force set forth a number of indicators that should be considered in evaluating whether to record revenues gross versus net (gross meaning revenue presented separately from the related costs). The Task force also stated that the decision is a matter of professional judgment and is dependent upon the relevant facts and circumstances. None of the indicators should be considered presumptive or determinative; rather, the relative strength of each indicator should be considered.

EITF Issue 99-19 Indicators of Gross Reporting:

1. The Company is the primary obligor in the arrangement
2. The Company has general inventory risk (before customer order is placed or upon customer return)
3. The Company has latitude in establishing price
4. The Company changes the product or performs part of the service
5. The Company has discretion in supplier selection
6. The Company is involved in the determination of product or service specifications
7. The Company has physical loss of inventory risk (after customer order or during shipping)
8. The Company has credit risk.

EITF Issue 99-19 Indicators of Net Reporting:

1. The supplier is the primary obligor in the arrangement
2. The amount the Company earns is fixed
3. The supplier has credit risk.

For a contract that is deemed to be an energy trading contract under EITF Issue 02-3, the related gains or losses should be presented net in the income statement whether or not settled physically. Also, the gross transaction volumes for those energy trading contracts that are to be physically settled should be disclosed. For those contracts that are accounted for under SFAS No. 133's normal purchase and sale exception, evaluation of gross versus net presentation should be made under the indicators mentioned above.

Financial statement disclosures

APB Opinion No. 22, "Disclosure of Accounting Policies," requires disclosures of "...important judgments as to appropriateness of principles relating to the recognition of revenue." SAB Topic 13 expresses the opinion of the SEC Staff that because revenue recognition generally involves the exercise of judgment, companies are always required to disclose their revenue recognition policies. SAB Topic 13 also provides that, when applicable, the notes the financial statements shall include disclosure of:

1. The revenue recognition policy for each type of material transaction
2. If the Company were to enter into multiple-element sales arrangements, the method of accounting for each element and the method used to determine each element and value it
3. Material changes in estimates of returns in accordance with SFAS No. 48, if applicable.

The SEC Staff, in Financial Reporting Release ("FRR") No. 60, "Cautionary Advice Regarding Disclosure about Critical Accounting Policies," strongly suggested that companies disclose in their filings with the SEC, their accounting policies that required a significant level of management estimate and judgment in their application. The Staff, as mentioned above, believes that revenue recognition involves the exercise of judgment. Thus, they would in turn expect to see revenue recognition discussed in light of FRR No. 60 as a critical accounting policy. Therefore, Duke Energy shall discuss, in Management's Discussion and Analysis, its policies related to revenue recognition that contain significant estimates and judgments.

In addition, SEC Regulation S-X requires that each of the following categories of revenue (and the related costs), if applicable, be stated separately on the face of the income statement:

1. Sales of tangible products
2. Operating revenues of public utilities
3. Income from rentals
4. Revenue from services
5. Other revenues.

Currently, income from rentals is immaterial to Duke Energy and to Duke Energy's subsidiary SEC registrants, and therefore is not stated separately on the statement of operations. Duke Energy, on an elective basis, presents separately its regulated revenue (electric and natural gas are presented separately) from its non-regulated revenues. Both regulated and non-regulated contain revenue from services, and sales of tangible products. Regulated contains operating revenues of public utilities. If any of the other types of revenue as listed above were to become material, then they shall be stated separately in the statement of operations.

*Unbilled revenues*

The following is a comment from the SEC, along with the Company's response, from a comment letter received in 2007 from the SEC's review of the 2006 form 10-K of Duke Energy Carolinas:

**“Please revise future disclosure to indicate the amount of unbilled revenues recorded at period end. To the extent applicable, please explain any material differences in amounts recorded between periods.**

The Company will revise future disclosure to indicate the amount of unbilled revenues recorded at period end. To the extent applicable, the Company will explain any material differences in amounts recorded between periods.”

Accordingly, these disclosures should be made in all future SEC filings for all Duke Energy SEC registrants.

**Related Links:**

[Accounting for Derivative Instruments and Hedging Activities Policy](#)

[Accounting for Regulated Entities \(SFAS No. 71\)](#)

[Fair Value Measurements Used in Accounting](#)

[Duke Energy PPA Contract Review Accounting Checklist](#)

[Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters](#)



Duke Energy Accounting Policy Statement

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## Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance
<b>Approval:</b>	Corporate Controller

<b>Effective Date:</b>	12/15/2004
<b>Revision Date:</b>	03/01/2008
<b>Reissue Date:</b>	12/31/2008

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### **Statement of Purpose and Philosophy**

To ensure ethicality and consistency, this policy was developed to provide guidelines related to (1) the roles and responsibilities for the accounting for major transactions, new accounting issues, new accounting guidance, and significant non-recurring transactions, (2) the documentation of significant accounting or reporting matters and (3) the consultation protocol for interacting with the Corporate Accounting Research Group ("CARG"), a unit of the Corporate Controller's Department, and the external auditor regarding significant accounting and reporting matters. This policy is applicable to all Business/Corporate Units of Duke Energy Corporation and its consolidated subsidiaries ("Duke Energy" or "the Company"). The objectives of this policy include describing the appropriate components of a memo for a significant accounting or reporting matter and best practices for documentation; addressing reporting, consultation and review requirements; and developing consistency in the documentation throughout Duke Energy. The Company's Accounting Function roles and responsibilities are also discussed in the "Duke Energy Finance Entity Level Controls Documentation".

### **Accountability: Roles and Responsibilities**

#### Corporate Controller Department:

- The Corporate Controller or the head of CARG is required to approve, or concur with, conclusions reached on all matters that require CARG involvement as indicated in this policy.
- Review this policy periodically, identify any areas of improvement and communicate any changes to Business Unit Accounting Personnel.
- Maintain CARG Research Matters Lotus Notes database and file all documentation subject to this policy in the database in a timely manner.
- Provide feedback to Business Units/Corporate Areas regarding areas of non-compliance with this policy for any particular matter in a timely manner.

#### Business Unit/Corporate Area Accounting Management:

- Ensure Business Unit/Corporate Area personnel abide by the outline of the roles and responsibilities and the documentation requirements and consultation protocol as stated herein.

### **Standards/Requirements**

The roles and responsibilities for the proper documentation and consultation on significant accounting and reporting matters include:

1. Identification and communication of the issues or new accounting guidance
2. Research and documentation of accounting issues
3. Resolution of issues
4. Recording the entries
5. Coordination with transaction sources (e.g., Mergers & Acquisitions or Business Unit team), and other relevant participants (e.g., Treasury, Tax).

This policy applies to all Business Units (B.U.) and Corporate Groups responsible for accounting entries, the Corporate Accounting Research Group (CARG), and the remainder of the Corporate Controller's area. Other areas which may generate transactions (e.g., M&A or B.U. team, Tax, Treasury, etc.) are also addressed as potential sources of transactions requiring application of the policy. This policy specifically addresses Corporate versus Business Unit roles, as opposed to how Business Units will manage the processes internally.

The types of transactions this policy pertains to include the following:

1. Significant transactions generated either by a Business Unit (asset acquisitions or divestitures, business expansion, etc.) or by Corporate (e.g., divestiture or acquisition of business units) that are outside of the normal course of business.
2. Significant transactions generated by other areas (e.g., tax, treasury, HR, etc.) that are outside of the normal course of business.
3. Significant, non-recurring entries or issues (i.e., those that are anticipated to occur singularly or infrequently; e.g., impairments, restructuring charges, severance charges, etc.)
4. New accounting pronouncements or interpretations (e.g., new guidance from FASB, internal or external reinterpretation of existing guidelines, reclassifications, etc.)

### **Identification and Communication of the Issues /Transactions or New Accounting Guidance:**

- See Roles and Responsibilities Matrix below
- CARG will have primary responsibility for identifying new accounting pronouncements or interpretations that affect the company. The Corporate Controller or the head of CARG will make an assessment to determine the needs of the implementation. The Corporate Controller or the head of CARG may either assign primary responsibility for the implementation to a member of the CARG team, or when it affects one particular area, a specific business unit or corporate area. When deemed appropriate, an implementation team will be formed to help ensure a consistent implementation of the accounting guidance across the company. The implementation of a new accounting pronouncement is still subject to the Roles and Responsibilities Matrix below.
- Issues should be addressed on an ongoing basis throughout the year as they arise. For significant issues pending during a quarter close, they should be identified early in the quarter-close process, consultation with CARG should occur if required by this policy, and if warranted the issues should be discussed at the meeting called to specifically identify pending and open issues (termed internally as the "audit issues" meeting). For significant issues closed during the quarter, those issues should be identified, and resolution communicated at the audit issues meeting.
- Assignment of the issues will take place based on the matrix below. An individual will be assigned accountability, and will be responsible for updating the quarter close project manager and all other parties as defined in the matrix. This individual will act as the "Issue Project Manager" or IPM in



managing through the deliverables and timelines. The IPM will use the matrix to determine who is responsible for each of the tasks defined.

- Deadlines and accountabilities will also be established at the pre-close meeting, and the IPM will have the responsibility of adhering to deadlines and schedules and keeping the quarter close project manager informed of any issues that will jeopardize meeting the deadline for resolution, documentation, and approval. Deadlines for submission for approval, if needed, will allow sufficient time for the review and approval process at Corporate (CARG / Corporate Controller). This review time will be established up front, and CARG and the Corporate Controller will be held accountable for adhering to it and updating the quarter close project manager and IPM of any issues that will jeopardize meeting the deadlines established.

#### **Resolution of issues:**

- The IPM will submit all required documentation and facts for approval, including opinion of local D&T reps, as necessary to CARG and /or the Corporate Controller.
- Corporate Controller / CARG will review in time period allotted. Approval or agreement by Corporate Controller / CARG will be communicated to the B.U, or any disagreement with the interpretation of GAAP or other guidelines will be addressed immediately with the submitting B.U. and D&T via meetings or conference calls.
- For B.U. specific issues < \$10M, for which the B.U. is wholly responsible, copies of the documentation will be filed in the corporate database. The documentation should indicate approval up through the B.U. Informational only copies of the outcome and documentation should be sent to CARG and the Corporate Controller. CARG will review informational copies to ensure that there is not applicability across other B.U.s. If the issue is applicable to other B.U.s and is deemed significant, the proper protocol per the matrix must be applied.
- **Ultimate decision making authority rests with the Corporate Controller and Corporate CFO for all accounting decisions and interpretations covered per the matrix.** The IPM should allow time for dispute resolution, and ultimate concurrence among all parties is the goal. However, if a B.U. does not agree with the ultimate decision made, that position can be noted in the quarterly internal management representation letter signed by the B.U. for the 302 certification process.
- In the extremely rare instance that consensus on an accounting decision is not reached for an entity that has separately certified financial statements, the decision will ultimately be made by the audit committee for each legal entity (i.e., Duke Energy and the separate subsidiary).

#### **Recording the entries:**

- If the resolution of the issue results in the need to record an entry in the books the IPM will determine the proper time and reporting level to record the entry.

#### **Coordination with transaction sources and other relevant participants:**

- The IPM will determine when it is appropriate to coordinate with transactions sources (e.g., Mergers & Acquisitions or Business Unit teams) and other relevant participants (e.g. Treasury, Tax).
- The IPM will be responsible for ensuring the proper communication with the transaction sources and other relevant participants.

### **Roles and Responsibilities Matrix**

This matrix is to be used in assigning responsibility for the various tasks. The \$10 million amount is a gross dollar amount by issue (pre-tax income statement effect – i.e., the \$10 million amount does not apply to issue that clearly have a balance sheet only effect), whether the impact is immediate, potential, or a cumulative effect of anticipated ongoing entries. Significant transactions are those that are outside of the normal course of business for a B.U. or Duke Energy (e.g., acquisitions, divestitures, etc.)

Description	Identification / Communication of Issue and Status	Research & Documentation	Coordination with D&T	CARG Involvement
New accounting guidance	CARG or B.U. (either may identify - if B.U. identifies, CARG is responsible for communicating to other B.U.s). The B.U.s, with the assistance of CARG, are responsible for determining applicability.	CARG to determine (e.g. depending on whether the change impacts a single or multiple areas in the company)	CARG to determine (e.g. depending on whether the change impacts a single or multiple areas in the company)	Mandatory if impact of accounting change is greater than \$10 million. CARG to determine specific extent of CARG involvement (e.g. based on the significance and pervasiveness of the accounting change)
Non-recurring issues of \$10M or less pertaining to a specific B.U.	B.U.	B.U.	B.U. (at local level)	Optional - informational copy of documentation sent. Position paper logged into database
Non-recurring issues pertaining to all or multiple B.U.s	CARG or B.U. (either may identify - if B.U. identifies, CARG is responsible for communicating issues potentially pertaining to other B.U.s). The B.U.s, are responsible for determining applicability.	<b>Research - CARG.</b> If any B.U. specific items to research, B.U. is responsible  <b>Entity level documentation - CARG</b>  <b>B.U. specific documentation - B.U.</b>	CARG	Mandatory
Non-recurring issues greater than \$10M pertaining to a specific B.U.	B.U. or CARG (either may identify)	B.U., with CARG involvement and consultation up front	<b>B.U. D&amp;T staff - B.U.</b>  <b>Central D&amp;T staff - CARG</b>	Mandatory
Significant, non-recurring transactions or deals specific to a B.U. (e.g., asset acquisition or divestiture, business expansion, etc.)	M&A or B.U. team	B.U., with CARG involvement and consultation up front	<b>B.U. D&amp;T staff - B.U.</b>  <b>Central D&amp;T staff - CARG</b>	Mandatory

Significant, non-recurring transactions or deals generated at or by Corporate (e.g., B.U. acquisition or divestiture)	M&A or other originating party	CARG	CARG	Mandatory
Significant, non-recurring issue generated by any other area (e.g., Tax issues, Treasury issues)		CARG, initially with transfer to B.U. if appropriate.	<b>B.U. D&amp;T staff - B.U.</b>  <b>Central D&amp;T staff - CARG</b>	Mandatory

**Key Terms**

**Description:** Details the type of transaction or entry to which the policy applies

**Identification / Communication of Issue and Status:** Denotes who would typically identify that an accounting issue exists or that a transaction or deal has taken place that will require accounting involvement.

**Research and Documentation:** The party accountable for this activity will conduct the research, with input as necessary from CARG and the external auditors to reach a conclusion as to the proper accounting for the issue. The party will then adhere to the policy for the appropriate documentation content and format.

**Coordination with D&T:** The party accountable for this activity will coordinate with D&T at either the B.U. or central D&T level as appropriate. This will include managing the activity and timeline to ensure timely signoff by D&T, at each level needed. If local D&T representatives must get signoff at a higher level, the party accountable for the coordination will make sure time is built into the timeline for resolution, and communicate the status to the appropriate parties.

**CARG Involvement:** This denotes whether involvement of CARG is mandatory or optional. All B.U.s should use their judgment when deciding when to use CARG if their involvement is optional. It is highly advisable to use CARG if a matter requires consultation with the external auditor, includes significant assumptions or subjectivity, has little or no accounting guidance, or requires significant interpretation of available accounting guidance. Additionally, if an item does not initially meet the threshold for CARG involvement, but future activity is anticipated that will bring the total amount to the threshold, the B.U. is required to involve CARG, to avoid restatements and different interpretations in later periods. Regardless of the consultation activity, any and all position papers should be sent to CARG to be logged into the Corporate database. If a position does not require CARG input or consultation, the final position paper should note that CARG has not reviewed or approved the position. CARG "Involvement" encompasses both (1) consultation with and review by CARG and (2) approval or agreement from CARG. Any matters for which CARG is involved but does not

agree with or approve of the position of the B.U. will be elevated to the Corporate Controller for resolution as discussed in "Resolution of issues" above.

For items for which CARG involvement is deemed appropriate, the reporting, consultation and review protocol may be summarized into the following general steps:

- Notify CARG of accounting or reporting matter
- Provide documentation of accounting or reporting matter (as discussed above) to CARG
- Submit revisions to documentation as a result of CARG review
- Coordinate external auditor review with CARG
- File documentation within Business/Corporate Unit files
- Provide a copy of final documentation, including any attachments, to CARG in electronic format

For items for which CARG is not involved, the procedures should generally follow these same steps, substituting the references to "CARG" with "external auditor." For matters for which CARG was not involved, a final version of any documentation should be provided to CARG, as discussed in "Provide a copy of final documentation to CARG" below.

An explanation of each of the above steps is as follows:

Notify CARG of accounting or reporting matter - Upon identification of an accounting or reporting matter within the Business/Corporate Unit, a Business/Corporate Unit contact (the "Contact") should be established and such individual should inform a member of CARG regarding the matter to be addressed.

Provide documentation of accounting or reporting matter to CARG - Upon discussion of the matter with CARG, the Contact and CARG will jointly determine the nature and timing of the documentation to be provided and any assistance that the Business/Corporate Unit may require from CARG. While assistance may be provided from CARG, responsibility of all documentation will reside with the Business/Corporate Unit unless expressly agreed with CARG. All documentation submitted by the Contact should receive local management approval prior to being sent to CARG for review. CARG members will consult internally and with others as they deem appropriate based upon the facts and circumstances surrounding each matter (e.g., materiality, level of judgment required, any potential impact on prior periods, etc.).

The author of each memo is responsible to ensure that any other policies have been complied with, including the policy on "Preparing & Reviewing Financial Schedules, Statements, or Reports." While each issues memo is not required to undergo a formal "prepare/review" process, any financial information in an issues memo, or in any corresponding attachment to a memo, authored by anyone outside of CARG should be subjected to the procedures in the "Preparing & Reviewing Financial Schedules, Statements, or Reports" policy, including the documentation requirements of this policy. For any memos authored by members of CARG, since any financial information used by CARG usually comes from a corporate or business unit, any financial information in an issues memo, or in any attachments, should be verified to CARG's source of the information by another member of CARG. The performance of these procedures by CARG should be documented when "final" versions of memos are placed in the CARG Research Matters Lotus Notes database (including the name of the person who verified any financial or other quantitative information).

Submit revisions to documentation as a result of CARG review - As mentioned above, upon Business/Corporate Unit approval, an initial draft memo will be presented to CARG. Depending on the nature of the matter, documentation may be reviewed by one or more members of CARG. A version of the memo containing comments or proposed revisions will be provided to the Contact within the established time frame. The Contact should process proposed revisions or indicate why such revisions should not be processed and address all questions posed by CARG. Upon completion of review, the Contact should submit a revised version of the documentation to CARG. This process may repeat, as necessary, until approval is received from CARG. CARG will also coordinate any other review deemed appropriate (e.g., Corporate Controller).

Coordinate external auditor review with CARG - Upon notification of the accounting or reporting matter to CARG, CARG will coordinate with the Business/Corporate Unit regarding responsibility for communications with the external auditor for both the corporate and local teams. The standard procedure on matters requiring documentation will be for the Business/Corporate unit (or CARG if requested by the Business/Corporate unit) to initially inform the external audit team in the respective location. The Business/Corporate Unit and CARG will also coordinate the timing for communications with the external auditor, with concurrent communications permitted for matters of a time sensitive nature.

File documentation within Business/Corporate Unit files - If CARG involvement is determined to be appropriate by the Business/Corporate unit, no documentation subject to this policy will be considered final until indicated, or signed-off, by CARG. Either the Corporate Controller or the head of CARG is required to approve, or concur with, conclusions reached on all matters that require CARG involvement as.

Upon finalization of the documentation of a significant accounting or reporting matter, the Contact should remove the draft stamp, ensure the date of documentation is appropriate, and modify electronic file name, as appropriate. All previous drafts should be disposed in accordance with Duke Energy's documentation retention policies. An electronic copy of the final documentation should reside in a designated folder on the local Business/Corporate Unit's server. Discretion may be applied to storage of hard copy documentation by local management.

Provide a copy of final documentation to CARG - Upon finalization of the documentation of a significant accounting or reporting matter, provide an electronic copy of the final documentation, including any attachments, in electronic format to the CARG representative for filing in the CARG Research Matters Lotus Notes database. When indicating a matter as "final" in the CARG Research Matters Lotus Notes database, the CARG member should indicate whether the Corporate Controller or the head of CARG, or both, approved, or concurred with, the documented conclusion. Also, as discussed above, when filing a memo in the database, the CARG member should also indicate the name of the person who verified any financial or other quantitative information included in the memo, or in any attachments to the memo, that was prepared by a member of CARG.

Copies of all documentation of significant accounting or reporting matters subject to this policy should be submitted to CARG. The procedures for matters in which CARG is involved are outlined above. For matters for which CARG was not involved, a final version of the documentation should be provided to a member of CARG for filing in the CARG Research Matters Lotus Notes database. If a position does not require CARG input or consultation, the final position paper should note that CARG has not reviewed or approved the

position. CARG members may choose to read such documentation submitted to them for filing purposes and any CARG questions or comments should be resolved prior to filing the documentation as final.

**Research and Documentation of Accounting Issues:**

Documentation of an accounting or reporting matter should be comprised in order of the following general sections:

- Purpose
- Background
- Issue(s)
- Accounting Guidance and Discussion
- Conclusion
- Attachments

A description of each of the above sections is as follows:

Purpose - The purpose section describes why the memo has been written. It typically is brief in nature (1-3 sentences) and alerts the reader as to the key subject matter.

Background - The background section describes information leading up to the issue to be discussed. It provides information regarding key personnel, decisions made regarding related business and economic events and why such decisions are important to the matter under evaluation. The Background section provides the context needed to understand and evaluate the accounting or reporting matter to be addressed. Depending on the nature of the matter, this section may range from a few sentences to several paragraphs.

Issue - The issue section describes the specific accounting or reporting matter or matters to be addressed. An issue should be specific in nature and, if appropriate, multiple issues should be separately listed and separately addressed in the memo. Documentation of this section may be accomplished in the form of a question (e.g., how should Duke Energy account for a particular transaction?) or in the form of an assertive position (e.g., Duke Energy should account for a particular transaction in this manner).

Accounting Guidance and Discussion - The accounting guidance and discussion section describes the applicable literature related to the issue and an explanation of the applicability of such guidance to the issue being addressed. Documentation should include specific citations of the accounting references used and excerpts, as applicable. This section should discuss the accounting literature that is in support of any desired accounting treatment as well as any literature that might point to a different conclusion. The purpose of this section is to ensure that all applicable accounting literature has been identified and appropriately considered.

Conclusion - The conclusion section draws on the information provided in the previous section to provide a final resolution on the issue being addressed. It is typically fairly brief in nature and should often be evident based on the discussion above.

Attachments - The attachments section contains information referenced in the body of the memo. Such information includes supporting documentation, calculations, other related memos, examples, etc. Depending on the nature of the memo, this section may or may not exist.

Documentation of all matters prepared in accordance with this policy should contain the following attributes:

- Memo included on related Duke Energy Business/Corporate Unit letterhead
- Memo should include the caption "Draft- for discussion purposes only" until such memo is approved by business/corporate unit management, external auditors, and CARG if appropriate.
- Memo should include a date indicator, version number or some other identifier to indicate the progression of initial and revised documentation.
- Memo should include the name of external auditor personnel to whom the memo was provided as well as the name(s) of CARG and any other Duke Energy personnel (including Business/Corporate Unit management) copied on the memo

In addition, documentation style of internal memos should be consistent among Business/Corporate Units. When preparing documentation in accordance with this policy, the following best practices should be employed:

- Always assume the documentation will be delivered to a third party (e.g., SEC)
- Focus on the facts
- Avoid extraneous comments and discussion
- Use short and complete sentences with action verbs
- Include relevant dates and Duke Energy personnel involved
- Define terms and acronyms
- Use "Duke Energy" or "the Company" instead of "I" or "you"
- Perform a thorough self-review with each draft memo
- For sensitive matters, obtain input from Duke Energy legal department regarding privileged information

**Related Links:**

- [Engaging the Independent Auditor for Services](#)
- [Preparing & Reviewing Schedules, Statements, or Reports](#)



## Duke Energy Accounting Policy Statement

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### U.S. GAAP Accounting and Disclosure Compliance Checklists

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller

<b>Effective Date:</b>	12/01/2004
<b>Revision Date:</b>	12/31/2008
<b>Reissue Date:</b>	12/31/2008

#### **Statement of Purpose and Philosophy**

As part of Duke Energy's effort to ensure complete and consistent application of United States generally accepted accounting principles ("U.S. GAAP") across its business and corporate units, separate U.S. GAAP Accounting and Disclosure Compliance Checklists will be used to help assess complete and consistent application of U.S. GAAP, including conformity with the related disclosure requirements, at Duke Energy. U.S. GAAP encompasses both the appropriate accounting under promulgated standards by the Financial Accounting Standards Board ("FASB") as well as applicable incremental requirements of the U.S. Securities and Exchange Commission ("SEC") for U.S. public companies.

#### **Policy Expectations**

This policy and related processes should help to ensure (1) complete and consistent application of U.S. GAAP across Duke Energy and (2) compliance with all U.S. GAAP disclosure requirements in Duke Energy's Form 10-K and Form 10-Q filings. Two separate checklists and processes will be used - one for accounting (the "Accounting Checklist") and one for disclosure (the "Disclosure Checklist").

- The Accounting Checklist will be used quarterly to help assess (1) any areas of noncompliance with U.S. GAAP accounting and (2) any areas of inconsistent application, or changes in interpretation or application of, U.S. GAAP. The Accounting Checklist will be completed in connection with the closing of the books, and any events of noncompliance with U.S. GAAP or inconsistencies should be resolved prior to the year end or quarterly earnings release. The Accounting Checklist for each business or corporate unit will apply to the Duke Energy consolidated level and therefore will cover any other SEC registrants under the Duke Energy umbrella. The timeframe for completion of the Accounting Checklist will be communicated to the business/corporate units in the periodic data requests sent by the External Reporting Group ("ERG") or in a separate communication from Corporate Accounting Research Group ("CARG"). The date will coincide with the earnings release.



- The Disclosure Checklist will be completed by the Corporate Controller's Department - ERG in connection with the drafting of the Form 10-K or Form 10-Q with any disclosure gaps resolved prior to the filing of the Form 10-K or Form 10-Q. A single Disclosure Checklist will be completed for Duke Energy as a whole and will apply to all registrants.

### **Accountability: Roles and Responsibilities**

#### Business Units/Corporate Areas

- Ensure appropriate business/corporate unit personnel understand the requirements and timeline for completing the Accounting checklist.
- Ensure appropriate business/corporate unit personnel with appropriate level of experience complete the checklist (i.e., those with sufficient knowledge of GAAP).
- Complete the Accounting Checklist within the appropriate timeframe, including submitting to the Corporate Controller's Department.
- Work with the Corporate Controller's Department - CARG to address any identified cases of noncompliance with or inconsistencies in the application of U.S. GAAP.
- Determine the appropriate level of "drill-down" that is required to appropriately address the application of U.S. GAAP within each respective business/corporate unit.
- Business/corporate unit controller should review and approve the final checklist prior to sending the checklist to CARG.

#### Corporate Controller's Department

- ERG will complete the Disclosure Checklist at each quarter and year-end for the Consolidated Company. The Checklist will be subject to the Do/Review policy.
- CARG will be the responsible group within the Corporate Controller's Department with respect to the Accounting Checklist.
- Identify the business and corporate units for which the Accounting checklist needs to be completed.
- Communicate timeline to business/corporate units in a timely manner to allow for sufficient time to complete the Accounting checklist.
- Distribute the Accounting checklists and accumulate the completed checklists. Review the completed checklists for any identified areas of noncompliance with U.S. GAAP and for any inconsistencies across business/corporate units.
- Provide assistance in completing the Accounting Checklist by answering questions from the business/corporate units.
- Address any instances of noncompliance with U.S. GAAP or any inconsistencies and review and approve final results with the Corporate Controller.

### **Standards/Requirements**

1. CARG and ERG will coordinate with Corporate Internal Controls to ensure that appropriate representations are included in the appropriate internal management representation letters. A representation will be required from the business/corporate units to indicate that they have completed, reviewed and submitted the Accounting checklist to CARG, as discussed below. Other representations may be deemed necessary as appropriate in the circumstances.

2. The CARG Accounting Issues database will be used for housing the Accounting Checklists. The business/corporate units will not be able to view each other's checklists. Each business/corporate unit will be responsible for completing the Accounting Checklist for their respective unit prior to the quarterly or annual earnings release. The ERG will be responsible for completing the Disclosure Checklist in connection with the issuance of the Form 10-K or Form 10-Q.
3. CARG will assist the business/corporate units in completing the Accounting Checklist by answering questions regarding U.S. GAAP.
4. CARG will review an accumulation of the completed Accounting Checklists for any identified events of noncompliance with U.S. GAAP and any inconsistencies in the application of U.S. GAAP.
5. CARG will coordinate and document the resolution of any identified instances of noncompliance with U.S. GAAP or any inconsistencies noted. ERG will coordinate and document the resolution of any required disclosures that are not included in the draft Form 10-K or Form 10-Q.
6. The Accounting Checklist process is to be completed prior to the quarterly and annual earnings releases; the Disclosure Checklist process is to be completed prior to the filing of the DEC Form 10-K or Form 10-Q.

**Related Links:**

[Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters](#)



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## Accounts Payable and Imprest Petty Cash Policy

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**Applicability:** Applies to Enterprise  
**Originator:** Corporate Controller  
**Approval:** Corporate Controller

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**Approval Date:** 7/19/2006

**Revision Date:** 04/20/2009

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**Statement** - This policy covers accounts payable and imprest petty cash fund systems used by business/corporate units. The policy describes the minimum controls required. The business/corporate unit should implement additional procedures and controls as needed to ensure an appropriate level of control exists within the accounts payable and imprest petty cash fund systems.

Imprest petty cash funds should only be established when necessary to facilitate local payments of minor incidental expenditures. Business/corporate unit accounts payable systems or corporate cards are preferred methods of payment for purchases due to enhanced control benefits.

Imprest funds and corporate cards should not be used to circumvent company purchasing policies or procedures. Imprest funds should be reimbursed through the business/corporate unit's accounts payable system.

### Roles and Responsibilities-

#### Business/Corporate Unit-

Implement internal controls as necessary to ensure accounts payable and imprest petty cash fund disbursements are appropriate. The following minimum controls are required:

##### Accounts Payable:

- Payment authorization must be approved in accordance with the business/corporate unit delegation of authority. See the *Delegation of Authority Policy* for additional information.
  - Approvals should be by original signature or properly secured electronic approval.
  - Approvals by initials, rubber stamp, forging a signature or using another person's password are prohibited.
  - Automated approval of payments using automated matching of approved purchase order, receipt and invoice is acceptable.
- The following functions should be separated between at least two people. Weaker segregation of duties should be accompanied by additional management review.
  - originating and approving a purchase
  - receiving goods and services
  - approving invoices
  - processing and signing checks
- The general ledger accounts payable account should be reconciled to the accounts payable sub-ledger at least monthly. Corrections should be made within one month of identifying a reconciliation difference.
- Procedures should restrict entry or payment of duplicate payments.
- Payments should be made in a timely manner considering discount terms.
- Payments should be supported by an invoice, receipt, or other documentation that accurately describes the purpose of the disbursement.
- All data required on Form 1099s and related state reporting for payments made to contractors and independent consultants must be accurately captured and reported by the business units.

- Business/corporate units must obtain Forms W-9s or W-8s before making payments to customers where required.

Imprest Petty Cash Funds:

- Imprest petty cash funds may be used for incidental expenses of less than \$1,000.
  - Unusual circumstances warranting a different transaction limit may be approved by the Corporate Controller.
- The fund should be secured, such as in a locked box, or deposited in a local bank checking account in the company's name. See the **Bank Account and Check Disbursement Policy** for additional information.
- The imprest fund should be reimbursed by submitting approved documentation (invoices, receipts, expense reports, etc.) to the business/corporate unit's accounts payable system.
  - Approval of the imprest fund reimbursement request should be authorized through the business/corporate unit delegation of authority for expenditures. See the **Delegation of Authority Policy** for additional information.
- The following functions should be separated between at least two people. Weaker segregation of duties should be accompanied by additional management review:
  - fund custodian
  - approving invoices
  - approving reimbursement request to replenish the imprest fund
  - signing checks
- The imprest fund bank statement and checkbook should be reconciled to the fund advance amount at least monthly. Corrections should be made within one month of identifying a reconciliation difference.
  - The reconciliation should be reviewed by management on a monthly basis.
- Relevant accounts payable controls indicated above apply to imprest funds.



## Duke Energy Policy Statement

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### Approval of Annual Budget Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	SVP Investor Relations and Financial Planning
<b>Approval:</b>	Chairman, President and Chief Executive Officer ("CEO")
<b>Effective Date:</b>	08/31/2000
<b>Revision Date:</b>	04/01/2008
<b>Reissue Date:</b>	04/01/2008

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**Statement-** The following approval requirements describe the process for Duke Energy's CEO and Board of Directors approval of annual Business/Corporate Unit income/expense forecasts, as well as annual capital budgets.

#### Approval-

- Business/Corporate Unit annual capital budgets and income/expense forecasts are reviewed in a Senior Executive Leadership Team (SELT) meeting prior to submitting to CEO and Board of Directors for approval.
- Business/Corporate Unit annual capital budgets and income/expense forecasts are presented to the CEO and Board of Directors for approval in the year preceding the budget period.
- Annual capital budgets must include all projected capital expenditures, even if the specific projects or acquisitions are not yet determinable.
- Annual capital budgets must be presented gross with separate identification of divestitures.
- Annual capital budgets should be segmented as follows:
  - Expansion
  - Environmental
  - Maintenance

#### Variance Reporting-

- Income and annual capital budget variances must be reported monthly to the CEO, Direct Reports to the CEO and the Board of Directors.
- Refer to the Approval of Business Transactions Policy for approvals required associated with project cost overruns.

#### **Related Links:**

[Approval of Business Transactions](#)



## Duke Energy Policy Statement

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### Approval of Business Transactions

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance
<b>Approval:</b>	President & Chief Executive Officer ("CEO")
<b>Effective Date:</b>	07/01/2000
<b>Revision Date:</b>	01/01/2009
<b>Reissue Date:</b>	01/01/2009

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#### **Statement of Purpose and Scope:**

This Policy outlines the minimum reviews and approvals required for the execution of transactions, documents and forms necessary for the conduct of business of (1) Duke Energy Corporation ("Duke Energy"), (2) subsidiaries of Duke Energy that are treated by it as consolidated subsidiaries for accounting purposes, and/or (3) non-consolidated subsidiaries of Duke Energy that require the approval or consent of (i) Duke Energy, or any of its wholly-owned subsidiaries, or (ii) any board member or other voting representative appointed by Duke Energy or any of its wholly-owned subsidiaries. Transactions for purposes of this Policy, include, but are not limited to: expenditures of cash; use of employee(s) time; use of equipment, facilities, vehicles; payment of invoices; employee expense reimbursement; payroll related transactions; project approvals; contracts; operating and capital leases; divestitures and terminations; issuance of corporate securities; credit support; guarantees; non-binding bids or offers; warranties; and purchases or sales of commodities.

Transactions, including related contracts or other legally binding agreements, must be approved, in writing, by the appropriate authority prior to execution by Duke Energy or any of its subsidiaries.

No employee may approve a transaction that is for his/her own benefit.

This Policy does not provide for every possible scenario regarding the approval of transactions and is not a substitute for good judgment or communication; nor is it the objective of this Policy to set forth all additional necessary reviews which may be advisable in certain circumstances (e.g., Legal, Finance, Risk Management, etc.). It is Management's intent that those given the authority by this Policy to conduct business be responsible and accountable for assuring the advice, counsel, and review from appropriate staff are obtained and evidenced, as necessary.

This Policy outlines the authority limits of Duke Energy related to the commitment or disbursement of funds or resources. Approvals of the many varied work management documents and/or reports are to be defined and administered by the various Business Units/Corporate areas.

In addition to this Policy, Duke Energy has other corporate policies (e.g., Purchasing Controls Policy, Credit Policy, Legal Settlement Procedures, etc.). The approval of transactions shall conform to all corporate policies.

Lastly, Duke Energy maintains a Delegation of Authority ("DOA") Policy covering Duke Energy employees below the level of Direct Reports to the CEO. Employees based outside of the United States are covered by the Delegation of Authority – International Employees Policy.

#### **Accountability: Roles and Responsibilities:**

The **Board of Directors** is responsible for approving the authority limits for the President and CEO.

The **President and CEO** is responsible for approving this Policy and any updates. In addition, the **President and CEO** and the **Corporate Controller** are responsible for approving any requests for exceptions to the standard authority limits of the Direct Reports to the CEO.

The **Direct Reports to the CEO** are responsible for approving any requests from individuals within their organization for exceptions to the standard authority limits that are specified within this or the DOA Policy. They are also responsible for establishing and maintaining the appropriate processes to ensure all transactions are appropriately reviewed and approved and initiating or updating, as necessary, exceptions to his/her standard authority limits.

[View Direct Reports to the CEO Authority Limit Matrices.](#)

**Duke Energy Management** is responsible for adhering to this Policy and the DOA Policy, ensuring that their employees are classified in the proper Management Levels, and verifying the appropriateness of employee access to transactional systems.

The **Duke Energy Senior Vice President and Controller** is responsible for maintaining this Policy, including communicating all applicable updates and exceptions.

**Administrators of Duke Energy Systems** that utilize or store ABT data are responsible for the proper use, updating and maintenance of that data.

#### **Approvals:**

Below are the authority limits associated with the President and CEO and the standard authority limits for the Direct Reports to the CEO. If circumstances warrant, additional dollar level restrictions may be defined by individual Business Unit/Corporate areas and incorporated into department policy and/or procedures so long as the limits established do not increase approval authority from those limits set forth in this Policy or the DOA Policy.

Individual transactions cannot be separated into multiple transactions for the purpose of circumventing an individual's authorized approval limit. However, transactions may be evaluated for required authority limits individually where the transactions are discrete, separate and independent of each other.

*Authority Limits for the President and CEO 1/*

<b>Standard Authority</b>	<b>Authority Limits</b>
Non-Routine and Routine Transactions (Including Expenditures and Terminations)	<ul style="list-style-type: none"> <li>• US &lt; \$100 million</li> <li>• Non-US &lt; \$50 million</li> </ul>
Cost Overruns/Scope Changes/Additional Funding for Previously Approved Transactions	Greater of \$30 million or 20% of original amount; total overrun capped at \$100 million for US and \$50 million non-US
Purchases or Sales of Commodities, Storage, Transportation or Capacity, or Other Sales: <ul style="list-style-type: none"> <li>• Fixed Price Contracts – Coal</li> <li>• Fixed Price Contracts – All others</li> <li>• Indexed, Cost Plus, Reimbursable or Tariff Contracts</li> <li>• Option Contracts</li> </ul>	<ul style="list-style-type: none"> <li>• Any transaction =&gt; 5 years in term</li> <li>• &lt;= \$750 million</li> <li>• &lt;= \$500 million</li> <li>• &lt;= \$1 billion</li> <li>• &lt; \$100 million premium</li> </ul>
Outgoing Credit Support, Guarantees and Warranties (Including Letters of Credit; Performance Bonds; Surety Bonds; Comfort Letters; Warranties; and Uncapped Guarantees for Measurable Theoretical Exposures, Standard Seller Indemnities, and Workers' Compensation)	<ul style="list-style-type: none"> <li>• &lt;= \$500 million and prior approval of the Chief Financial Officer</li> </ul>
Routine Common Stock Issuances (Including Dividend Reinvestment and Retirement Savings Plans)	<ul style="list-style-type: none"> <li>• &lt;= Existing shelf registration</li> </ul>
Incurrence of Debt, Issuance of all Corporate Securities, Excluding Common Stock: <ul style="list-style-type: none"> <li>• If Consistent with an Existing Shelf Registration and the Company's Approved Financing Plan</li> <li>• If Not Consistent with an Existing Shelf Registration and the Company's Approved Financing Plan</li> </ul>	<ul style="list-style-type: none"> <li>• &lt; \$1 billion</li> <li>• &lt;= \$500 million</li> </ul>
Component Transactions of a Previously Approved	<ul style="list-style-type: none"> <li>• &lt;= Amount of previously</li> </ul>



Transaction	approved transaction
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*1/ All transactions exceeding the specified authority limits must be approved by the Board of Directors and/or Finance & Risk Management Committee. Transactions which require Finance & Risk Management Committee approval are: Cost Overruns/Scope Changes/Additional Funding for Previously Approved Transactions and Incurrence of Debt, Issuance of all Corporate Securities, Excluding Common Stock.*

For approval purposes under this Policy, the transaction amount is broadly defined and is based on expected gross, aggregate expenditures and commitments (including debt, leases, and other liabilities). The expenditures and commitments are considered in nominal dollars and not present value amounts. For dispositions or divestitures, the capital amount, for approval purposes, is the higher of the original cost or sales price. The measurement period for the term limit requirement includes the current calendar year the transaction is entered into, regardless of the obligation start date, through the end date of the transaction.

The routine standard authority limit for the Direct Reports to the CEO is \$25 million.

Transactions which exceed the Direct Reports to the CEO authority limits require review/approval by the TRC and approval by the President and CEO. The Secretary of the TRC should be contacted for guidance and coordination of such approval requests. The *Financial Analysis Manual* provides specific guidelines for conducting a Financial Analysis.

***Exceptions to Routine Standard Authority Limits:***

Through the ABT Policy exception process, the President and CEO may delegate his/her authority limits to another individual within Duke Energy, as business needs dictate. The President and CEO and the Corporate Controller must approve all exceptions to the Direct Reports to the CEO standard authority limits. For further guidance and direction on the ABT Policy exception process, see Request for Exception to the Approval of Business Transactions (ABT) Policy.

For existing exception authority limits applicable to the Direct Reports to the CEO, see the applicable Direct Report to the Chief Executive Officer (CEO) Authority Limit Matrix.

Any material changes made by the President and CEO to existing authority limits must be communicated to the Audit Committee of the Board of Directors.

Any exception to the standard approval authority limits for employees reporting up through the Direct Reports to the CEO requires approval by the applicable Direct Report to the CEO.

For those limited circumstances where an increase in approval limit is needed, the Delegation of Authority Exception Request Form should be used to request an exception. For further guidance and direction, see the DOA Policy.

***Standard Authority Limits – Non-Routine Transactions:***

For purposes of this Policy, non-routine transactions are transactions that are not part of an individual's normal course of business and include such items as acquisitions, mergers, divestitures, joint ventures, partnerships and investments in third party businesses.

A Direct Report to the CEO has authority to approve non-routine transactions up to \$5 million. Any non-routine transaction which is greater than \$5 million must be approved by the President and CEO. Prior to submission to the President and CEO for approval, all such transactions must first be reviewed and approved by the TRC.

**Special Approval Requirements:**

- Transactions that might pose unusual or unique contingent exposure or risk to Duke Energy or any affiliate, as determined by the President and CEO, will be presented to the Board of Directors for approval.
- The President and CEO shall cause the Board of Directors to receive an informational briefing of transactions greater than \$25 million, which do not otherwise require approval by the Board of Directors. These informational briefings are coordinated by the Board Secretary.
- Procurement of goods and services, including pricing agreements, must follow the guidelines in the Purchasing Controls Policy.
- Any transaction which causes a material change to Duke Energy's capital structure (e.g., consolidation of debt resulting from an increase in ownership percentage) will also require the prior approval of the Treasurer. All capital leases need to be approved by the Treasurer. However, once approved, these leases can be executed by Treasury, Business Unit, or Corporate area personnel with an appropriate authority limit. All operating leases are the responsibility of the appropriate Business Unit or Corporate area.
- Transactions involving less than 100% owned Duke Energy subsidiaries must be approved by individuals with the appropriate authority limits based on Duke Energy's direct or indirect ownership percentage in the subsidiary or the amount of the transaction attributable to Duke Energy, whichever value requires the higher level of approval.
- Non-binding bids or offers (e.g., indicative bids, indications of interest, letters of intent, memorandums of understanding, or other non-binding bids or offers) of a dollar amount which would otherwise require the approval of the President and CEO and/or Board of Directors, are to be reviewed and approved by the President and CEO and the Chief Financial Officer ("CFO"). A confirmation from Legal must be obtained supporting that the bid or offer is non-binding. For purposes of this approval, term limit requirements do not apply. In addition, notice to or review by the TRC is not required.
- A brief informational report must be provided to the TRC for material changes in project scope for transactions that do not have a monetary impact (e.g., a change in the location of a proposed power plant, a significant change in counterparties involved in the project) which were originally approved by the President and CEO and/or Board of Directors. The TRC will determine if notification to or re-approval by the President and CEO is required.
- The President and CEO may substitute an alternative committee review for an otherwise required review by the TRC.
- A brief informational report must be provided to the President and CEO and CFO for cost overruns/scope changes/additional funding for previously approved transactions approved by the Direct Reports to the President and CEO that result in total cost exceeding their normal authority.

**Direct Reports to the CEO - Authority Limit Matrices**

- Group Executive and Chief Administrative Officer
- Group Executive and Chief Financial Officer
- Group Executive and President, Commercial Businesses
- Group Executive and Chief Legal Officer
- Group Executive and Chief Nuclear Officer
- Group Executive and Chief Strategy, Policy and Regulatory Officer

- [Group Executive and President, Chief Operating Officer, U.S. FE&G](#)
- [Senior Vice President and Chief Sustainability Officer](#)
- [President, Office of Nuclear Development](#)
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**Related Links:**

- [Approval of Business Transactions – FAQs](#)
- [Request for Exception to ABT Authority Limits](#)
- [Delegation of Authority](#)
- [Delegation of Authority – International Employees](#)
- [Credit Policy](#)
- [Intercompany Funding Policy](#)
- [Purchasing Controls Policy](#)
- [Credit Delegation of Authority](#)
- [Financial Analysis Manual](#)
- [Legal Settlement Procedures](#)
- [Commodity Risk Policy](#)
- [Financing Activity and Financial Risk Management Policy](#)
- [Creation, Dissolution, or Restructuring of Legal Entities and Subsidiaries](#)



## Duke Energy Policy Statement

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# Check Signing Policy

**Originator:** Vice President & Treasurer  
**Sponsor:** Vice President & Treasurer  
**Approval:** Vice President & Treasurer

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**Approval Date:** 01/01/09

**Revision Date:** 01/01/09

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**Statement-** This policy covers check signing processes used by business/corporate units. The policy describes the minimum controls required. The business/corporate unit should implement additional procedures and controls as needed to ensure an appropriate level of control exists within the check signing process.

The purpose of this policy includes the requirement for proper management authorization for the payment of disbursements by checks.

### Roles and Responsibilities-

#### **Business/Corporate Unit-**

- Issue checks only for properly approved disbursement requests supported by adequate documentation.
- Check signers must review supporting documentation before signing and releasing checks, unless the check is for an expenditure that has been authorized by business/corporate unit management as a recurring transaction with a credible vendor.
- Check signers must not have access to blank checks.
- Check signature requirements are as follows (table below excludes Midwest business due to differences in the corporate banking resolutions):

<b>Amount of Check</b>	<b>Minimum Signature Requirement</b>
Under \$1 million	<ul style="list-style-type: none"><li>• facsimile or manual signature of a designated/ authorized signer or their designee.</li></ul>
\$1 million to \$5 million	<ul style="list-style-type: none"><li>• manual signature of a designated/authorized signer.</li></ul>
\$5 million and over	<ul style="list-style-type: none"><li>• manual signature of two designated/authorized signers.</li></ul>



## Duke Energy Policy Statement

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### Contract Administration Policy

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Supply Chain
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	July 1, 2008
<b>Revision Date:</b>	
<b>Reissue Date:</b>	

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#### **Statement**

This Policy covers contract administration for Business/Corporate Units. The Policy describes the minimum controls and responsibilities required. The Business/Corporate Unit should implement additional procedures and controls as needed to ensure an appropriate level of control is included in their business processes associated with contract administration.

#### **Definition of Contract Administration**

Contract administration involves those activities performed by designated individuals to determine that the contract invoices comply with the pricing and other terms of the contract as well as other oversight roles as specified by the Business/Corporate Unit.

#### **Roles and Responsibilities**

**Managers/supervisors** are responsible for ensuring that this Policy is understood by all employees involved in the contract administration process. Management is also responsible for monitoring compliance of this Policy in their workgroup.

The **Contract Administrator's** specific responsibility is to review and attest to the appropriateness of all contract-related invoices. A Contract Administrator must understand the administrative, billing, cost, legal, and other aspects of a contract in order to ensure that the supplier is paid for work performed or goods provided within the scope of the contract. Any persons involved in contract administration should ensure adherence to the Policy and should raise concerns regarding any steps defined herein to their manager or the appropriate purchasing personnel.

A Contract Administrator must complete:

- Contract Administrator training, and
- Have a thorough understanding of the [Purchasing Controls Policy](#)

#### **Contract Administration Guidelines**

Contract Administrators or individuals performing contract administration activities should perform the following when applicable:

- Verify that invoices match the service/goods received and that labor costs, per diem, etc. comply with the contract, working in conjunction with the contract/project manager.
- Determine the documentation needed to validate invoicing and maintain such a file in accordance with the [Records Management Policy](#). Documentation requirements vary, however, examples may include a log of labor, equipment and material usage, and other types of costs charged to the job.
- Review and route for approval invoices, prior to release of funds using the appropriate Delegation of Authority depending on the value of the invoice.
- Resolve questions related to supplier invoices, involving appropriate Purchasing Personnel as needed.
- Ensure the Purchase Order (PO) dollar value will not be exceeded by the processing of the invoice(s).
- Ensure the Contractor is back charged for use of Duke Energy materials or equipment if appropriate, as the information is received.

Supplemental roles may include the following as designated by the Business/Corporate Unit

- Ensure the contractor is aware of the appropriate individuals to handle questions for various aspects of the work being performed, i.e., safety, work scope, invoicing, etc.
- Ensure an evaluation of the contractor is done at work completion.

The [Purchasing Controls Policy](#) requires clear segregation of duties such that contract administrators may not receive goods or services and authorize payment for the work. Refer to the Purchasing Controls Policy for more information on segregation of duties.

#### **Related Links:**

- [Purchasing Controls Policy](#)
- [Records Management Policy](#)
- [Delegation of Authority Policy](#)
- [Approval of Business Transactions Policy](#)



## Duke Energy Policy Statement

# Delegation of Authority

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<b>Applicability:</b>	Applies to U.S. Employees
<b>Originator:</b>	Finance
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	08/31/2000
<b>Revision Date:</b>	01/01/2008
<b>Reissue Date:</b>	01/01/2008

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### Statement of Purpose

This policy establishes the approval authority limits for all employees within the organization below the Direct Reports to the Chief Executive Officer (CEO). Approval authority limits for the Board of Directors, CEO, and Direct Reports to the CEO are defined in the Approval of Business Transactions (ABT) Policy. Employees based outside of the United States are covered by the International Employee Delegation of Authority Policy.

This policy does not provide for every possible scenario regarding approval limits and is not a substitute for good judgment or communication.

### Scope of Policy

This policy applies to business transactions that are part of an individual's normal course of business for commitments of less than five years. It applies to routine transactions including, but not limited to, invoice approvals, requisition approvals, employee expense approvals, and project approvals. Authority to execute transactions above an individual's standard approval limit requires approval, at a minimum, by a Direct Report to the CEO. Non-routine transactions, as defined by the ABT Policy, are transactions that are not part of an individual's normal course of business and include such items as acquisitions, mergers, divestitures, joint ventures, partnerships, and investments in third party businesses. Non-routine transactions are not covered by the standard approval authority limits set forth in this policy. Accordingly, unless an exception to the standard approval authority limits has been granted, all non-routine transactions of this nature must be approved by a Direct Report to the CEO or higher in accordance with the ABT Policy. Transactions with terms greater than or equal to five years also require approval in accordance with the ABT Policy.

Other policies that address approval limits for specific transactions or commitments will take precedence over the Delegation of Authority (DOA) Policy. Examples include, but are not limited to: [Commodity Risk Policy](#) and [Credit Delegation of Authority](#) as amended from time to time. In addition, transactions for the purchase of goods and services are subject to the [Purchasing Controls Policy](#).

**Accountability: Roles and Responsibilities**

**The Duke Energy Controller** is responsible for approving this policy and any updates. Per the ABT Policy, the CEO and the Controller approve any requests for exceptions to the standard approval authority levels that are above the approval limits specified for the Direct Reports to the CEO.

**Direct Reports to the CEO** are responsible for approving any requests from individuals within their organization for exceptions to the standard approval authority levels that are specified within this policy. They are also responsible for establishing and maintaining the appropriate processes to track and monitor transaction expenditures within their respective areas of responsibility to ensure cost overruns are appropriately identified and approved.

**Duke Energy Management** is responsible for ensuring adherence to this policy, ensuring that their employees are classified in the proper Management Levels, and verifying the appropriateness of employee access to transactional systems.

The **Duke Energy Chief Procurement Officer** is responsible for communicating and implementing this policy throughout the corporation. This responsibility also includes interpreting requirements under the policy. The Chief Procurement Officer has purchasing approval authority up to the previously approved amount for the underlying transaction.

**The Duke Energy DOA Administrator**, under the direction of the Chief Procurement Officer, is responsible for the day to day administration of this policy including maintaining and updating the related database and exception form process.

**Administrators of Duke Energy Systems** that utilize or store DOA data are responsible for the proper use, updating and maintenance of that data.

**Standard Approval Authority Limits**

The table below defines the authorized approval limits for specified levels of the organization. Individual transactions cannot be separated into multiple transactions for the purpose of circumventing an individual's authorized approval limit.

<b>Management Level<sup>1</sup></b>	<b>Standard Approval Authority Limits</b>
Level 1 (CEO)	Covered by ABT Policy
Level 2 (Direct Reports to CEO)	Covered by ABT Policy
Level 3 (Senior Vice President Level)	\$10,000,000
Level 4 (Vice President Level)	\$5,000,000
Level 5 (General Manager Level)	\$1,000,000
Level 6 (Director Level)	\$750,000
Level 7 (Manager Level)	\$500,000



Level 8 (Supervisor Level)	\$100,000
Level 9 (Individual Contributor Level) <sup>2</sup>	\$5,000

1. These titles are representative of Management Levels 1-9; all other job titles are mapped to one of these management levels.

2. Certain individual contributors need substantially more than the \$5,000 of standard approval authority to perform their job duties. Within the DOA database application, such positions are mapped to either a \$50,000 or \$100,000 approval limit. These positions include, but are not limited to, the following: engineers, scientists, material planners, project/product managers, and certain technicians.

### Supplemental Funding Requests for Capital Projects

- It is the responsibility of the Direct Reports to the CEO to establish and maintain the appropriate processes to track and monitor project expenditures within their respective areas of responsibility
- If at any time total expected project expenditures exceed the original approver's DOA authority limit, project re-approval is required (e.g., Form 201)
- If actual project expenditures exceed the approved estimate by \$3.5 million:
- Project re-approval is required (e.g., Form 201), and
- The appropriate Direct Report to the CEO must be notified

**Note:** For non-capital projects, if at any time the total expected expenditures exceed the original approver's DOA authority limit, re-approval of total expected expenditures is required by someone with the appropriate DOA authority.

### Exceptions to Standard Approval Authority Levels

Any exception to the standard approval authority levels requires approval by a Direct Report to the CEO. Exceptions above the limits specified for the Direct Reports to the CEO require approval by the CEO and the Controller. For those limited circumstances where an increase in approval limit is needed, the Delegation of Authority Exception Request Form should be used to request or delegate an exception.

### Related Links:

- [Delegation of Authority – International Employees](#)
- [DOA Frequently Asked Questions](#)
- [Purchasing Authority Policy](#)
- [Approval of Business Transactions Policy](#)
- [DOA Inquiry Tool](#)



## Duke Energy Policy Statement

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# Employee Expense Reimbursement Policy

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<b>Applicability:</b>	Enterprise
<b>Originator:</b>	Supply Chain
<b>Approval:</b>	Corporate Controller

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<b>Effective Date:</b>	08/31/2000
<b>Revision Date:</b>	04/20/2009
<b>Reissue Date:</b>	04/20/2009

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**Statement** - This policy describes the minimum requirements for employee expense reporting and reimbursement. Information about covered expenses for Duke Energy employees is found in the [Travel and Work Expense Procedure](#), and information on travel services is found in the [Business Travel Policy](#). A business/corporate unit can implement additional procedures and controls as needed to support this policy and to ensure an appropriate level of control exists for employee expense reimbursements.

NOTE: If Duke Energy management authorizes contractors to receive a Corporate Card and/or to incur expenses on behalf of the company, contractors have the same responsibilities as employees for compliance with this policy. Managers have a responsibility to inform contractors of the policy and the contractors' need to comply.

### **Roles and Responsibilities**

#### Approver's Responsibilities

- Ensure that submitted expenses are valid and reasonable business expenses, and are properly described for tax purposes.
- Ensure that expenses are coded appropriately for accounting purposes.
- Ensure that business/corporate unit procurement, travel, human resources, and asset policies/procedures are being followed for reported items.
- Ensure that expense reports and/or cash advances are approved by a higher level of management with direct authority over the expenses being charged.
- Ensure that expenses were not incurred on behalf of the approver, unless for a group function.
- Ensure that required receipts are submitted and legible.

#### Corporate Card

- The Corporate Card should be used where possible for payment of the following types of business-related expenses:
  - Employee expenses
  - Travel-related business expenses
  - Material purchases less than \$5,000 (cannot be used for stock items or to purchase chemicals).
  - Services less than \$5,000 (cannot be used for on-site services with risk factors requiring certificates of insurance or Environmental Health & Safety (EH&S) program compliance).
  - The Corporate Card should not be used to circumvent the procurement process.
- The Corporate Card should not be used for personal expenses unless it is an exceptional situation. If personal charges are incurred on the Corporate Card, those charges must be paid directly to the card provider bank. If not reimbursed in a timely manner, personal use of the Corporate Card will be considered to be an unapproved cash advance.
- Corporate Card expenditures should be reconciled and approved within 30 days of transaction date.
- If Corporate Card transactions are not reconciled within 90 days, the Corporate Card is subject to cancellation.
- The issuance of the Corporate Card must be approved by the next level of management with sufficient Delegation of Authority (DOA).

- All expenses must be appropriately documented as shown below.

#### Expense Reports

- Receipts or supporting documentation are required for:
  - Each expenditure of \$75 or more, if not charged on the Corporate Card.
  - Itemized hotel bills, regardless of method of payment or amount of charge.
  - Any purchase of materials such as office supplies, subscriptions, tools, etc. (the resource type begins with a "3" in the accounting codeblock)
- Out of pocket expenses should be submitted promptly, normally within 30 days of expenditure.
- All expenses on the report must include:
  - Date(s)
  - Where the expenditure was incurred (place)
  - Merchant (if required for the expense type)
  - Amount
  - Descriptions (should clearly identify the business purpose, i.e., meeting, outage, conference, business trip. Description is necessary to support the Company's tax deductions for business expenses).
- For Company tax purposes, the following applies to meals and entertainment:
  - Business meals must list attendees.
  - Meals must be reported separately from other travel expenses on the expense report, even when included in other expenditures such as hotel bills.
  - The "Entertainment" expense type should be used for any expenses incurred while entertaining vendors, customers, or persons from other companies (as defined in the Business Courtesy Policy), or for expenditures allowable under client contracts (i.e., "pass-through" charges). Entertainment must be reported separately from other travel expenses.
  - Overtime meals, service award luncheons, and other similar meals should not be reported as "meals and entertainment". Specific expense types are available in the PeopleSoft Travel and Expense system for these expenditures.
- All Corporate Card transactions and credits must be included on an expense report and routed through the approval process. Any personal charges must be listed separately in the report. Employees are responsible for directly paying the card provider bank for any personal charges.
- When approved by management, the per diem allowance will be reimbursed by Duke Energy to the employee for each scheduled shift of incurred lodging expense to cover the expense of meals, accommodations and all related miscellaneous expenses.
- Per diem will be reimbursed per the amount stated in Travel and Work Expense Procedure for non-unionized employees and appropriate labor contract for union employees.

#### Expenses prohibited on Expense Reports:

- All moving related expenses must be submitted to the Company's third party moving coordinator for reimbursement and appropriate tax treatment.
- Charitable contributions: All charitable giving should be conducted through Duke Energy Foundation. For more information refer to the Portal Community Involvement Page.
- Educational Assistance: Refer to the Human Resources procedure Continuing Education Procedure.
- Software should be purchased by contacting the IT Help Desk.

#### Cash Advances

- Cash advances for travel-related expenses should be requested, approved, reported and reconciled through the PeopleSoft Travel and Expense System.
- Requests must indicate the purpose of the advance.
- Individuals may not approve their own advances.
- Cash advances may be obtained no earlier than 30 days before the date for which the expenses are to be incurred.
- The employee should reconcile the advance and related expenses **and** reimburse Duke Energy for the unspent Cash Advance within 30 days.
- Reports of cash advances not remitted in a timely manner will be provided to the next level of management and/or Human Resources for follow-up.
- Failure to reconcile this cash advance may result in corrective action and/or income tax withholding on the balance.

*IRS guidelines state that cash advance amounts outstanding **more than 120 days** will be treated as taxable income to the employee.*

#### Foreign Currency Exchange

- Employees should only convert company funds that they would reasonably expect to need for business purposes.
- The actual exchange rate realized by the employee for converting US dollars to foreign currency should be the exchange rate used for reporting foreign currency in US dollars for cash expenditures listed on the employee's expense report.
- The foreign currency exchange gain or loss must be calculated on company funds by multiplying the money converted back to US dollars by the difference between:
  - the rate at which the original funds were exchanged to the foreign currency and
  - the rate the remaining funds were converted back to US currency.
- Corporate Card charges listed on the expense report should reflect the exchange rate at which charges were processed by the card provider bank.

#### Taxable Expenses

Expense reports must list the following reimbursements as taxable benefits for the employee per Internal Revenue Service requirements. This list is not all inclusive; these are the most commonly used. Please refer to the Portal for additional taxable expense types.

- Memberships - in organizations that are not civic, service, or professional.
- Meal expenses - when employees are authorized lodging accommodations, but with advance management approval choose to return home.
- Reimbursements for off-premise overtime meals.
- Temporary Assignment Living Expenses- living expenses (e.g. meals, lodgings, per diem) for temporary away-from-home assignments projected to last more than 1 year.
- Professional Exam Fees - Management may authorize a single reimbursement of professional exam fees and reasonable related expenses.

#### **Related Links:**

[Travel and Work Expense Procedure](#)

[Business Travel Policy](#)

[Business Courtesy Policy](#)

[Delegation of Authority Policy](#)

[Purchasing Controls Policy](#)

[Employee Expense Report Worksheet](#)

[Corporate Card Missing Receipt Form](#)

[Continuing Education Procedure](#)

[Expense Type Descriptions](#)



Duke Energy Policy Statement

Purchasing Authority Policy

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Supply Chain Operations
<b>Approval:</b>	Chief Procurement Officer
<b>Effective Date:</b>	01/01/2008
<b>Revision Date:</b>	01/01/2008
<b>Reissue Date:</b>	01/01/2008

**Statement of Purpose**

This Policy defines the approval limits for all employees of Duke Energy (excluding Duke Energy employees based outside the United States) with purchasing authority. Approval limits will be assigned based on an employee's position and /or responsibilities in the organization. This policy will be maintained in the Duke Energy Supply Chain organization.

**Accountability: Roles and Responsibilities**

The **Duke Energy Chief Procurement Officer (CPO)** is the owner of this policy and is responsible for approving this policy and all exceptions to this policy. The approval authority for purchasing is delegated to individuals in supply chain organizations by the CPO based on approval levels delegated to the CPO per the Corporate Delegation of Authority (DOA) policy.

**Supply Chain Management** is responsible for compliance with this policy.

**DOA Approval Levels**

Purchase Order approval must comply with the following Purchase Order Approval matrix. The job positions in the matrix are general purchasing titles; however, actual purchasing positions throughout Duke Energy will be mapped to these titles. Non purchasing positions who perform purchasing functions will be treated as exceptions to this policy and require CPO approval. The approval levels are based on the purchasing organizational hierarchy. The approval levels and exceptions will be maintained in a DOA database.

<b>Job Position / Authority Level</b>	<b>Approval Dollar Limits</b>
CPO	up to previously approved amount
GM	\$7,500,000
Sourcing Director	\$2,500,000
Purchasing Manager	\$1,000,000

Senior Sourcing Specialist	\$1,000,000
Sourcing Specialist	\$750,000
Buyer II	\$500,000
Buyer I	\$250,000
Purchasing Clerks	\$100,000

**Related Links:**

- [Approval of Business Transactions Policy](#)
- [Delegation of Authority Policy](#)



## Duke Energy Policy Statement

# Purchasing Controls Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Global Sourcing and Logistics
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	03/31/2004
<b>Revision Date:</b>	04/01/2008
<b>Reissue Date:</b>	04/01/2008

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### **Statement of Purpose**

This policy defines the roles, responsibilities, and requirements related to the procurement process at Duke Energy Corporation and its subsidiaries (Duke Energy or the Company). Specific topics addressed include required approvals, the sourcing process, contract formation, segregation of duties, and standards of business conduct.

### **Accountability: Roles and Responsibilities**

The **Duke Energy Controller** is responsible for approving this policy and any exceptions to the policy.

The **Duke Energy Chief Procurement Officer** is the owner of this policy and is also responsible for communicating this policy throughout the corporation to all persons involved in the supply chain processes. Any exceptions to this policy should be documented and approved in advance by the Chief Procurement Officer prior to obtaining approval by the Duke Energy Controller.

**Operational Management** is responsible for compliance with this policy within their areas of responsibility. This responsibility includes ensuring the unit has adequate internal controls over the procurement process and establishing effective contract management.

**Supply Chain Management** is responsible for compliance with this policy for all purchases made by their personnel. Supply Chain personnel are responsible for managing the sourcing process for the purchase of goods and services above \$100,000 excluding exceptions as defined within this policy.

**Designated Sourcing Personnel** are employees outside of the Supply Chain function within Duke Energy International (DEI) and Duke Energy Generation Services (DEGS) who have been authorized by the Chief Procurement Officer to act in an agent capacity to contractually obligate Duke Energy. Designated Sourcing personnel are responsible for managing the purchasing process for goods and services greater than \$100,000. They may also be involved with procurements of less than \$100,000 as requested. Designated Sourcing personnel should comply with this policy in carrying out their responsibilities.

## **Standards/Requirements**

### **1. Purchase Commitments**

Supply Chain personnel and Designated Sourcing personnel are authorized to make purchase commitments consistent with their Delegation Of Authority (DOA) limits. Officers can make contractual commitments consistent with the Approval of Business Transaction Policy and this policy. Other employees covered by the Delegation of Authority Policy are not authorized to contractually commit the Company. All purchases of goods and services for amounts greater than \$100,000, except those noted below, must be sourced through Supply Chain personnel or Designated Sourcing personnel. Supply Chain personnel and Designated Sourcing personnel will be active in the selection of qualified bidders; developing the sourcing strategy; managing the bidding process; negotiating terms and conditions; and ensuring compliance with this policy. In cases where, pursuant to this policy, involvement of Supply Chain personnel or Designated Sourcing personnel is not required, the person making the purchase is responsible for compliance with this policy.

Pricing Agreements or Blanket Orders are long term agreements that establish pricing and legal terms and conditions for recurring or routine purchases of goods or services but do not represent a financial commitment. Examples of such transactions include: alliance agreements, service agreements, enterprise pricing agreements and supplier terms and conditions agreements. These types of agreements use a requisition, purchase order, contract, or letter agreement to execute specific transactions or releases against the Pricing Agreement. Specific transactions or releases under a Pricing Agreement are subject to authorization per the DOA limits. Pricing Agreements are not subject to review by the Transaction Review Committee per the requirements of the Approval of Business Transaction Policy. However, Pricing Agreements with expected purchases above \$10 million will comply with all other requirements of this policy and require approval of the Chief Procurement Officer.

Exceptions to this policy include: real estate (buying, selling, leasing properties), fuel, energy trades, mergers and acquisitions, financing charges/treasury fees/audit services, legal services, statutory tax payments and insurance. These do not require involvement of Supply Chain personnel or Designated Sourcing personnel.

### **2. Sourcing**

Subject to the exceptions listed above, competitive bids are required for all purchases greater than \$100,000. Purchases may not be split into multiple transactions to avoid use of competitive bidding. All other exceptions must be documented and approved as required below. Competitive bidding is not required for each purchase under a strategic alliance when the alliance relationship was formed in accordance with this policy.

#### Single Sourcing

A single source purchase occurs when a competitive bidding process is not undertaken and the decision is made to select a *specific supplier based on technical, commercial, or other valid business reasons*. Because a single source procurement removes the advantages of the competitive bidding process, it should be used on an exception basis. Contract extensions, inclusive of exercising contract options to extend longer than six months should be treated as single sourcing decisions.



#### Sole Sourcing

This situation exists when because of unique or specialized characteristics only one supplier offers a particular product or service. An example of a sole source would be a supplier who has a specific patent or other proprietary right on a good or service. In this case, there is not an opportunity to use a competitive bid process.

#### Premium Over Low Bid Sourcing

Another purchasing exception is premium over low bid sourcing. This occurs when the decision is made to select a supplier who is not the lowest evaluated bidder based on technical, commercial, or other business considerations.

#### Single, Sole, or Premium over Low Bid Sourcing Documentation and Approval Requirements

Any recommendation to single source or to pay a premium over lowest evaluated bid for spend greater than \$100,000 must be supported by documentation explaining the rationale for the recommendation. This recommendation requires joint approval by a Vice President (VP) or their designee and Supply Chain. The VP will establish the designee's single source or premium over lowest evaluated bid approval limits (can be separate from their DOA limits) with a signed document to be filed with, and retained by Supply Chain. Recommendations to sole source purchases greater than \$100,000 must be approved by Supply Chain in accordance with their DOA limits.

#### Purchasing Cards

All employees are expected to utilize purchasing cards for non-stock purchases of \$5,000 or less per transaction. Below are guidelines for the use of purchasing cards.

1. All employees are expected to utilize purchasing cards for non-stock purchases of \$5,000 or less per transaction, while giving consideration to leveraging common use goods or high volume purchases to obtain favorable pricing.
2. Repetitive purchases for designated goods should be coordinated with the purchasing group so the best terms can be contracted.
3. Purchasing cards should not be used for chemicals or on-site services with risk factors requiring *certificates of insurance or Environmental Health & Safety (EH&S) program compliance*. (Refer to MasterCard Enterprise Purchasing Card Program Manual on the Services Center for other restrictions.)
4. Operational management must establish maximum limits for each employee.
5. The maximum limit must be below the limit of the manager/supervisor authorizing the card. Managers/supervisors have an inherent limit of \$5,000 per transaction unless otherwise approved by the business unit in accordance with DOA limits.
6. Transactions may **not** be split into multiple transactions to allow the use of a purchasing card.
7. The process must ensure appropriate sales tax is paid to the vendor.
8. Purchases must be reviewed by a higher level of management.
9. Purchasing cards should **not** be used to make personal purchases, even if the Company is later reimbursed.

#### Supplier Diversity

Qualified diverse suppliers will be actively solicited to participate in bidding opportunities and their bids will be evaluated on a nondiscriminatory basis. Additionally, suppliers will be encouraged to utilize diverse suppliers to fulfill their contracts with the Company.

### **3. Contract Formation**

Contracts can take many forms, such as purchase orders, written agreements, intellectual properties/software licenses, pricing agreements and engagement letters. These are defined below. Contracts must be written and include:

- a. A clear, concise statement of work or description of materials/equipment.
- b. Standard legal terms and conditions or Legal Department approval of any exceptions.
- c. Specifications for accrual and payment of taxes for purchase of goods and services.
- d. The right to terminate the contract for convenience; exceptions must be approved by the Legal Department.
- e. Requirements for appropriate business conduct in accordance with Code of Business Ethics, EH&S programs and fitness for duty, as applicable.
- f. An audit clause for non-fixed price contracts and for any non-fixed price subcontracts created by Duke Energy's prime contractor within the scope of their work.

A purchase order (PO) is a legally binding document prepared by a purchaser to describe all terms and conditions of a purchase.

A written agreement is a legally binding document used to describe more complex contracts. It contains the terms and conditions needed to cover risks, complexities and/or service levels. This type of contract is used because the transaction is not adaptable to standard commercial terms and conditions.

Intellectual properties/software licenses are used to document appropriate language specific to purchase of software, and it contains the terms and conditions necessary to protect the Company's interests related to use of software.

Engagement letters are used to describe specific work activities to be done by consultants or other professionals. They normally reference a master agreement or larger contract.

### **4. Purchasing Process Guidelines**

The purchasing process and related documentation should reflect the complexity and materiality of the goods or services being purchased. The steps identified below should be considered and included in the process as appropriate to support compliance with this policy or to meet specific operational requirements.

- a. Engineering or technical review to ensure compliance with statement of work or other specifications.
- b. Supplier qualification review.
- c. Compliance with a standard set of terms and conditions with any legal exceptions approved by Legal.
- d. Commercial and risk assessment including insurance and credit considerations and appropriate hedges against foreign currency or commodity risks.
- e. Reviews by Accounting and Corporate Tax for any sales or property tax implications (e.g., mill machinery) or accounting considerations (e.g., lease obligations).
- f. Other analyses and functional coordination as appropriate.

Documentation of the purchase process should support that the appropriate steps were taken and provide an audit trail. Documentation should be maintained in accordance with the Records Management Policy and the Duke Energy Records Retention Schedule (DERRS) and may be attached to the request in the purchasing system.

#### **5. Changes in any Contract Terms, Requirements, or Work Scope**

Prior to being implemented, any material changes in contract terms including requirements, work scope, or cost should be documented in writing and approved in accordance with this policy, the Delegation of Authority, and Approval of Business Transactions policies.

#### **6. Confidentiality**

In cases where Duke Energy is entering into a relationship with a prospective or selected supplier and confidential or proprietary information will be shared, a **Mutual Confidentiality and Non-Disclosure Agreement** must be signed by both parties. This is a legally binding agreement that will protect Duke Energy and the supplier's interests and information. These non-disclosure requirements should also be included in the procurement documentation.

Supplier quotations should always be maintained as confidential information. Quotations of one supplier are not to be divulged to another. This information should not be made available within the Company except to individuals with a business need to know. The number of bidders, who is bidding, how much is in the budget, the past performance of bidders, and future business potential are topics that should **not** be discussed with suppliers unless Supply Chain personnel or Designated Sourcing personnel authorize the discussion.

#### **7. Segregation of Duties**

The following functions should be segregated between at least two people:

- Requisitioning and/or specifying
- Vendor File Maintenance
- Procurement/contracting
- Contract administration
- Receipt of goods or services
- Invoice approval
- Check signing or disbursements

Weaker segregation structures should be accompanied by additional management review. If anyone performs both the procurement and invoice approval processes, an additional level of management must review the approval of the invoice.

#### **8. Standard of Business Conduct and Ethics**

Duke Energy complies with all applicable governmental laws, rules and regulations and maintains the highest standard of business ethics and conduct. Employees should refer to the Duke Energy Code of Business Ethics for an explanation of the Company's policies pertaining to topics such as *gifts and*

entertainment; conflicts of interest; and bribery, kickbacks and other improper payments. Employees or contractors who are concerned about unethical behavior can anonymously report their concerns on the EthicsLine by calling 1-800-525-3783 or visiting <http://www.dukeenergy-ethicsline.com/>. Employees should also consult and follow policies, procedures, and guidelines for complying with applicable Affiliate Codes of Conduct for any transactions between the regulated and non-regulated businesses.

### 9. Sourcing Requirements Summary

Category	Requirements
Purchases >\$100K	Competitive bid process will be required unless sourced through an alliance agreement. Approval by Supply Chain personnel and Designated Sourcing personnel in accordance with DOA limits. Must actively involve Supply Chain personnel or Designated Sourcing personnel.
Purchases <\$100K	Approval at appropriate DOA limits.
Single source recommendation above \$100,000	Documentation and approval by functional VP or their designee. Approval by Supply Chain management in accordance with DOA limits.
Sole source recommendation above \$100,000	Approval by Supply Chain management in accordance with their DOA limits.
Premium over low bid recommendation of \$100,000 or greater	Documentation and approval by functional VP or their designee. Approval by Supply Chain management in accordance with DOA limits.
Procurement card	Should be used for non-stock purchases of less than \$5,000 per transaction.

#### Related Links:

- [Purchasing Authority Policy](#)
- [Business Courtesy Policy](#)
- [Brand Policy](#)
- [Diversity and Inclusion](#)
- [Approval of Business Transactions Policy](#)
- [Delegation of Authority](#)
- [Delegation of Authority – International Employees](#)
- [Sales/Use and Excise Tax Policy](#)
- [Records Management Policy](#)

- Code of Business Ethics
- Figure 1 – Sample Purchase Decision Summary



## Duke Energy Policy Statement

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### Engaging Major Accounting Firms for All Services

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	4/30/2009
<b>Revision Date:</b>	4/30/2009
<b>Reissue Date:</b>	4/30/2009

#### Statement of Purpose

This policy defines the roles, responsibilities, and requirements related to the engagement process at Duke Energy Corporation and its subsidiaries (Duke Energy or the Company) for any and all services from major accounting firms, other than the Company's independent auditor.

#### Accountability: Roles and Responsibilities

The **Duke Energy Corporate Controller** is the owner of this policy and is responsible for approving this policy and any exceptions to the policy. In addition, the Corporate Controller is responsible for approving all engagement letters of named major accounting firms other than Duke Energy Corporation's independent auditor. Engagement letters using Duke Energy Corporation's independent auditor are governed by the Engaging the Independent Auditor for Services policy.

**Operational and Financial Management** personnel are responsible for compliance with this policy within their areas of responsibility. This responsibility includes obtaining the Corporate Controller's approval for any and all services from named major accounting firms prior to entering into the engagement and retaining related approval documentation.

**Audit Services and General Counsel** personnel are responsible for promptly notifying the Corporate Controller of engagement letters entered into with the named major accounting firms for any and all services.

#### Standards/Requirements

##### **1. Engaging of Major Accounting Firms for All Services**

The Corporate Controller is authorized to approve engagements with Major Accounting Firms (defined below) for any and all services consistent with his/her Delegation of Authority (DOA) limits.

Other employees covered by the Delegation of Authority Policy are not authorized to contractually commit the Company without prior approval from the Corporate Controller.

## **2. Named Major Accounting Firms**

Major Accounting Firms, as currently defined, are:

- Ernst & Young\*
- KPMG\*
- PricewaterhouseCoopers\*
- RSM McGladrey
- Grant Thornton
- BDO Seidman

\* Note: Fees paid to these firms are reported to the Audit Committee

## **3. Services**

Any and all services (including but not limited to audit, tax consulting and other types of consulting) to be provided by the Major Accounting Firms are subject to this policy.

## **4. Exceptions**

Engagements by or on behalf of the Vice President Audit Services or in support of the legal departments of the Office of General Counsel for any and all services of Major Accounting Firms, other than financial statement audit services, are not subject to prior submission to or approval by the Corporate Controller. The Vice President Audit Services or General Counsel, as applicable, shall promptly notify the Corporate Controller of such engagements.

## **5. Applicability of Other Policies**

Other than the additional requirement of obtaining the Corporate Controller's approval prior to engaging a Major Accounting Firm for any and all services, all other applicable policies (ex. Purchasing Controls Policy, etc.) and their requirements are still in effect.



## Duke Energy Policy Statement

# Engaging the Independent Auditor for Services

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance
<b>Approval:</b>	Audit Committee
<b>Effective Date:</b>	04/04/2006
<b>Revision Date:</b>	12/09/2008
<b>Reissue Date:</b>	12/12/2007

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### Statement of Purpose and Philosophy

This policy describes the guidelines to be used when considering the use of the independent auditor for all audit and non-audit services work.

### Policy Expectations

The Audit Committee of the Board of Directors (the "Audit Committee") of Duke Energy Corporation (the "Company") is required to pre-approve all audit and non-audit services performed by the Company's independent auditor in order to assure that the provision of such services does not impair the auditor's independence. Unless a type of service to be provided by the independent auditor has received general pre-approval pursuant to the policies and procedures set forth in this Policy, it will require specific pre-approval by the Audit Committee. In addition, any proposed services exceeding pre-approved cost levels will require specific pre-approval by the Audit Committee.

The term of any pre-approval is 12 months from the date of pre-approval, unless the Audit Committee specifically provides for a different period. The Audit Committee will periodically, but no less often than annually, review and revise, as necessary, the list of pre-approved services that may be provided by the independent auditor without obtaining specific pre-approval from the Audit Committee. The services by the independent auditor pre-approved by the Corporate Controller in accordance with this policy shall be reported to the Audit Committee by the independent auditor at the Audit Committee's first regularly-scheduled meeting that occurs after the independent auditor's engagement. In addition, the Company will inform and review with the Audit Committee at each of its meetings, but not less frequently than on a calendar quarterly basis, all services being provided by the independent auditor.



The Audit Committee may delegate specific pre-approval authority to one or more of its members. The member or members to whom such authority is delegated shall report any pre-approval decisions to the Audit Committee at its next scheduled meeting. The Audit Committee does not delegate its responsibilities to pre-approve services performed by the independent auditor to management.

### **Accountability: Roles and Responsibilities**

Business Units/Corporate Areas:

- Prior to beginning any engagement of Duke Energy Corporation's independent auditor, contact the Corporate Controller's Department to confirm whether or not the requested services are included in the annual base scope of work that has been approved by the Audit Committee. If the requested services are outside the approved base scope of work, then these requirements must be followed:
  - o Obtain advance approval from the Corporate Controller prior to beginning the engagement of the independent auditor
- Ensure that only officers of the Company or authorized contracting agents sign engagement letters

Corporate Controller:

- Determine whether services are included in the base scope of work that has been approved by the Audit Committee or whether separate approval of the services is required
- Obtain Audit Committee approval for any engagement outside of the base scope or pre-approved services
- Approve engagements of the independent auditor in accordance with pre-approvals by the Audit Committee, as follows:
  - o Audit Services. The annual audit services engagement terms and fees will be subject to the specific pre-approval of the Audit Committee. The Audit Committee will approve, if necessary, any changes in terms, conditions and fees resulting from changes in audit scope, Company structure or other matters. The Audit Committee pre-approves other Audit services listed below, which are those services that only the independent auditor reasonably can provide. The Audit services listed below are pre-approved up to \$100,000 in estimated fees per individual project and up to \$1,000,000 in estimated fees in the aggregate. All Audit services not listed below or that exceed the amounts stated above must be separately pre-approved by the Audit Committee.
    - Statutory audits or financial audits for subsidiaries or affiliates of the Company
    - Services associated with Securities and Exchange Commission (SEC) registration statements, periodic reports and other documents filed with the SEC or other documents issued in connection with securities offerings (e.g., comfort letters, consents), and assistance in responding to SEC comment letters
    - Consultations by the Company's management as to the accounting or disclosure treatment of transactions or events and/or the actual or

- potential impact of final or proposed rules, standards or interpretations by the SEC, FASB, or other regulatory or standard setting bodies<sup>1</sup>
- Consultations regarding accounting research and appropriate accounting treatment of transactions, including any fees associated with the independent auditor's electronic or web-based, proprietary tools (e.g., Deloitte & Touche's Deloitte Accounting Research Tool, a web-based accounting research system)
  - Attest services required by statute or regulation
- Audit-Related Services. Audit-related services are assurance and related services that are traditionally performed by the independent auditor. The Audit Committee believes that the provision of Audit-related services does not impair the independence of the auditor, and pre-approves the Audit-related services listed below. The Audit-related services listed below are pre-approved up to \$100,000 in estimated fees per individual project and up to \$1,000,000 in estimated fees in the aggregate. All Audit-related services not listed below or that exceed the amounts stated above must be separately pre-approved by the Audit Committee.
- Due diligence services related to potential business acquisitions/dispositions
  - Financial statement audits of employee benefit plans
  - Internal control reviews and assistance with internal control reporting requirements
  - Agreed-upon or expanded audit procedures related to accounting and/or billing records required to respond to or comply with financial, accounting or regulatory reporting matters
  - Consultations by the Company's management as to the accounting or disclosure treatment of transactions or events and/or the actual or potential impact of final or proposed rules, standards or interpretations by the SEC, FASB, or other regulatory or standard-setting bodies
  - Consultations regarding accounting research and appropriate accounting treatment of transactions, including any fees associated with the independent auditor's electronic or web-based, proprietary tools (e.g., Deloitte & Touche's Deloitte Accounting Research Tool, a web-based accounting research system)
  - Attest services not required by statute or regulation
- Tax Services. The Audit Committee believes that the independent auditor can provide Tax services to the Company, such as tax compliance, tax planning and tax advice, without impairing the auditor's independence. The Audit Committee pre-approves the Tax services listed below. The Tax services listed below are pre-approved up to \$100,000 in estimated fees per individual project and up to \$1,000,000 in estimated fees in the aggregate. All Tax services not listed below or that exceed the amounts stated above must be separately pre-approved by the Audit Committee.
- Review of international and U.S. federal, state and local income and non-income tax returns and similar types of returns for the Duke Energy consolidated entity
  - Review and preparation of international and U.S. federal, state and local income tax returns, non-income tax returns and similar types of returns for subsidiaries, investments, and joint ventures
  - Assistance in connection with tax audits and appeals of international and U.S. federal, state and local income and non-income tax returns, including communicating with taxing authorities regarding tax returns

- Assist in resolving identified state reporting and disclosure tax compliance issues
- Tax compliance and consulting services, including assistance with respect to (1) tax savings/planning/refund opportunities, (2) the proper tax treatment of certain types of income and expenses, (3) calculation of total tax liabilities relating to exposures, (4) preparation of calculations needed to properly reflect certain types of income, expenses, exemptions, and credits on a tax return, (5) updates and analysis of legislative tax matters, (6) planning for deduction of certain transaction costs, (7) confirmation of the current administrative position of revenue authorities, (8) ruling requests filed with taxing authorities, (9) planning and calculation of debt/equity ratios for thin capitalization purposes to come to a conclusion regarding inter-group interest deductibility, (10) foreign tax treaties, and (11) verification of tax assessments
- Assistance regarding tax issues with respect to acquisitions, dispositions and restructurings, including due diligence on potential acquisition targets, ruling requests and meetings with tax authorities
- Assistance in determining the corporate income tax and indirect tax implications of proposed or actual transfers of the Company's subsidiaries' stock between related Company entities
- Services related to compensation and compensation packages; granting and exercise of stock options; benefit plans; and payroll, social security and information reporting tax issues
- Assistance with GST and Value Added Tax (VAT) issues in foreign jurisdictions
- Compliance and planning issues with respect to import, export, and international transport services and activities
- Technical, planning, and other assistance relating to transfer pricing issues
- Services related to internet website tools
- Other Services. The Audit Committee pre-approves the Other services listed below. The Other services listed below are pre-approved up to \$100,000 in estimated fees per individual project and up to \$500,000 in estimated fees in the aggregate. All Other services not listed below or that exceed the amounts stated above must be separately pre-approved by the Audit Committee.
  - Accounting and other related training
  - Other general consulting not prohibited as described below
- Maintain an internal process to ensure compliance with approved services and accurate reporting to the Audit Committee

### **Standards/Requirements**

The following guidelines should be used in engaging the independent auditor for services:

- When a need is identified for additional services from the independent auditor, the Business Unit/Corporate Area should submit a scope of work including a fee estimate to the Corporate Controller's Department in advance of work being performed
- The independent auditor is to perform services only at the Company's request and in conformity with all applicable standards. The scope of service and estimate of fees must be documented in an engagement letter or scope definition signed by both the independent auditor and the Company (typically the Corporate Controller or Business Unit Accounting Vice President) in advance of work being performed.

- Engagement letters must be signed by an appropriate Company representative in advance of work
- Engagement letters must be provided to the Corporate Controller for approval in advance of work
- The Corporate Controller's Department will maintain copies of all engagement letters
- If the requested services are not included in the base scope or pre-approved services, each new service request or change order will require approval individually by the Audit Committee. The Corporate Controller will coordinate the approval. Requests to provide services that require separate pre-approval by the Audit Committee will be submitted to the Audit Committee by the Chief Financial Officer or Controller and a representative of the Legal Department, and must include a joint statement, in writing, (a) describing (i) the scope of the service, the fee structure for the engagement, and any side letter or other amendment to the engagement letter, or any other agreement (whether oral, written, or otherwise) between the independent auditor and the Company, relating to the service; and (ii) any compensation arrangement or other agreement, such as a referral agreement, a referral fee or fee-sharing arrangement, between the independent auditor (or an affiliate of the independent auditor) and any person (other than the Company) with respect to the promoting, marketing, or recommending of a transaction covered by the service; and (b) discussing the potential effects of the services on the independence of the independent auditor. The independent auditor will provide a detailed description of the scope of the services to be performed, a description of the fee structure for the engagement, and a statement that the independent auditor does not believe the service will impair its independence.
- Independent auditor cannot be engaged to perform the following services<sup>2</sup>:
  - Bookkeeping or other services related to the audit client's accounting records or financial statements
  - Financial information system design or implementation services
  - Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
  - Actuarial services
  - Internal audit outsourcing services
  - Management functions or human resources
  - Broker or dealer services, investment adviser or investment banking services
  - Legal services and expert services unrelated to the audit
  - Tax services on a contingency basis
  - Tax service to a person in a financial reporting oversight role at the Company, or an immediate family member of such person, during the audit and professional engagement period, unless: (a) the person is in a financial reporting oversight role at the Company only because he or she serves as a member of the Board of Directors or similar management or governing body of the Company; (b) the person is in a financial reporting oversight role at the Company only because of his or her relationship to an affiliate of the Company (i) whose financial statements are not material to the consolidated financial statements of the entity being audited; or (ii) whose financial statements are audited by an auditor other than the firm or an associated person of the firm; or (c) the person was not in a financial reporting oversight role at the Company before a hiring, promotion, or other change in employment event and the tax services are (i) provided pursuant to an engagement in process before the hiring, promotion, or other change in employment event; and (ii) completed on or before 180 days after the hiring or promotion event

- Invoices must be approved by the Business Unit/Corporate Area requesting party under an established engagement letter; invoices should reference which engagement letter authorizes the payment
- Business Unit/Corporate Area requesting party will process invoice for payment if within the parameters of an approved engagement letter
- Copies of all approved invoices of the independent auditor must be sent to the Corporate Controller
- The Corporate Controller will provide a report on the use of the independent auditor and associated fees at each Audit Committee meeting

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<sup>1</sup>Under SEC rules, some consultations may be considered "audit-related" services rather than "audit" services. For example, the SEC recognized that complex accounting issues may require that the firm engage in consultation with "national office" or other technical reviewers to reach an audit judgment and stated that this activity constitutes an audit service since it is a necessary procedure used by the accountant in reaching an opinion on the financial statements. This would contrast, the SEC stated, with a situation where a registrant is evaluating a proposed transaction and asks the independent auditor to evaluate the accounting for the proposed transaction. After research and consultation, the accounting firm provides an answer to the registrant and bills for those services. In considering the nature of the services, the SEC stated that these services would not be considered to be audit services.

<sup>2</sup>The Legal Department should be consulted for guidance as to the definitions of these services and the applicability of exceptions to certain of the prohibitions.

**Related Links:**

[Approval of Business Transactions](#)



## Duke Energy Policy Statement

# Hiring Policy for Employees and Former Employees of the External Auditor

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Controller
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	04/04/2006
<b>Revision Date:</b>	02/01/2008
<b>Reissue Date:</b>	02/01/2008

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### **Statement of Purpose and Philosophy**

This Policy describes the guidelines to be used by Duke Energy Corporation and its subsidiaries ("Duke Energy") when considering the hiring of employees and former employees of the external auditor. The Sarbanes-Oxley Act of 2002 increases focus on key aspects of auditor independence including the potential conflict of interest that can be created when a former member of the audit engagement team accepts certain positions with the audit client, and the role of the audit committee in the assessment of auditor independence. The rules are intended to protect the reliability and integrity of the financial statements of public companies and to promote investor confidence in the independence of accountants and the audit process. According to the rules, the external auditor is not considered independent with respect to the registrant if certain employees or former employees of the external auditor are hired by the registrant into a financial reporting oversight role.

### **Policy Expectations**

Business Units and Corporate Areas are expected to understand the requirements of this policy and to have internal processes in place to ensure compliance.

### **Standards/Requirements**

The following guidelines should be used in hiring employees or former employees of the external auditor:

- The terms used in these guidelines are defined as follows:
  - **Audit Team** - Lead partner, concurring partner, or any other member of the audit engagement team who provides more than ten hours of audit, review or attest services for the issuer.
  - **Financial Reporting Oversight Role** - Means a role in which a person is in a position to or does exercise influence over the contents of the financial statements and related information (e.g., management discussion and analysis) or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

- No member of the Audit Team that is auditing Duke Energy and its affiliated entities can be hired into a Financial Reporting Oversight Role for a period of 2 years following association with that audit.
- Any uncertainties (e.g. whether a position is a Financial Reporting Oversight Role) must be cleared with the Duke Energy Corporate Controller before any job offers are executed.
- Duke Energy's Corporate Controller must approve any hires from the independent auditor prior to an offer being made.
- Duke Energy's Corporate Chief Financial Officer ("CFO") must approve all executive level (O classification and above and all Leadership jobs) hires from the external auditor.
- Duke Energy's Corporate Controller shall report annually to the Audit Committee any of the preceding year's hires from the external auditor.

#### **Accountability: Roles and Responsibilities**

##### Business Units/Corporate Areas

- Submit request for any planned hires from Duke Energy's external auditor (employees or former employees) to the Corporate Controller for review. Such request must be made whether or not the prospective employee is being hired into a Financial Reporting Oversight Role. Approval from the Corporate Controller and, if necessary, the Corporate CFO is required prior to an offer being made.

##### Corporate Controller/Corporate CFO

- Review and approve, if appropriate, requests to hire employees from Duke Energy's external auditor.
- Report annually to the Audit Committee any of the preceding year's hires from the external auditor.



Duke Energy Policy Statement

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## Property, Equipment and Inventory Policy

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**Originator:** Corporate Controller  
**Sponsor:** Corporate Controller  
**Approval:** Corporate Controller

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**Approval Date:** 08/31/00

**Revision Date:**

**Statement-** This policy covers property, equipment and inventory systems used by business/corporate units. The policy describes the minimum controls required. The business/corporate unit should implement additional procedures and controls as needed to ensure an appropriate level of control exists within property, equipment and inventory systems.

### Roles and Responsibilities-

#### Business/Corporate Unit-

- Items classified as inventory must be physically reconciled to the ledger at least every two years.
- Discrepancies in physical inventory counts must be reported to management and corrected in accounting records.
- Reasonable physical safeguards must be in place to protect company assets against improper use or disposition.
- Losses of and damage to company property must be immediately reported to the appropriate level of management and site security personnel or Duke Energy's Corporate Security Department.
  - Losses estimated to exceed \$10,000 must be promptly reported to Duke Energy's Insurance Department.
- Inventory must be evaluated for surplus or obsolescence on a routine basis followed by appropriate authorized disposition.

#### Asset Sales

- Business/corporate unit management must authorize the disposal or sale of company property, equipment or inventory in accordance with the Delegation of Authority. See the Delegation of Authority Policy for additional information.
- Significant company assets (property, plant, equipment and inventory) should be marked, or otherwise identified, so they can be readily located in detailed asset and inventory records.
- Bids or other competitive mechanisms should be used to sell property, equipment, or inventory.
- A different person should perform each of the following functions. These functions must be segregated between at least two people. Weaker segregation structures should be accompanied by additional management review.
  - declaration of need to sell
  - entry on accounting tracking system
  - sales





## Duke Energy Policy Statement

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### Creation, Dissolution, or Restructuring of Legal Entities and Subsidiaries

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Legal and Finance
<b>Approval:</b>	Corporate Controller

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<b>Effective Date:</b>	03/25/2004
<b>Revision Date:</b>	05/15/2009
<b>Reissue Date:</b>	03/15/2008

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#### Statement of Purpose and Philosophy

This policy describes the accountability for and the process of creating, dissolving, or restructuring (e.g., merge, convert, change a parent or reporting relationship, etc.) a Duke Energy legal entity or subsidiary.

#### Policy Expectations

All Business Units and Corporate areas must follow this policy and obtain the requisite approvals identified in this policy before taking formal actions affecting the status of a Duke Energy legal entity or subsidiary.

#### Accountability: Roles and Responsibilities

Business Unit /Corporate Area

- Provide rationale and required pieces of information as identified on the respective e-form (located on the Portal) to initiate the approval process related to the creation, dissolution, or restructuring of a Duke Energy legal entity or subsidiary.
- Identify the placement of the affected entity or subsidiary in the entity hierarchy. The current entity structure can be located on the [General Counsel Web site](#) under World Records.
- Follow the guidelines established in the Business Unit Capitalization Protocol (as established by the Corporate Treasurer and Tax staffs) when funding or changing the funding structure for the creation, dissolution, or restructuring of any legal entity or subsidiary.
- The General Manager of Consolidations and Controls in the Corporate Controller's Group should determine for each SEC registrant, based on U.S. Generally Accepted Accounting Principles ("GAAP") guidance provided by the Corporate Accounting and Research Group ("CARG"), if the legal entity affected by the creation, dissolution, or restructuring should be consolidated or deconsolidated under U.S. GAAP (including Financial Accounting Standards Board Interpretation ("FIN") 46, *Consolidation of Variable Interest Entities*, as revised) and should ensure that the accounting for the legal entity is in accordance with U.S. GAAP. This determination and any instructions related to accounting entries for the creation, dissolution, or restructuring of the legal entity should be documented and retained by the Business Unit or Corporate Area. In making this determination, the General Manager of Consolidations and Controls should consult with the Corporate Accounting and Research Group ("CARG") in accordance with the "Roles and Responsibilities Matrix" contained in the [Roles and Responsibilities for the Consultation on and Documentation of Significant Accounting or Reporting Matters](#) policy

- Obtain the requisite internal approvals before finalizing actions affecting the status of a legal entity or subsidiary.

#### Corporate Secretary Office

- Retain the completed request form which serves as evidence of the approval for the creation, dissolution, or restructuring of the Duke Energy legal entity or subsidiary.
- Distribute a summary of final approved actions to the appropriate parties involved in the approval process.

#### Business Unit General Counsel/Corporate Secretary Office

- Prepare and circulate for signature the requisite consents formally approving said action.
- Ensure consents of the Board of Directors and/or Board of Managers are filed in the respective minutes books.

#### **Approvals**

- Actions affecting the status of a Duke Energy legal entity or subsidiary must be approved by the Corporate Secretary Office, Office of General Counsel, Corporate Secretary, Corporate Tax Contact, Treasurer, and Controller. These contacts are specified in the electronic form for approval.
- A formal request to alter the status of a Duke Energy legal entity or subsidiary shall be accomplished by completing the respective Duke Energy e-form that contains rationale for the request and to serve as a record of the action including the requisite approvals. Separate forms for the creation, dissolution, or restructuring of Duke Energy legal entities and subsidiaries are located in the Electronic Forms Repository under General Counsel. With respect to a restructuring, a white paper detailing the request (including a summary of the restructuring, a current and proposed entity structure of the affected entity(ies), the tax position, and formal actions needed to accomplish the restructure (e.g. written consents), must be attached.
- The respective Board of Directors and/or Board of Managers for each affected entity shall formally approve the requisite actions as set forth in order for the creation, dissolution, or restructuring to be effectuated.

# Duke Energy Corporation (DEC)

## Disclosure Committee Charter

*Steven K Young*  
1/7/09

*J. Huse*  
1/8/09

Case No. 2009-00202  
STAFF-DR-01-008  
Page 268 of 349

The Disclosure Committee of DEC and subsidiaries (the "Company") has been established to consider the materiality of information and to assist in determining disclosure obligations pursuant to applicable securities laws and regulations and stock exchange requirements. The Disclosure Committee (the "Committee") shall review and reassess this Charter as necessary and recommend any proposed changes to the Company's Chief Financial Officer for approval.

### I. Organization

The membership of the Committee shall consist of the following:

- SVP & Controller (Chairperson)
- GM Accounting Research
- GM Corporate Accounting
- GM Internal & External Reporting
- GM Financial Consolidation and Controls
- VP FE&G Accounting
- VP DEI Accounting
- VP Non-Regulated Accounting
- VP Legal, Securities & Financial Reporting & Assistant Secretary
- SVP Investor Relations
- VP Audit Services & Chief Ethics & Compliance Officer
- VP & Treasurer
- SVP & Chief Communications Officer
- SVP Tax
- SVP Rates & Regulatory Accounting
- SVP & Chief Information Officer
- VP Supply Chain & Chief Procurement Officer

The members of the Committee will also represent all reporting subsidiaries of the Company, including Duke Energy Carolinas, LLC, Cinergy Corp., Duke Energy Ohio, Inc., Duke Energy Indiana, Inc., and Duke Energy Kentucky, Inc. Members of the Committee may be replaced, or new members added, at any time and from time to time by the Chief Financial Officer. The Chairperson may recommend to the Chief Financial Officer changes to the composition of the Committee. All such changes shall be subject to the approval of the Chief Financial Officer.

The Chairperson may designate three or more delegates who can, acting together, review Disclosure Statements (other than periodic reports) when time does not permit the full Committee to meet. All delegates must be employees of the Company, at least one delegate must be a member of the Committee, at least one delegate must be knowledgeable about financial reporting matters and at least one delegate must be an attorney knowledgeable about SEC rules and regulations with respect to disclosure. One delegate may satisfy more than one of the above requirements.

The Committee shall meet as frequently as circumstances dictate. The Chairperson shall be responsible for scheduling and presiding over meetings and preparing agendas, as applicable. Any question of interpretation of this charter or the Committee's procedures shall be determined by the Chief Financial Officer or, in his absence, the Chairperson.

## II. Purpose

The purpose of the Committee is to assist the Company's Chief Executive Officer and Chief Financial Officer ("Senior Officers") in fulfilling their responsibility for oversight of the accuracy and timeliness of disclosures made by the Company in accordance with applicable laws and regulations.

The Committee shall focus on the following areas, in each case subject to the supervision and oversight of the Senior Officers:

- Monitoring the integrity and effectiveness of disclosure controls and procedures that have been designed to ensure that (1) information required by the Company to be filed with or furnished to the Securities and Exchange Commission ("SEC") under the Securities and Exchange Act of 1934, as amended (the "Act") is recorded, processed, summarized and reported accurately and on a timely basis and (2) information is accumulated and communicated to management, including the Senior Officers, as appropriate to allow timely decisions regarding such required disclosure ("**Disclosure Controls**"). This monitoring will include, but not be limited to, a periodic assessment of the effectiveness of Disclosure Controls.
- Reviewing for completeness of disclosure, in advance of filing or public disclosure, the Company's periodic and current reports, proxy statements and/or any other information filed with or furnished to the SEC under the Act (collectively, the "**Disclosure Statements**").

No member of the Committee will be responsible individually for evaluating, approving or overseeing Disclosure Controls or any process, procedure or document of any area of the Company other than the area under his or her responsibility, nor will they be responsible for reviewing the completeness of disclosure for any area of the Company other than the area under his or her responsibility. Rather, the Committee will perform its functions by applying the members' collective expertise and experience in and knowledge of the areas of the Company for which the respective members are responsible for the monitoring of Disclosure Controls and review of Disclosure Statements.

The Chairperson, or such other Committee member or members designated by the Chairperson, shall discuss with the Senior Officers, individually or together, all relevant information with respect to the Committee's proceedings and findings, including the results of reviews of Disclosure Statements and the Committee's findings with respect to the integrity and effectiveness of the Company's Disclosure Controls. Such discussions shall occur prior to the filing by the Company of each Form 10-K and Form 10-Q (and any amendments thereto), and at such other times as is necessary or appropriate.

In discharging its duties, the Committee shall have full access to all Company books, records, facilities, and personnel, including the internal auditors.

Date of Last Update: *January 2009*



## Duke Energy Policy Statement

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### Disclosure Controls and Procedures Overview

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	GM Financial Controls and Office of General Counsel
<b>Approval:</b>	Corporate Controller and Chief Legal Officer
<b>Effective Date:</b>	01/01/2008
<b>Revision Date:</b>	01/01/2008
<b>Reissue Date:</b>	01/01/2008

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#### **Statement of Purpose and Philosophy:**

It is the policy of Duke Energy Corporation and its subsidiaries ("DEC" or the "Company"), to prepare full, fair, accurate, timely and understandable disclosures in reports filed or submitted with the Securities and Exchange Commission ("SEC") and to comply with all applicable governmental rules and regulations, including the Sarbanes-Oxley Act of 2002 ("SOX").

As part of this policy, the Company wants to ensure that business unit and corporate area management establish and maintain appropriate controls and procedures to collect, process, summarize and report information required to be disclosed in the Company's filings and submissions with the SEC, within the time periods specified by the SEC's rules, forms and regulations, specifically under the Securities Exchange Act of 1934, as amended. The policy requires all applicable business units and corporate areas to design and maintain appropriate controls and procedures to accumulate and communicate information to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

#### **Policy Expectations and Scope:**

This policy is applicable to all business units and corporate areas of DEC involved in the collection, processing, summarizing and/or reporting of information required to be disclosed in the Company's filing and submissions with the SEC.

#### **Accountability: Roles and Responsibilities:**

**Disclosure Committee members** are responsible for considering the materiality of information and assisting in determining disclosure obligations pursuant to applicable securities laws and regulations and stock exchange requirements. The Disclosure Committee maintains a charter describing the functions and responsibilities of the committee.

**Business Unit and Corporate Area Executives** are responsible for maintaining controls and procedures, documented via documentation related to internal controls over financial reporting and Section 404 of SOX, to meet their specific needs and business situations to help ensure that information required to be disclosed is gathered, processed and communicated. On a quarterly basis, certain employees are required to attest that, among other things, they have evaluated the effectiveness of disclosure controls and procedures associated with their areas of responsibility.

**The Corporate Controller's Department** is responsible for the quarterly internal management representation letter process, which is a key element in supporting the Chief Executive Officer and Chief Financial Officer certifications to the SEC. The Corporate Controller's Department is also responsible for coordinating the timely submission of the Company's SEC filings.

**The Chief Legal Officer's Department** is responsible for the facilitation of the "fraud" sub-certification process and the quarterly review of ethics violations, which are key elements supporting the Chief Executive Officer and Chief Financial Officer certifications to the SEC.

**Glossary:**

**Disclosure Controls and Procedures** – controls and other procedures designed to ensure that information that is required to be included in SEC filings is recorded, processed, summarized and reported in a timely basis.

**Internal Control Over Financial Reporting** – a process implemented by the Board of Directors, management and other personnel that is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements in accordance with generally accepted accounting principles.

**Related Links:**

[Disclosure Committee Charter](#)



## Duke Energy Policy Statement

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### Sarbanes-Oxley Change Control

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	General Manager, Financial Controls
<b>Approval:</b>	Corporate Controller
<b>Effective Date:</b>	04/01/2004
<b>Revision Date:</b>	09/15/2007
<b>Reissue Date:</b>	04/01/2006

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#### Statement of Purpose and Philosophy

*It is the policy of Duke Energy Corporation, including its subsidiaries, such as Duke Energy Carolinas, LLC, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc. and affiliates, to comply fully with the Sarbanes-Oxley Act of 2002 ("the Act"). As part of this policy, the Company wants to ensure that, as relevant business processes, controls and information technology (IT) components (collectively, "SOX processes") are changed or enhanced, appropriate approval is obtained for such changes, and documentation is maintained reflecting the latest approved processes, controls and systems. Collectively, the disciplines associated with the timely approval, coordination and documentation of changes in SOX processes covered under the Act shall be referred to as "SOX Change Control."*

To ensure adequate time for management testing, external audit testing, and remediation of ineffective controls prior to year-end, process changes that impact SOX controls (planned or unplanned) after September 30 will need prior approval of the business unit and/or corporate area executive responsible for SOX compliance.

#### Policy Expectations

A designated universe of SOX processes, sub-processes, controls and IT components has been defined, and can be obtained by contacting the Sarbanes-Oxley Program Management Office.

- Each Business Unit and/or Corporate area executive is ultimately responsible for identifying all required process, control or system changes for their respective business area, and is further responsible for communicating such changes, as well as the timing of those changes, to the Corporate Financial Controls Group ("Corporate FCG"), using the established change control mechanisms. For changes after September 30, an assessment should be completed with input from the Corporate FCG to determine the potential risks and impacts to the overall compliance effort
- Standard change control reporting tools and methods will provide an audit trail and current status of SOX-relevant process and control changes
- Changes to SOX processes will be approved by the defined Business Process Owner and/or Business Unit or Corporate area executive, or designee

- Changes that affect the Corporate financial closing and reporting process require Corporate Controller or designee review and approval to assess design effectiveness prior to a change being implemented
- Defined Sarbanes-Oxley testing and documentation standards will be adhered to on a timely basis by all Business Units and Corporate areas\
- As SOX process changes are implemented, the responsible Business Process Owner shall enter a current, standards-compliant, approved copy of the process and control documentation to the Sarbanes-Oxley Process/Control Documentation Repository located on the portal at Home – Policies – Sarbanes-Oxley Compliance gadget.
- IT change activities will comply with enterprise level change control policies and local IT change control procedures
- The Sarbanes-Oxley Process/Control Documentation Repository will be a controlled file housing the most recent and official SOX documentation. The content of the repository will be the responsibility of the Business Unit or Corporate area process owner. Centralized maintenance of the repository will be the responsibility of the Corporate FCG

#### **Accountability: Roles and Responsibilities**

The responsibilities of Business Unit/Corporate area management are to:

- Establish and maintain a strong and effective system of internal controls consistent with the Sarbanes-Oxley Act of 2002, including an appropriate tone at the top
- For all SOX process changes, ensure that appropriate approvals occur in accordance with this policy and ensure that appropriate documentation, testing and training on changes occur in a timely manner and as prescribed by this policy

The responsibilities of the Business Process Owners in each Business Unit/Corporate area are to:

- Identify, approve and implement necessary process, control and IT improvements to maintain business effectiveness
- Update or prepare required documentation, conduct testing and communicate SOX process changes as required by this policy

The responsibilities of the Business Unit and/or Corporate area executive are to:

- Approve, or ensure approval, of necessary SOX process changes for the Business Unit/Corporate area
- Assist with the identification of needed improvements in controls, processes or systems in the Business Unit/Corporate area or in the enterprise as a whole
- Appoint or ensure the appointment of Business Process Owners within the Business Unit/Corporate area for each identified process which falls under SOX purview

The responsibilities of the Corporate Controller are to:

- Review and approve, or ensure approval, of changes that affect the Corporate financial closing and reporting processes
- Assist with the identification of needed improvements in controls, processes or systems in the Business Units/Corporate areas or in the enterprise as a whole

The responsibilities of the Corporate Financial Controls Group are to:

- Set policy regarding change control or modify this policy as appropriate for Sarbanes-Oxley Act matters
- Periodically review the effectiveness of the change control policies and procedures



- Ensure a continuing program of communication and education occurs to keep enterprise members current on required compliance with change control requirements of Sarbanes-Oxley Act compliance
- Maintain and ensure the completeness of the Sarbanes-Oxley Process/Control Documentation Repository

### **Glossary**

SOX Processes - Business processes, controls and IT components which have a role in ensuring an appropriate financial control environment at Duke Energy Corporation and its subsidiaries and which play a role in the accuracy of the financial statements of the Company.

Process Control/Documentation Repository - The Sarbanes-Oxley Process/Control Documentation Repository will be a controlled file housing the most recent and official documentation for SOX processes throughout the Company.



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## Payroll Policy

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**Originator:** Corporate Controller  
**Sponsor:** Corporate Controller  
**Approval:** Corporate Controller

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**Approval Date:** 08/31/00

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**Revision Date:**

**Statement-** This policy covers payroll systems used by business/corporate units. The policy describes the minimum controls required. The business/corporate unit should implement additional procedures and controls as needed to ensure an appropriate level of control exists within payroll systems.

### Roles and Responsibilities-

#### Business/Corporate Unit-

- Paid hourly, regular non-exempt, overtime and supplemental hours reported by employees must be appropriately approved.
- Business/corporate unit management, who does not have other payroll responsibilities such as modifying employee payroll files or entering time, must review O&M budget variances or other similar reports for reasonable and accurate payroll entries.



## Duke Energy Policy Statement

# Commodity Risk Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance - Corporate Risk Management
<b>Approval:</b>	Chief Financial Officer
<b>Effective Date:</b>	05/24/2004
<b>Revision Date:</b>	04/01/2006
<b>Reissue Date:</b>	04/01/2006

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### Statement of Purpose and Philosophy

The purpose of the Commodity Risk Policy ("the Policy") is to provide clear and consistent directives in the identification, quantification, management and reporting of commodity risk across the Enterprise.

This Policy covers all sales or purchases of commodities, storage, transport, capacity or fuel procurement and related services.

All subsidiaries and affiliates, including consolidating Joint Ventures, will manage commodity risk in accordance with this policy or in the case of Joint Ventures, the risk policy approved by their Board of Directors, or other appropriate governing body. The Chief Risk Officer (CRO) or designee will review such joint venture policies to ensure compliance with the Duke Energy Commodity Risk Policy.

### Commodity Policy, Risk Limits and Procedures

#### Commodity Policy

This policy outlines broad business objectives and identifies general operating practices in the management of commodity risk.

#### Risk Limits

The Risk Limits set the strategic and operational parameters that bridge Policy, enterprise risk-reward objectives, and evolving market opportunities. These limits are unique for each Business Unit.

As such, these Limits will be reviewed more frequently and updated than the Policy.

#### Business Unit Procedures

It is the responsibility of the Business Unit to develop procedures which describe specific activities to ensure compliance with the Commodity Policy and Risk Limits. Business Unit procedures will be reviewed by the CRO or a designee.

These policies and limits are intended to:

- Provide guidance and direction to achieve the business objectives
- Assign responsibilities for commodity risk planning, transaction management, and monitoring
- Create awareness of commodity risk among commercial and risk management personnel
- Ensure consistency across the business units in commodity risk methodologies, models, policies, methods of analysis, and procedures
- Establish effective, efficient and consistent commodity risk management practices, including organizational accountabilities, approved products, term, calculations, procedures and information management.

### **Policy Expectations**

#### Objectives

The four primary objectives of this Policy relating to risk governance are:

- A. Identification- The recognition and classification of risks to the Enterprise
- B. Quantification- The measurement of identified risks
- C. Management- Actions designed to alter the risk profile of the Enterprise
- D. Communication- The reporting of risks and mitigation as appropriate within the Enterprise

#### Risks

The Enterprise participates in many physical and financial commodity markets, which expose the Enterprise to a variety of risks. Business Units subject to this policy will address the following risks in their process and procedures:

- A. Market Risk- exposure to movements in prices, volatilities, and correlations; swings in demand and supply volumes; the market value of capacity; illiquid markets; modeled valuations; inability to physically deliver on obligations
- B. Transaction Risk- exposure caused by inefficiencies in the transaction processes that may cause transactions to be lost, delayed, or processed incorrectly, thereby subjecting the Enterprise to risk of loss; Transaction Risk is also the risk that personnel may hide, incorrectly value, fail to record, or incorrectly represent positions

#### Approved Counterparties

Employees who execute transactions are responsible for ensuring that Corporate Risk Management has approved all prospective counterparties, and that any new transactions or modifications to existing transactions are within specified limits. Transactions with counterparties not on the approved list are prohibited. New counterparties must be reviewed and approved by Corporate Risk Management prior to trade execution.

In addition, transactions in excess of existing credit risk limits shall be reviewed with Corporate Risk Management prior to trade execution to determine how to enhance the credit position and/or modify credit limits.

#### Approval of Business Transactions

All transactions that are reviewed by a Business Unit scrub team must be reviewed by Corporate Risk Management.

#### **Accountability: Roles & Responsibilities**

The Chief Financial Officer is responsible for approval of the Policy. Amendments to the Policy must also be approved by the Chief Financial Officer or his/her designee and will be effective immediately upon approval.

The CRO or his/her designee has authority to approve exceptions to this policy. Any activity, not explicitly approved by the Commodity Policy, BU Risk Limits, Option Trading Addendum or the Approved Products and Instruments documents, is prohibited. CRO approval required for any exceptions.

The Policy will be reviewed annually by Corporate Risk Management (CRM) to ensure all provisions are reasonable and in accordance with the industry and Duke Energy's business activity.

Failure to comply with this policy may result in disciplinary action up to and including termination.

All personnel are responsible for ensuring a sound risk control environment. The responsibility for risk oversight is owned in varying degrees throughout the Enterprise's management structure.

#### Senior Management

The following business functions constitute Senior Management and are ultimately responsible for establishing and communicating the risk tolerances and objectives for the organization.

- A. Chief Executive Officer (CEO)
- B. Chief Financial Officer (CFO)
- C. Business Unit Presidents / Chief Commercial Officer (CCO)
- D. Chief Risk Officer (CRO)
- E. Business Unit CFO (BU CFO)

#### Corporate Risk Management

The CRM function develops the Policy and the Risk Limits. Additionally, CRM is responsible for the adequacy of the risk management control infrastructure, approving Business Unit specific risk practices, and provides independent identification, oversight and management of market risks.

#### Business Units

Commercial Operations executes the Enterprise's risk taking and risk mitigation strategies. Commercial Operations is also responsible for developing and executing business plans that are consistent with the strategies and risk tolerances of the Enterprise and compliant with the established policies, procedures and limits.

Each Business Unit is responsible for developing procedures and processes designed to govern commodity risk management activity in a manner consistent with the risk tolerance of the Enterprise, and which also comply with this policy.

Each Business Unit's procedures will be approved by the CRO or his/her designee and the Business Unit CFO or its designee.

For purposes of the Commodity Risk Policy, Business Units are defined in Appendix A. The CRO has the authority to change Appendix A.

## **Requirements**

### Risk Decomposition and Transaction Designation

Duke Energy recognizes that many transactions have multiple commodity risk components and the Enterprise will capture such transactions in a manner that allows the Enterprise to properly measure and monitor the associated market risks.

For businesses which have accrual and MTM portfolios, individual book managers are not permitted to manage both portfolios or compensating controls must be in place and operating to ensure proper designation of transactions in accordance with applicable Enterprise policy and Generally Accepted Accounting Principles.

### Conflict of Interest and Confidentiality

No Duke Energy employees (including employees of affiliates) shall cause Duke Energy (or its affiliates) to enter into, or direct others to cause Duke Energy (or its affiliates) to enter into, energy commodity contracts for account of themselves, members of their families, friends, or persons or entities with whom they have a personal business interest.

To maintain the confidentiality and integrity of the Enterprise's portfolio, no Enterprise employee shall knowingly, willfully or intentionally, disclose to any person not employed by the Enterprise any confidential business strategy or position, except when compelled by an outside government or oversight body, or with approval from Senior Management.

## **Authorization and Approval of Commodities, Products, and Projects**

### Approved Commodities

Each Business Unit will maintain a list of authorized commodities. The original list of authorized commodities will be approved by the Chief Risk Officer and the Business Unit President or CCO. Any proposed alteration to this list shall require approval by the Chief Risk Officer and the Business Unit President.

#### Approved Products

Each Business Unit will maintain a list of authorized instruments. The original list of authorized commodities will be approved by the Chief Risk Officer and the Business Unit President or CCO. Any proposed alteration to this list shall require approval by the CRO or his/her delegate and the Business Unit President. New products will not be approved until an appropriate valuation model has been implemented as defined in the Modeling Review and Approval Process.

#### Transaction Review Process

As defined in the Approval of Business Transactions Policy, certain transactions with large capital requirements or extended duration require the review by the Transaction Review Committee (TRC). The CRO or his/her designee must approve the commodity price assumptions for the proposed transaction in addition to overall risk review of the transaction.

#### **Risk Measurement**

All Business Units will utilize appropriate risk measures to quantify the risk inherent in the business. The CRO or his/her designee has primary authority to approve the analytic methodologies, models and assumptions supporting the risk measurement calculations and will additionally determine appropriate calculation frequency.

#### Deal Capture

The business unit shall be responsible for the accuracy of the firm's books and records and is required to ensure that all transactions under its given activity are accurately captured and reported in Duke's systems. These systems include the source system (deal capture system), as well as the downstream risk systems.

#### Limit Violations

Material violations are to be remediated within 24 hours unless exception is received from the Chief Risk Officer or his/her designee. The violation must be explained identifying the cause of the violation, any corrective action taken, profit and loss impact as well as future plans to better manage the portfolio within limits. Other violations and notifications are defined in the Risk Limit documents and/or the Business Unit Procedure documents.

#### Commodity Forward Market Curves and Commodity Price Forecasts

Forward market commodity curves will be developed using methodologies and sources of information approved by the CRO or his/her designee to ensure consistency of application. Subject to limitations imposed by Code of Conduct requirements, each unique forward market commodity curve (energy/location)

will have a single owner across the corporation who will maintain the curve and make the curve available to other traders and/or Business Units. Responsibility for the validation of these curves resides with the CRO or his/her designee.

Each Business Unit will develop and maintain procedures regarding the use of Commodity Price Forecasts within that Business Unit.

#### Modeling and Valuation

All models utilized for valuation of commodity instruments must be reviewed and approved by the CRO or his/her designee. See Model Review and Approval Process documentation for detailed procedures. Corporate Risk Management will maintain an inventory of commodity valuation models to ensure consistent and appropriate use across all Business Units.

#### Risk Limits

Any Business unit which is engaged in commodity market activity will have risk limits to govern and control this activity. The CRO will determine what type of limit shall be utilized to govern and control each type of activity. The CRO or his/her designee will ensure effective and appropriate limits are in place and operating effectively in each affected Business Unit.

Risk Limits will also govern the risk management activity related to operating asset revenue and/or expense risk driven by commodity prices, except where such risk is already mitigated by regulatory mechanisms. The CRO or his/her delegate will monitor risk metrics to ensure compliance.

Commercial personnel will keep their positions within the risk limits. Any proposed transaction(s) that would result in a situation where a guideline would be exceeded requires pre-approval of the CRO. If a risk limit violation has occurred, the commercial employee must get back within compliance within 24 hours after having received notification of the violation.

Where appropriate, risk limits will be utilized to ensure compliance with the risk tolerances of the Enterprise as established by Senior Management to govern and control all other commodity market activity. The CFO will approve such risk limits. The CRO or his/her designee will ensure appropriate limits are in place and are operating effectively in each Business Unit.

#### Reporting

Corporate Risk Management and the Business Unit will produce periodic reports that will help management monitor, understand, and make decisions regarding its market risks. Business Units will work with Corporate Risk Management to determine the proper frequency and content of the reports. The CRO will periodically report on Risk Management issues to Senior Management and Board of Directors.

#### **Changes to Policy & Risk Limits**



All changes to the Commodity Policy will be reviewed by the Chief Risk Officer (CRO) and approved by the Chief Financial Officer (CFO).

### **Adoption & Implementation**

This policy supersedes prior publications and is effective April, 2006. Both Corporate Risk Management and the business units must comply. Updated policy will require business units and Corporate Risk Management to adopt or alter business practices and procedures.

Prior to the effective date noted above, Corporate Risk Management and all affected business units are expected to implement those elements of this policy that do not require material changes in underlying processes.

Gap assessments outlining misalignment between current practice and new requirements are to be developed by the business units with assistance from Corporate Risk Management, as needed. Business units that are out of compliance must assess the deviation and develop action plans to bring conditions into compliance.

Business unit management is responsible for monitoring progress on these action plans and providing status updates to Corporate Risk Management on a monthly basis.

Corporate Risk Management is responsible for notifying Business Units of changes to this policy. Special circumstances may occasionally require deviation from the standards of this policy. All exceptions require the approval of the CRO and /or designee.

If any requirement in this document is inconsistent with any law, tariff or regulation applicable to Duke Energy Corporation or its subsidiaries, the law, tariff or regulation will prevail.

### **Related Links:**

- [Approval of Business Transactions](#)
- [Code of Business Ethics](#)
- [Credit Policy](#)
- [Model Review and Approval Process](#)
- [Appendix A](#)



## Duke Energy Policy Statement

# Credit Delegation of Authority

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance - Global Risk Management
<b>Approval:</b>	Treasurer - Duke Energy
<b>Effective Date:</b>	04/01/2006
<b>Revision Date:</b>	05/01/2008
<b>Reissue Date:</b>	05/01/2008

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### Statement of Purpose and Philosophy

The Credit Delegation of Authority ("Credit DOA") contains various required credit activities and standards involved in setting credit limits including the delegation of credit authority. It bridges the Credit Policy and evolving market conditions as well as provides guidance for best practices to ensure consistent application across Duke Energy Corporation and its subsidiaries ("Duke Energy"). As such, the Credit DOA will be more frequently reviewed and updated than the Credit Policy.

Business Units ("BU") are required to conform with this Credit DOA in conjunction with the requirements of the Approval Of Business Transactions Policy.

### Approval

Only Global Risk Management ("GRM") personnel have credit approval authorization for transactions within the scope of the Credit Policy. Such authorization may be delegated to BU personnel with the approval of the head of GRM.

Approval requirements for an unsecured line of credit or specific tenor limit transaction with a given counterparty will be determined in accordance with the Credit Approval Matrix. For required approvals beyond the delegated authority of the credit underwriter, approvals must be obtained by all individual signers up to and including the required final approver. A peer group authorized to delegate (same level credit authority within the Credit Peer Group only) may provide an approval in the absence of an authorized delegate in the chain of command.

Limits will be established by counterparty at the BU level. In certain cases approvals may also contain tenor limits. As an alternative to establishing a counterparty credit limit, GRM may approve extensions of credit to a counterparty on a transaction-by-transaction basis.

The risk rating, amount and tenor of the proposed credit award determine the required approval authority as shown in the matrices below. The amount is the total credit by counterparty, net of cash, U.S. Treasury

securities, and letter of credit amounts only. Other forms of collateral (equity, guarantees, realty, receivables, physical assets, etc...) are not to be deducted from the total credit when determining approval authority.

Tenor is the maximum of the following three time periods:

- The term as specified by contract,
- The length of time that passes before goods or services are received and payments for goods or services are satisfied in full, or
- For evergreen contracts, the length of time until the Duke Energy entity has the right or option to ultimately fulfill its obligations or receive its rights under the contract.

If certain regulatory or contractual provisions for creditworthiness are present, such as the right to obtain a letter of credit or other security, or terminate the contract, when the service provider determines that creditworthiness has fallen below acceptable levels or upon the occurrence of any other default event, as determined by the service provider, then the tenor is deemed to be 1 year for the purpose of determining approval authority.

### Credit Approvals Authority

The Credit Approval Matrix below shows the credit approval authorization levels by Tenor and Internal/External Counterparty Ratings. Counterparties shall be assigned a credit limit based upon the Credit Authority Limits below. In the event no credit limit is established, but approval is requested for a specific transaction, the dollar amounts in the Credit Approval Matrix should be compared to the estimated credit exposure associated with the transaction for determining the required authorization. Internal Credit Ratings for counterparties sharing a common parent or affiliate are based on a composite of the entities within that corporate group. Prior to assigning a new counterparty credit limit in excess of \$15 million, GRM personnel will consult internally to insure that the new limit does not result in an unacceptably high unsecured limit for the Corporate group of the counterparty.

### Credit Approval Matrix – Tenor up to Five Years

Internal Credit Rating	1	2	3	4	5	6	7
(S&P equivalent)	AAA	AA	A	BBB	BB	B	CCC
Lead Analyst	\$30MM	\$20MM	\$15MM	\$10MM	\$2MM	\$0	\$0
Manager	\$40MM	\$35MM	\$30MM	\$25MM	\$5MM	\$1MM	\$0
Director	\$75MM	\$60MM	\$50MM	\$40MM	\$20MM	\$5MM	\$1MM
Head of GRM	\$200MM	\$150MM	\$150MM	\$75MM	\$40MM	\$10MM	\$5MM
Treasurer	>\$200MM	>\$150MM	>\$150MM	>\$75MM	>\$40MM	>\$10MM	>\$5MM

### **Spot Transactions**

For purchases of commodities with tenor of less than one year wherein delivery of the commodity is required prior to payment, credit approval may be granted without performing a detailed counterparty review and establishing an Internal Credit Rating, subject to quantity and tenor restrictions approved by the Head of GRM.

For spot emission allowance transactions, wherein delivery of the allowances is required within three days, credit approval may be granted without performing a detailed counterparty review and establishing an Internal Credit Rating, subject to quantity and/or dollar restrictions approved by the Head of GRM.

### **Tenor greater than five years**

All credit authorizations for transactions greater than five years with counterparties with an Internal Credit Rating of 4 or better require approval of the Head of GRM. Any transaction with a tenor greater than five years with counterparties with an Internal Credit Rating worse than 4 requires approval of the Treasurer, Duke Energy.

### **Approval Requirements**

Input and approval from both Legal and Credit is required prior to negotiating, finalizing and executing agreements with counterparties. Based on the type of account, additional approvals may be required in accordance with the guidelines and/or procedures.

### **Denial of Credit**

Duke Energy will not approve credit for a counterparty if the entity does not have adequate creditworthiness as established in the underwriting process. Reasons for the denial of credit may include, but are not limited to, the following:

- Counterparty is unable or unwilling to provide audited financial statements,
- Counterparty refuses to provide a Letter of Credit or other collateral acceptable to Duke Energy
- Counterparty fails to provide a prepayment as collateral
  
- Counterparty refuses to agree to critical credit terms and conditions in underlying or governing document

### **Process for Appealing a Denial of Credit Approval**

To appeal the denial of credit, the credit package will be routed to the next higher level authority on the approval matrix. It is incumbent on the requesting party to document the reasons for credit denial at all previous levels before forwarding the request to the next level.



## Duke Energy Policy Statement

### Credit Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance - Global Risk Management
<b>Approval:</b>	Treasurer - Duke Energy
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<b>Effective Date:</b>	04/01/2006
<b>Revision Date:</b>	05/01/2008
<b>Reissue Date:</b>	05/01/2008

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#### Statement of Purpose and Scope

Extending and monitoring credit to customers and counterparties is integral to all of Duke Energy Corporation's businesses. Global Risk Management (GRM) has established standards of practice related to Credit Risk Management across Duke Energy Corporation and its subsidiaries ("Duke Energy"). This policy governs the extension of credit related to wholesale business activity (including fuel procurement), major construction projects and all enterprise sourcing. This policy does not pertain to the extension of credit for the franchised customer sales which are governed by applicable state law and regulatory rules for each jurisdiction.

Extension of credit includes sales of goods, services, commodities, storage, transportation, and capacity to counterparty where payment is expected at a future date and/or where Duke prepays counterparty for the delivery of goods or services at a future date. Extension of credit also includes the fixed price purchase of goods, services, commodities, storage, transportation and capacity as well as any contract which under which Duke Energy may assert a monetary damage claim in the event of failure to perform by the other party.

Authorized employees are expected to provide for and utilize resources necessary to make sound, credit decisions under the Credit Delegation of Authority (Credit DOA).

All subsidiaries and affiliates, including consolidated Joint Ventures, will manage credit risk in accordance with this policy or in the case of Joint Ventures, the risk policy approved by its Board of Directors, or other appropriate governing body. The Treasurer or designee will review such joint venture policies to assess compliance with this Policy.

#### Credit Policy, Credit Delegation of Authority, and Procedures

##### Credit Policy

This policy outlines broad business objectives and identifies general operating practices in the management of credit risk.

#### Credit Delegation of Authority

The Credit DOA contains various required credit activities and standards involved in setting credit limits including the delegation of credit authority. It bridges Policy and evolving market conditions as well as provides guidance for best practices to ensure consistent application across the Enterprise. As such, the Credit DOA will be more frequently reviewed and updated than the Policy. All credit limits must be approved by GRM in accordance with the Credit DOA.

#### Credit Procedures

It is the responsibility of GRM to develop Credit Procedures to ensure compliance with both the Credit Policy and Credit DOA. Credit Procedures will be reviewed and approved by the head of GRM or a designee.

The Credit Policy, Credit DOA and Credit Procedures are intended to:

- Provide guidance and direction to achieve the business objectives
- Assign responsibilities for credit risk planning, transaction management, and monitoring
- Create awareness of credit risk among commercial and credit risk personnel
- Ensure appropriate consistency across the business units in credit risk methodologies, models, policies, methods of analysis, and procedures
- Establish effective, efficient and consistent credit risk management practices, including organizational accountabilities, exposure calculations, credit procedures and information management
- Assign responsibilities for managing credit to achieve business unit, corporate, and stakeholder objectives

#### **Policy Expectations**

GRM must approve all extensions of credit related to business transactions within the Scope of this Policy, as defined below:

- All transactions involving extension of credit must be with counterparties approved by GRM.
- All Commodity, Storage, Transportation or Capacity purchases or sales transactions must be with approved counterparties.
- Any exception to this Policy must be approved by the Treasurer.

GRM will analyze counterparties, approve or reject counterparties and set credit limits. Business Units will ensure that any new transactions or modifications to existing transactions shall be within the specified counterparty limit. Credit extension to any counterparty not approved is prohibited. New counterparties must be reviewed and approved by GRM. All credit support instruments (e.g. parent guarantees or letters of credit) must be submitted to GRM and Legal Counsel for review before consenting to the form of these documents.

#### **Accountability: Roles and Responsibilities**

##### **Duke Energy Treasurer**

The Treasurer leads the credit risk management function across Duke Energy. Responsibilities include:

- Formulating credit strategy

- Creating a common credit culture by developing efficient, effective and consistent applications of Credit Policy
- Approving either directly or through a delegate, Credit DOA and Credit Procedures
- Approving either directly or through a delegate, any exceptions to Credit Policy, Credit DOA or Credit Procedures

### **Global Risk Management**

As it relates to credit risk management, GRM has the following areas of responsibility:

- Formulating Enterprise Credit Policy  
GRM supports the Treasurer in formulating credit strategy, establishing a consistent credit culture and recommending new or revised credit policies. GRM ensures that the Credit Policy and Credit DOA support strategy and stakeholder objectives. GRM sets credit risk objectives, contract-related credit risk terms and conditions and is responsible for reporting credit exposure to management.
- Monitoring and Reporting  
GRM monitors credit exposure and performance and analyzes counterparty credit quality.
- Managing Credit Risk  
GRM performs credit reviews on specific transactions, counterparties and/or credit exposures as set forth above. GRM sets credit risk objectives, assigns credit limits and Internal Risk Ratings to counterparties. GRM is responsible for negotiating credit terms of transactions and trading agreements (e.g. default parameters, collateral arrangements); As a result of such review, GRM may require risk mitigation consistent with corporate objectives.
- Technology Applications. GRM maintains adequate credit risk systems which allow for timely recording and reporting of exposures.
- Information and Analysis Consistency  
GRM identifies, reviews and approves consistent credit exposure calculations and credit risk methodologies.

### **Business Units and Corporate Areas**

- All Business Units and Corporate Areas must comply with the Credit Policy, operate within credit limits set forth by GRM and develop procedures and controls to ensure compliance.
- All Business Units and Corporate Groups must communicate/report information and/or transactions to GRM with adequate time for review so they can complete the counterparty credit risk assessments.
- Prior to entering into any transaction, all Business Units and Corporate Areas must receive credit approvals for extension of credit and credit-related contract terms.
- Employees who execute transactions are responsible for ensuring that GRM has approved all prospective counterparties before extension of credit, and that any new transactions or modifications to existing transactions are within specified limits. Transactions with counterparties not approved by GRM are prohibited.
- In addition, transactions in excess of existing credit limits shall be reviewed with GRM to determine how to enhance the credit position and/or modify credit limits.

### **Organizational Relationships**

The GRM group is independent of the business. No member of GRM should have a direct reporting relationship to any of the businesses. However, Business Units may have risk personnel that maintain a dotted line reporting relationship with GRM.

*Compensation, including incentive compensation or spot bonuses, for all GRM personnel shall be independent of Business Unit financial performance.*

Any exceptions to the above rule must be approved by the Treasurer or designee.

### **Changes to the Policy**

All changes to the Credit Policy will be reviewed and approved by the Treasurer.

### **Adoption & Implementation**

This policy supersedes prior publications and is effective April, 2008. GRM, Corporate Areas and the Business Units must comply. Policy updates may require changes to business practices and procedures at Business Units and Corporate Areas.

Gap assessments outlining misalignment between current practice and requirements are to be developed by the Business Units and Corporate Areas with assistance from GRM, as needed. Business Units and Corporate Areas that are out of compliance must develop action plans to bring conditions into compliance.

GRM is responsible for notifying Business Units and Corporate Areas of changes to this policy. Special circumstances may occasionally require deviation from the standards of this policy. All exceptions require the approval of the Treasurer and /or designee.

If any requirement in this document is inconsistent with any law, tariff or regulation applicable to Duke Energy Corporation or its subsidiaries, the law, tariff or regulation will prevail.

### **Related Links:**

[Approval of Business Transactions](#)

[Code of Business Ethics](#)

[Credit Delegation of Authority](#)

[Commodity Risk Policy](#)





## Duke Energy Policy Statement

### Loan Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Finance - Corporate Risk Management
<b>Approval:</b>	Chief Financial Officer - Duke Energy
<b>Effective Date:</b>	01/07/2002
<b>Revision Date:</b>	04/01/2006
<b>Reissue Date:</b>	04/01/2006

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#### **Statement of Purpose and Philosophy**

Duke Energy Business/Corporate Units may originate or administer loans in accordance with this policy and the Credit Policy.

For the purposes of this policy, regardless of maturity, Loans shall be defined as:

- Money advanced by Duke Energy to non-wholly owned borrowers under a note or other instrument of indebtedness other than those non-wholly owned subsidiaries in place as of the date of this policy. Such subsidiaries will be grandfathered under their existing financing arrangements
- All new enhancements of credit provided by Duke to non affiliated entities, and the continuance of credit enhancement for affiliates which will no longer be owned by Duke Energy
- A note or other instrument of indebtedness equal to or greater than \$5MM received by Duke Energy as consideration for providing a good or service or as part of the proceeds of an asset sale

Extensions of credit made in the ordinary course of business such as standard trade credit for commodities sold or transmission capacity provided are not subject to this Loan Policy but are subject to the Credit Policy and Credit Risk Limits.

In the event the originating business unit or corporate area is unsure whether or not this Policy applies to a given transaction, the Chief Risk Officer shall be advised of the relevant facts and will make the final determination.

#### **Roles and Responsibilities**

##### Business Units and other Corporate Units (Origination)

- Responsible for all loan administration and accounting for all 3<sup>rd</sup> party credit support fees, interest and principal, monitoring applicable loan covenants and financial information, and safeguarding all relevant loan information and documentation.
- Will periodically review loan performance with Corporate Treasury and Corporate Risk Management.

##### Corporate Treasury

- Responsible for negotiating the terms and conditions of all Loans, including, but not limited to the repayment schedule and interest rate charged by Duke Energy.
- Responsible for pricing, structuring and negotiating all relevant loan information and documentation, including perfecting any security interest granted to Duke as collateral for the loan.

#### Corporate Risk Management

- Will approve the transaction and structure of any Loan prior to any written offer (indicative or binding) to provide such Loan in accordance with the Corporate Credit Policy and related Corporate Credit Risk Limits.
- Establish Duke Energy Corporate Credit Policy and Risk Limits for business unit loans, origination and administration.

#### **Risk Limits for the Origination and Administration of Loans**

##### Guiding Principles

- Follow a specified system of loan origination and management, as detailed in the Credit Policy and Risk Limits
- Adhere to all applicable laws and regulations regarding the extension of credit and investment of funds
- Avoid conflicts of interest in accordance with the Code of Business Ethics
- Respect and preserve the confidentiality that is entrusted by clients
- Comply with federal securities laws, which forbid the use of material non-public information in buying, selling or advising the transfer of securities. Accordingly, employees must not give material non-public information about clients or Duke Energy itself, to outsiders, or use such information themselves in the purchase or sale of securities

##### Client Files

- A client file should be maintained on all loan customers.
- The client file should consist of Loan Service and Loan Transaction sections.
- The Loan Service section should include customer requests, history and extent of relationship, borrowing base calculations and correspondence.
- The Loan Transaction Documentation section should include all original executed documents related to a) debt instruments, b) loan or letter agreements perfecting the security interest in negotiable/non-negotiable collateral, c) other documents obtained at closing, and e) all original amendments/releases/waivers related to these documents.

##### Financial Statement Requirements

- Financial statements should be maintained on all customers, including guarantors/endorsers/co-makers, general partners in partnership and other third parties providing support to a transaction.
- Financial statements include:
  - balance sheet
  - income statement
  - statement of cash flows
  - consolidating statements for all entities, and
  - footnotes including description of contingent liabilities, discussion of material subsequent events, and description of deviations from GAAP.
  - Updated financial statements are to be received at least annually and within three months of the customer's fiscal year end.

##### Credit Approval Form

- All Originating Units should use a Credit Approval Form similar to and containing relevant significant information as found in the Credit Policy and Risk Limits document.

#### Credit Memorandum

- The Credit Memorandum is the presentation of factors for consideration by management on which a credit decision is to be based.
- Originating Units should use a Credit Memorandum similar to, and containing all significant and relevant topics, as found in the Credit Policy and Risk Limits.

#### Extension of Credit

- Approval of commitments to extend credit must comply with the Credit Policy.
- Commitments to extend credit must be made in writing if \$500,000 or greater.

Material modifications in terms, conditions, covenants, or collateral (releases or substitutions) are to be approved at the same level as originally required.



## Duke Energy Policy Statement

# Summary of Internal Controls and Financial Controls Policies

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Duke Energy Corporate Controller
<b>Approval:</b>	Duke Energy Corporate Controller
<b>Effective Date:</b>	12/16/2004
<b>Revision Date:</b>	12/16/2004
<b>Reissue Date:</b>	12/16/2004

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### **Statement of Purpose and Philosophy**

To ensure all units are aware of the Duke Energy Corporation internal controls and financial controls policies, these policies are posted on the employee portal. See link below for "List of Internal Controls and Financial Controls Policies."

### **Policy Expectations**

All units are expected to comply with corporate policies that are applicable to their business. Management within each unit must ensure that appropriate communications and training as needed are provided to employees. In rare instances, an exception to a corporate policy may be approved by the Corporate Controller or other comparable Corporate Officer. The "Request for Exception to Policy Form" (see link below) or other comparable information should be provided to support the requested exception.

### **Accountability: Roles and Responsibilities**

#### Business Units/Corporate Areas ("unit(s)")

- Maintain awareness of approved internal controls and financial controls policies
- Ensure unit compliance with all applicable policies
- Communicate applicable policies to appropriate personnel within the unit and ensure training is received as needed

#### Corporate Controller's Department

- Communicate new and revised policies to the units
- Work with policy subject matter experts and recommend/coordinate training as needed
- Maintain the internal controls and financial controls policies on the employee portal as well as a complete listing of all these policies (Internal Controls Group)

### **Standards/Requirements**

List of Internal Controls and Financial Controls Policies

The Internal Controls Group of the Corporate Controller's Department will ensure a complete list of approved internal controls and financial policies is available to the units. The internal controls and financial controls policies are located on the "Policies/Compliance" page of the employee portal. The Corporate Controller's Department will also communicate new and/or revised internal controls and financial controls policies.

**Related Links:**

[Request for Exception Process](#)

[List of Internal Controls and Financial Controls Policies](#)



## Duke Energy Policy Statement

# Accounting for Income Taxes

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Senior Vice President Tax
<b>Approval:</b>	Senior Vice President Tax
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<b>Effective Date:</b>	06/30/2004
<b>Revision Date:</b>	03/31/2009
<b>Reissue Date:</b>	03/31/2009

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### Statement of Purpose and Philosophy

Provide a framework for the processes, organization, and policies encompassing income tax accounting for Duke Energy Corporation and its subsidiaries ("Company").

### Policy Expectations

This Policy sets forth certain standards for U.S. Federal, U.S. State, and foreign income tax accounting and clarifies organizational responsibilities within the Finance function.

### Accountability: Roles and Responsibilities

The **Senior Vice President Tax** is responsible for:

- Preparation and review of the consolidated income tax provisions and payments
- Review and approval of quarterly and annual internal representation letters required by Duke Energy to support Sarbanes Oxley compliance and other internal control procedures as it relates to income tax accounting and related disclosures.
- Worldwide tax compliance, tax audits and tax strategy
  - The Senior Vice President Tax may delegate compliance work to staff and/or outside firms.
  - The Senior Vice President Tax retains responsibility for compliance regardless of delegations.
- Preparing and filing the U.S. Federal, U.S. State, and foreign income tax returns
  - The Chief Financial Officer must approve the U.S. Federal Income Tax return before it is filed.
- Preparation and review of tax return to tax accrual reconciliations. Preparation and review of worldwide income tax valuation allowances and reserves. Preparation and review of the consolidated income tax forecast. Complying with Generally Accepted Accounting Principles (GAAP) and all related accounting standards and interpretations related to tax accounting.
  - Identify and submit issues to the Corporate Controller or his designee which relate to complex income tax accounting issues.
- Ensuring that staff assigned to income tax accounting is adequately trained and knowledgeable with respect to GAAP, accounting interpretations and other authoritative guidance
- Ensuring the do - review process is present and responsibilities are segregated amongst the staff and that staff with adequate knowledge of income tax accounting is engaged in this process

- Ensuring the monthly close cycle allows adequate time for analyzing and recording the income tax provision, including income tax reserves, rollforwards of asset and liability accounts, calculation of the effective tax rate (ETR) and other key analyses
- Recording income tax provisions, perform reconciliations and provide reports and other information as prescribed in this Policy
- Preparing the income tax forecast in a manner that is materially consistent with this Policy (for input to the Corporate forecast model)

The **Corporate Controller** is responsible for:

- Company wide compliance with GAAP
  - The Corporate Controller may delegate the work associated with GAAP compliance to Business Unit (BU) Accounting staff.
  - The Corporate Controller remains responsible for GAAP compliance regardless of delegations.
- Final approval of income tax accounting positions and interpretations.
- Determining documentation requirements related to internal controls, external audit and other issues surrounding income tax accounting

### **Standards (policies)**

The Company shall comply with Financial Accounting Standards (FAS) 109, *Accounting for Income Taxes* and Financial Accounting Standards Board (FASB) Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FAS 109 and all related interpretations and other guidance issued by the FASB, Emerging Issues Task Force (EITF), American Institute of Certified Public Accountants (AICPA) and other authoritative bodies.

U.S. Federal, U.S. State, and foreign income tax accounting shall be performed each month in conjunction with the accounting close process.

Internal financial statements shall reflect the Company's current income tax position each month.

The do - review process is required Company wide, by employees with adequate knowledge of income tax accounting.

### **Requirements (procedures)**

Recording income tax provisions:

- The Corporate Tax Department's income tax accountants are responsible for recording income tax provisions in the general ledger.
  - The monthly close calendar should allow adequate time to analyze and record income tax provisions (at least one business day).
  - Income tax provisions and related accounting analysis should begin after book pretax income is materially correct.
- The Corporate Tax Department's income tax accountants will analyze the current consolidated federal income tax balance each month and record appropriate adjusting accounting entries.
  - The Corporate Tax Department's income tax accountants will record the accounting entries necessary to properly reflect the consolidated current federal income tax asset or liability in the financial statements.

Income tax valuation allowances and reserves:

- The Senior Vice President Tax, or designee, will analyze income tax valuation allowances and reserves at each fiscal quarter end.
- The Senior Vice President Tax will update the Corporate Controller as to the adequacy of income tax valuation allowances and reserves once each fiscal quarter prior to closing the books.
  - The Senior Vice President Tax will arrange a meeting with the Corporate Controller to review workpapers and documentation.
  - The Corporate Controller will determine the adequacy of the workpapers and documentation with respect to internal controls, external audit and other related issues.
- The Senior Vice President Tax will have final approval as to the adequacy of reserves and valuation allowances related to operations after considering input from the Corporate Controller.

Reconciliation of tax returns to the general ledger:

- The Senior Vice President Tax, or designee, shall prepare workpapers that reconcile U.S. federal and state income tax returns, by legal entity or BU as appropriate, and foreign tax returns to the general ledger records.

Reporting:

- The Corporate Tax Department's income tax accountants shall prepare a consolidating ETR Report of income tax provisions, tax asset and liability account reconciliations, and other key income tax statistics as requested by executive management.
- A consolidating ETR report will be prepared by the General Manager - Income Tax Accounting, or designee, and will be available to the Senior Vice President Tax and Corporate Controller for review.

**Related Links:**

[Tax Reserves Policy](#)





## Duke Energy Policy Statement

### Property Tax Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Senior Vice President Tax
<b>Approval:</b>	Senior Vice President Tax

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<b>Approval Date:</b>	09/19/2005
<b>Revision Date:</b>	03/31/2009
<b>Reissue Date:</b>	03/31/2009

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**Statement-** This policy covers property tax processes used by business/corporate units. The policy describes the minimum controls required to ensure an appropriate level of control exists regarding property tax. This policy excludes joint ventures, partnerships, etc. where Duke Energy is not the Tax Matters Partner.

#### **Roles and Responsibilities-**

##### **Business/Corporate Unit-** **Property Taxes and Payments Policy**

- All business/corporate units will notify the Corporate Property Tax Group (CPTG) within the Corporate Tax Department in a timely manner of new and/or changes in property tax reporting responsibility to ensure timely property tax reporting requirements.
- If business/corporate units have acquired and/or disposed of plant, property and equipment, the CPTG must be notified within 30 business days of such activity. Regulated units are exempt from this requirement.
- If business/corporate units have entered into and/or made modifications on any capital and/or operating leases, the business/corporate units must notify the CPTG within thirty (30) business days of said events.
- All business/corporate units must maintain records of property, plant, equipment, inventories, leased equipment (capital and/or operating), asset additions and asset disposals and the appropriate taxing district information in order for the CPTG to accurately file tax returns, exemptions, incentives and to negotiate equitable assessments with state and local taxing authorities and make the necessary property tax payments.
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##### **Corporate Property Tax Group**

- All property tax returns, payments, exemptions and incentives are to be filed by the CPTG.
- CPTG will be responsible for all property tax audits and/or any correspondence from state and/or local authorities.



## Duke Energy Policy Statement

### Relations With Tax Authorities Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Senior Vice President Tax
<b>Approval:</b>	Senior Vice President Tax
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<b>Effective Date:</b>	08/31/2000
<b>Revision Date:</b>	03/31/2009
<b>Reissue Date:</b>	03/31/2009

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**Statement** - This Policy covers relations such as inquires and correspondence with tax authorities by Business Unit/Corporate Areas. The Policy describes the minimum controls required. The Business Units/Corporate Areas should implement additional procedures and controls as needed to ensure an appropriate level of control exists regarding relations with tax authorities.

#### **Roles and Responsibilities-**

##### Business Unit/Corporate Area-

##### Relations with Taxing Authorities Policy

- Business Units/Corporate Areas must refer all U.S. Federal, U.S. State, and foreign tax inquiries or correspondence received from taxing authorities, except general payroll related correspondence, to the Tax Department for resolution. This includes all income, franchise, property, consumption, and foreign tax inquiries or correspondence received from taxing authorities.



## Duke Energy Policy Statement

### Sales/Use and Excise Tax Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Senior Vice President Tax
<b>Approval:</b>	Senior Vice President Tax

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<b>Effective Date:</b>	08/31/2000
<b>Revision Date:</b>	03/31/2009
<b>Reissue Date:</b>	03/31/2009

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**Statement-** This policy covers sales/use and excise tax processes used by Business/Corporate units and Corporate Tax. The policy describes the minimum controls required. Business/Corporate units and Corporate Tax should implement additional procedures and controls as needed to ensure an appropriate level of control exists regarding sales/use & excise taxes. This policy excludes the telecommunication excise taxes in which Duke Net has the responsibility for compliance, audits, correspondence, and all aspects of telecommunication excise taxes.

#### **Roles and Responsibilities**

Business/Corporate Units are responsible for:

- ensuring that employees responsible for processing vendor invoices are properly trained on the sales and use tax requirements for coding transactions through the applicable Accounts Payable systems. This includes, for example, proper category, ship-to, DCE, and tax codes selection for transactions processed using Peoplesoft, Passport, MAPPS, or EAM.
- ensuring that employees responsible for generating customer invoices are properly trained on sales/use and excise tax requirements as they pertain to applicable billing systems.
- collecting and maintaining valid customer exemption certificates and/or direct pay permits, when applicable. These certificates must be kept up-to-date and must be available for presentation to a state/local tax auditor.
- notifying Corporate Tax in a timely manner when a new legal entity is formed and working with Corporate Tax to initiate new tax registrations and to resolve any non-routine situations.
- notifying Corporate Tax in a timely manner if an existing entity begins conducting business in a new state or taxing jurisdiction and working with Corporate Tax to initiate new tax registrations and to resolve any non-routine situations.
- notifying Corporate Tax in a timely manner regarding any audits initiated by taxing authorities.

Corporate Tax is responsible for:

- filing on a timely basis all sales/use and excise tax returns with applicable taxing authorities, for remitting the proper tax to those taxing authorities, and for handling any follow-up correspondence,

It will also be the responsibility of Corporate Tax to initiate new tax registrations and to resolve all compliance and registration issues.

- coordinating and leading all audit matters related to sales/use and excise tax returns.
- reconciling on a regular basis all sales/use and excise tax accrual accounts associated with the returns filed. Discrepancies will be reviewed within the Business/Corporate unit or Corporate Tax Department accordingly and any necessary adjustments booked on a timely basis.
- providing oversight and communication on a timely basis to Business/Corporate units regarding new sales/use or excise tax statutes and regulations, with the exception of Duke Net's telecommunication excise tax returns
- advising Business/Corporate units on compliance, systems, and processing matters with respect to sales/use and excise taxes, with the exception of Duke Net's telecommunication excise tax returns.



## Duke Energy Policy Statement

### Tax Reserves Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Senior Vice President Tax
<b>Approval:</b>	Senior Vice President Tax
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<b>Effective Date:</b>	12/31/2004
<b>Revision Date:</b>	03/31/2009
<b>Reissue Date:</b>	03/31/2009

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#### **Statement of Purpose and Philosophy**

The purpose of the policy is to provide a framework for the processes, organization and policies encompassing the recording of reserves for taxes for the company and its subsidiaries.

#### **Policy Expectations**

This policy sets forth certain standards for U.S. Federal, U.S. State, and foreign tax reserves, including income, property, franchise, capital, and all consumption taxes.

#### **Accountability: Roles and Responsibilities**

The Senior Vice President Tax is responsible for:

- Analyzing and documenting the need for reserves.
- Recording the journal entries for tax reserves.
- Updating the Corporate Controller as to the adequacy of income tax reserves once each fiscal quarter prior to closing the books.
- Maintaining account reconciliations for reserve accounts.
- Determining the adequacy of the work papers and documentation with respect to internal controls, external audit and other related issues.

The Corporate Controller is responsible for:

- Determining the GAAP treatment of the reserves.

The Senior Vice President Tax will have final approval as to the adequacy of reserves after considering input from the Corporate Controller.

The Corporate Controller and the Senior Vice President Tax will review the reserves with the Chief Financial Officer each quarter.

## Standards/Requirements

### Analysis of Tax Reserves and Identification of Potential Tax Reserves

Each quarter, the Senior Vice President -Tax or designee will analyze tax reserves. The analysis considers tax, interest and penalties, if applicable. With the analysis, consideration is given to changes in facts and events, including business transactions, lapse of audit cycles, and issuance of case law or Internal Revenue/State Department of Revenue positions. Reserves will be documented and maintained by the Corporate Tax department.

The Senior Vice President Tax exercises professional judgment as to the need for third party tax and/or legal consultation and possible need to obtain formal Tax Opinions or other written advice for issues identified during the above review.

### Analytical Process for Determining the Possible Need for and Related Amount of Tax Reserves

Income tax reserves: The Company follows FIN 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109". FIN 48 prescribes a minimum recognition threshold a tax position is required to meet, otherwise, a reserve of all or a portion of the tax position is required. Tax positions are filing positions that the Company has taken or expects to take on its tax return by including the position in the current tax provision. Under FIN 48, a tax benefit is not recognized unless the "more likely than not" recognition threshold is met, i.e. the tax benefit is expected to be sustained on audit by the taxing authority based solely on the technical merits of the position. If the recognition threshold is met, the tax benefit recognized is measured at the largest amount of the tax benefit that is greater than 50 percent likely to be realized.

Non-income tax reserves: The Company follows FAS 5 in determining the need for and the amount of non-income tax reserves. In accordance with FAS 5, reserves will be accrued if information available prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and that amount of the loss can be reasonably estimated. Reserves may be accrued at 100% or risk adjusted based on the facts and circumstances.

### Documentation of Tax Reserves and the Calculation of the Reserve Amounts

- Adequate documentation supporting the tax reserves and any changes to the tax reserves is required to be developed and retained in the Corporate Tax department, including spreadsheets, memoranda and other documentation.
- The Do/Review process is used and documented according to company policy for calculations of reserve amounts.

### Proper Recording of Tax Reserves

- Tax reserves must be recorded in the appropriate taxes payable account.
- Reserves should be recorded at the appropriate registrant level.

**Related Links:**

[Accounting for Income Taxes](#)



## Duke Energy Policy Statement

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# Bank Account and Check Disbursement Policy

**Applicability:** Applies to Enterprise  
**Originator:** Corporate Treasury  
**Approval:** Vice President & Treasurer

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**Effective Date:** 08/31/00

**Revision Date:** 01/01/09

**Reissue Date:** 01/01/09

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**Statement-** This policy covers bank account and check disbursement systems used by business/corporate units. The policy describes the minimum controls required. The business/corporate unit should implement additional procedures and controls as needed to ensure an appropriate level of control exists within the bank account and check disbursement systems.

### **Roles and Responsibilities-**

#### Corporate Cash Management Department –

- Domestic – All domestic bank accounts must be established and modifications (including signature card updates) must be processed through Corporate Cash Management.
- International - All bank accounts denominated in U.S. or Canadian dollars must be established and modifications (including signature card updates) must be processed through Corporate Cash Management. Corporate Cash Management must approve the establishment of international local in-country bank accounts. After Corporate Cash Management's approval, the business unit must notify Cash Management within ten (10) business days of a local in-country bank account being opened. These local in-country accounts, including authorized signers, must be reported to Corporate Cash Management on a quarterly basis.

#### Business/Corporate Unit –

- Requests for establishing and modifying all domestic and international bank accounts denominated in U.S. or Canadian dollars must be made through Corporate Cash Management. Corporate Cash Management must approve the establishment of international local in-country bank accounts. Each request must include documentation describing the business reason for the request. After Corporate Cash Management's approval, the business unit must notify Cash Management within ten (10) business days of a local in-country bank account being opened.
- Bank accounts must be reconciled on a periodic basis. Corrections should be made within one month of identifying a reconciliation difference.
  - The bank statement must be reconciled to the general ledger account
  - Reconciliations must be reviewed by management
- Unissued checks, including blank check stock, must be physically secured.
- Check signers must not have access to blank checks.
- Checks must be controlled by sequential numbering.

#### Guidelines –

- The following functions should be separated between at least two people. Weaker segregation of duties should be accompanied by additional management review.
  - cash disbursement
  - purchasing
  - contract administration
  - receiving
  - bank account reconciliation



- accounts payable
- Unissued checks should be accounted for periodically by personnel independent of check custody.



## Duke Energy Policy Statement

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### Corporate Cash Management Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Treasury - Corporate Cash Management
<b>Approval:</b>	Corporate Treasurer
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<b>Effective Date:</b>	04/01/2006
<b>Revision Date:</b>	06/01/2007
<b>Reissue Date:</b>	01/01/2009

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#### Statement of Purpose and Philosophy

The purpose of this Policy is to confirm Duke Energy's Cash Management Objectives and to define the responsibilities and the authority within the Corporation for achieving those objectives.

#### Policy Expectations

This policy applies to the consolidated Corporation, which consists of Duke Energy Corporation and all of its consolidated or controlled subsidiaries and affiliates. Cash is a critical asset of the Corporation. Duke Energy's policy is that all cash assets of the Corporation be properly safeguarded and then managed to maximize value. The Cash Management Guidelines provide detailed parameters for allowed investing activity.

#### Accountability: Roles and Responsibilities

Duke Energy's Corporate Cash Management Group (Corporate Cash Management) is responsible for achieving Duke Energy's Cash Management Objectives which are as follow:

- Provide daily liquidity
- Safeguard cash assets
- Maximize the value of cash assets
- Minimize short-term interest expense
- Maximize short-term interest income
- Provide cost effective banking services

For those entities with non-Duke shareholders, Corporate Cash Management recognizes its fiduciary responsibilities and will optimize the cash assets of those entities using the above objectives. Corporate Cash Management is responsible for executing or directing all cash management activities within the consolidated Corporation.

#### Cash Management Activities

Cash management activities include:

- Prepare cash forecasts
- Set cash position
- Consolidate cash, where appropriate (taking into consideration legal, regulatory, tax and any other appropriate considerations)
- Manage movement of funds through the money pool arrangement
- Borrow needed funds at attractive rates
- Maximize return on available cash within approved guidelines
- Maintain strong relationships with a broad group of commercial banks
- Open, maintain (including signature card updates), and close all U.S. and Canadian dollar bank accounts and provide approval and oversight for the establishment of international in-country bank accounts
- Select banking services and monitor service quality and price
- Execute wire transfer payments and other electronic payments accurately and timely
- Execute certain foreign currency payments
- Arrange other commercial banking services, including escrow agreements

Borrowing for the entire consolidated Corporation is the responsibility of Duke Energy's Treasury Department. Corporate Cash Management will coordinate with other Treasury Department personnel to determine and establish short-term borrowing programs across the consolidated Corporation. Only individuals authorized by the head of Cash Management will be permitted to initiate short-term borrowings. Such authorizations are reflected in the appropriate Delegation of Authority and communicated to appropriate borrowing agents through letters signed by the head of Cash Management. Authorized individuals are authorized to borrow up to the size of the individual borrowing programs.

Investing cash for the entire consolidated Corporation is the responsibility of Duke Energy's Treasury Department. Only authorized individuals may make cash investments on behalf of Duke Energy and its subsidiaries. Authorizations and approved short-term investment products are outlined in the Short-Term Investment Guidelines maintained by Treasury.

Corporate Cash Management is responsible for the consolidation of cash for the consolidated Corporation. Authorizations and requirements for cash consolidation are further defined in the [Intercompany Funding Policy](#).

#### DOMESTIC CASH MANAGEMENT

Corporate Cash Management is responsible for executing all cash management activities within the consolidated Corporation in the US, and will work closely with all business units to ensure that Duke Energy's Cash Management Objectives are being achieved while maximizing business unit and corporate earnings.

Bank accounts must be established and modifications (including signature card updates) must be processed through Corporate Cash Management.

Corporate Cash Management (as authorized by appropriate Boards) is responsible for executing all short-term borrowing and cash investing within the consolidated Corporation. With regard to wire transfer and

other individual electronic payments, Corporate Cash Management is responsible for ensuring that such wire transfer and certain electronic payments have been properly approved before being executed.

#### INTERNATIONAL CASH MANAGEMENT

Corporate Cash Management is responsible for executing, directing, or approving all cash management activities within the consolidated Corporation at Duke Energy's international locations. Corporate Cash Management will work closely with local and regional Treasury and Cash Management personnel as well as *local and regional business unit management*, to ensure that Duke Energy's Cash Management Objectives are achieved.

Prior to seeking approval from Corporate Cash Management for cash management activities, the group accountable for the execution of such activities must coordinate and consult with appropriate individuals within the business unit, tax, legal, treasury, and other key personnel to ensure that the proposed activities incorporate appropriate strategic, legal and tax considerations, country and currency risks, parent and local banking relationship considerations, and local banking regulations and restrictions.

International Cash categories are defined in the Cash Management Guidelines. Whenever possible and practical, Available Cash, as defined in the Guidelines, should be converted into US dollars and held outside the local country.

#### **Standards: The following section contains information that applies to all Treasury policies and guidelines**

- **Treasury:** Treasury is a centralized corporate center servicing and operating on behalf of Duke Energy and its consolidated or controlled subsidiaries and affiliates. All Corporate Departments and Business Units are expected to comply with the contents of this manual. Changes to policies must be approved in accordance with Duke Energy policy. Changes to guidelines will be made within functions and must be approved by the Treasurer.
- **Delegation of Authority:** Only authorized individuals may enter into Treasury activities. Such activity and limits are covered under the Approval for Business Transactions Policy. Individuals and their corresponding functions and limits are listed in the Delegation of Authority ("DOA"). Exceptions may be granted with written approvals by individuals authorized to the required transaction levels consistent with the DOA. Both documents are managed within the Controller's group. No Duke Energy employee shall knowingly personally benefit from any Treasury transaction. All Treasury activity will conform to the "Approval of Business Transactions" policy and the DOA.
- **External Counterparts:** External counterpart determination will be made within the Duke Energy Finance organization in coordination with Treasury and Global Risk Management & Insurance. Credit Risk guidelines will be the responsibility of Global Risk Management & Insurance.
- **Transactional Controls:** Transactional control procedures will comply with documented control procedures.
- **Accounting Standards:** Accounting treatment for all transactions will be in accordance with GAAP and will be determined, if applicable, in coordination with the Corporate Accounting Research Group in accordance with the Accounting for Derivative Instruments and Hedging Activities and Accounting for Intercompany Transactions Policy, on the portal and managed within the Controller's group.
- **Terms, Definitions and Approved Products and Instruments:** Financial terms shall have meanings consistent with definitions found in Barron's Dictionary of Finance and Investment Terms. A list of approved finance and hedging products and instruments is available from Treasury. Use of other products or instruments must be approved by the Treasurer and Chief Financial Officer.

**Related Links:**

[Wire Transfer Policy](#)

[Intercompany Funding Policy](#)

[Accounting for Intercompany Transactions Policy](#)

[Approval of Business Transactions](#)

[Delegation of Authority](#)



## Duke Energy Policy Statement

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# Financing Activity and Financial Risk Management Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Treasury
<b>Approval:</b>	Corporate Chief Financial Officer
<b>Effective Date:</b>	04/01/2006
<b>Revision Date:</b>	04/01/2006
<b>Reissue Date:</b>	04/01/2006

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### Statement of Purpose and Philosophy

Policy Objectives: The scope of this policy covers financing and financial risk management activities within Duke Energy's Corporate Treasury. This policy does not cover other activities managed within Corporate Treasury that include: Cash Management, Long-Term Investment and Financial Planning and Analysis. Policy and guideline information for those activities is managed under separate policies and guidelines within the "Corporate Treasury Policy and Guideline Manual."

The objective of Duke Energy's financing and financial risk management activities within Corporate Finance and Portfolio Management in Corporate Treasury is to provide enterprise-wide services that enhance Duke Energy's, its subsidiaries', affiliates' and each Business' ability to increase revenue, reduce costs and manage risk. This is accomplished through, but is not limited to the following activities:

- Optimize capitalization, including all financing activity
- Optimize liquidity, including access to bank and capital markets
- Position debt portfolios of Duke Energy and its operating companies to minimize cost of capital and optimize maturity profile, consistent with overall risk management goals
- Manage and monitor long-term debt, including administration and compliance
- Optimize credit ratios to maintain desired credit ratings
- Manage and monitor interest rate risk exposure
- Manage and monitor foreign currency risk exposure
- Forecast enterprise financing needs
- Issue and manage credit enhancements
- Oversee transaction review, including establishing cost of capital and hurdle rates

Functions within Corporate Finance and Portfolio Management fall into two categories: Financing Activity and Financial Risk Management.

### Policy Expectations and Accountabilities

#### Financing Activity

Financing activity throughout the corporation is the sole responsibility of Corporate Treasury. With the

exception of the short-term and intercompany financing activity within Cash Management, financing activity is the responsibility of Corporate Finance. Financing activity includes, but is not limited to, the following: (A) Security issuances in the public and private placement markets, including long-term and short-term debt, equity, hybrid structures, MLP and Income Fund units; (B) Repurchases, redemptions or retirements of any debt and equity instruments or units; (C) Lines of credit and borrowing facilities, whether syndicated or bilateral; and (D) Issuances of letters of credit and corporate guarantees.

In connection with this activity, primary financial institution relationships will be managed exclusively out of Corporate Treasury. Specifically, Corporate Finance will be the lead managers of, and primary points of contact to, the financial institutions that serve the corporation. Business Units are prohibited from hiring financial institutions for financing activity.

Under no circumstances will any group or entity, for which Duke Energy has controlling interest, outside of Corporate Treasury, conduct the above actions without prior written approval from the Corporate Chief Financial Officer.

#### Credit Enhancement Instruments (Guarantees and Letters of Credit)

Corporate credit enhancement instruments will be negotiated, issued and administered within Corporate Treasury. All applications and requests for the issuance of guarantees or letters of credit require review and approval in accordance with this policy and the Approval of Business Transactions Policy.

Credit enhancement instruments should be issued with a stated fixed amount and a fixed term, or with a right of revocation. Uncapped guarantees must be reviewed and approved by the business unit head and then forwarded for review by an Expanded Executive Committee member for the business unit, the Corporate Treasurer and the Corporate CFO. Uncapped guarantees require the approval of the Board of Directors unless a theoretical maximum exposure can be established and is within authorized approval limits of the CFO and CEO. Credit enhancement instruments with a maturity date greater than 10 years from the date of issuance must be approved by the Corporate Treasurer and the Corporate CFO, and for instruments in excess of 20 years, by the CEO.

Credit enhancement instruments issued on behalf of non-wholly owned entities shall be in an amount based on Duke Energy's pro-rata ownership interest in such entity. Credit support in excess of such pro-rata ownership interest requires approval in accordance with the Approval of Business Transactions Policy and the Corporate Treasurer of Corporate CFO.

No credit enhancement instruments should be issued on behalf of unaffiliated third parties.

Credit enhancement instruments issued in support of assets or subsidiaries being divested must be terminated or released at the closing of such divestiture, or promptly thereafter. Failure to terminate such credit enhancement instruments at closing must be back-stopped and supported by an indemnity from the purchaser or other credit enhancement instrument acceptable to Credit Risk Management for the limited period that the credit support remains outstanding. Exceptions to this Policy must be approved by the Corporate Treasurer, the Chief Risk Officer and the Corporate CFO.

Contracts requiring the issuance of a credit enhancement instrument must be executed by a person(s) so authorized by the DOA and in accordance with the Approval of Business Transactions Policy. No Contract incorporating language requiring the issuance of a credit enhancement instrument can be executed unless both *Corporate Legal* and *Corporate Treasury* have approved such language.

If specifically authorized in writing pursuant to a business unit DOA (signed by the Corporate Treasurer), a business unit may, however, issue its own guarantees in support of its own subsidiaries. Such issuance must be consistent with language and procedures developed by Corporate Legal and Corporate Treasury in accordance with the "Guaranty Documentation Guide", which is available from Corporate Treasury.

The Corporate Treasurer and Head of Corporate Finance are authorized to execute properly approved guarantees. The Corporate Treasurer and Head of Corporate Finance may approve bank applications for letters of credit which have been properly authorized, and may delegate such approval.

Any exceptions to compliance with this section of the policy must be requested by a business unit CEO or CFO, Corporate General Manager or Corporate Vice President and approved by the Corporate Treasurer and Corporate CFO.

#### Transaction Review

The transaction review process will be executed as is detailed in the "Financial Analysis Manual". This includes involvement of the Transaction Review Committee. Any material changes to approved projects, whether quantitative or qualitative, must re-visit the "Approval of Business Transactions" process. Please review the "Financial Analysis Manual" or contact the Corporate Finance group within Corporate Treasury for further clarity on this issue.

### **Financial Risk Management**

#### Interest Rate Risk Management

Interest rate risk is defined as the impact on Duke Energy earnings per share and asset returns from interest rate market movements. The goal of the interest rate risk management program is to reduce the cost of funds, manage the mix of fixed and floating rate debt and to position the company for changes in interest rate levels.

#### Authorization

- Corporate Treasury is authorized to use derivative financial instruments to manage the interest rate risks associated with outstanding debt or to hedge interest rate risk associated with new debt issuances.
- All interest rate trading activity with third parties will be executed solely by/in coordination with Corporate Treasury.
- Speculation in interest rate transactions is prohibited.

#### Reporting



- Interest rate risk and hedge information will be periodically reported by Corporate Treasury to senior management. Business units will report interest rate risk to Corporate Treasury, as requested.

#### Foreign Currency Risk Management

Foreign Currency risk is defined as the impact on Duke Energy earnings per share and asset returns from foreign currency market movements. This will include, but is not limited to net investment, earnings and cash flow risk as well as risk arising from planned projects. This policy statement covers the management of foreign currency risk associated with existing asset positions, new and anticipated asset positions or changes as well as physical and financial energy commodity trading positions. The extent to which a business segment is held accountable for foreign currency results for incentive performance evaluation purposes will be determined by its Group President.

#### Authorization

- Corporate Treasury is authorized to manage foreign currency risk through local currency funding activity as well as by entering into derivative transactions with third parties.
- Business units are authorized only to manage foreign currency risk through commercial contract arrangements with its customers or suppliers or by entering into internal derivative transactions with Corporate Treasury.
- All foreign currency trading activity with third parties will be executed solely by/in coordination with Corporate Treasury. Corporate Treasury may transact in a corporate name and transfer the results to a business unit or may transact in the name of the business unit entities consistent with international laws. Actual results will be fully transferred to the applicable business unit.
- Hedging activity related to intercompany foreign currency exposures will be managed consistent with external exposures and will be managed by Corporate Treasury.
- Speculation in foreign currency transactions is prohibited.

#### Reporting

- Foreign currency risk and hedge information will be periodically reported by Corporate Treasury to senior management. Business units will report currency risk to Corporate Treasury, as requested.
- Business units will report forecasted Balance Sheet, Income Statement and Cash Flow items by currency to Corporate Treasury, as requested.
- Corporate Treasury will report hedge determination and results to the business units, as needed.

#### New Projects

- Any business unit that creates foreign currency risk due to a project, expansion, acquisition, or divestiture must develop a foreign currency risk assessment in coordination with Corporate Treasury. If applicable, this assessment must be included in the project's approval recommendation.
- Corporate Treasury will establish a project specific FX Rate Curve. Corporate Treasury will consider input from the business unit in this process. The business unit will use the FX Rate Curve during the approval process.
- Corporate Treasury will provide sovereign-adder guidance for hurdle rates.
- Corporate Treasury will be responsible for creating hedge strategies as well as acquiring or selling currency needed to complete all international investments.

**Standards: The following section contains information that applies to all Corporate Treasury policies and guidelines**

- Corporate Treasury: Corporate Treasury refers to and includes the functions of Cash Management, Corporate Finance, Portfolio Management, Long-Term Investments and Financial Planning and Analysis and is a centralized corporate center servicing and operating on behalf of Duke Energy and its consolidated or controlled subsidiaries and affiliates. All Corporate Departments and Business Units are expected to comply with the contents of this manual. Changes to policies must be approved in accordance with Duke Energy policy. Changes to guidelines will be made within functions and must be approved by the Corporate Treasurer.
- Delegation of Authority: Only authorized individuals may enter into Corporate Treasury activities. Such activity and limits are covered under the "Approval for Business Transactions" policy. Individuals and their corresponding functions and limits are listed in the Corporate Treasury "Delegation of Authority" ("DOA"). Exceptions may be granted with written approvals by individuals authorized to the required transaction levels consistent with the DOA. Both documents are managed within the Controller's group. No Duke Energy employee shall knowingly personally benefit from any Corporate Treasury transaction. All Corporate Treasury activity will conform to the "Approval of Business Transactions" policy and the Corporate Treasury "Delegation of Authority."
- External Counterparts: External counterpart determination will be made within the Duke Energy Finance organization in coordination with Corporate Treasury and Corporate Risk Management. Credit risk guidelines will be the responsibility of Corporate Risk Management.
- Transactional Controls: Transactional control procedures will comply with documented control procedures.
- Accounting Standards: Accounting treatment for all transactions will be in accordance with GAAP and will be determined, if applicable, in coordination with the Corporate Accounting Research Group in accordance with the "Accounting for Risk Management and Hedging Activities Policy" and "Accounting for Intercompany Transactions Policy", on the portal and managed within the Controller's group.
- Terms, Definitions and Approved Products and Instruments: Financial terms shall have meanings consistent with definitions found in *Barron's Dictionary of Finance and Investment Terms*. A list of approved finance and hedging products and instruments is available from Corporate Treasury. Use of other products or instruments must be approved by the Treasurer and Chief Financial Officer.

**Related Links:**

[Approval of Business Transactions](#)

[Delegation of Authority](#)

[Accounting for Derivative Instruments and Hedging Activities Policy](#)

[Financial Analysis Manual](#)

[Guaranty Documentation Guide](#)

[Treasury Policy and Guideline](#)



## Duke Energy Policy Statement

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### Intercompany Funding Policy

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Treasury
<b>Approval:</b>	Vice President & Treasurer
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<b>Effective Date:</b>	04/01/2006
<b>Revision Date:</b>	01/01/09
<b>Reissue Date:</b>	06/01/2007

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#### **Statement of Purpose and Philosophy**

The scope of this policy covers Intercompany Funding activities managed by Duke Energy's Corporate Treasury. The purpose of this document is to provide parameters around the activities that encompass cash consolidation.

Corporate Treasury has the responsibility to ensure that in accordance with the "Corporate Cash Management Policy", cash assets are, i) properly safe-guarded, ii) managed to maximize value within approved investment parameters, iii) available to Corporate Treasury on a timely basis to fund general corporate needs, iv) not left idle and under utilized, and v) not unnecessarily exposed to the claims of lenders, other creditors, or unacceptable short-term cash investment risks.

Corporate Treasury is also responsible and accountable for funding all expenditures that have been appropriately approved in accordance with the "Approval of Business Transactions Policy". This funding will often require the movement of cash between business entities in the form of Intercompany Cash Advances, Intercompany Loans, Equity Distributions and/or Intercompany Equity Investments.

#### **Policy Expectations**

##### Cash Consolidation Expectations

This policy applies to Duke Energy and its consolidated or controlled subsidiaries and affiliates.

All Corporate Departments and Business Units are expected to comply with this policy.

This policy is not meant to cover intercompany accounts payable and receivable occurring from the purchase and sale of intercompany products or services, or accounting entries resulting from cross-billing for products and services paid on behalf of another Business Unit. These intercompany transactions are settled in cash on a periodic basis.

This policy does not supplant compliance with any legal requirements related to corporate authorizations, corporate filings, registration statements, or other required regulatory actions.

Depending on the entities involved, board resolutions and/or other approval processes may be necessary in order to comply with applicable governance and legal requirements.

In cases of joint ventures or minority owned projects where Duke Energy is represented on the board or other management committee, the Duke Energy ownership percentage of the joint venture or project must be voted in accordance with the direction of the Delegation of Authority.

All Intercompany Funding Transactions covered under these guidelines should be accounted for and periodically reviewed in accordance with the "Accounting for Intercompany Transactions Policy".

#### General Description

All cash not necessary for day-to-day operations of the business units will be distributed, except:

- Approved cash reserves for near-term expenses and changes in working capital.
- Approved cash reserves to fund near-term capital expenditures (in general less than 3 months).
- Restricted reserve account balances (e.g., project finance reserve accounts).
- Cash reserves to meet Rating Agency requirements.
- Cash reserves to meet regulatory requirements.

Consideration will be given to the associated tax, accounting, legal, and regulatory implications of any cash distribution or cash contribution.

#### **Accountability: Roles and Responsibilities**

##### Corporate or Business Unit

- All Corporate and Business Unit personnel of the Enterprise shall ensure compliance with these guidelines.
- All Intercompany Funding Transactions must be approved in accordance with the Delegation of Authority.
- Originator of the transaction must coordinate with Tax, Treasury, Accounting and Legal to determine the nature of funding (dividend or return of capital, equity contribution, cash advance or Intercompany loan).
- Each Business Unit Controller, or his or her designee, will be responsible for tracking, servicing and accounting for their respective Intercompany Funding Transactions.
- Notice of all Intercompany Funding Transactions, along with copies of any supporting documentation, should be provided upon closing to the associated Business Unit Controller's group and accounted for as appropriate for the type of transaction.
- All Intercompany Funding Transactions should be accounted for and periodically reviewed in accordance with the "Accounting for Intercompany Transactions Policy".

##### Corporate Cash Management and other Treasury Groups

- Corporate Cash Management will ensure the wire requests comply with the "Wire Transfer Policy".

- Corporate Cash Management will, at its discretion determine the appropriate Funding Node for each Business Unit, and with regard to regular and routine transactions, will keep a chart of designated Funding Paths.
- The Vice President and Treasurer or his designee jointly with Tax, Legal and Business Unit, will determine the nature of funding (dividend or return of capital, cash advance, equity contribution or Intercompany loan).
- Corporate Treasury will coordinate with BU or Corporate Departments requiring approvals by Treasurer or CFO.
- Corporate Treasury will provide appropriate financial terms and conditions for all Intercompany Loans based upon consultation with the Business Unit Controllers and giving consideration to relevant legal, regulatory, tax and other business reasons.
- Corporate Treasury will monitor all intercompany loans funded.
- Corporate Cash Management has unlimited authorization to transact any Domestic Intercompany Cash Advance as needed. International Cash Advances require the additional approval of Tax. All Intercompany Cash Advances initiated by other Corporate Departments or Business Units must be approved by Corporate Cash Management.

#### Tax

- The Senior Vice President of Tax or his designee, jointly with Treasury, Legal and Business Unit, will determine the nature of funding (dividend or return of capital, cash advance, equity contribution or Intercompany loan).
- Corporate Cash Management has unlimited authorization to transact any Domestic Intercompany Cash Advance as needed. International Cash Advances require the additional approval of Tax. All Intercompany Cash Advances initiated by other Corporate Departments or Business Units must be approved by Corporate Cash Management.

#### Legal

- Corporate Legal will provide standard loan templates for all Intercompany Loans. The use of documents other than the standard templates must be approved by Corporate Legal and Corporate Cash Management.
- Legal will ensure proper approvals and resolutions are executed for equity contribution or distributions or intercompany loans.

#### **Requirements**

The approvals per these guidelines are in addition to any legal requirements related to corporate authorizations, corporate filings, registration statements, or other required regulatory actions.

All project funding plans for new projects approved in accordance with other corporate policies at levels commensurate with the Delegation of Authority policy are deemed to have been authorized as part of the project approval.

#### Intercompany Cash Advances

- All Intercompany Cash Advance transactions will be evidenced in the respective Business Unit's daily bank account report, and should be accounted for by the net lender and net borrower in their respective Intercompany Advance accounts.
- Corporate Cash Management has unlimited authorization to transact any Domestic Intercompany Cash Advance as needed. International Cash Advances require the additional approval of Tax and should be approved in accordance with the "Approval of Business Transactions Policy". All Intercompany Cash Advances initiated by other Corporate Departments or Business Units must be approved by Corporate Cash Management.

### Intercompany Loans

All intercompany loans must be approved by Corporate Treasury and Corporate Tax in accordance with the Delegation of Authority.

- Where required for legal, regulatory, tax or other business reasons, certain Intercompany Funding Transactions will be funded using a formal Intercompany Loan.
- The standard templates must be used. Any changes should be approved by Corporate Legal and Corporate Treasury. For international or cross-border Intercompany Loans, special consideration should be given to the accounting designation of such loans and any associated foreign currency impacts. Any foreign currency hedging will be in accordance with the Financing Activity & Financial Risk Management Policy.
- Notice of all Intercompany Loans, and copies of any supporting documentation, should be provided upon closing to the associated Business Unit Controller's group. Interest expense and accruals for Intercompany Loans should be accounted for by the respective Controller's group.
- Scheduled interest and principal payments of an Intercompany Loan approved in accordance with this policy are deemed to have been approved concurrent with the loan approval.
- Draw downs and repayments of principal and interest under an Intercompany "revolving" loan agreement that was approved in accordance with this policy are deemed to have been approved as part of the approved loan agreement.
- A "Money Pool Agreement" is a specific kind of intercompany revolving loan.
- Transactions within the loans established under this policy are considered previously approved.

### Intercompany Equity Investments or Distributions

- All Intercompany Equity Investments or distributions must be approved by Corporate Treasury and Corporate Tax in accordance with the Delegation of Authority. This approval is in addition to any legal requirements related to corporate authorizations, corporate filings, registration statements, or other required regulatory actions.
- Business Unit Controllers must be informed of any equity distributions from their Business Unit(s).
- Each Business Unit Controller, or his or her designee, will be responsible for tracking, monitoring, servicing and accounting for Intercompany Equity Investments and Equity Distributions at entities within their management control; including any up stream roll-up and reconciliation.

### Conflict Resolution

- In the unlikely event that consensus cannot be gained among the relevant internal constituencies (i.e., Legal, Tax, Regulatory, Treasury, Business Unit), the Corporate CFO will have final authority in resolving any conflicts with regard to the appropriate type of Intercompany Funding Transactions to use in certain situations.

### **Standards: The following section contains information that applies to all Corporate Treasury policies and guidelines**

- Corporate Treasury: Corporate Treasury is a centralized corporate center servicing and operating on behalf of Duke Energy and its consolidated or controlled subsidiaries and affiliates. All Corporate Departments and Business Units are expected to comply with the contents of this manual. Changes to policies must be approved in accordance with Duke Energy policy. Changes to guidelines will be made within functions and must be approved by the Corporate Treasurer.

- **Delegation of Authority:** Only authorized individuals may enter into Corporate Treasury activities. Such activity and limits are covered under the "Approval for Business Transactions" policy. Individuals and their corresponding functions and limits are listed in the Delegation of Authority ("DOA"). Exceptions may be granted with written approvals by individuals authorized to the required transaction levels consistent with the DOA. Both documents are managed within the Controller's group. No Duke Energy employee shall knowingly personally benefit from any Corporate Treasury transaction. All Corporate Treasury activity will conform to the "Approval of Business Transactions" policy and the Delegation of Authority.
- **External Counterparts:** External counterpart determination will be made within the Duke Energy Finance organization in coordination with Corporate Treasury and Global Risk Management. Credit risk guidelines will be the responsibility of Global Risk Management.
- **Transactional Controls:** Transactional control procedures will comply with documented control procedures.
- **Accounting Standards:** Accounting treatment for all transactions will be in accordance with GAAP and will be determined, if applicable, in coordination with the Corporate Accounting Research Group in accordance with the "Accounting for Risk Management and Hedging Activities Policy" and "Accounting for Intercompany Transactions", on the portal and managed within the Controller's group.
- **Terms, Definitions and Approved Products and Instruments:** Financial terms shall have meanings consistent with definitions found in *Barron's Dictionary of Finance and Investment Terms*. A list of approved finance and hedging products and instruments is available from Corporate Treasury. Use of other products or instruments must be approved by the Treasurer and Chief Financial Officer.

#### **Key Terms**

**Corporate Treasurer:** the Treasurer for Duke Energy Corporation

**Equity Distributions:** cash distributions such as dividends, return of capital, capital reductions, etc., by an entity to its parent companies, or shareholders - excludes repayment of loan principal, or repayment of cash advances

**Funding Node:** designated Business Unit(s) used by Corporate Treasury to consolidate cash resources and provide cash resources to other Business Units as needed for appropriately authorized and approved business transactions

**Funding Path:** path designated by Corporate Cash Management between a Funding Node and a Business Unit for funding routine Intercompany Cash Advances

**Intercompany Cash Advances:** a non-interest bearing cash loan, as evidenced only in the daily bank reports of two Business Units, and accounted for on a net basis in the general ledgers of the Business Units

**Intercompany Equity Investments:** includes any kind of equity like investment such as equity infusions/contributions, paid in capital, additional paid in capital, share capital, and common and preferred stock/share purchases

**Intercompany Funding Transaction:** an intercompany transaction where cash is sent from one Business Unit to another in order to 1) provide funds for appropriately approved and authorized

cash expenditures or 2) consolidate cash at a particular designated Funding Node at the discretion of Corporate Cash Management

**Intercompany Loans:** a formal, documented cash loan between two Business Units





## Duke Energy Policy Statement

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### Property and Liability Insurance

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**Applicability:** Enterprise

**Originator:** Global Risk Management & Insurance

**Approval:** VP & Treasurer

**Approval Date:** January 1, 2009

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**Effective Date:** January 1, 2009

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#### Statement of Purpose and Philosophy

Duke Energy Corporation has a responsibility to its customers, employees, investors and the communities that it serves to protect its employees, customers, assets and income streams from losses. Recognizing that the Corporation is exposed to various property and liability risks which either may or may not be insured, in whole or in part, it is corporate policy with respect to management of such risks to:

- evaluate risk primarily from the standpoint of the entire Corporation rather than a single business unit;
- eliminate or modify conditions and practices, whenever practical, which may cause loss;
- assume risk whenever the amount of potential loss would not significantly affect the Corporation's financial position;
- insure risks whenever the amount of potential loss would be significant; and
- purchase insurance from whatever source (agent, broker or insurance company) is deemed to be in the best interests of the Corporation.

Property and Liability Insurance – It is the policy of Duke Energy Corporation to minimize the financial impacts of property/casualty (liability) exposures to loss via an appropriate mix of risk retention, self insurance, and risk transfer (insurance protection). Risk is retained to the extent warranted by the Corporation's financial resources and/or the cost efficient financing of losses. This is reflected in the retention levels assumed by the Corporation and the terms of, or types of, insurance coverages purchased by the Corporation. Insurance is purchased from third-parties to protect against potential catastrophic losses and for circumstances wherein risk-retention is inappropriate or impractical.



## Duke Energy Policy Statement

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### Property and Liability Insurance

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#### Policy Expectations

This policy applies to Corporation operations and assets worldwide, including those subsidiaries operated by Duke Energy and/or majority owned. Global Risk Management & Insurance provides for the protection from:

- loss of, or damage to, physical properties owned, controlled, or for which the Corporation has assumed responsibility;
- liabilities of the Corporation resulting from claims of third-parties relating to legal or contractual liabilities;
- liabilities of the Corporation to employees for workers' compensation;
- liabilities of the Corporation to the general public;
- liabilities of directors, officers, and fiduciaries for claims based on performance in such capacities

This Policy outlines the responsibilities of the business units and Global Risk Management & Insurance.

#### Accountability:

Global Risk Management & Insurance (GRMI) department senior management is accountable for:

- Determining exposure of the Corporation and each business unit (based on property values, revenue, payroll, etc.)
- Determining which risks and how much should be retained
- Determining the amount of excess coverage to be acquired
- Acquiring the excess coverage
- Managing retained risk through captive operations
- Managing claims settlement

GRMI management has the responsibility to direct the placement of all insurance coverages with an objective to arrange and maintain the most appropriate methods possible to manage the exposures of financial loss due to accidental damage to corporate assets and legal liability from third party injuries and damage to third party property.

Business unit management is accountable for informing GRMI of the operational, contractual, environmental, and financial risk exposures that it has and provide GRMI personnel with data in quantifying the risks. Each business unit will work with GRMI to ensure:

- Compliance with all applicable laws and regulations regarding insurance
- Timely notifications of losses



## Duke Energy Policy Statement

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### Property and Liability Insurance

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- Take all prudent steps to mitigate losses when they occur
- Identify and develop a recovery strategy losses

GRMI is responsible for the placement of all insurance policies (except employee medical, life insurance and long-term disabilities) in accordance with the Approval of Business Transactions Policy and the Purchasing Controls Policy.



## Duke Energy Policy Statement

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### Surety Bonds

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<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Global Risk Management & Insurance
<b>Approval:</b>	Vice President and Treasurer
<b>Effective Date:</b>	09/26/2000
<b>Revision Date:</b>	01/01/2009
<b>Reissue Date:</b>	06/01/2007

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#### **Statement of Purpose and Philosophy**

This Surety Bond policy (hereinafter, this "Policy") addresses the approval, issuance and management of all surety bonds to be issued for the account of Duke Energy Corporation (hereinafter, "DEC") or any of their direct or indirect subsidiaries and affiliates. This Policy is designed to support Duke Energy's business values, in particular the value of financial statement integrity and sound internal controls.

This policy does not address the approval, issuance, entering into or management of liabilities associated with guarantees, letters of credit or analogous credit enhancement instruments or indemnities, warranties or comfort letters. The execution of General Agreements of Indemnity with Surety Companies financially obligating DEC, that allows the issuance of surety bonds on DEC's behalf, are handled like guarantees and not addressed by this policy.

#### **Policy Expectations**

The issuance and administration of outgoing Surety Bonds is managed by Global Risk Management & Insurance. The majority of Surety Bonds are required to secure contractual obligations such as performance and bid bonds requirements. Other bonds are required by law or regulation of government agencies. Requests for the issuance of surety bonds to a single entity should be for the total anticipated obligation.

FASB Interpretation No. 45 (hereinafter, "FIN 45") requires DEC to recognize and disclose a liability for the fair value of obligations it assumes under certain credit enhancement instruments, such as Indemnities. This Policy does **not** address recognition or disclosure of obligations that are within the scope of FIN 45. Any questions regarding the application of FIN 45 to the underlying indemnity obligations upon the issuance of surety bonds covered by this Policy should be addressed to the Corporate Controller's Department – General Manager, Accounting Research. All Business Units and Corporate Units must comply with this Policy. Any exceptions to this Policy must be requested per the provisions of the Approval Requirements section of this Policy.

#### **Standards/Requirements**

##### **Approval Requirements**

- All applications and requests for the issuance of surety bonds require review and approval in accordance with this Policy and the Approval of Business Transactions Policy.
- The General Manager, Global Risk Management & Insurance is authorized to and approves the issuance of surety bonds in accordance with the Approval of Business Transactions Policy ("ABT"). The General Manager, Global Risk Management & Insurance may delegate in writing such authority for bonds not exceeding \$25 million pursuant to a properly executed Delegation of Authority Form, if not covered by the ABT.
- The General Manager, Global Risk Management & Insurance must approve any increases in the aggregate bond program term amount with any Surety Company for which DEC has a General Agreement of Indemnity.
- Contracts requiring the issuance of a surety bond must be executed by a person(s) so authorized by the Delegation of Authority Policy and in accordance with the Approval of Business Transactions Policy.
- Business Unit management will contact Global Risk Management & Insurance to review and evaluate surety bond requirements.
- The General Manager, Global Risk Management & Insurance is authorized to approve applications to insurance brokers for the issuance of surety bonds. The General Manager, Global Risk Management & Insurance may delegate in writing the authority to approve such applications.
- Exceptions to this Policy may be approved in some instances. Any exception to this Policy must be requested by the Head of the corresponding Business Unit or Corporate Function and approved by the Corporate Treasurer. Exceptions to policy requests must be submitted to Global Risk Management & Insurance, as appropriate, in the Request for Exception to Policy Form. Global Risk Management & Insurance will pursue the approval of the Corporate Treasurer, if deemed advisable, and further retain all necessary documentation of all such exceptions to policy so approved. In turn, the Business Unit or Corporate Unit whose request for an exception to policy has been duly approved must document such an approval in its Delegation of Authority form in accordance with the Delegation of Authority Policy.

#### **Application and Reporting of Surety Bonds**

- Surety bonds must be requested through Global Risk Management & Insurance. Requests are submitted using the surety bond forms and procedures available via links on this Policy site, through Duke Energy's electronic forms repository or on the Portal site maintained by Global Risk Management & Insurance.

#### **Accountability: Roles and Responsibilities**

#### **Business Unit/Corporate Units**

- If there are proposed changes in standard terms and conditions for the surety bonds, submit drafts to Legal and Global Risk Management & Insurance for review and recommendation for approval, prior to the submission of any DEC bond application or request for approval and issuance.
- Obtain Business Unit and Corporate Unit approval per the Delegation of Authority Policy and the Approval of Business Transactions Policy, if required, before requesting the final issuance of surety bonds from Global Risk Management & Insurance.
- Request surety bond using the surety bond forms and procedures available via links on this Policy site, through Duke Energy's electronic forms repository or on the Portal site maintained by Global Risk Management & Insurance.
- Provide Global Risk Management & Insurance with the internal accounting information needed to process the annual bond premium.
- Evaluate the continued need for all outstanding bond obligations and strive to eliminate bonds when no longer required. Inform Global Risk Management & Insurance to request cancellation of bonds as projects are completed or when the bond obligation is no longer required and when bonds should not be renewed by submitting a Bond Release Request Form available via links on this Policy site, through Duke Energy's electronic forms repository or on the Portal site maintained by Global Risk Management & Insurance.

### **Partially Owned Affiliates (Joint Ventures, Partnerships, etc.)**

- DEC's representative on an affiliate governing board or management committee must ensure the affiliate in question does not obligate or bind DEC to cause the issuance of a surety bond prior to approval at the appropriate levels within DEC pursuant to this Policy and the Approval of Business Transactions Policy.
- The required approval level will be determined by the amount and term requested in accordance with the Approval of Business Transactions Policy and this Policy.
- DEC's representative must obtain approval from the General Manager, Global Risk Management & Insurance for affiliate or joint venture requests or applications for surety bonds to be issued under a DEC General Agreement of Indemnity.
- Surety bond application requests must be submitted to Global Risk Management & Insurance for review and approval in accordance with this Policy. The General Manager, Global Risk Management & Insurance is authorized to approve request applications to insurance brokers for the issuance of surety bonds. The General Manager, Global Risk Management & Insurance may delegate in writing the authority to approve such surety bond request applications.

### **Global Risk Management & Insurance**

- Approve and assign insurance brokers for issuance of surety bonds.
- Manage the issuance of surety bonds consistent and in accordance with this Policy. Review all applications or requests for unusual or special surety bonds and address any issues with the Business Units. After verifying appropriate approvals, manage the execution, issuance, delivery and reporting of all surety bonds.
- Maintain records and reports on all outstanding surety bonds.
- Annually renew all existing bonds and invoice the business units for bonds they request unless a Bond Release Request Form is received requesting cancellation prior to renewal.
- Coordinate the cancellation of bonds no longer needed as documented by the Bond Release Request Form.
- Prior to approving a surety bond request from a Crescent Resources, LLC subsidiary under DEC Credit Support in accordance with the Formation and Sale Agreement dated September 7, 2006, verify that the surety bond is for a project of a subsidiary qualifying as an "existing project" per the Formation and Sale Agreement and would not exceed DEC's outstanding credit support obligations as delineated in Section 6.8 of the noted Formation and Sale Agreement.
- Review the DEC total outstanding credit support obligations as delineated in Section 6.8 of the Formation and Sale Agreement for qualifying Crescent Resources, LLC subsidiary projects to ensure it does not exceed DEC's outstanding credit support obligations as delineated in Section 6.8 of the noted Formation and Sale Agreement at least quarterly.

### **Corporate Legal**

- Review and approve any DEC contract or agreement that requires DEC issuance of a surety bond.
- Provide the Corporate Seal on surety bonds as needed for final distribution to obligees.
- Review and approve all General Agreements of Indemnity with Surety Companies.

### **Related Links:**

[Approval of Business Transactions Policy](#)

[Delegation of Authority Policy](#)

[Request for Exception to Policy Form](#)

[Surety Bond Procedures and Reference](#)



## Duke Energy Policy Statement

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### Wire Transfer Policy

<b>Applicability:</b>	Applies to Enterprise
<b>Originator:</b>	Corporate Treasurer
<b>Approval:</b>	Corporate Treasurer
<b>Effective Date:</b>	08/31/2000
<b>Revision Date:</b>	01/01/2008
<b>Reissue Date:</b>	01/01/2008

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#### **Statement of Purpose and Philosophy**

The intent of this Policy is to adequately safeguard cash while processing wire and Automated Clearing House (ACH) transfers for authorized amounts. The owner of this policy is Corporate Cash Management (CCM) within Treasury.

#### **Role of Corporate Cash Management**

- Maintain internal department procedures to address the following:
  - Segregation of duties.
  - Security of data.
  - Verification of approvals for manual wires and ACHs.
- Except for transactions processed first through Accounts Payable (see Accounts Payable Exception to the Wire Transfer Policy section below), CCM will verify that both approvers of a wire/ACH have Delegation of Authority (DOA) approval limits and at least one of the approvers has sufficient DOA approval limits to authorize the dollar amount associated with the transaction.
- An email with attached payment instructions sent directly from an authorized individual is considered a valid approval. Since two approvers are required, the first and second approver's emails must be received separately by CCM. The second approver cannot simply forward the first approver's email due to editing capabilities within the email system.
- Attached is a link to the DOA portal page where the DOA Policy and Inquiry Tool can be found **here**.
  - Dual control over the input and verification/release of wires and ACHs in the treasury or banking systems.
  - Balancing and transaction verification of Treasury generated payments on a daily basis.
  - Generation of properly authorized Treasury automated wires (e.g., funding wires, investment wires, etc.) through CCM's treasury system.
  - Review and approval of International wire transfer procedures as submitted by the international business units.

#### **Business/Corporate Units**

- Domestic
  - Units must process all manual wire transfers and ACHs through CCM.
  - Units are responsible for ensuring employees have the appropriate DOA to process manual wires and/or ACH's. Any exceptions to authorization levels based upon unique needs of the group such as the approval of Payroll, Tax, or Treasury transactions should be captured via the DOA exception form process.
  - Except for Accounts Payable transactions (see Accounts Payable Exception to the Wire Transfer Policy section below), all manual wire transfer requests and ACHs require approvals from two (2) DOA authorized individuals. One of these approvers must have a sufficient DOA level to authorize the transaction. Approval levels are documented within the Delegation of Authority On-Line Inquiry system. CCM will validate approvals per the Delegation of Authority On-Line Inquiry prior to payment.
  - Units must provide a properly authorized *Wire Transfer or ACH Payment Requisition form* (in accordance with the format and timing established by CCM) for manual wires and ACHs prior to the transfer of funds.
- International
  - *With the issuance of any revisions to this policy, international offices must present their local in-country wire transfer procedures to CCM for review and approval. These procedures should include such basic internal controls as validation against the Delegation of Authority and dual control through the bank or banking system for the execution of wire transfers.*
- Accounts Payable Exception to the Wire Transfer Policy
  - Wire transfer or ACH requests processed first through the Accounts Payable Department (A/P) can be processed either manually or via the electronic payment files created by the Accounts Payable system. For both forms of wire/ACH payment requests, A/P will evidence their validation of the approver's DOA limits in a mutually agreed-upon (i.e. between CCM and A/P) format. Therefore, CCM needs only to confirm the wire is being submitted by the A/P department on behalf of a business unit or department within the company.

**Related Links:**

[Approval of Business Transactions](#)

[Delegation of Authority](#)

[Wire Transfer Requisition Form](#)

[ACH Payment Request Form](#)



## **Cash Management Guidelines: Short-Term Investment Guidelines**

### **Guideline Objectives**

Cash is a critical asset of Duke Energy Corporation (“DEC”). DEC’s policy states that all cash assets of DEC and all of its consolidated or controlled subsidiaries and affiliates be properly safeguarded and then managed to maximize value while assuring appropriate amounts of cash are available for operations. Safety and liquidity, including the objective of minimizing foreign exchange and sovereign risk, outweigh return considerations.

### **Authorization:**

- Authorized short-term investors for DEC and its respective subsidiaries and affiliates, include the following corporate officers: Chief Financial Officer, Treasurer and Assistant Treasurer or Authorized Agents as designated by one of the aforementioned corporate officers.
- DEC’s Corporate Cash Management group is responsible for investing or directing the investment of all cash assets.

### **Guidelines Exceptions:**

- Temporary exceptions to the guidelines must be coordinated through Corporate Cash Management and can be made with approval of any two of the following corporate officers:
  - Chief Financial Officer
  - Treasurer
  - Assistant Treasurer(s)

### **Domestic Cash Investments**

The primary objective of domestic cash investments is to meet the daily funding needs of DEC and its respective subsidiaries and affiliates.

Acceptable securities, dollar limitations, maturity guidelines and custody requirements are identified in Supplement A.

### **Cash Investments Outside of the US**

The primary objective of international cash investments is to meet the daily funding needs of DEC and its respective subsidiaries and affiliates with the additional objective of minimizing foreign exchange and sovereign risk.

This section applies to cash investments for DEC consolidated companies that are domiciled outside the United States and includes all of DEC’s majority owned subsidiaries and including entities in which DEC owns more than 50% of the stock or is the managing partner. Whenever

possible and practical, Available Cash (as defined below) will be converted into US dollars and invested outside of the local country.

International Cash includes the following:

1. Working Capital Cash is defined as quarterly (current assets – current liabilities) + (historical uncollectibles).
2. Capital Expenditures Cash is defined as cash requirements over the next three months for projects that have been approved according to the Approval of Business Transactions Policy and the Delegation of Authority.
3. Dividend Cash is defined as cash to be held for the payment of one period of dividends during the upcoming dividend period.
4. Inconvertible Cash is defined as cash that cannot be legally removed from the country..
5. Restricted Cash is defined as cash required to be held as part of debt covenants or other contractual obligations.
6. Available Cash is defined as all other cash not defined above.

Acceptable securities, dollar limitations, maturity guidelines and custody requirements are identified in Supplements A and B.

**Supplement A: Domestic Short-Term Investments Including USD Investments Outside of the US**

Acceptable Investments (including both physical and book entry):

1. Direct Obligations of the US government or any of its agencies.
2. Obligations guaranteed by the US government or any of its agencies.
3. Repurchase Agreements
  - a. Must be at least 102% collateralized by securities of the US government, one of its agencies, or other securities eligible for purchase under these guidelines.
  - b. Must be purchased from a financial institution whose money market securities qualify for purchase by Duke Energy Corp.
4. Money Market Securities (taxable and federal tax exempt)
  - a. Variable Rate Demand Obligations (VRDO's, VRDN's) which have minimum underlying ratings from one of the following agencies and Commercial Paper which has minimum underlying ratings from both of the following agencies:

	Moody's	S&P
Short-Term Rating	P1, VMIG1	A1, SP1
Long-Term Rating	A2	A

- b. Time Deposits, Certificates of Deposit, and other widely used Bank Investment Products.
- c. Money Market Funds – Must be rated Aaa by Moody's or AAA by S&P and seek to maintain a \$1 per share net asset value. Assets should be reviewed on a monthly basis, or more often as market conditions suggest.

Investments in securities with ratings less than those above are prohibited unless an exception has been granted through the approval process as noted in the Authorization section above. Consideration should be given to maintaining a mix of various investment types.

Dollar Limitations

1. Total investment exposure, including accrued interest, to any single domestic issuer should be according to the table below.

<u>Total S-T Investment</u>	<u>Maximum per Issuer</u>	<u>Maximum per L/C Bank</u>	<u>Maximum per Dealer</u>
\$100 million or less	\$30 million	\$100 million	40% of portfolio
Greater than \$100 million	\$50 million	\$100 million	40% of portfolio

<u>Investment Type</u>	<u>Maximum Percentage / \$ Amount Invested</u>
Commercial Paper	25% or \$100MM, whichever is lower
VRDNs	25% or \$100MM, whichever is lower
Money Market Funds	100%
US Gov't or its Agencies	100%
Repo	100%

2. Investment exposure to any single money market fund (domestic or international) may be up to, but cannot exceed \$100 million or 10% of the fund (whichever is less) at any time.
3. No investment limit applies to the U.S. Government or any of its Agencies.

Maturity Guidelines

1. Other than U.S. Government or U.S. Agency debt, contracted maturities cannot exceed 60 days.
2. The maturity of the U.S. Government or its Agency debt cannot exceed 180 days.
3. A maturity, by definition, shall include puts, announced calls or auctions, allowing for the redemption of the investment at a quantifiable price consistent with safety and preservation of capital.

Custody

1. Leave securities in custodial accounts or funds on deposit with financial institutions whose money market securities qualify for purchase.
2. Require delivery, including book entry delivery to the Depository Trust Corporation, of securities or collateral to a third party custodial account, or
3. Send funds to money market funds for credit to a Duke account.

**Supplement B: Short-Term Non-US Dollar Investments Outside of the US**

Acceptable Investments (including both physical and book entry):

1. Direct Obligations of the relevant local government, the U.S. Government or any of their agencies.
2. Obligations guaranteed by the relevant local government, the U.S. Government or any of their agencies.
3. Money Market Securities (local currency ratings)
  - a. Commercial paper with ratings of A1/P1 or higher.
  - b. Time Deposits, Certificates of Deposit and other widely used bank investment products with banks rates A+ or higher.
  - c. Money market Funds – Must be rated AAA. Local money market funds below AAA can be considered, but must be approved by Corporate Cash Management through the approval process previously defined.
4. Synthetic US dollar investments with banks rated A+ or higher.

If no Acceptable Investments are available in the relevant country and there is cash that must be invested locally, then such cash should be invested in the safest instrument available for the shortest appropriate time as agreed between local in-country Duke Management and Corporate Cash Management with an exception granted through the approval process as prescribed herein. If no agreement can be reached, the Corporate Treasurer will have authority to resolve any conflicts.

International Currency Limitations

1. At a minimum, Available Cash must be reviewed monthly. Available Cash will then be converted into US dollars and held outside of the local country. Such cash must then be managed according to the Domestic Cash Policy and Guidelines.
2. Declared dividends that will ultimately be held in USD should be converted into USD after declaration, if a currency market exists to execute the conversion. The accounting treatment of such conversion can be considered in the timing of the execution. The execution of the currency transaction must be channeled through Corporate Treasury.
3. Investment exposure to any single issuer will not exceed US \$25 million (or the equivalent) at any one time.
4. Investment exposure to any single money market fund will not exceed \$25 million (or the equivalent) or 10% of the fund (whichever is less) at any time.
5. No investment limit applies to the U.S. Government or any of its Agencies.
6. Counterparty exposure limits for all local foreign cash investments are as follows:

<u>Category</u>	<u>Maximum Exposure (US Dollar Equivalent)</u>
Eligible Relationship Bank	\$25 Million
Eligible Non-Relationship Bank	\$15 Million
Non-Eligible Bank	\$ 5 Million

An Eligible Bank is defined as one that has a local currency rating of A+ (or equivalent) or higher.

A Relationship Bank is defined as a bank that participates in one of the credit facilities within the Duke Energy family of businesses.

For exposures greater than those listed herein, exceptions must be granted through the approval process described defined.

#### Maturity Guidelines

- 1 Other than U.S. Government or U.S. Agency debt, maturities cannot exceed 60 days.
- 2 The maturity of the U.S. Government or its Agency debt cannot exceed 180 days.
- 3 A maturity, by definition, shall include puts, announced calls or auctions, allowing for the redemption of the investment at a quantifiable price consistent with safety and preservation of capital.

#### Custody

The company may leave securities in custodial accounts or funds on deposit with financial institutions whose money market securities qualify for purchase.

Revision Date: 12/19/2008

# Financial Analysis Manual

**This manual is a guideline to conducting Financial Analysis and is not Corporate Policy.**

## Contents

**Section 1: Financial Analysis Methodology, Best Practices and Calculation Requirements**

**Section 2: Project Approval Process**

**Section 3: Project Report Guidelines**

**Section 4: Glossary of Terms**

Revision Date: 12/19/2008

## Financial Analysis Manual

### Introduction

Duke Energy is in business to earn an attractive return on the investment made by our shareholders. If we cannot meet this requirement, we cannot succeed in all the other objectives of Duke Energy Corporation. The economic well-being of an organization is not only the result of top management's efforts. Profitability is the aggregate result of many small and large decisions made at every level of management within the entire organization. It is therefore of vital importance that each one of us be fully aware of the economic consequences our decisions can have and of the responsibility we have to make prudent decisions. This awareness can be better developed by careful study of the alternative courses of action available to solve a particular problem. A complete and detailed economic analysis of expenditures of any significance should be prepared before taking action.

In any industry the supply of funds available for expenditures is limited. One of management's tasks, therefore, is the allocation of funds towards competing alternatives that can provide an attractive or competitive return for our investors. An economic analysis provides managers with a yardstick to decide upon the relative economic merits of two or more competing alternatives.

Economic analysis must be used in conjunction with experience, management ability, and good judgment. There are many times when a sound, quantitative analysis should be modified because of non-quantifiable factors such as employee safety, customer response, etc. This tool of analysis is simply an additional, but important, source of input for making the right decisions.

#### What is Economic and Financial Analysis?

Economic Analysis is simply the study of the desirability of making an investment. Economic analysis is the process of gathering information on investment opportunities, evaluating each opportunity, and comparing the alternatives to select those which will maximize the value of the corporation, and therefore shareholder value. Financial Analysis is the evaluation of economic opportunities through the creation and analysis of financial models. The process of modeling is important as it allows the discovery, identification, and quantification of the risks and rewards in a transaction. The goal is to capture the complexity of a transaction in the simplest way. This manual should be used as a guideline which outlines expectations for a standard financial analysis. Variations on the methodologies included in the manual are allowed to better reflect the details and scope of a specific transaction or proposal under consideration, review and approval.

#### Purpose of the Manual

The purpose of this manual is to share the standardized approach for analyzing acquisition, growth and development, divestiture transactions and other business proposals at Duke Energy. The first section (*Financial Analysis Methodology, Best Practices and Calculation Requirements*) describes effective model structure including suggestions to help optimize financial modeling, lists contacts within the company for information, and describes preferred approaches. The second section (*Project Approval*) outlines the information needed to present a project to the Transaction Review Committee (TRC) including the whitepaper and required financial information. The next section (*Project Report Guidelines*) provides a guideline of what should be addressed in the whitepaper. The final section (*Glossary of Terms*) is a list of terminology one may use when analyzing a project at Duke Energy.

Revision Date: 12/19/2008

## **Section 1: Financial Analysis Methodology, Best Practices, and Calculation Requirements**

### **Financial Modeling**

Financial models can vary in the amount of information and the presentation. A simple operating and maintenance project may only concentrate on alternatives that focus on analyzing expenses using NPV and payback such as deciding to buy or lease equipment, evaluating cost savings from software upgrades, etc. A major capital program or acquisition may have a financial model consisting of a complete set of financial statements (Income Statement, Cash Flow Statement, and Balance Sheet). As a U.S. based company, the projects should be modeled according to US GAAP with cash returning to the U.S. A business unit should use an appropriate model that is reflective of the transaction or program under review.

#### **Standard Models**

In analyzing a transaction, use standard models if available. Many Business Units have developed standardized models for looking at recurring transactions. These models have the advantages of being used and looked at by a variety of different people over time. Standard models help reduce errors common when only one person has worked on a model. These models have also developed other tools that check the reasonableness of the results and present the results in ways in which senior management in the Business Units are comfortable seeing the data.

These standard models allow more time to be spent on analysis and the strategic implications of a proposed transaction rather than model creation and validation.

#### **New Models**

If a standard model is not available, or is not appropriate for analyzing a specific transaction, a new model should be created.

#### **Best Model Attributes**

The best models exhibit the following characteristics.

1. **Simplicity** - A model should move in small, measured steps from the gathering of assumptions to the final output in order to provide for effective review of the model's calculations. Deciding what information is material is an important assumption that affects what information the model generates for guiding decisions.

A model should clearly identify assumptions and sources for the inputs. These inputs will improve throughout the modeling process as better information is provided and better sources are found. As the model is being built, the analyst should be continuously aware of the differences between solid assumptions and initial estimates. By the end of the analysis, the analyst should be able to attribute all the assumptions in the model to credible sources. Make sure that the model can answer the questions that are being asked and make appropriate modification if necessary.

2. **Clarity** - Strongly related to simplicity, a model should provide clarity for a complex project. Assumptions and changes in formulas should be clearly identified. Assumptions should be made once, and all uses of that assumption should come from one source. The analyst's approach to handling assumptions will have an impact on the outcome. A model should provide insight as well as an answer.

A good model will incorporate not only the base case, but also other sensitivities. As the model is developed, keep in mind which assumptions have the largest impact on the end result ensuring that variations in these inputs are handled well by the model. Anticipating changes and asking questions early in the process that will allow the model to handle those sensitivities are indicative of best practice modeling. For example, timing delays can cause significant problems in basic models.



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3. **Focus** - The model should keep the end result in mind. The process is important but everything should eventually build to answer the goals of the model. By focusing on the goal of the model and the processes needed to meet that goal, a lot of additional complexity can be eliminated from the model.

### **Cash Flow Assumptions for Modeling**

There are four cash flow components that need to be considered in building a financial model.

1. **Initial Cash Outflows**

The first important element in a discounted cash flow model is the initial investment to set up the project. The timing of these cash flows should match, as closely as possible, the timing of the actual cash outflows.

The cash outflow should include actual cash, the value of any contributed assets, the value of any assumed debt, and the value of any guarantees, sureties, collateral or other commitments made to third parties. Any costs that have already been spent or committed should also be included. Sometimes management is interested in seeing the return on projects before and after all development costs have been included.

2. **Annual Cash Inflows and Outflows**

The yearly cash flows should be fiscal years rather than project or contract years. This method may result in stub periods in the first and last years. The projections should be in fiscal years to match with Business Unit planning and budgeting cycle. This method may require the use of XNPV and XIRR functions to properly match dates and cash flows.

The annual cash flows should be built up from the operational characteristics of the project and should also include projections on collateral outflows, inflows, maintenance and material capital expenditures and appropriate inputs. Details should be included on how these assumptions were derived. Price assumptions should be split out separately.

3. **Working Capital**

Working Capital can be a significant item depending on the relative timing of receiving revenues and paying costs. If costs are paid before receiving revenues (building inventory, market design) and especially if modeled as a growing business, working capital requirements should be modeled explicitly.

4. **Terminal Value**

Assets should be modeled for their remaining useful life. Any terminal value for an asset should reflect the liquidation value or clean up costs for the asset at the end of the asset's useful life. Ongoing businesses should be modeled until they reach a steady state of operations. Any resale value assumptions at the end of the project should be realistic and explicit.

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## Financial Standards at Duke Energy

There are a number of approaches that are internally consistent regarding the discounting of cash flows, evaluating international projects, and the incorporation of leverage. The Corporate Treasury, Tax, Risk Management and Insurance groups should be contacted early in the project to determine the proper method for a project.

### Key Contacts

Corporate Treasury	
Corporate Finance	Allen Carrick
Project & International Finance	Charlie Wilson
Cash Management	Donna Council
Foreign Exchange	Kitty McDonough
Corporate Risk Management	George Brown
Insurance	George Brown
Tax	
International Tax	Roy Burroughs
Federal Tax	Marcus Shore
State Tax	Cooper Monroe
Property Tax	Gregg Scott
Corporate Tax Accounting	John Panizza
Corporate Accounting	Bryan Buckler

### Key Financial Criteria

While many criteria are used to evaluate a project, some of the key financial criteria used at Duke Energy include the following:

**NPV – Net Present Value (“NPV”)** is the sum of the investment expenditures and discounted cash flows generated by a particular project. The discount rate should always be specified in any presentation (e.g. NPV@10% when a 10% discount rate is used).

**IRR – The Internal Rate of Return (“IRR”)** is the discount rate that makes the NPV of a project equal to zero. This rate is often compared to the Business Unit discount hurdle rate as an initial screen to see if a project generates sufficient value to proceed.

**Hurdle Rate – The Hurdle Rate** is the rate of return targeted to assure value is created from a given business activity.

**Payback – The number of years or months** required to recover the initial investment from the forecasted cash flows. Payback is very useful when comparing projects with similar NPV or to determine projects with a significant terminal value in the analysis.

To promote consistency of project evaluation, Duke Energy and its Business Units should use the following approaches in project analysis:

1. **Hurdle Rate Guidelines / Project Specific Rate Guidelines**

A discount rate is the measure of the overall cost of funds and is used to discount cash flows for project analysis. These rates are calculated by Corporate Treasury periodically for all business lines and corporate. The Hurdle Rate Guidelines include the weighted average cost of capital (WACC) plus a value adder. Corporate Treasury must determine the appropriate WACC rate to be used by each specific Business Unit. Additional adjustments are made to the Base Rates for project specific risks and international sovereign risk. These adjustments are updated semi-annually. These project specific discount rates are also calculated by Corporate Treasury. Projects may be brought forward that do not meet the hurdle rate guidelines but they should exceed the WACC rate.

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2. **Unlevered Analysis**  
Duke Energy evaluates projects on an unlevered basis. This method allows the TRC to focus on the evaluation of the business proposal process. Corporate Treasury will be responsible for financing decisions. For investments which involve the assumption or incurrence of debt, a levered analysis may also be appropriate, but only as a supplement to an unlevered analysis. Corporate Treasury can provide the appropriate levered discount rate (which will typically be higher than the unlevered rates due to the introduction of financial risk).
3. **Timing of Cash Flows**  
For this analysis, the actual timing of cash outflows for acquisitions and estimated timing of cash outflows for construction projects should be utilized. Cash outflows are often contractually defined and simple to model specifically. Cash Inflows should be estimated and all cash flows should follow the guidelines outlined in the Cash Flow Assumptions for Modeling on page 4. It may be helpful to show monthly or quarterly cash flows in the initial years of a project, and then show annual cash flows for the later years.  
  
For terminal value, or if exit is assumed, the actual date should be modeled.
4. **After Tax Analysis**  
WACC rates and hurdle rate guidelines are after tax so the cash flows of a project should be modeled after tax as well.
5. **Construction**  
Construction periods for projects should often be modeled monthly due to the large variations in cash spent over the period. For unlevered analysis, cash outflows during construction should be treated as if funded with equity even if construction financing is used.

#### **Company Acquisitions**

Acquiring a company may cause two significant modeling issues – retirement of debt and terminal value.

- **Retirement of Debt** - In cases in which Duke is acquiring a company with existing, assumable debt on its balance sheet, an estimate should be made to payoff this debt (Mark to Market) to de-lever the acquisition to complete an unlevered analysis. This estimate may be materially different from the notional amount of the debt if interest rates have moved significantly. Corporate Treasury can give guidance on whether the debt can be assumed and provide an estimate of the cost of retiring the debt for the purposes of project analysis.
- **Terminal Value** - As an ongoing concern, a company does not have the finite life of a project asset. Some assumptions will need to be made for additional capital to maintain and grow the business and the ongoing value of the business at the end of the model. Any resale value assumptions at the end of the project should be realistic and explicit.

#### **Divestitures**

The analysis method for the sale of an asset is similar to the analysis method for the acquisition or development of an asset with the following exceptions:

- The appropriate discount rate to use is the WACC rate (not the hurdle rate guideline) including sovereign risk adjustments as appropriate (see International Project Analysis below).
- Approval levels are determined by the higher of sale price or original cost (or current carrying cost, in the case of impairment), per the Approval of Business Transactions policy.

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### **Non-Revenue and Non-Discretionary Projects**

Some investments have no corresponding revenues (or reduced costs) and, therefore, the use of NPV or IRR for project evaluation may not be relevant. Furthermore, in most cases, these investments are non-discretionary and/or support existing revenue-generating investments. Finally, a distinction can be drawn between non-revenue projects in the regulated businesses (Franchised Electric or Gas) and non-regulated businesses since prudently-incurred investments may be entitled to cost recovery in accordance with the applicable regulated tariff, while there is no associated revenue for non-regulated businesses.

For non-revenue projects generally, discount the relevant after-tax expenditures (including initial investment, working capital and on-going operating costs) to the present using the assigned Business Unit hurdle rate guideline. Economically evaluate each equivalent alternative that provides equal service. The projected costs should be shown as a negative impact on EBIT for the selected least-cost alternative. If the project is considered non-discretionary, indicate this and briefly explain why.

For cost-only projects that support existing revenue-generating investments that increase revenue, reduce cost or both, the use of NPV or IRR would be appropriate. Include in the economic analysis any associated revenue enhancements, operating cost reductions or future life extension benefits. Be sure to only include "incremental" revenues or cost reductions specifically associated with the new project.

### **Foreign Exchange Exposure for U.S. Projects**

Projects which do not generate cash outside of the U.S. also can have international risk. Anytime a contract or agreement is entered into with a counterparty outside of the U.S. or in a currency other than the US dollar, there is potential international risk. International risk can arise in both the revenues and expenses of a project. Corporate Treasury should be consulted on foreign exchange exposure.

### **International Project Analysis**

International risk adds another layer of complexity to building a financial model. There are a number of sensitivities that need to be run to properly evaluate international exposures in order to put them on a comparable basis with purely domestic projects. In the case where projects may be generating cash outside of the U.S., two scenarios must be run:

1. Base Case - Cash is not returned to the U.S.  
The project should model cash going to a Blue Water location where it can be reasonably redeployed to other projects. The Tax Department and Project & International Finance will be able to provide guidance on suitable Blue Water assumptions.
2. Cash is returned to the U.S and evaluated on a marginal basis.  
For this case, immediate repatriation and the payment of US tax in addition to local tax is assumed. This scenario is representative of Duke Energy's current tax position. If meaningful, a more accurate model of repatriation risk can be prepared with the help of the Tax Department and Project & International Finance.

### **Leverage for Tax Purposes**

Investment returns are calculated on an unlevered basis for evaluation by the Transaction Review Committee.

It is often advantageous to utilize intercompany loans for international investments in order to minimize the payments of local taxes and avoid trapping cash in-country. It is appropriate to model this debt to obtain the tax benefits (minimize the penalty of local restrictions on the movement of cash). It is essential to have the Tax Department and Project & International Finance involvement to determine what structures and funding strategies are appropriate.

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When calculating Duke's return, this project debt should be treated as equity with repayments and interest treated in a similar fashion as dividends. This method will incorporate the tax benefits of debt while still providing the equivalent unlevered return.

#### **Sovereign Risk Adder**

International projects may have an adjustment to the hurdle rate guideline due to sovereign risk. These adjustments should be obtained from Project & International Finance.

#### **International Assumptions**

##### **Foreign Exchange and Inflation**

Corporate Treasury must provide all foreign currency and inflation curves to be used for project analysis.

International projects should calculate returns in USD. The modeling approach will assume a base rate, but will emphasize the importance of multiple modeling via scenario analysis. If the cash flows of a proposed project are international, the *base case* for such projects must be modeled as follows:

Inflate local currency cash flows, translate the cash flows into USD using a Corporate Treasury-provided forecast FX curve, then discount the cash flows at a USD final project discount rate. As above, Corporate Treasury will provide the discount rate adjusted for sovereign risk and project risk, if applicable.

With the prior approval of Corporate Treasury, a business unit may use the following method: Inflate local currency cash flows, discount the cash flows at a local currency discount rate, and then translate the result at the spot exchange rate. As noted earlier, Corporate Treasury will determine the appropriate USD rate to be used by the Business Units. In order to translate the USD investment rate into a local currency rate, an inflation differential will be added to the USD investment rate. In addition to this adder, other sovereign risk and project specific adjustments may be made to the rate in order to produce the final project discount rate.

For all international projects, discount rates must be adjusted for sovereign risk and may be adjusted for project specific risk as well. Treasury will provide discount rates, sovereign rates, project rates as well as inflation rates, spot exchange rates and forecast exchange rates. (Note: every cross-border project requires a minimum of 25bp sovereign risk adder.) Where market/business information or intelligence is available, cash flows should be adjusted to anticipate such information.

After the base case has been developed, the Business Unit proposing the project must complete a number of sensitivities. These sensitivities should include, but are not limited to, the risk associated with changes in discount rate and exchange rate assumptions. The Business Unit must contact Corporate Treasury to further define the appropriate sensitivities for all international projects. Corporate Treasury will provide all foreign currency and inflation curves to be used for project sensitivities.

Revision Date: 12/19/2008

## **Section 2: Project Approval Process**

### **Levels of Approval Required for Transactions**

Capital commitments, operating expenditures, contracts, or divestitures over a certain dollar amount require review by the Transaction Review Committee. The transaction amount is broadly defined and for acquisitions includes expected expenditures, assumed liabilities, and any future commitments to spend capital. For divestitures, the capital amount, for approval purposes, is the higher of the original cost or sales price. For transactions by entities only partially owned by Duke, these amounts are prorated to reflect only Duke's committed capital rather than the project's committed capital.

For a complete description see [Approval of Business Transactions Policy](#).

### **Transaction Review Committee (TRC)**

#### **Role of the Transaction Review Committee**

The TRC reviews any business transactions requiring approval by the President and CEO, the Board of Directors or a Board Committee as outlined in Duke Energy's [Approval of Business Transactions](#) policy.

Upon the satisfactory completion of the review, a recommendation will be made to the President and CEO to approve the transaction for execution or presentation, if required, to the Board of Directors or the Board Committee. If the TRC does not recommend the transaction be considered for approval by the President and CEO, the appropriate Business Unit or Corporate group will be notified and will have an opportunity to make modifications as appropriate for future review.

#### **Transaction Review Committee Structure**

##### **Committee Members**

Group Executive & Chief Financial Officer – Chairman of the TRC  
Vice President and Treasurer  
Group Executive & Chief Legal Officer  
Sr. Vice President of Corporate Tax  
Sr. Vice President of Investor Relations  
Group Executive & Chief Strategy, Policy and Reg Officer  
Group Executive & Chief Administration Officer

David Hauser  
Stephen De May  
Marc Manly  
Keith Butler  
Sean Trauschke  
Keith Trent  
Chris Rolfe

Secretary of the TRC

Donna Council

##### **Scrub Team**

The Business Unit Transaction Sponsors must involve the following functions in its scrub team process and communication with the scrub team early in the project process is required:

- Corporate Treasury
- Tax
- Accounting
- Legal
- Corporate Credit/Risk Management

To submit a project for review by the TRC, the scrub team should contact one of the TRC coordinators.

Revision Date: 12/19/2008

#### Meeting Dates

- Standing Meetings will be held generally at two week intervals. The Secretary of the TRC determines and communicates the schedule at the beginning of each calendar year. Projects that need the Board of Directors approval, or a Committee of the Board of Directors approval, will receive top priority for meetings immediately preceding a Board of Director's meeting
- Ad Hoc Meetings may be arranged on an exception basis by the Secretary of the Committee

#### Roles and Responsibilities

- Transaction Sponsors are responsible for the accuracy and completeness of information and analysis.
- Business Unit Presidents and other Direct Reports to the CEO must approve the transaction before bringing it to the TRC.
- TRC Secretary is responsible for scheduling meetings and keeping minutes as well as making a report to the CEO which includes the TRC recommendation.
- Treasury is responsible for delivering the final whitepaper to the TRC.

#### Minimum Notice

- Transaction Sponsors must deliver the final whitepaper to the Scrub Team not less than 5 business days prior to the TRC meeting.
- Treasury must deliver the final whitepaper to the TRC not less than 2 business days prior to the TRC meeting.

#### Other Requirements

- Executive Summary
- Project whitepaper should not exceed five pages and be in accordance with guidelines provided later in this manual. Whitepaper may be supported by a presentation.

#### ***Record Retention***

Once a project is approved, the Business Unit should keep a copy of the original model, whitepaper, and presentation for at least three years following the in-service date of the project for future follow-up and review. Any specific items of concern that are raised at the TRC meeting should also be noted and addressed.

Revision Date: 12/19/2008

### Section 3: Project Report Guideline

**Note:** The following is a guideline of what should be addressed in the TRC whitepaper (if applicable to the transaction). Since each transaction is unique, this is only a guide and it is the responsibility of the Business Unit to cover all pertinent information. This is a collaborative effort and the Business Unit will need to coordinate its contents with Corporate Treasury, M&A, Corporate Risk Management, Tax and Legal, as appropriate.

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**Project Report to the  
Duke Energy Corp. Transaction Review Committee  
"Project Title/Name"  
"Date"**

#### Project Overview

A short and concise description of the transaction, including the required investment (CAPEX), the anticipated/modeled results (IRR/NPV) and strategic rationale.

#### Strategic Rationale (Fit/Implications)

- Explanation of strategic considerations
- Consistency with corporate goals and direction
- Consistency with corporate financial plan

#### Analysis

A) Key Assumptions: (Prices, Volumes, Forecasts, etc.)

For example, an energy deal where pricing and volume are essential the whitepaper should cover:

1. Source of the data
2. Historic versus projected data
3. Comparison of the assumed data to 3<sup>rd</sup> party projections and indices
4. Volatility/variability of prices

B) Financial Analysis:

- For EPS impact assumptions, please coordinate with the Financial Planning and Analysis group in Finance.

1. At least a 3 year history (if applicable) of EBIT, Income Statement, Cash Flow or EBITDA, Balance Sheet and EPS
2. At least 5 years of projections of EBIT, Income Statement, Cash Flow or EBITDA, Balance Sheet, ROCE and EPS
3. Provide the assigned discount rate
4. Net Present Value (NPV) at the appropriate discount rate or rates.
5. Internal Rate of Return (IRR) and payback period (simple and/or discounted)
6. Change in forecasted plan for EBIT/Cash Flow/EPS/CAPEX as a result of the project



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7. Funding strategy and other credit support obligations (coordinated with Corporate Finance, Project and International Finance, Tax and Risk Management)
8. Sensitivity analysis on key value drivers (Tornado diagram, models)
  - Upside and downside scenarios should be shown using a two sigma range. The business unit should use a range of cash flow expectations and/or a range of discount rates if appropriate. If the Business Unit uses a different sensitivity methodology, then they should explain the reason for using the different methodology.
9. Tax and Accounting issues

Note – For projects that are required or mandated (regulatory, safety etc.), the financial analysis should focus on cost effectiveness rather than net present value or internal rates of returns.

### **Risks and Mitigation**

This section should cover the significant risks associated with the transaction and the steps that are being taken or will be taken to mitigate these risks. Some of the key risks to consider are:

1. Operational
2. Construction
3. Credit/Risk Management
4. Country Profile and Risks as appropriate
5. Market/Commodity Risk
6. Regulatory
7. Environmental, Health & Safety
8. FX
9. Competition

### **Legal**

1. Key terms of agreements and contracts
2. Environmental risk and litigation
3. Guarantees/Liabilities/Indemnifications
4. Regulatory approvals
5. Legislation
6. Consents
7. Contingencies

### **Recommendation**

The recommendation should be clearly stated; indicating the action to be taken.

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## Section 4: Glossary of Terms

**After-Tax Discounted Cash Flow Analysis.** An economic evaluation technique that involves the computation of the present value of the cash flows after inclusion of income taxes; the preferred method of analysis at Duke Energy.

**Allowance for Funds Used During Construction (AFUDC, AFDC, IDC, ADC).** An amount included in the investment outlay that represents the financing costs of an asset during its engineering and construction period.

**Analysis Period (Study Period).** The number of time intervals (i.e., years) used to compare various alternatives in an economic analysis.

**Blue Water.** Calculation of the project economic analysis based on the assumption that cash earnings are only divided up to an offshore entity so that no additional U.S. income taxes are paid. The only taxes to be incorporated in the economic analysis are those local country taxes such as local income taxes, VAT, property taxes, etc.

**Capital Expenditure.** See Investment Outlay.

**Carrying Charges.** For purposes of preparing economic analyses, these charges are computed using the fixed charges rate. However, for other applications, carrying charges can be defined differently to include other items or to exclude items accounted for in the fixed charges rate.

**Cash Flows.** Cash receipts and disbursements over the study period.

**Cost Escalation.** An increase in the cost of an asset or expense. If the cost of an asset increases above its previous level, it has increased in terms of nominal (escalated) dollars. For the cost of an asset to increase in terms of constant (real) dollars, its costs must escalate at a rate greater than the inflation rate.

**Depreciation (Book Depreciation).** The systematic charging of an asset's cost to income. The process by which a past investment outlay is recovered over time through the rate making process.

**Discount Rate.** The rate used in determining present values from other values occurring at different points in time. Often referred to as a company's cost of capital or hurdle rate.

**Discounted Cash Flow Techniques.** Methods of evaluating investment opportunities that account for the time value of money by using a discount rate.

**Elective Project.** Capital and operating expenditures which are not required but can be justified by economic and financial criteria or which have certain intangible benefits that can be justified on a case-by-case basis.

**Equivalent Value.** An amount in one time period that has the same present value as an amount in another time period.

**Essential.** Expenditures necessary to: comply with regulatory requirements, eliminate or prevent a non-conformance safety item, improve or maintain reliability of service, connect new customers, achieve load management goals, or promote the sale of off-peak power.

**Expected Life (Service Life).** The period of time that an asset can be used economically for its intended function.

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**Expenses.** Cash disbursements that relate to materials or services utilized within a relatively short period of time (one year or less). See Operating and Maintenance Costs.

**Fixed Charges Rate.** A rate that when applied to the investment outlay of an asset, results in the "levelized" (equivalent) annual revenues that are required to provide for:

- A return on the investment;
- A recovery of the investment outlay through depreciation charges;
- Compensation for the income taxes incurred by the Company as a result of earning a return on the investment; and
- Compensation for the property taxes and insurance expense associated within the investment.

**Fixed Cost.** Cost expected to stay constant over a given period (usually an annual period) regardless of changes in the level of production.

**Hurdle Rate.** (See Discount Rate). Often the same as the discount rate, but management sometimes requires a higher "hurdle" to achieve returns in excess of the company's cost of capital.

**Incremental Analysis.** Comparing two alternatives by computing the differences in cash flow and converting the differences to their present value.

**Incremental Cost of Capital (Incremental After Tax Cost of Capital, Cost of Money).** Minimum after tax required rate of return on potential investments.

**Inflation.** The increase in the aggregate price level of all goods and services in the economy.

**Internal Rate of Return.** The rate of return which equates the present value of cash outflows and inflows. In other words, the rate or return where  $NPV = 0$ . Will usually yield the same results as a NPV analysis, and can be used to express the results of an analysis provided it is consistent with the NPV calculation.

**Investment.** The total installed cost of placing a new asset in service, including interest during construction.

**Investment Outlay (Capital Expenditure).** Cash disbursements associated with asset acquisitions and improvements (other than normal maintenance). These costs are deemed to provide benefits in the future as well as current periods, and are therefore capitalized and depreciated over time.

**Levelization.** The process of converting a non-uniform series of amounts into an equivalent uniform series of equal amounts or an annuity stream.

**Operating and Maintenance Cost.** Expenses, excluding taxes and financing costs, associated with operations that require cash outflows. These costs can be either fixed or variable over an annual period depending on the particular activity that caused the cost to be incurred.

**Payback Period Method.** A method used for economic evaluations. The payback period is determined by identifying the number of years required for an investment outlay to be recovered from the net savings in O&M expenses (expressed in current dollars).

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**Present Value (Present Worth).** Recognition of the time value of money by computing the equivalent value at a specified present period in time of cash flows occurring in other periods of time. The equivalency relationship is established by discounting the cash flows.

**Present Value of Revenue Requirements Method (PVRR Method).** An economic evaluation technique that involves the computation of the present value of the revenue requirements for each alternative. The alternative that minimizes the present value of revenue requirements is selected.

**Reference Year.** The specified point in time used for establishing equivalency relationships among the various cash flows in an economic analysis.

**Return on Investment.** Ratio of after-tax operating income to the net (depreciated) value of assets.

**Revenue Requirements.** The total revenues that must be collected from customers to compensate a utility for all expenditures associated with the implementation of an alternative decision. (It includes O&M expenses and carrying charges.)

**Salvage Value.** The market value less all cost of removing and selling the asset.

**Sensitivity Analysis.** Determining the change in the measure of merit (such as present value of revenue requirements or net present value) caused by one or more changes in the assumptions of an analysis.

**Service Date.** The date that an asset is declared available for normal operation.

**Shareholder Value Analysis (SVA).** A technique used to estimate the economic value of various business strategies by discounting the forecasted cash flows each strategy would generate.

**Sovereign Risk.** Risks resulting from changes in national laws and policies.

**Sunk Cost.** The unrecoverable portion of a past expenditure.

**Tax Depreciation Factor.** A factor that when applied to the investment outlay for an asset will result in a lump-sum present value that provides for the recovery of tax depreciation charges.

**Tax Life.** The life of an asset used for computing the tax depreciation schedule used to derive the fixed charge rate for the asset. Tax lives for assets are specified by the Internal Revenue Service and can be significantly different than the useful life of an asset.

**Terminal Value.** Estimate of asset value at the end of the project period in future dollars. Also, see Salvage value.

**Time Value of Money.** The cost of deferring receipts of goods and services (money) from an earlier period to a later period in time. The cost is the opportunity to use the goods and services in their best alternative use at an earlier point in time.

**Uniform Series Present Value Factor.** A factor used to transform a uniform series of values into an equivalent present value.

**Useful Life (Service Life).** The period of time that an asset can be used economically for its intended function.

**Variable Costs.** Costs expected to vary within a given time period (usually an annual period) in direct proportion to changes in the level of production.



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-009**

**REQUEST:**

Provide Duke Kentucky's budget instructions, assumptions, directives, manuals, policies and procedures, timelines, and descriptions of budget procedures.

**RESPONSE:**

Refer to FR 10(9)(c) in the Company's Application in this proceeding.

**PERSON RESPONSIBLE:** Stephen R. Lee



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-010**

**REQUEST:**

Provide the studies, including all applicable workpapers, which are the basis for plant allocations and expense account allocations.

**RESPONSE:**

All plant and expenses are 100% jurisdictional except for common plant, which is allocated 25.74% to gas operations. Attachment STAFF-DR-01-010 is a workpaper supporting the development of the common plant allocation factor.

**PERSON RESPONSIBLE:** Brenda R. Melendez



Factors	PP&E		Labor		Gross Margin		3FF
FEG Elec - KY	714,170,237	73.35%	24,484,621	67.80%	197,388,285	81.65%	74.26%
FEG Gas - KY	259,489,257	26.65%	11,630,924	32.20%	44,364,331	18.35%	25.74%
	973,659,494	100.00%	36,115,545	100.00%	241,752,616	100.00%	100.00%
							Note: 34% PPE 33% Labor 33% Gross Margin



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-011**

**REQUEST:**

Describe the procedures that Duke Kentucky uses to plan and approve natural gas construction projects.

**RESPONSE:**

Each construction job is assigned to a job sponsor in the Gas Engineering group or the Customer Projects group. The job sponsor is responsible for preparing all engineering and planning aspects of that job, such as design, construction plans, permits, easements, work orders and cost estimates. Design decisions are made by the job sponsor and reviewed with the appropriate outside stakeholder (either a developer, in the case of Customer Projects, or governmental permitting agency, in the case of Gas Engineering) at the job review meetings. The job sponsor is ultimately accountable for every aspect of the design and construction of the job. Decisions involving complex design concepts or large expenditures of capital are documented using a structured decision methodology, such as Kepner-Tregoe, statistical analysis or modeling. The General Manager, Gas Engineering and the supervisors are responsible for authorizing spending on jobs within their respective authorized limits. Jobs above \$1 million are approved by the appropriate personnel within their authorized limits. The Duke Energy Kentucky construction budget rolls up into the Duke Energy Corp. budget, which is ultimately approved by Duke Energy Corp's senior management and the Board of Directors.

**PERSON RESPONSIBLE:** Gary J. Hebbeler



**Duke Energy Kentucky, Inc.**  
**Case No. 2009-00202**  
**First Set Staff Data Requests**  
**Date Received: June 19, 2009**

**STAFF-DR-01-012**

**REQUEST:**

Provide Duke Kentucky's long-term construction planning program.

**RESPONSE:**

See Attachment STAFF-DR-01-012 for the long-term construction planning program for the Company's gas operations.

**PERSON RESPONSIBLE:** Gary J. Hebbeler

**Duke Energy Kentucky**  
**Case No. 2009-00202**  
**Major Construction Projects**

Project ID/Description	Actual or Projected Start Date	Projected Completion Date	Projected Expenditures					2009 - 2013 Totals
			2009	2010	2011	2012	2013	
			\$	\$	\$	\$	\$	
AM01	1/1/2012	12/31/2012				5,220,746		5,220,746
CPERNST1 / CAMP ERNST	1/1/2010	12/31/2010		1,250,000				1,250,000
G712THST / 12th STREET	1/1/2009	12/31/2009	320,764					320,764
G7BUPG / KENTUCKY BUILDING UPGRADES	(a)	(a)		166,044	129,279	131,497	134,210	561,029
G7IMPRPL / INTEGRITY MANAGEMENT PROGRAM	(a)	(a)	46,916	42,000	42,572	43,303	44,196	218,987
G7LGMR / LARGE M & R	(a)	(a)	298,231	283,800	303,545	315,161	315,124	1,515,861
G7MAINS / MAINS	(a)	(a)	1,689,405	1,573,032	2,048,025	2,083,158	2,126,144	9,519,765
G7MSCPRD / MISCELLANEOUS PRODUCTION	(a)	(a)	159,875	449,280	163,323	166,124	169,552	1,108,154
G7NOBNDR / NORTH BEND ROAD	1/1/2009	12/31/2009	362,838					362,838
G7PRESIM / PRESSURE IMPROVEMENTS	(a)	(a)	49,880	104,902	59,406	60,425	61,672	336,285
G7PUBIMP / PUBLIC IMPROVEMENTS	(a)	(a)	1,601,500	1,428,972	1,550,242	1,601,986	1,609,373	7,792,073
G7PUINMR / GAS METERS AND REGULATORS	(a)	(a)	1,268,864	4,086,166	1,569,962	1,596,894	1,629,846	10,151,732
G7REPL / REPLACEMENTS	(a)	(a)	650,075	342,453	454,555	649,477	665,456	2,762,016
G7RISERS / RISERS	(a)	(a)	2,000,000	2,000,000	2,000,000	1,000,000		7,000,000
G7SERVMC / SERVICES	(a)	(a)	3,588,721	4,885,812	3,638,493	4,025,846	4,108,919	20,247,791
G7TOOLS / TOOLS	(a)	(a)	17,000	17,500	17,582	17,884	18,253	88,218
GITKYCAP / IT	(a)	(a)	416,077	582,077				998,154
IDWILD / IDLEWILD	1/1/2013	12/31/2013					1,049,278	1,049,278
KYCIBS09 / CAST IRON BARE STEEL	1/1/2009	12/31/2009	20,629,857					20,629,857
KYCIBS10 / CAST IRON BARE STEEL	1/1/2010	10/31/2010		8,262,379				8,262,379
KYGASG01 / KENTUCKY GAS GROWTH	(a)	(a)	56,613	69,000	65,040	66,155	67,532	324,339
LONGBRAN / LONGBRANCH ROAD	1/1/2009	12/31/2009	745,798					745,798
TAYLRMIL / TAYLOR MILL ROAD	1/1/2010	12/31/2010		300,000				300,000
U16ZMTRG / TOOLS - GAS MTR OPS	(a)	(a)	6,648	5,000	6,826	6,943	7,086	32,503
UFGASCAP / UTILITY OF THE FUTURE	(a)	(a)	300,000	795,209	825,544	12,285,513	6,353,385	20,559,651
			<b>34,209,062</b>	<b>26,643,626</b>	<b>12,874,395</b>	<b>29,271,111</b>	<b>18,360,025</b>	<b>121,358,219</b>

(a) Blanket Project - Start date is January 1 and completion date is December 31 of applicable year.



STAFF-DR-01-013

**REQUEST:**

Concerning Duke Kentucky's natural gas construction projects:

- a. For each project started during the last 10 calendar years, provide the information requested in the format contained in Schedule 13 a. For each project, include the amount of any cost variance and delay encountered, and explain in detail the reasons for such variances and delays.
- b. Using the data included in Schedule 13a, calculate the annual "Slippage Factor" associated with those natural gas construction projects. The Slippage Factor should be calculated as shown in Schedule 13b.
- c. In determining the capital additions reflected in the base period and forecasted test period, explain whether Duke Kentucky recognized a Slippage Factor.

**RESPONSE:**

- a. See Attachment STAFF-DR-01-13(a).
- b. See Attachment STAFF-DR-01-13(b).
- c. No. Duke Energy Kentucky did not recognize a Slippage Factor for capital additions in either the base period or forecasted test period. Duke Energy Kentucky intends that the dollars budgeted for capital construction projects will be spent in the year budgeted.

**PERSON RESPONSIBLE:** (a) & (b) – Gary J. Hebbeler

(c) – Robert M. Parsons







DUKE ENERGY KENTUCKY, INC.  
 CASE NO. 2009-00202  
 Construction Projects  
 Year 2001

Schedule 13a

Project No.	Project Title/Description	Annual Actual Cost	Annual Original Budget	Variance in Dollars	Variance as Percent	Percent of Budget	Total Actual Project Cost	Total Budget Project Cost	Variance in Dollars	Date	Date	Date	Date
										Budget Start	Budget End	Actual Start	Actual End
ACCREC*	MISCELLANEOUS ACCTS RECVBLE \$	(47,071)		\$ (47,071)			\$ (47,071)	\$ -	\$ (47,071)	N/A	N/A	2/1/2001	11/31/2001
G7MSCPRD	MISCELLANEOUS PRODUCTION	484,406	397,361	87,045	22%	122%	484,406	397,361	87,045	1/1/2001	12/31/2001	1/1/2001	12/31/2001
KYCIBS01	KY REPLACEMENTS 2001	4,774,677	5,413,512	(638,835)	-12%	88%	4,774,677	5,413,512	(638,835)	1/1/2001	12/31/2001	1/1/2001	12/31/2001
KYCIBS02**	CI&BS 2002 KY	68,128	-	68,128			68,128	-	68,128	N/A	N/A	N/A	N/A
G7LGMR	LARGE M&R S	227,429	243,423	(15,994)	-7%	93%	227,429	243,423	(15,994)	1/1/2001	12/31/2001	1/1/2001	12/31/2001
G7MAINS	MAINS	2,216,982	1,922,587	294,395	15%	115%	2,216,982	1,922,587	294,395	1/1/2001	12/31/2001	1/1/2001	12/31/2001
G7OVPRPT	OVER PRESSURE PROTECTION	311	37,410	(37,098)	-99%	1%	311	37,410	(37,098)	1/1/2001	12/31/2001	4/1/2001	12/31/2001
G7PRESIMP	PRESSURE IMPROVEMENTS	192,902	120,427	72,476	60%	160%	192,902	120,427	72,476	1/1/2001	12/31/2001	1/1/2001	12/31/2001
G7PUBIMP	PUBLIC IMPROVEMENTS	1,632,655	1,455,748	176,907	12%	112%	1,632,655	1,455,748	176,907	1/1/2001	12/31/2001	1/1/2001	12/31/2001
G7REPL	REPLACEMENTS	1,980,723	1,523,919	456,804	30%	130%	1,980,723	1,523,919	456,804	1/1/2001	12/31/2001	1/1/2001	12/31/2001
G7SERVMC	SERVICES M-C	3,778,595	2,717,083	1,061,511	39%	139%	3,778,595	2,717,083	1,061,511	1/1/2001	12/31/2001	1/1/2001	12/31/2001
G7SXTH	SIXTH STREET	(1,852)		(1,852)			(1,852)	-	(1,852)	N/A	N/A	3/1/2001	3/31/2001
KYGASG01	KENTUCKY GAS GROWTH	125,622	723,937	(598,315)	-83%	17%	125,622	723,937	(598,315)	1/1/2001	12/31/2001	1/1/2001	8/31/2001
KYGASGR	KY GAS GROWTH	82,975	-	82,975			82,975	-	82,975	5/1/2001	8/31/2001	6/1/2001	11/30/2001
TURFWAY1	TURFWAY PI	-	248,649	(248,649)	-100%	0%	-	248,649	(248,649)	5/1/2001	11/30/2001	N/A	N/A
ZIMRVCR	LAFARGE	(58,739)	-	(58,739)			(58,739)	-	(58,739)	N/A	N/A	1/1/2001	12/31/2001
G7BUPG	KENTUCKY BUILDING UPGRADES	365,430	427,710	(62,280)	-15%	85%	365,430	427,710	(62,280)	1/1/2001	12/31/2001	1/1/2001	12/31/2001
G7TOOLS	TOOLS	57,007	81,802	(24,795)	-30%	70%	57,007	81,802	(24,795)	1/1/2001	12/31/2001	1/1/2001	11/30/2001
G7PUINMR	GAS METERS AND REGULATORS	921,805	1,143,393	(221,587)	-19%	81%	921,805	1,143,393	(221,587)	1/1/2001	12/31/2001	1/1/2001	12/31/2001
		<u>\$ 16,801,986</u>	<u>\$ 16,456,962</u>	<u>\$ 345,025</u>									

\*Customer contributions

\*\*Actual Costs added to KYCIBS01 for calculations