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JUN 20 2017

PUBLIC SERVICE
COMMISSION

VIA OVERNIGHT DELIVERY

June 19, 2017

Talina Rose Mathews
Executive Director
Kentucky Public Service Commission
211 Sower Blvd
Frankfort, KY 40602-0615

Re: Case No. 2011-00124

In the Matter of the Joint Application of Duke Energy Corporation, Cinergy Corp., Duke Energy Ohio, Inc., Duke Energy Kentucky, Inc., Diamond Acquisition Corporation, and Progress Energy, Inc. for Approval of the Indirect Transfer of Control of Duke Energy Kentucky, Inc.

Dear Dr. Mathews:

In the Settlement Agreement in the above-referenced case, Duke Energy Kentucky, Inc. (Duke Energy Kentucky) made several merger commitments. In response to Merger Commitment No. 12, which states:

"Joint Applicants commit to periodic comprehensive third-party independent audits of the affiliate transactions under the affiliate agreements approved as part of the merger transaction. Such audits will be conducted no less often than every two years, and the reports will be filed with the Commission and the Attorney General. Duke Energy Kentucky shall file the audit report, if possible, when Duke Energy Kentucky files its annual report. The audits will continue for six years or until three service company audits are performed, in the event more than six years are needed to perform three audits."

Enclosed herein is an original and six copies of the 2015 Affiliate Management Audit Final Report of Duke Energy Kentucky. As Duke Energy Kentucky has now submitted three service company audits, it has fulfilled this merger commitment.

Please file stamp the two copies of this letter and the Final Report enclosed herein and return in the enclosed return-addressed envelope.

Respectfully submitted,



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cc: Rebecca Goodman (w/ enclosure)

Schumaker & Company



**2015 Affiliate Management Audit
of
Duke Energy Kentucky**

**Case Number: 2011-00124
Final Report**

May 8, 2017

Table of Contents

- I. EXECUTIVE SUMMARY 1**
 - A. Background & Perspective..... 1
 - B. Audit Methodology & Work Plan..... 3
 - C. Summary of Recommendations 7
- II. MERGER ORDER REQUIREMENTS..... 9**
 - A. Background & Perspective..... 9
 - B. Findings & Conclusions 9
 - C. Recommendations 15
- III. AFFILIATE RELATIONSHIPS 17**
 - A. Background & Perspective..... 17
 - Organization Structure 17
 - Transactions 28
 - Services..... 28
 - Convenience Payments..... 31
 - Personnel Transfers..... 33
 - Asset Transfers 34
 - Separation..... 35
 - Ethics & Compliance Organization..... 37
 - Other Organizations 39
 - Competitive or Sensitive Information 40
 - Transfer Confidentiality Agreements 42
 - B. Findings & Conclusions 43
 - Affiliate Agreements 43
 - Affiliate Training 47
 - Benchmarking..... 51
 - Separations 56
 - Filings..... 57

Table of Contents (continued)

C. Recommendations.....	57
Affiliate Agreements.....	57
Affiliate Training.....	57
Benchmarking.....	58
Separations.....	58
Filings	58
IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT..	59
A. Background & Perspective	59
Methodologies Used.....	60
Description of Transactions	60
Services	60
Asset Transfers.....	63
Cost Accumulation, Assignment, & Allocation.....	67
Billing Mechanisms.....	70
B. Findings & Conclusions	70
C. Recommendations.....	75
V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE	77
A. Background & Perspective	77
Long-term Debt	77
Long-term Debt Composition	77
Credit Ratings.....	79
Short-Term Debt	81
Money Pool.....	81
Credit Facility	84
Capital Structure.....	86
Dividend Payouts	86
Capitalization.....	87
B. Findings & Conclusions	87
C. Recommendations.....	89

Table of Contents (continued)

VI. INTERNAL CONTROLS.....	91
A. Background & Perspective.....	91
SOx Controls.....	92
Internal Audits	98
B. Findings & Conclusions	99
C. Recommendations.....	100

Table of Exhibits

I. EXECUTIVE SUMMARY	1
Exhibit I-1 Summary Duke Energy Corporation Organization as of December 31, 2015	2
Exhibit I-2 Summary of Recommendations	7
Exhibit I-3 Duke Energy Actions to Prior Schumaker & Company 2013 Audit.....	8
II. MERGER ORDER REQUIREMENTS.....	9
Exhibit II-1 Impacts and Participation by Program July 2014-June 2015.....	11
Exhibit II-2 Impacts and Participation by Program 2015.....	12
Exhibit II-3 Cost Effectiveness Test Results by Program July 2014-June 2015.....	13
III. AFFILIATE RELATIONSHIPS	17
Exhibit III-1 Detailed Duke Energy Corporation Organization Structure as of December 31, 2015 (Page 1 of 10).....	17
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 2 of 10).....	18
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 3 of 10).....	19
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 4 of 10).....	20
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 5 of 10).....	21
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 6 of 10).....	22
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 7 of 10).....	23
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 8 of 10).....	24
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 9 of 10).....	25
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2015 (Page 10 of 10)	26
Exhibit III-2 Duke Energy Kentucky Parental Structure as of December 31, 2015	27
Exhibit III-3 Affiliate Service Charges 2013 to 2015.....	28
Exhibit III-4 Affiliate Service Charges 2013 to 2015.....	30
Exhibit III-5 DEO Commercial Power Convenience Payments 2013 to 2015.....	31

Table of Exhibits (continued)

Exhibit III-6 General Convenience Payments 2013, 2014, and 2015	32
Exhibit III-7 Affiliate Personnel Transfers 2013 to 2015	33
Exhibit III-8 Average Fringe Rates by Year.....	33
Exhibit III-9 Affiliate Asset Transfers (Based on Original Cost) 2013 to 2015	34
Exhibit III-10 KRS 278.2213 Separate recordkeeping for utility and affiliate -- Prohibited business practices -- Confidentiality of information -- Notice of service available from competitor as of December 31, 2015.....	36
Exhibit III-11 DEBS Ethics & Compliance Organization as of December 31, 2015	38
Exhibit III-12 DEBS Ethics & Compliance Organization as of September 30, 2016.....	39
Exhibit III-13 Affiliate Restrictions – Information Disclosure Procedure as of October 2015	41
Exhibit III-14 Existing Affiliate Agreements (Page 1 of 4) as of December 31, 2015	44
Exhibit III-14 Existing Affiliate Agreements (Page 2 of 4) as of December 31, 2015	45
Exhibit III-14 Existing Affiliate Agreements (Page 3 of 4) as of December 31, 2015	46
Exhibit III-14 Existing Affiliate Agreements (Page 4 of 4) as of December 31, 2015	47
Exhibit III-15 Duke Energy Training Sessions 2015.....	50
Exhibit III-16 Latest DEBS Benchmarking Studies	52
Exhibit III-17 Feasibility Matrix for Service Company Functions	54
Exhibit III-18 Process Workflow Diagram.....	54
Exhibit III-19 DEBS Services Part of Market Study Assessment Process as of May 2016.....	55
Exhibit III-20 Duke Energy Logos	57

IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT ..59

Exhibit IV-1 Summary Pricing Guide Services as of December 31, 2015	62
Exhibit IV-2 Summary Pricing Guide Services as of December 31, 2013	63
Exhibit IV-3 Summary Pricing Guide Asset Transfers as of December 31, 2015	66
Exhibit IV-4 Allocation Factors as of December 31, 2015	68
Exhibit IV-5 DEBS Allocation Factors by Function as of December 31, 2015	69

Table of Exhibits (continued)

V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE.....77

Exhibit V-1 Duke Energy Long-Term Debt as of December 31, 2015	78
Exhibit V-2 Sampled Long-term Debt Instruments as of December 31, 2015.....	79

Exhibit V-3 Duke Energy Credit Ratings as of December 31, 2015..... 80

Exhibit V-4 Duke Energy Money Pool Participants as of December 31, 2015 82

Exhibit V-5 Money Pool Funds Lent by DEK as of December 31, 2015 83

Exhibit V-6 Money Pool Funds Borrowed by DEK as of December 31, 2015..... 84

Exhibit V-7 Duke Energy Credit Agreement Participants as of December 31, 2015 85

Exhibit V-8 Duke Energy Credit Agreement Pricing Schedule as of December 31, 2015 (Basis Points per Annum)..... 86

Exhibit V-9 DEK’s Dividend Payout History 2007 to 2015..... 87

Exhibit V-10 DEK’s Capital Structure History 2011 to 2015..... 87

VI. INTERNAL CONTROLS..... 91

Exhibit VI-1 Finance Governance & Business Excellence Organization 2015..... 93

Exhibit VI-2 2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group Page 1 of 4 94

Exhibit VI-2 2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group Page 2 of 4 95

Exhibit VI-? 2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group Page 3 of 4 96

Exhibit VI-? 2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group Page 4 of 4 97

Exhibit VI-3 Internal Audits Associated with Affiliate Relationships/Transactions 2013 to 2015 98

Table of Findings

I. EXECUTIVE SUMMARY 1

II. MERGER ORDER REQUIREMENTS.....9

 Finding II-1 Duke Energy has essentially addressed Commitments 10, 11, 12, and 13 of Case No. 2005-00228 that KPSC established and other KPSC regulations.9

 Finding II-2 DEK continued to offer a full range of cost-effective energy conservation and efficiency programs.9

 Finding II-3 The Board of Directors of the combined company includes at least one non-employee member who resides in the company’s service territory in Kentucky, Indiana, or Ohio.14

 Finding II-4 DEK appears to be responsive to the KPSC’s merger order conditions, but it cannot be determined if any merger costs will be passed on to DEK ratepayers until DEK’s next rate case.15

III. AFFILIATE RELATIONSHIPS 17

 Finding III-1 Only three affiliate agreements were changed in 2015 or the beginning of 2016.43

 Finding III-2 Significant improvements have been made regarding Duke Energy’s affiliate training sessions and communications with its employees regarding these sessions.47

 Finding III-3 Duke Energy recently performed various market assessment studies as a means to compare costs to market values for services performed.....51

 Finding III-4 There was no use of the DEK logo by any non-utility affiliate.56

 Finding III-5 There have been no KPSC filings in 2015 relative to service agreements.....57

IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT ..59

 Finding IV-1 The DEK cost allocation manual includes KPSC requirements, but continues to miss key elements of comprehensive CAM documentation used by other utility organizations.70

 Finding IV-2 DEK does not have service level agreement documentation included in its agreements with affiliates.73

 Finding IV-3 Appropriate cost allocation factors are being used.74

 Finding IV-4 Appropriate levels of direct charging are generally occurring with regard to DEK’s affiliate transactions.74

 Finding IV-5 Sufficient policy and associated documentation has not been available in past years regarding accounting for asset loans.....74

Table of Findings (continued)

V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE		77
Finding V-1	The long-term indebtedness DEK or that of its affiliates does not expose DEK or its ratepayers to undue risk.	87
Finding V-2	The financial agreements in which DEK is a participant do not obligate or increase the financial risk for DEK.	88
Finding V-3	During 2014 and 2015 DEK has not issued any security for the purpose of financing the acquisition, ownership, or operation of an affiliate.	88
Finding V-4	DEK has not assumed any obligation or liability as guarantor, endorser, surety, or otherwise in respect of any security of an affiliate.	88
Finding V-5	DEK has not pledged, mortgaged, or otherwise used as collateral any of its assets for the benefit of an affiliate.	88
Finding V-6	DEK has maintained a consistent credit rating since mid-2012.	89
Finding V-7	DEK's Money Pool transactions in 2015 have caused it to incur unnecessary expense.	89
VI. INTERNAL CONTROLS.....		91
Finding VI-1	Internal audit reports regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been addressed by DEBS staff in a timely manner.	99

Table of Recommendations

I. EXECUTIVE SUMMARY		1
II. MERGER ORDER REQUIREMENTS.....		9
Recommendation II-1	Provide sufficient documentation during DEK’s next rate case to ensure that Duke Energy/Progress Energy merger costs were not passed on to DEK ratepayers. (Refer to Finding II-4).....	15
III. AFFILIATE RELATIONSHIPS		17
Recommendation III-1	Provide the KPSC in early 2017 a copy of the results from the market study assessments performed in 2016. (Refer to Finding III-3.)	58
IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT ..		59
Recommendation IV-1	Continue to develop an improved formal comprehensive cost allocation manual that brings together all required elements of such documentation. (Refer to Finding IV-1).....	75
Recommendation IV-2	Develop service level agreements for key functions providing affiliate services to DEK. (Refer to Finding IV-2.).....	76
Recommendation IV-3	Develop a formal policy and associated documentation regarding process for handling asset loans, so that they exist going forward in situations where asset loans are actually done. (Refer to Finding IV-5.)	76
V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE.....		77
Recommendation V-1	Change the way DEK calculates interest expense for the use of excess borrowed short-term funds. (Finding V-7).....	90
VI. INTERNAL CONTROLS.....		91

**2015 Affiliate Management Audit
of
Duke Energy Kentucky
Case Number: 2011-00124
Final Report**

May 8, 2017

I. Executive Summary

A. Background & Perspective

In 2011, Duke Energy Corp. (Duke Energy), the ultimate corporate parent company of Duke Energy Kentucky (DEK), merged with Progress Energy, Inc. (Progress). As part of its approval of the merger in Case No. 2011-00124, Duke Energy Kentucky was ordered to adhere to 46 merger commitments the Kentucky Public Service Commission (KPSC) established in Case No. 2005-00228, of which four (4), specifically Commitments 10, 11, 12, and 13 specifically relate directly to this audit. They apply as follows:

- ◆ DEK is in compliance with its Commitment 10, which requires proper accounting of costs (accounting and reporting system used by Duke Energy Kentucky will be adequate to provide assurance that directly assignable utility and non-utility costs are accounted for properly and that reports on the utility and non-utility operations are accurately presented).
- ◆ DEK is in compliance with its Commitment 11, which requires that it implement and maintain appropriate cost allocation procedures that will accomplish the objective of preventing cross-subsidization, and be prepared to fully disclose all allocated costs, the portion allocated to Duke Energy Kentucky, complete details of the allocations methods, and justification for the amount and the method, plus giving the Commission 30 days' advance notice of any changes in cost allocation methods set forth in agreements approved as part of the merger transactions.
- ◆ DEK is in compliance with its Commitment 12, which requires that it commit to third-party independent audits of the affiliate transactions under the affiliate agreements approved as part of the merger transaction.
- ◆ DEK is in compliance with its Commitment 13, which requires that it protect against cross-subsidization in transactions with affiliates.

Also within the scope of this audit is DEK's compliance with KPSC regulations, including:

- ◆ 807 KAR 5:080 SECTION 2 — Annual reports
- ◆ 807 KAR 5:080 SECTION 3 — Filing of cost allocation manual and amendments
- ◆ 807 KAR 5:080 SECTION 4 — Notice of establishment of new non-regulated activity

With the approval of the merger of Duke Energy with Progress Energy Corporation (Progress Energy), the KPSC imposed three additional conditions on its approval of the merger, specifically:

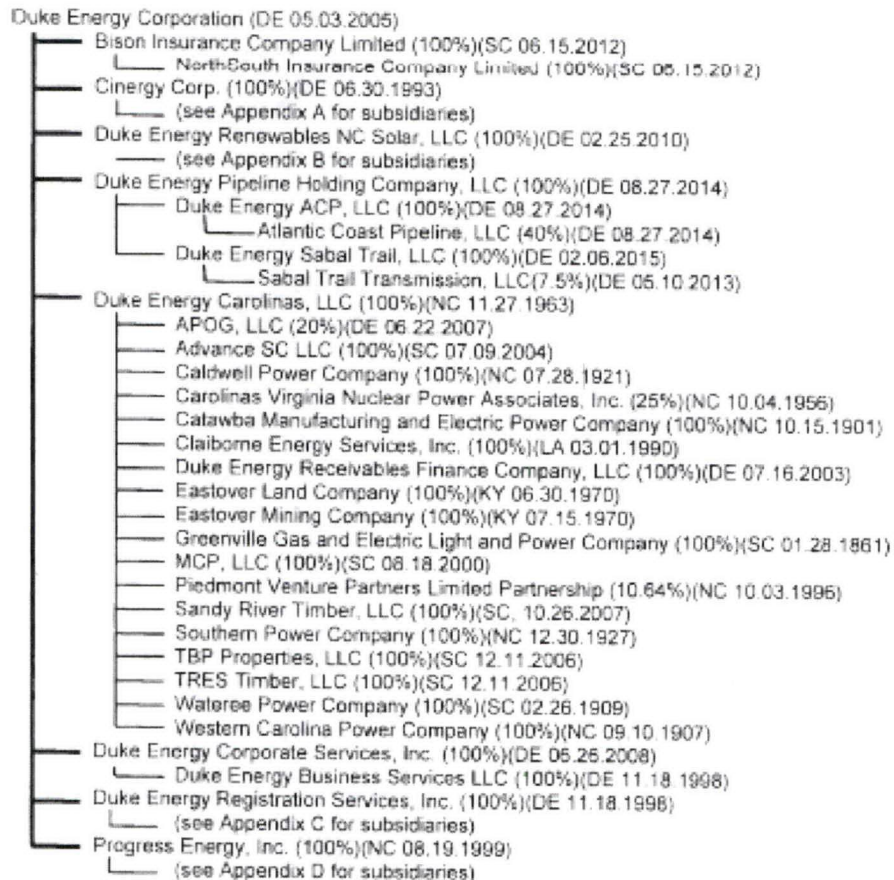
- ◆ DEK must continue to offer a full range of cost-effective energy conservation and efficiency programs.
- ◆ The Board of Directors of the combined company must include at least one non-employee member who resides in the company's service territory in Kentucky, Indiana, or Ohio.
- ◆ No merger costs may be passed on to DEK ratepayers.



Refer to *Chapter II – Merger Order Requirements* for a discussion of Duke Energy’s responses.

DEK is part of the Duke Energy organization, in which its summary organization structure, as of December 31, 2015 is depicted on *Exhibit I-1*.

Exhibit I-1
Summary Duke Energy Corporation Organization
as of December 31, 2015



Source: Information Response 1 (SCH-DR-01-001 Supplemental Attachment)

The service company is Duke Energy Business Services, LLC (DEBS).

The regulated utilities are Duke Energy Carolinas, LLC (DEC), plus Duke Energy Indiana, Inc. (DEI), Duke Energy Ohio, Inc. (DEO), Duke Energy Kentucky, Inc. (DEK), Miami Power Corporation, and Ohio Valley Electric Corporation, which are part of the Cinergy Corporation. See *Exhibit III-1* for additional detail in organization.

B. Audit Methodology & Work Plan

Schumaker & Company followed a three-step process designed to sustain vital, interactive working relationships our project team and DEK. Our approach for achieving the audit objectives was as follows:

- ◆ Step I – Diagnostic Review
- ◆ Step II – Detailed Review and Analysis
- ◆ Step III – Draft and Final Report Preparation

Each task area in our work plan was designed to allow our team to efficiently gather and analyze information necessary to develop an opinion whether DEK adequately complied with Kentucky's affiliate standards in 2015. The tables on the following pages illustrate a general discussion of the type of work steps typically performed for each task area, as well as the preliminary information that would be required and the key indicators that we would use to assess that specific task area.

Affiliate Relationships		
Typical Work Steps	Information Required	Key Indicators
<p>Review governing regulations, orders, and decisions from the Commission regarding affiliate transactions and determine if these affiliate relations rules have been fully complied with by DEK; identify any situations of non-compliance and determine the actual or potential impact of this non-compliance.</p> <p>Obtain DEK organization charts showing the relationships of DEK with its affiliates.</p> <p>Identify all affiliates that had transactions with DEK during the last three years.</p> <p>Identify all products and services provided from/to regulated and unregulated affiliates of DEK during the last three years.</p> <p>Document the frequency and dollar magnitude of all affiliate goods and services by year and by affiliate for all items received by or provided by DEK.</p> <p>Develop diagrams, graphs, and/or tabulations identifying affiliates, services, dollar magnitude, and other useful information and data. Explain any significant trends or changes.</p> <p>Analyze trends of these allocated amounts compared to the trends of these costs in the parent/affiliate.</p> <p>Separately identify affiliate transactions involving the transfer of employees, property, and/or technology.</p> <p>Identify, by plant category, any capital expenditures made by affiliates but allocated to DEK's operations.</p> <p>Evaluate any transactions that have had a significant effect on depreciation expense.</p> <p>Identify shared facilities, systems, and programs among affiliates including employee training, joint purchasing, information technology, advertising and promotion, and corporate support services.</p> <p>Review internal systems for providing assurance that goals and objectives are accomplished at the lowest possible cost and maximum benefit to ratepayers.</p> <p>Identify internal controls in place to protect against irregular, illegal, and/or improper transactions.</p> <p>Review filings, reports, and communications involving affiliate relationships.</p>	<p>Copies of all governing regulations, orders, and decisions from the Commission regarding affiliate transactions</p> <p>Duke Energy and DEK organization charts showing all affiliate relationships, including regulatory status of affiliates</p> <p>Description of all products and services provided from/to regulated and unregulated affiliates of DEK during the last three years</p> <p>Level and nature of affiliated transactions (actual and budget dollars) from/to DEK's operations and affiliates during the last three years, including a breakdown by:</p> <ul style="list-style-type: none"> ◆ From/to affiliate ◆ Type of transaction ◆ Time period <p>Actual dollars and personnel equivalents, by functional category, for each associated regulated and/or non-regulated DEK affiliate</p> <p>The level and nature of affiliated transactions (actual and budgeted capital expenditure dollars, by plant category) allocated to DEK's operations by affiliates during the last three years – as compared to its parent/affiliates</p> <p>Any cost allocation manual documentation, including formulas and basis</p>	<p>All affiliate transactions of DEK should be in complete compliance with all of the governing regulations, orders, and decisions from the Commission regarding affiliate transactions.</p> <p>The relationships with affiliates are clearly documented.</p> <p>The costs are fairly representative of the value of goods and services provided and of the benefits derived by Kentucky ratepayers.</p> <p>DEK should be able to easily furnish information regarding the products and services provided to/from its affiliates and the corresponding financial transactions that result.</p> <p>DEK should not be negatively impacted by its relationships in the overall corporate organization.</p> <p>Any affiliate costs charged to DEK are reasonable and competitive in the market.</p>

Cost Allocation Methodologies – Affiliate Transactions and Cost Accumulation and Assignment		
Typical Work Steps	Information Required	Key Indicators
<p>Determine procedures specified for identifying, tracking, and posting direct, indirect, and general overhead costs to specific projects or cost pools.</p> <p>Determine how these assignment policies, procedures, and practices have changed over time; assess the rationale for these changes.</p> <p>Assess methodologies (e.g., accounting systems) used to accumulate and assign costs. Examine criteria used to assign costs. Evaluate Duke Energy’s hierarchy for placing emphasis on direct billing versus cost allocation, and for developing causal relationships in formulating allocation methodologies. Evaluate whether direct billing is used whenever possible.</p> <p>Assess whether cost accumulation/assignment bases are reasonable and appropriate (e.g., based on cost causative factors) and whether they have been consistently developed.</p> <p>Review documentation involving policies and guidelines in place to establish the appropriation of resources and costs, including (but not limited to):</p> <ul style="list-style-type: none"> ◆ Finance manuals ◆ Assignment policies ◆ Cost allocation manuals <p>Identify generic direct billing and/or cost allocation methodologies in place within DEK and its affiliates used to calculate the costs for services or products provided.</p> <p>Assess whether cost allocation methodologies, and their associated bases and factors, are reasonable and appropriate, and whether they have been consistently applied. Assess whether these methodologies are regularly reviewed and revised.</p> <p>Determine whether the policies, procedures, and practices governing these transfer pricing methodologies and accounting standards are adequately documented and understood by the personnel involved.</p> <p>Identify the data sources and special studies required to develop allocations factors (if they are used), and evaluate their appropriateness.</p> <p>Determine how allocation policies, procedures, and practices have changed over time; assess the rationale for these changes.</p>	<p>Any cost accounting documentation involving cost accumulation and assignment</p> <p>Copies of DEK’s general ledger and pertinent subsidiary ledgers</p> <p>Any accounting manuals and other documentation describing methodologies, bases, and factors used for direct billing and/or cost allocation, and/or segregating regulated and unregulated costs, including (but not limited to):</p> <ul style="list-style-type: none"> ◆ Finance manuals ◆ Assignment policies ◆ Cost allocation manuals <p>Description of daily accounting standards and recordkeeping methods and procedures that support the daily operations between DEK and its affiliates</p>	<p>DEK and its affiliates should have in place well-defined and consistently applied procedures for accumulating and assigning costs, and should be able to provide timely, current, and accurate information regarding the level, nature, and magnitude of costs incurred.</p> <p>Direct billing and allocation methodologies used by DEK and its affiliates should be founded on reasonable and fair factors and bases that properly reflect the value of products and services received, and should be supported by automated systems and contracts that provide management with the information and data it needs for recording and managing these activities.</p> <p>DEK should not be negatively impacted by its relationships in the overall corporate organization.</p> <p>Any affiliate costs charged to DEK are reasonable and competitive in the market.</p>

Cost Allocation Methodologies – Affiliate Transactions and Cost Accumulation and Assignment		
Typical Work Steps	Information Required	Key Indicators
<p>Determine if contracts are in place and current where appropriate. Determine if the formal contracts define the nature of affiliate services rendered, set forth clearly defined bases for associated charges, and stipulate terms and conditions favorable to DEK's regulated operations in Kentucky.</p> <p>Determine if any contracts with third parties involving more than one affiliate provide DEK's operations with full consideration for performance, taking into account risk premiums or time value of money implicit in the payment or collection terms of such contracts.</p> <p>Assess whether the direct billing and cost allocation processes are adequately automated.</p> <p>Evaluate those mechanisms and procedures in the direct charges/cost allocation guidelines intended to guard against the cross-subsidization of unregulated entities, either through intentional or unintentional means.</p> <p>Identify the extent to which DEK's financial strength is impacted by or insulated from its affiliated (regulated or unregulated) companies.</p>		
<p>Identify the decision-making process used in the determination of services required, and for identifying the most optimum means of providing these services.</p> <p>Identify how DEK determines whether internal or external resources are used; identify instances of comparisons between outside vendors and internal resources for products and services provided to DEK.</p>	<p>Any analyses regarding use of external vendors for the development and delivery of services to DEK and its operations</p> <p>Any cost/benefit analyses performed during the last three years regarding provision of services by DEK or its affiliates</p>	<p>Decisions pertaining to the use of external vendors should be based on analysis that considers cost-benefit, financial, and other factors. These decisions should consider comparisons to provision directly by DEK or its affiliates, as well as the benefits that customers of regulated operations will receive.</p>

C. Summary of Recommendations

The recommendations contained in the audit report are shown in Exhibit I-2, including recommendation number, page number in the report, priority, and estimated time-frame to initiate implementation efforts.

Exhibit I-2
Summary of Recommendations

	Description	Page	Implementation	
			Priority	Initiation Time Frame
II-1	Provide sufficient documentation during DEK's next rate case to ensure that Duke Energy/Progress Energy merger costs were not passed on to DEK ratepayers.	15	High	0-24 Months
III-1	Provide the KPSC in early 2017 a copy of the results from the market study assessments performed in 2016.	58	High	0-6 Months
IV-1	Continue to develop an improved formal comprehensive cost allocation manual that brings together all required elements of such documentation.	75	Medium	0-12 Months
IV-2	Develop service level agreements for key functions providing affiliate services to DEK.	76	Medium	0-12 Months
IV-3	Develop a formal policy and associated documentation regarding process for handling asset loans, so that they exist going forward in situations where asset loans are actually done.	76	Low	0-24 Months
V-1	Change the way DEK calculates interest expense for the use of excess borrowed short-term funds.	90	High	0-6 Months

Actions taken by Duke Energy regarding prior Schumaker & Company 2013 report recommendations are summarized in *Exhibit I-3*.¹



Exhibit I-3
Duke Energy Actions to Prior Schumaker & Company 2013 Audit

Recommendation	Action Taken
<p>Recommendation II-1 Provide sufficient documentation during Duke Energy Kentucky's next rate case to ensure that Duke Energy/Progress Energy merger costs are not being passed on to DEK ratepayers.</p>	<p>Kentucky has not had a rate case since the last audit period.</p>
<p>Recommendation III-1 Aggressively send notifications to employees who have not passed affiliate rules training even before the Day 30 currently used.</p> <p>Recommendation III-2 Continue to enhance Affiliate Standards training, plus make sure all Duke Energy employees taking such training using <i>MyTraining</i> by the end of 2014.</p>	<p>For regulatory training deployed by the Ethics & Compliance Department, Duke Energy has revised its standard deployment period from 60 days to 90 days and made significant changes to the reminder and past due escalation schedules. Employees receive a total of five (5) reminders prior to the due date, including the initial notice. Duke Energy has also increased the escalation and automated system reminders (from <i>MyTraining</i>), which are also sent to immediate managers earlier in the process, prior to the due date. Previously Duke Energy began escalation two (2) weeks after the due date with management and escalated weekly thereafter, until it notified senior management.</p> <p>Below is the current deployment reminder and escalation process now being used:</p> <ul style="list-style-type: none"> ◆ DAY 1 – <i>MyTraining</i> > initial notice to individual ◆ DAY 45 – <i>MyTraining</i> > reminder to individual ◆ DAY 60 – <i>MyTraining</i> > reminder to individual and copy to manager ◆ DAY 70 – Manual reminder and incomplete report to management ◆ DAY 80 – <i>MyTraining</i> > reminder to individual, copying manager, and manual > incomplete report to management ◆ DAY 89 – <i>MyTraining</i> > reminder to individual ◆ DAY 91 – <i>MyTraining</i> > overdue to individual, copy to manager, and manual > incomplete report to senior management ◆ DAY 98 (and weekly thereafter) – <i>MyTraining</i> > overdue to individual, copy to manager, and manual > incomplete report senior management until 100% complete
<p>Recommendation IV-1 Develop a formal comprehensive cost allocation manual that brings together all required elements of such documentation.</p>	<p>The Ohio/Kentucky Rates & Regulatory Group has updated the Kentucky cost allocation manual to include similar information that is presented in the North Carolina cost allocation manual.</p>
<p>Recommendation IV-2 Develop a formal policy and associated documentation regarding asset loans.</p>	<p>Each asset loan is considered unique; therefore, a company-wide policy does not exist and Duke Energy does not believe it would be beneficial. Each asset loan requires significant discussions between legal, asset accounting, and supply chain to determine the best strategy and ensure all affiliate requirements are met. As Duke Energy has affiliate transfer training, this training program includes information about asset loans. Given the rarity of an asset loan, Duke Energy believes this information is sufficient to ensure all affiliate guidelines are followed when there is an asset loan. Supply Chain is not aware of any loans in 2015 for any jurisdiction.</p>

Source: Information Response 48

II. Merger Order Requirements

A. Background & Perspective

This chapter addresses Duke Energy Kentucky's (DEK's) response to merger order requirements previously discussed in *Chapter II – Executive Summary*.

B. Findings & Conclusions

Finding II-1 **Duke Energy has essentially addressed Commitments 10, 11, 12, and 13 of Case No. 2005-00228 that KPSC established and other KPSC regulations.**

As detailed in *Chapter I Section A – Background & Perspective* section of, in 2011, Duke Energy Corporation (Duke Energy) merged with Progress Energy, Inc. (Progress). As part of its approval of the merger in Case No. 2011-00124, Duke Energy Kentucky was ordered to adhere to 46 merger commitments the Kentucky Public Service Commission (KPSC) established in Case No. 2005-00228, of which four (4), specifically Commitments 10, 11, 12, and 13, specifically related directly to this audit. Also, the three KPSC regulations involve annual reports, filing of cost allocation manual and amendments, and notice of establishment of new non-regulated activity. DEK has generally been in compliance with these items.

Finding II-2 **DEK continued to offer a full range of cost-effective energy conservation and efficiency programs.**

The energy efficiency programs that DEK offers include:²

- ◆ Residential programs
 - Program 1: Low Income Services Program
 - Program 2: Residential Energy Assessments Program
 - Program 3: Energy Efficiency Education for Schools Program
 - Program 4: Residential Smart \$aver Efficient Residences Program (The Smart \$aver[®] Residential Energy Efficient Products Program and the Energy Efficient Residences Program are individual measures that are part of a single and larger program referred to and marketed as Residential Smart \$aver[®]. For ease of administration and communication with customers, the two measures have been divided into separate tariffs, even though they are a single program.)
 - Program 5: Residential Smart \$aver Energy Efficient Products Program
 - Program 6: Power Manager Program



- Program 7: Low Income Neighborhood
- Program 8: My Home Energy Report
- ◆ Non-residential programs
 - Program 1: Smart \$aver Prescriptive Program
 - Program 2: Smart \$aver Custom Program
 - Program 3: PowerShare®
 - Program 4: Non-Residential Small Business Energy Saver Program

DEK was also granted a limited automatic approval process for cost effective pilot programs that are not greater than \$75,000 as well as, automatic approval of cost effective additions to existing programs of measures that do not exceed \$75,000 per program. In the 2012 status update filing, Case No. 2012-00495, the Commission ordered that DEK file any Demand Side Management (DSM) program evaluations, proposed program expansion(s), or new programs in a separate filing due each year by August 15th. The amendment filings give an annual update of changes to the portfolio and a refreshed look at costs on an annual basis. Based on these orders, DEK indicates that it has been able to continually update and enhance the DSM portfolio in a cost effective manner, essentially filing an updated portfolio on an annual basis.³

For example, DEK made a filing in November 2015 with the KPSC for the fiscal year ending June 30, 2015. As indicated in the filing, the company's offering of DSM programs dates back close to two decades. Throughout the years, the company has offered many enhancements to its portfolio with the purpose of increasing participation and providing customers new and innovative opportunities to control their consumption and impact their utility bill. DEK has been using an August filing process since 2013 to enhance the DSM portfolio and react to market changes.⁴ The fiscal year 2015 impacts and participation by program are shown in *Exhibit II-1*.⁵

**Exhibit II-1
Impacts and Participation by Program
July 2014-June 2015**

	1	Summary of Load Impacts July 2014 Through June 2015*		
		Incremental Participation	kWh	kW
Residential Programs				
Appliance Recycling Program		779	316,032	35
Energy Efficiency Education Program for Schools		2,213	577,006	166
Low Income Neighborhood		718	557,078	147
Low Income Services		243	351,265	89
My Home Energy Report	2	53,267	10,869,228	3,207
Residential Energy Assessments		577	447,175	88
Residential Smart Saver®		385,099	8,639,278	1,243
Power Manager	3	10,719	-	11,033
Total Residential		453,615	21,757,061	16,007
Non-Residential Programs				
		Incremental Participation	kWh	kW
Smart Saver® Prescriptive - Energy Star Food Service Products		803	519,321	19
Smart Saver® Prescriptive - HVAC		101,560	910,166	247
Smart Saver® Prescriptive - Lighting		37,112	4,435,230	771
Smart Saver® Prescriptive - Motors/Pumps/VFD		572	364,758	34
Smart Saver® Prescriptive - Process Equipment		125	55,054	13
Smart Saver® Custom		1,793	5,071,530	638
Small Business Energy Saver		592,308	528,145	119
Power Share®	4	22	-	21,787
Total Non-Residential		734,295	11,884,203	23,630
Total		1,187,910	33,641,264	39,637
1 - Impacts are net of freeriders, without losses and reflected at the customer meter point. 2 - Actual participants and impact capability shown as of the June 2015 mailings. 3 - Cumulative number of controlled devices installed. Impacts reflect average capability over the contract period. 4 - Impacts reflect average capability over the contract period.				

Source: Information Response 52

Based on the scope of this affiliate audit, the calendar year 2015 impacts and participation by program are shown in *Exhibit II-2*.⁶

Exhibit II-2
Impacts and Participation by Program
2015

	1	Summary of Load Impacts 2015		
		Incremental Participation	kWh	kW
Residential Programs				
Appliance Recycling Program		699	284,381	31
Energy Efficiency Education Program for Schools		1,036	294,723	78
Low Income Neighborhood		609	365,945	100
Low Income Services		208	282,992	70
My Home Energy Report	2	58,157	11,917,320	3,517
Residential Energy Assessments		507	392,925	77
Residential Smart Saver*		289,024	6,570,484	933
Power Manager	3	10,918	-	11,300
Total Residential		361,158	20,108,770	16,105
Non-Residential Programs				
Smart Saver* Prescriptive - Energy Star Food Service Products		33	93,466	10
Smart Saver* Prescriptive - HVAC		6,270	139,134	56
Smart Saver* Prescriptive - IT		1	70	-
Smart Saver* Prescriptive - Lighting		32,393	4,920,620	794
Smart Saver* Prescriptive - Motors/Pumps/VFD		647	425,821	40
Smart Saver* Prescriptive - Process Equipment		25	11,011	3
Smart Saver* Custom		384	449,001	54
Small Business Energy Saver		2,444,542	2,179,706	499
Power Share*	4	22	-	23,816
Total Non-Residential		2,484,317	8,218,829	25,272
Total		2,845,475	28,327,598	41,377
1 - Impacts are net of freeriders, without losses and reflected at the customer meter point. 2 - Actual participants and impact capability shown as of the December 2015 mailings. 3 - Cumulative number of controlled devices installed. Impacts reflect average capability over the contract period. 4 - Impacts reflect average capability over the contract period.				

Source: Information Response 52

All programs listed in *Exhibit II-2* were in effect during 2015. Included are the number of customers and/or energy efficiency kits added during 2015, plus kWh and KW. For dollars, one must look at the fiscal year filings (July-June) that DEK makes annually in November of each year to the KPSC.⁷

Exhibit II-3 displays the cost effectiveness test results by program for FY2015 (July 2014-June 2015).⁸

Exhibit II-3
Cost Effectiveness Test Results by Program
July 2014-June 2015

Program Name	2014-2015			Participant
	UCT	TRC	RIM	
Appliance Recycling Program	0.95	1.15	0.61	
Energy Efficiency Education Program for Schools	1.06	1.22	0.73	
Low Income Neighborhood	1.16	1.50	0.77	
Low Income Services	0.60	0.79	0.48	
My Home Energy Report	1.83	1.83	1.02	
Residential Energy Assessments	3.53	3.55	1.71	
Residential Smart Saver®	2.87	2.98	1.15	6.10
Power Manager	3.31	3.86	3.31	
Smart Saver® Custom	7.56	3.46	1.49	3.98
Smart Saver® Prescriptive - Energy Star Food Service Products	7.96	3.70	1.42	5.51
Smart Saver® Prescriptive - HVAC	3.67	1.01	1.39	1.38
Smart Saver® Prescriptive - Lighting	5.02	1.35	1.49	1.72
Smart Saver® Prescriptive - Motors/Pumps/VFD	6.56	2.35	1.50	3.36
Smart Saver® Prescriptive - Process Equipment	6.64	4.75	1.80	6.19
Smart Saver® Prescriptive - IT*	NA	NA	NA	
Small Business Energy Saver	3.79	2.42	1.49	2.69
Power Share®	3.98	12.61	3.98	

*NA = Not Applicable (There was no participation for this measure for July 2014 - June 2015.)

Source: Information Response 52 and Interview 10

UCT=Utility Cost Test; includes only DEK costs; target > 1;

TRC=Total Resource Test; includes DEK and participant costs; target > 1

RIM=Rate Impact Measure; includes non-participants, target > 1

Participant=includes participant costs only; target > 1; blank indicates that participant charged no costs for program

The Utility Cost Test (UCT) test compares utility benefits (avoided energy, transmission and distribution capacity and generation capacity related costs) to incurred utility costs to implement the program, such as marketing, customer incentives, and implementation costs, and does not consider other benefits such as participant savings or societal impacts.⁹ This test compares the cost (to the utility) to implement the measures with the savings or avoided costs (to the utility) resulting from the change in magnitude and/or the pattern of electricity consumption caused by implementation of the program. Avoided costs are considered in the evaluation of cost-effectiveness based on the projected cost of power, including the projected cost of the utility's environmental compliance for known regulatory requirements. The cost-effectiveness analyses also incorporate avoided transmission and distribution costs, and load (line) losses.¹⁰ For UCT test results below 1, these figures according to Duke Energy management, occur as follows:¹¹



- ◆ The Appliance Recycling Program results are below 1, because the program is no longer offered, as the vendor stopped participating; however, Duke Energy is looking to begin the program again with another vendor.
- ◆ The Low Income Services results are below 1, but because DEK believes it is an important program, it continues to offer it to low income customers.

For Total Resource Cost (TRC) test compares the total benefits to the utility and to participants relative to the costs to the utility to implement the program along with the costs to the participant. The benefits to the utility are the same as those computed under the UCT. The benefits to the participant are the same as those computed under the Participant Test; however, customer incentives are considered to be a pass-through benefit to customers. As such, customer incentives or rebates are not included in the TRC.¹² For TRC test results below 1, these figures according to Duke Energy management, DEK believes it is an important program; therefore, it continues to offer it to low income customers despite not making the target figure of 1.¹³

The Rate Impact Measure (RIM) test, or non-participants test, indicates if rates are expected to increase or decrease over the long-run as a result of implementing the program.¹⁴ It compares the benefits to the utility, the same benefits as included in the UCT test, to the costs required to implement a program including lost revenues.¹⁵

The Participant (PCT) test compares the benefits to the participant or customer through bill savings and incentives from the utility, relative to the costs to the participant for implementing the energy efficiency measure. The costs can include incremental equipment and installation costs, as well as increased annual operating cost, if applicable. This test is critical to understanding the market viability of a program or measure.¹⁶ The benefits include reductions in utility bills, incentives paid by the utility and any state, federal or local tax benefits received.¹⁷ None of the participants cost effectiveness test results are below 1, but those showing as blank are because participants do not have any costs associated with such programs.¹⁸

Finding II-3 The Board of Directors of the combined company includes at least one non-employee member who resides in the company's service territory in Kentucky, Indiana, or Ohio.

The Board of Directors of the combined company must include at least one non-employee member who resides in the company's service territory in Kentucky, Indiana, or Ohio. Of the 12 current Duke Energy directors, Michigan G. Browning resides in Indiana,¹⁹ and is Chair of Browning Investments, LLC.²⁰ He is an *Independent Lead Director* on Duke Energy's Board whose responsibilities include: Member, Compensation Committee; Chair, Corporate Governance Committee; and Member, Finance and Risk Management Committee. He has been a *Director* of Duke Energy since 2006.²¹

Finding II-4 **DEK appears to be responsive to the KPSC’s merger order conditions, but it cannot be determined if any merger costs will be passed on to DEK ratepayers until DEK’s next rate case.**

According to Duke Energy management, any costs to achieve associated with the merger are charged to the appropriate account pursuant to communicated guidelines provided to Schumaker & Company during our 2013 and 2015 audits. Then, at the time of a rate case, adjustments would be made, if necessary, to remove costs charged to “costs to achieve” from the revenue requirement calculation to be used for establishing new base rates. Duke Energy management believes that such adjustments would ensure that DEK meets its commitment to ensure that “no merger costs are passed on to its retail electric or gas customers.”²²

C. Recommendations

Recommendation II-1 **Provide sufficient documentation during DEK’s next rate case to ensure that Duke Energy/Progress Energy merger costs were not passed on to DEK ratepayers. (Refer to Finding II-4)**

According to documentation provided by Duke Energy management in our prior 2013 audit, costs could have been treated as costs to achieve (CTA) the merger if they are incremental, non-recurring, and incurred as a direct result of the merger. Also, for operations & maintenance (O&M) purposes, internal labor was not considered incremental; therefore, it was not included by Duke Energy in CTA, although internal labor could have been charged to capital CTA projects, if employees were involved in the merger activities. External labor (contractors) hired to work on O&M and capital CTA projects were considered incremental and were to be directly charged to CTA projects. Other guidelines, such as those provided for travel/lodging, were included in the documentation. Therefore, we recommended that, during the next DEK rate case, Duke Energy must provide rationalization as to why internal labor costs are not charged to CTA merger costs in selected situations, plus it must provide sufficient documentation to ensure that Duke Energy/Progress Energy merger CTA were not being passed on to Duke Energy Kentucky ratepayers.²³

As there has not been a rate case since our 2013 audit report, no such documentation has been provided, but should be in DEK’s next rate case.²⁴



C. Recommendations

None

-
- ¹ / Information Response 48
- ² / Information Response 52
- ³ / Information Response 52
- ⁴ / Information Response 52
- ⁵ / Information Response 52
- ⁶ / Information Response 52
- ⁷ / Interview 10
- ⁸ / Information Response 52 and Interview 10
- ⁹ / Information Response 52
- ¹⁰ / Duke Energy Carolinas Integrated Resource Plan (Annual Report) 2011
- ¹¹ / Interview 10
- ¹² / Information Response 52 and Duke Energy Carolinas Integrated Resource Plan (Annual Report) 2011
- ¹³ / Interview 10
- ¹⁴ / Information Response 52 and Duke Energy Carolinas Integrated Resource Plan (Annual Report) 2011
- ¹⁵ / Information Response 52
- ¹⁶ / Information Response 52
- ¹⁷ / Duke Energy Carolinas Integrated Resource Plan (Annual Report) 2011
- ¹⁸ / Interview 10
- ¹⁹ / Information Response 51
- ²⁰ / <http://www.duke-energy.com/corporate-governance/board-of-directors/board.asp> indicates Browning Consolidated, LLC; however, Browning's website <http://www.browninginvestments.com/about/company-overview> indicates Browning Investments, LLC.
- ²¹ / <http://www.duke-energy.com/corporate-governance/board-of-directors/board.asp>
- ²² / Prior Schumaker & Company audit report, Interview 1, and Information Response 50
- ²³ / Prior Schumaker & Company audit report
- ²⁴ / Information Responses 48 and 50
- ²⁵ / Information Response 1
- ²⁶ / Interview 1
- ²⁷ / Information Response 1
- ²⁸ / Information Responses 1 and 2
- ²⁹ / Information Response 53 and <https://www.duke-energy.com/about-us/leaders>
- ³⁰ / Information Response 6
- ³¹ / Information Response 38
- ³² / Interview 2
- ³³ / Prior Schumaker & Company audit report, Information Response 41, and Interviews 2 and 7
- ³⁴ / Information Response 41
- ³⁵ / Information Response 54
- ³⁶ / Information Responses 41 and 65
- ³⁷ / Information Response 4
- ³⁸ / Information Response 4
- ³⁹ / Information Responses 5 and 64 and Interview 3
- ⁴⁰ / Schumaker & Company Prior Audit Report
- ⁴¹ / Information Response 64
- ⁴² / KRS 278.2213
- ⁴³ / Information Response 37 and Interviews 6 and 8
- ⁴⁴ / Interviews 6 and 8



93 / Interviews 1 and 2
94 / Interview 1
95 / Information Response 10
96 / Information Response 10
97 / Interview 3
98 / Interview 3
99 / Interview 2
100 / Interview 1
101 / Information Responses 2 and 8 and Interview 1
102 / Interview 1
103 / Interview 1
104 / Interview 1
105 / Information Response 55
106 / Interview 1
107 / Interview 8
108 / Interview 3
109 / Schumaker & Company prior audit report and Interview 3
110 / Interview 3
111 / Schumaker & Company prior audit report and Interview 3
112 / Information Response 43
113 / Information Response 43
114 / Information Response 45 and Interview 3
115 / Schumaker & Company prior audit report and Interview 3
116 / Schumaker & Company prior audit report and Interview 3
117 / Schumaker & Company prior audit report and Interview 3
118 / Schumaker & Company prior audit report and Interview 3
119 / Schumaker & Company prior audit report and Interview 3
120 / Information Response 44
121 / Information Response 42
122 / Prior Schumaker & Company audit report and Interview 1
123 / Information Response 2 and Interview 3
124 / Information Response 10 and Interview 1
125 / Information Response 9 and Interview 1
126 / Interview 1
127 / Prior Schumaker & Company audit report and Interview 1
128 / Information Responses 2 and 8
129 / Schumaker & Company prior audit report and Information Responses 2 and 8, and Interview 6
130 / Information Response 21
131 / Schumaker & Company prior audit report and Information Responses 2 and 8, and Interview 6
132 / Information Responses 2 and 8
133 / Information Responses 2 and 8
134 / Interview 1, 2, and 8
135 / Interview 1, 2, and 8
136 / Schumaker & Company prior audit report
137 / Schumaker & Company prior audit report
138 / Information Response 47
139 / Information Response 48
140 / Duke Energy Website, Fixed Income Investors, Long-term Debt Details



45 / Interview 8
 46 / Schumaker & Company prior audit report
 47 / Interview 7
 48 / Interview 7
 49 / Interview 7 and Information Response 26
 50 / Interview 7
 51 / Interview 7
 52 / Interview 7 and Information Response 26
 53 / Information Response 25
 54 / Information Response 18
 55 / Schumaker & Company prior audit report and Interview 8
 56 / Information Responses 18 and 30
 57 / Interview 6
 58 / Information Responses 2 and 8
 59 / Information Response 2
 60 / Interview 8
 61 / Information Response 48
 62 / Information Response 48
 63 / Information Response 48 and Interview 8
 64 / Interview 8
 65 / Interview 8
 66 / Information Responses 18 and 19
 67 / Information Response 61
 68 / Information Response 61
 69 / Information Response 61
 70 / Information Response 61
 71 / Information Response 61
 72 / Information Response 19
 73 / Interview 8
 74 / Schumaker & Company prior audit report and Interview 8
 75 / Interview 6
 76 / Interview 6
 77 / Information Response 16
 78 / Interview 6
 79 / Interview 6
 80 / Information Response 14 and Interview 6
 81 / Information Response 14 and Interview 6
 82 / Information Response 14
 83 / Information Response 14
 84 / Information Response 14
 85 / Duke Energy Website and Information Response 49
 86 / Interview _ and Information Response 49
 87 / Information Response 49 and Interview 7
 88 / Information Response 49
 89 / Information Response 32
 90 / Information Response 2
 91 / Information Response 34
 92 / Information Response 10

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- ¹⁴¹ / Duke Energy Website, Fixed Income Investors, Recent Issuances & Prospectus
¹⁴² / Information Response 24
¹⁴³ / Information Response 24
¹⁴⁴ / Information Response 23, Attachment 2 and Interview 5
¹⁴⁵ / Information Response 23, Attachment 2
¹⁴⁶ / Information Response 23, Attachment 2
¹⁴⁷ / Information Response 23, Attachment 2
¹⁴⁸ / Information Response 23, Attachment 2
¹⁴⁹ / Information Response 23, Attachment 2
¹⁵⁰ / Information Response 23, Attachment 2
¹⁵¹ / Information Response 23, Attachment 1
¹⁵² / Information Response 23, Attachment 1
¹⁵³ / Information Response 23, Attachment 1
¹⁵⁴ / Information Response 23, Attachment 1
¹⁵⁵ / Duke Energy Website, Fixed Income Investors, Credit Facility & Liquidity, Master Credit Facility Agreement
¹⁵⁶ / Duke Energy Website, Fixed Income Investors, Credit Facility & Liquidity, Master Credit Facility Agreement
¹⁵⁷ / Duke Energy Website, Fixed Income Investors, Credit Facility & Liquidity, Master Credit Facility Agreement
¹⁵⁸ / Information Response 12
¹⁵⁹ / Interview 5
¹⁶⁰ / Information Responses 12 and 58
¹⁶¹ / Information Response 59
¹⁶² / Interview 9
¹⁶³ / Information Response 37 and Interview 9
¹⁶⁴ / Information Response 36
¹⁶⁵ / Prior Schumaker & Company Audit Report
¹⁶⁶ / Information Response 36
¹⁶⁷ / Information Response 36
¹⁶⁸ / Information Response 15
¹⁶⁹ / Interview 3
¹⁷⁰ / Interview 3
¹⁷¹ / Information Response 15
¹⁷² / Information Response 15
¹⁷³ / Information Response 15
¹⁷⁴ / Information Response 15
¹⁷⁵ / Information Response 15
¹⁷⁶ / Information Response 15

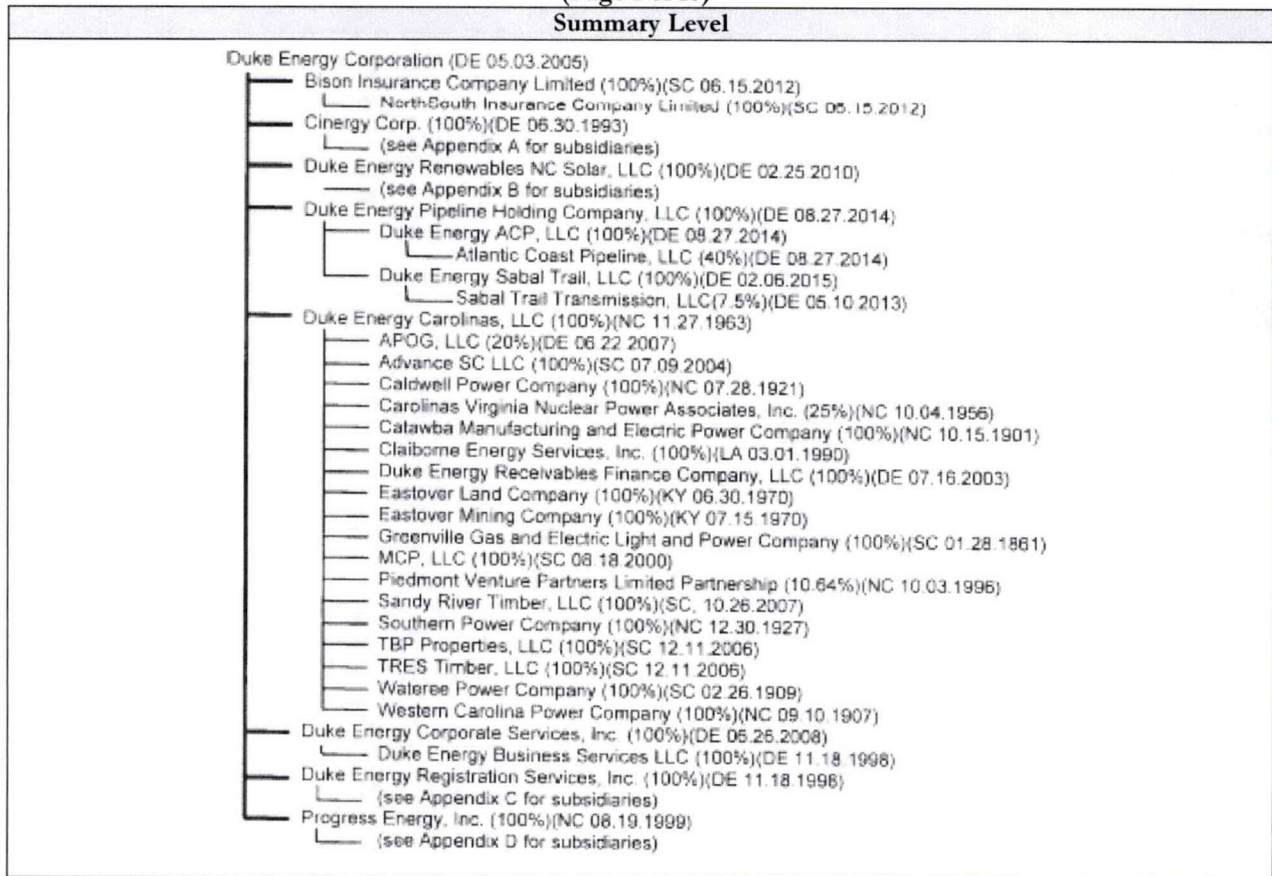
III. Affiliate Relationships

A. Background & Perspective

Organization Structure

While *Exhibit I-1* displayed in the *Executive Summary* chapter is a summary look at Duke Energy Corporation’s (Duke Energy’s) organization, *Exhibit III-1* is a detailed look, including changes made September 30, 2015-December 31, 2015.²⁵

Exhibit III-1
Detailed Duke Energy Corporation Organization Structure
as of December 31, 2015
(Page 1 of 10)



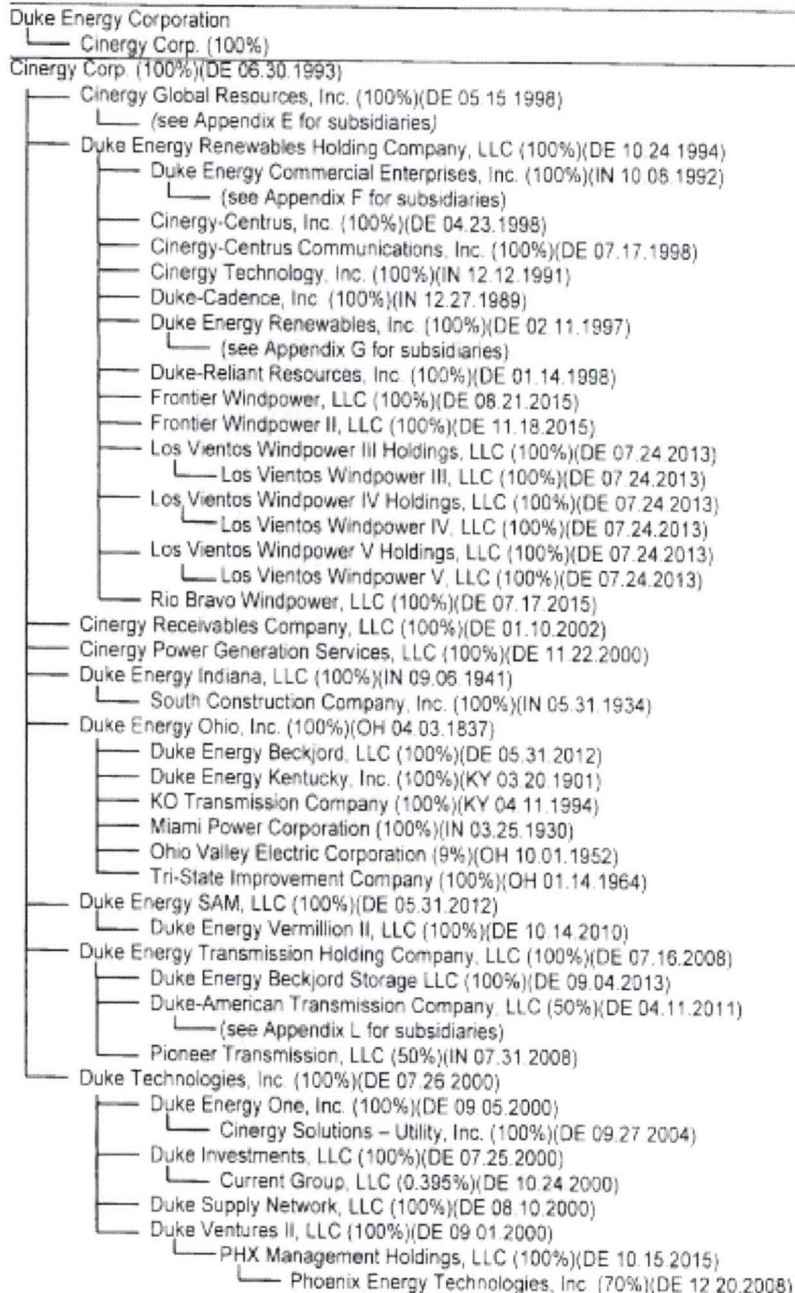
Source: Information Response 1 (SCH-DR-01-001 Supplemental Attachment)



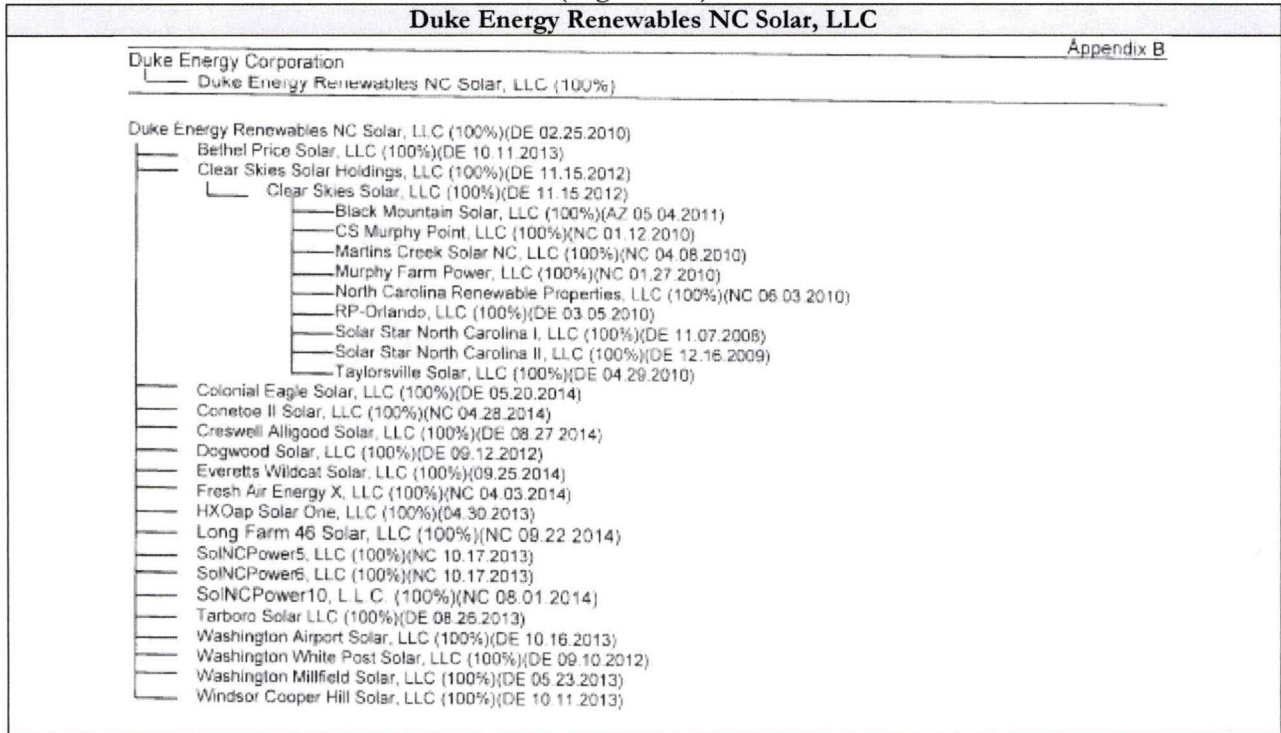
**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 2 of 10)**

**Cinergy Corporation
(including Duke Energy Kentucky organization)**

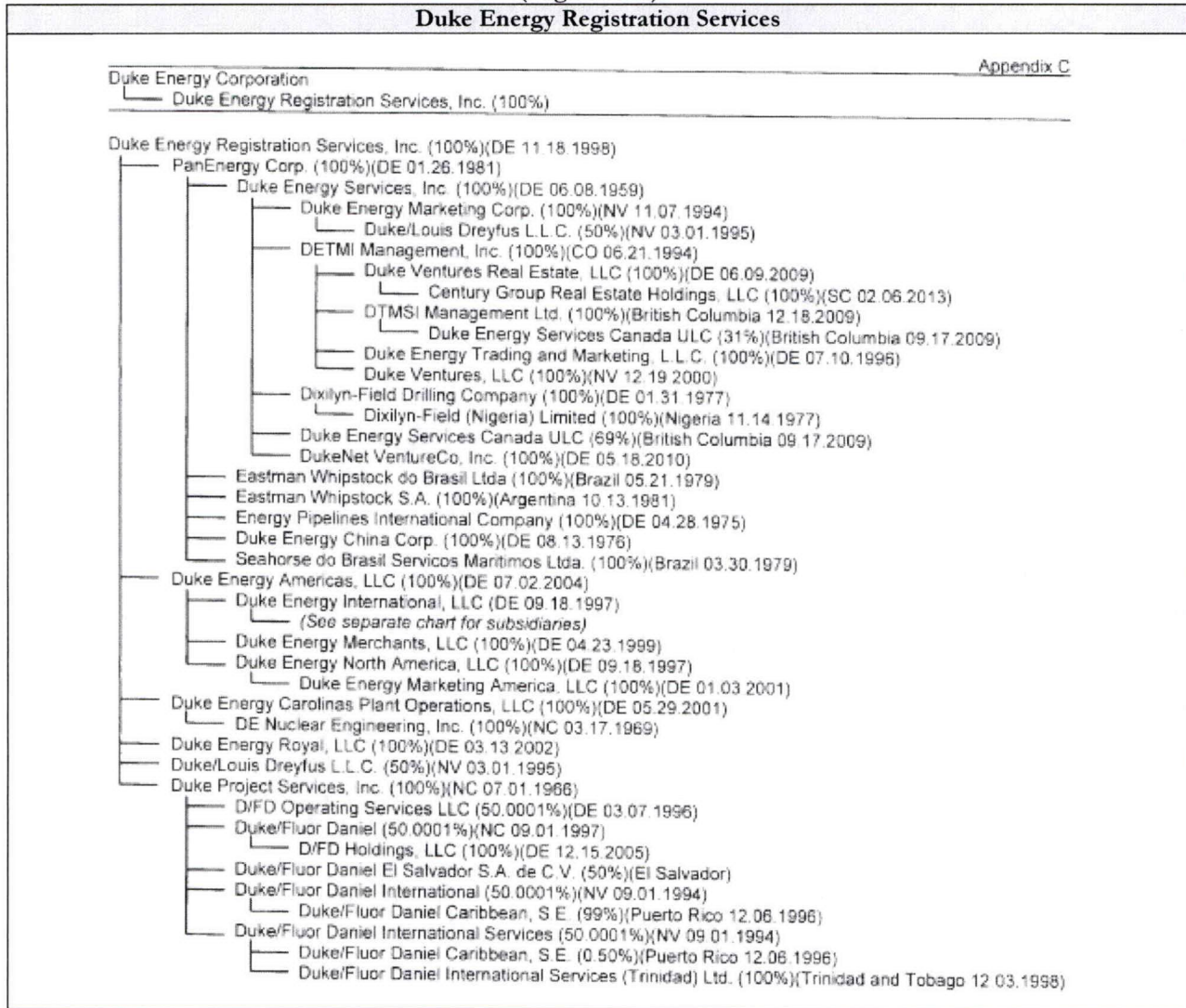
Appendix A



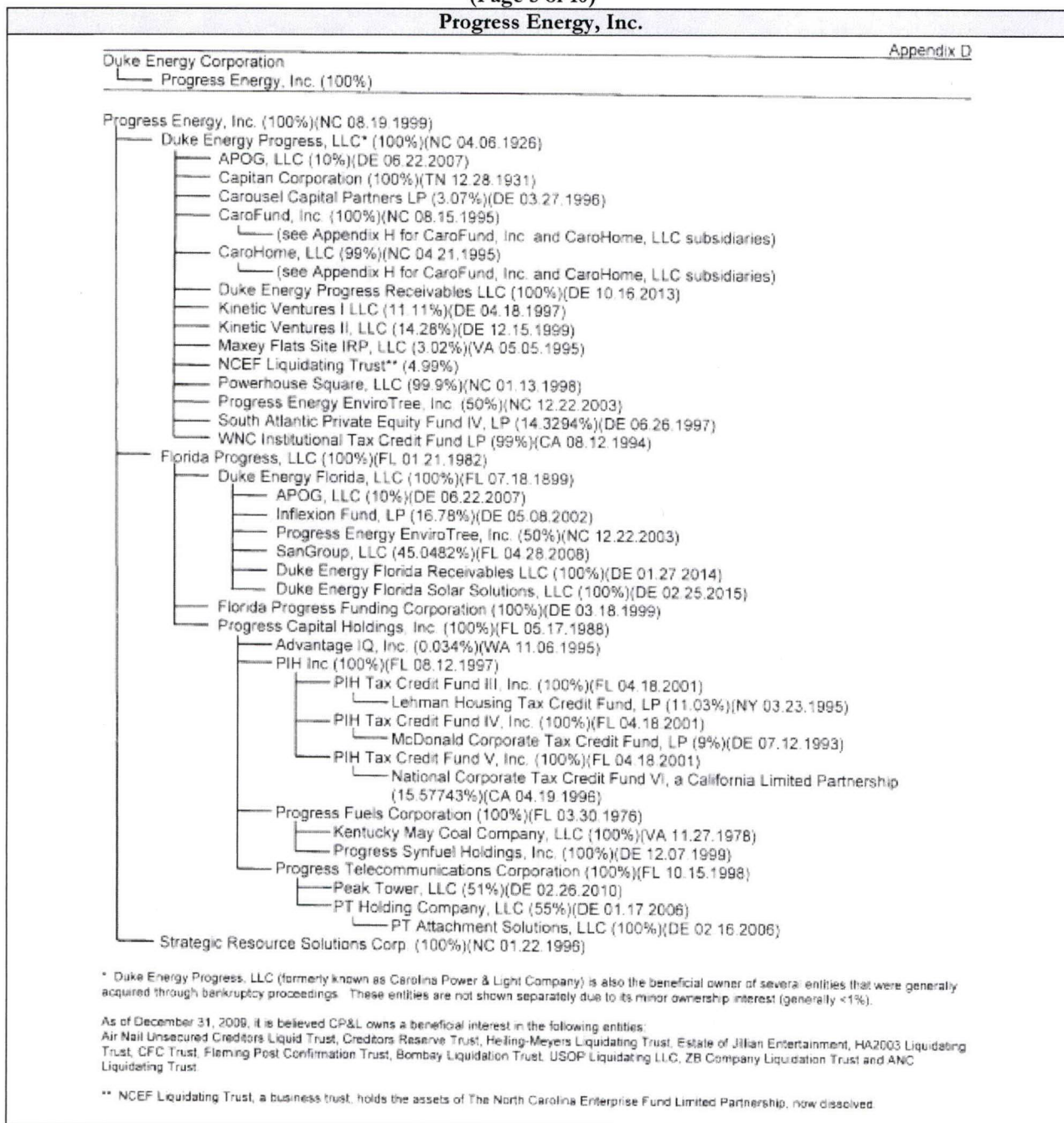
**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 3 of 10)**



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 4 of 10)**



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 5 of 10)**



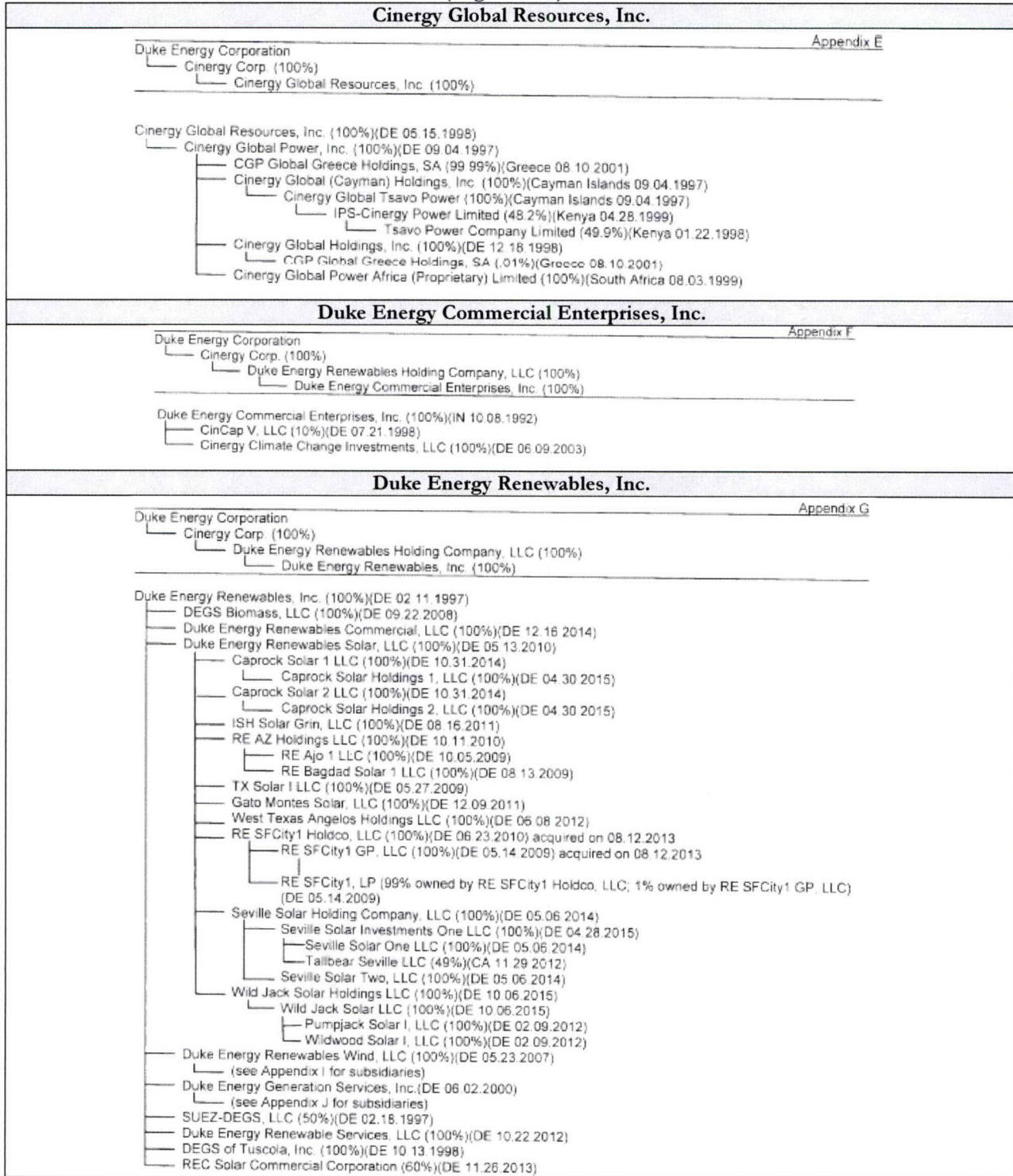
* Duke Energy Progress, LLC (formerly known as Carolina Power & Light Company) is also the beneficial owner of several entities that were generally acquired through bankruptcy proceedings. These entities are not shown separately due to its minor ownership interest (generally <1%).

As of December 31, 2009, it is believed CP&L owns a beneficial interest in the following entities: Air Nail Unsecured Creditors Liquid Trust, Creditors Reserve Trust, Heilig-Meyers Liquidating Trust, Estate of Jillian Entertainment, HA2003 Liquidating Trust, CFC Trust, Fleming Post Confirmation Trust, Bombay Liquidation Trust, USOP Liquidating LLC, ZB Company Liquidation Trust and ANC Liquidating Trust.

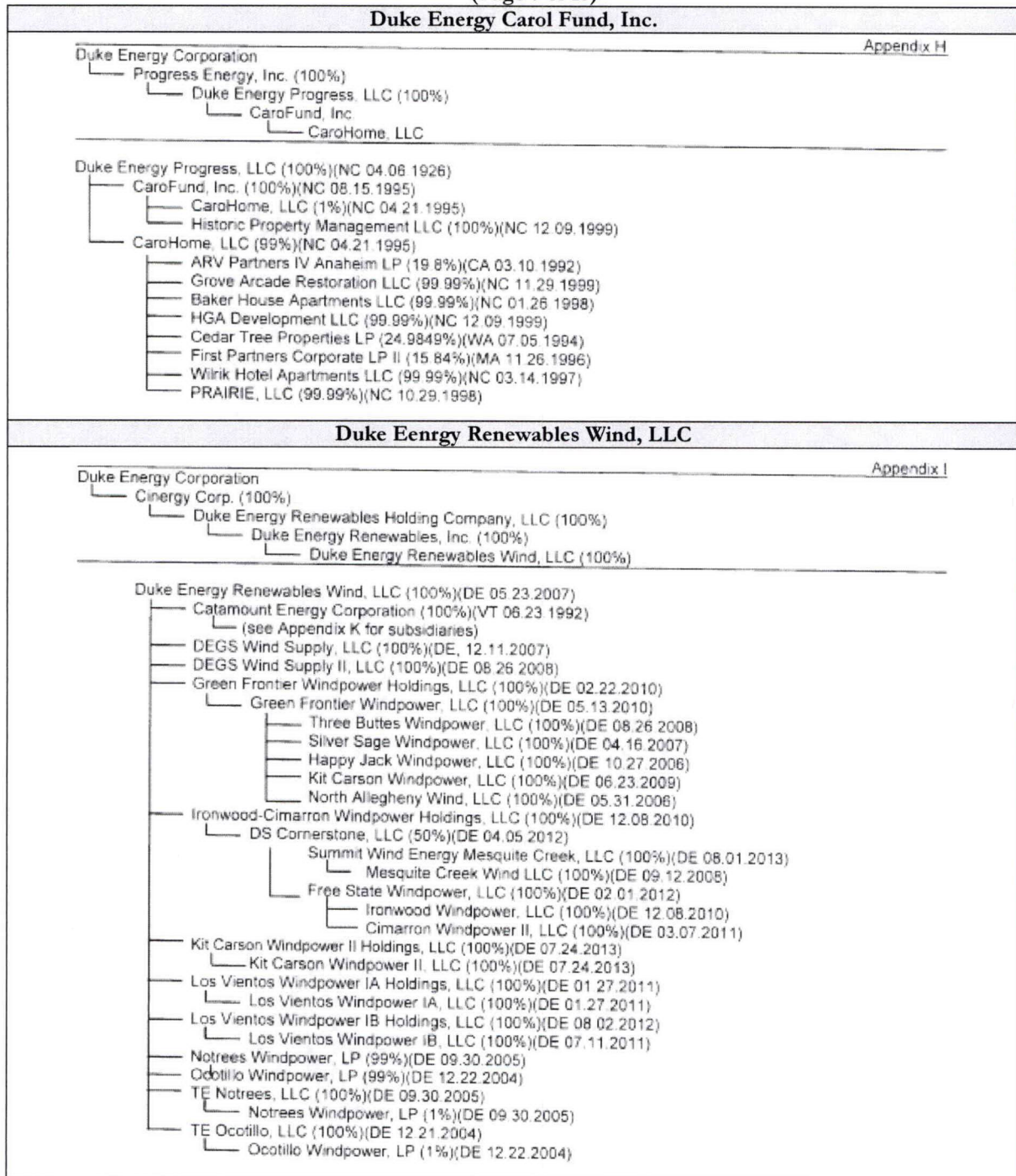
** NCEF Liquidating Trust, a business trust, holds the assets of The North Carolina Enterprise Fund Limited Partnership, now dissolved.



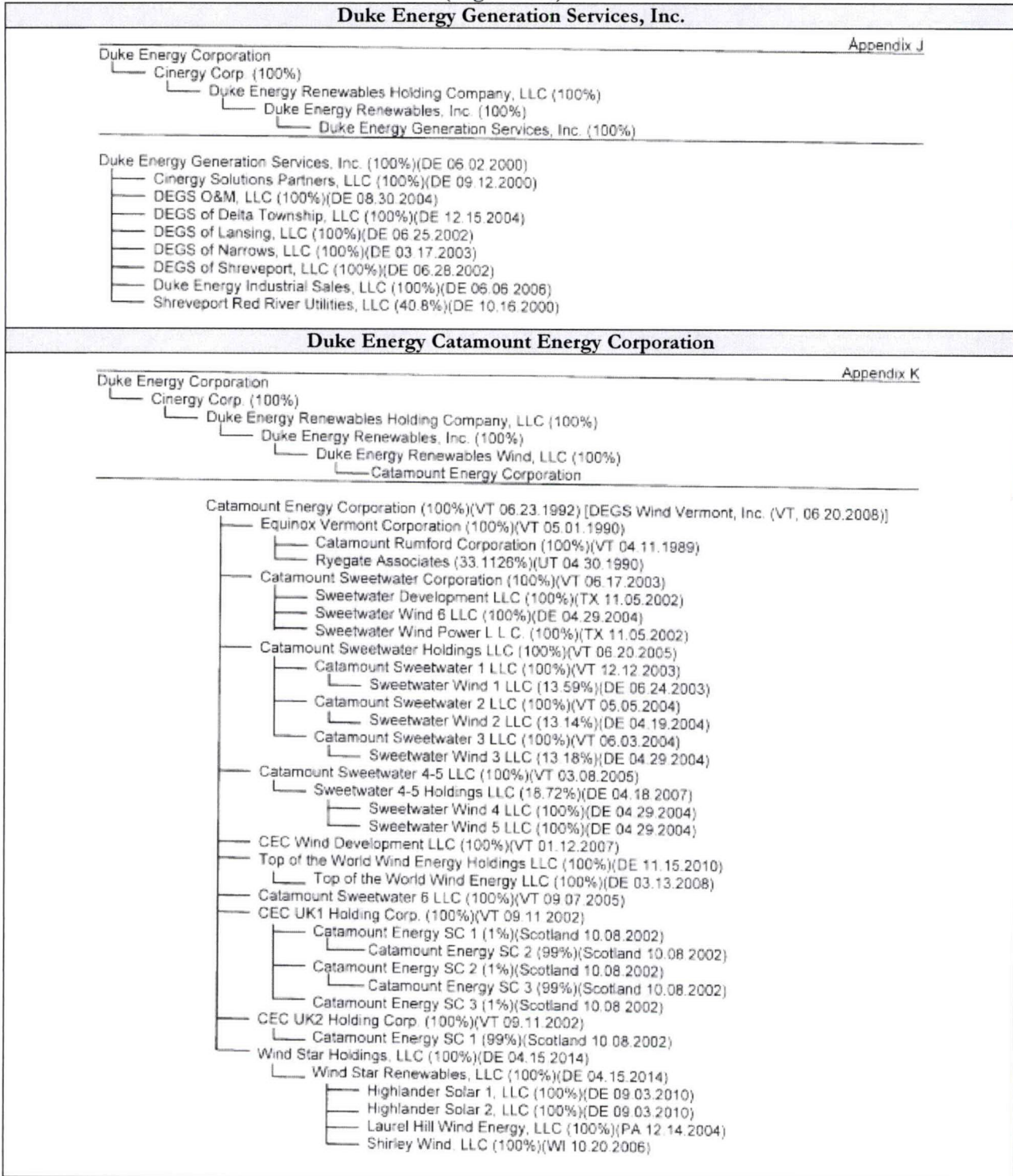
**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 6 of 10)**



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 7 of 10)**



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 8 of 10)**



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 9 of 10)**

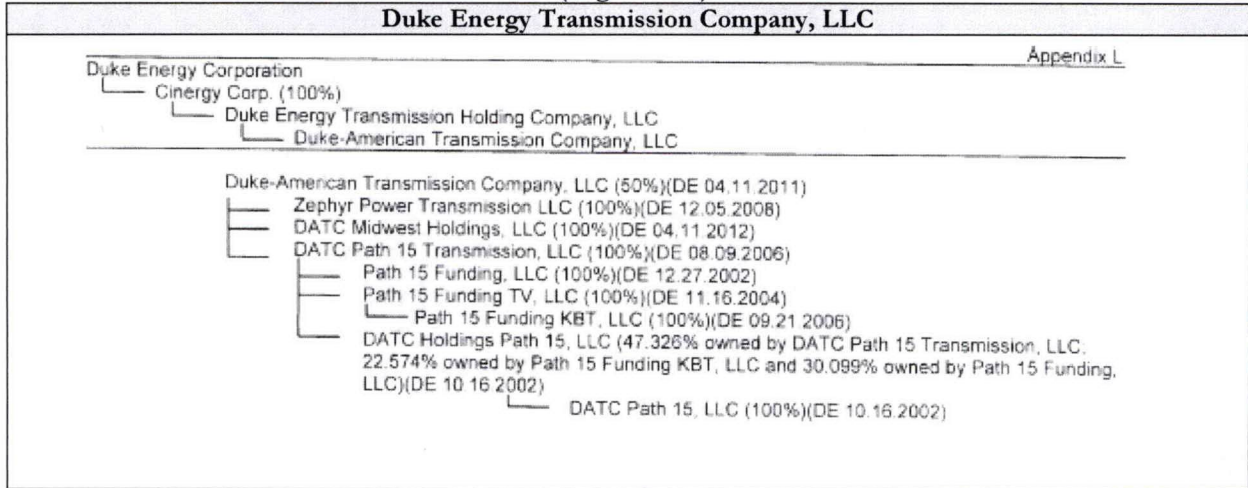


Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2015
(Page 10 of 10)

Changes to Corporate Structure – September 30, 2015-December 31, 2015

Entities Removed

- On October 21, 2015, CST General, LLC (100%)(TX 05.22.2001) was dissolved.
- On November 24, 2015, Duke Communications Holdings, Inc. (100%)(DE 09.20.1996) was dissolved.
- On December 17, 2015, SUEZ-DEGS of Orlando LLC (51%)(DE 06.12.1998) was dissolved.
- On December 31, 2015, Progress Energy Service Company, LLC (100%)(NC 07.12.2000) was merged into Duke Energy Business Services LLC (100%)(DE 11.18.1998).

Entities Added

- On October 6, 2015, Wild Jack Solar Holdings LLC (100%)(DE 10.06.2015) was formed in Delaware by Duke Energy Renewables Solar, LLC.
- On October 6, 2015, Wild Jack Solar LLC (100%)(DE 10.06.2015) was formed in Delaware by Wild Jack Solar Holdings LLC.
- On October 15, 2015, PHX Management Holdings, LLC (100%)(DE 10.15.2015) was formed in Delaware by Duke Ventures II, LLC.
- On October 22, 2015, Forest Subsidiary, Inc. (100%)(NC 10.22.2015) was formed in North Carolina by Duke Energy Corporation.
- On October 29, 2015, 70% of the equity interests of Phoenix Energy Technologies, Inc. (70%)(DE 12.20.2008) were acquired by PHX Management Holdings, LLC (100%)(DE 10.15.2015) through the merger of a newly formed subsidiary of PHX Management Holdings, LLC, Firebird Merger Sub, Inc. (100%)(DE 10.15.2015), with an into Phoenix Energy Technologies, Inc. The remaining 30% of the equity interests of Phoenix Energy Technologies, Inc. were retained by its original shareholders.
- On November 18, 2015, Frontier Windpower II, LLC (100%)(DE 11.18.2015) was formed in Delaware by Duke Energy Renewables Wind, LLC.
- On December 21, 2015, the following entities were acquired by Duke Energy Renewables Solar, LLC from Infigen Energy US Development Corporation:
 - Caprock Solar 1 LLC (100%)(DE 10.31.2014)
 - Caprock Solar 2 LLC (100%)(DE 10.31.2014)
 - Caprock Solar Holdings 1, LLC (100%)(DE 04.30.2015)
 - Caprock Solar Holdings 2, LLC (100%)(DE 04.30.2015)
- On December 31, 2015, the following entities were acquired by Duke Energy Renewables NC Solar, LLC from NC State Renewables LLC:
 - Long Farm 46 Solar, LLC (100%)(NC 09.22.2014)
 - SolNCPower10, L.L.C. (100%)(NC 08.01.2014)
- On December 31, 2015, Tarboro Solar LLC (100%)(DE 08.26.2013) was acquired by Duke Energy Renewables NC Solar, LLC from DERSM, LLC and Community Energy, Inc.

Entity Type Changes

- On December 15, 2015, Cinergy Investments, Inc. (100%)(DE 10.24.1994) converted from a Delaware corporation to a Delaware limited liability company and was renamed Duke Energy Renewables Holding Company, LLC.
- On January 1, 2016, Duke Energy Indiana, Inc. (100%)(IN 09.06.1941) converted from an Indiana corporation to a Indiana limited liability company and was renamed Duke Energy Indiana, LLC.

Entities Restructured

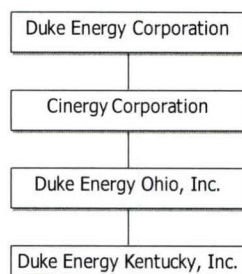
- On October 6, 2015, the equity interests in Pumpjack Solar I, LLC (100%)(DE 02.09.2012) and Wildwood Solar I, LLC (100%)(DE 02.09.2012) were contributed by Duke Energy Renewables Solar, LLC to Wild Jack Solar LLC (100%)(DE 10.06.2015).
- On December 15, 2015, the equity interests in the following companies were distributed by Duke Energy Renewables Wind, LLC through the corporate chain to Duke Energy Renewables Holding Company, LLC (f/k/a Cinergy Investments, Inc.) (see Appendix A, page 2, for the new structure):
 - Frontier Windpower, LLC (100%)(DE 08.21.2015)
 - Frontier Windpower II, LLC (100%)(DE 11.18.2015)
 - Los Vientos Windpower III Holdings, LLC (100%)(DE 07.24.2013) and its subsidiary, Los Vientos Windpower III, LLC (100%)(DE 07.24.2013)
 - Los Vientos Windpower IV Holdings, LLC (100%)(DE 07.24.2013) and its subsidiary Los Vientos Windpower IV, LLC (100%)(DE 07.24.2013)
 - Los Vientos Windpower V Holdings, LLC (100%)(DE 07.24.2013) and its subsidiary Los Vientos V, LLC (100%)(DE 07.24.2013)

Information contained in the GEMS database takes precedence over information disclosed in this document.
 Balance of ownership for entities <100% owned by a Duke entity can be referenced in GEMS.
 5/4/15

Also Progress Energy Service Company (PESC) employees became Duke Energy Business Services (DEBS) employees in 2014, but the legal entity was kept for existing contract requirements, although no charges were made; then in 2015 PESC was no longer a legal entity.²⁶

Exhibit III-2 illustrates Duke Energy Kentucky's (DEK's) parent, Duke Energy Ohio (DEO); DEO's parent, Cinergy Corporation; and Cinergy Corporation's parent, Duke Energy.²⁷

**Exhibit III-2
Duke Energy Kentucky Parental Structure
as of December 31, 2015**



Source: Information Response 1 (Attachment 1)

DEK is responsible for the transmission, distribution, and sale of electricity energy and the sale and transportation of natural gas in northern Kentucky. Its parent company is DEO, which is engaged in the production, transmission, distribution, and sale of electricity and the sale and transportation of natural gas in the southwestern portion of Ohio. Cinergy Corporation is the parent holding company of Duke Energy Indiana, Inc. (DEI), DEO, and Cinergy Investments, Inc.²⁸

The DEK Board is comprised of three directors, who have held Duke Energy positions, as follows:²⁹

- ◆ Lynn J. Good (1/29/2010 to present) – Duke Energy Board Chair; Duke Energy President & Chief Executive Officer; Chief Executive Officer of other Duke Energy entities, including Cinergy Corporation, DEBS, Duke Energy Carolinas (DEC), Duke Energy Florida (DEF), Duke Energy Indiana (DEI), DEK, DEO, Duke Energy Progress (DEP), and Progress Energy; Florida Progress President; Manager at Duke Energy Americas and Duke Ventures; plus Board Director of various Duke Energy entities
- ◆ Douglas F. Esamann (6/1/2015 to present) – Duke Energy Executive Vice President, Energy Solutions and President of Midwest and Florida Regions, including DEBS, DEC, DEF, DEI, DEK, DEO, and Duke Energy Progress; Chief Executive Officer of Miami Power Corporation and Tri-State Improvement Company; President of Eastover Land Company and Eastover Mining Company; plus Board Director of various Duke Energy entities
- ◆ Dhiaa M. Jamil (6/1/2015 to present) – Duke Energy Executive Vice President and Chief Operating Officer
- ◆ Lloyd M. Yates (1/1/2015 to 6/1/2015) – Duke Energy Executive Vice President & Delivery Operations and President – Carolinas Region
- ◆ B. Keith Trent (1/1/2015 to 6/1/2015) – Previously DEK Executive VP and DEO Executive VP & Chief Operating Officer, Regulated Utilities



Transactions

Services

Exhibit III-3 and Exhibit III-4 display affiliate charges (associated with non-power goods and services) to/from DEK for 2013 to 2015.³⁰

**Exhibit III-3
Affiliate Service Charges
2013 to 2015**

From Affiliates to DEK			
	2013	2014	2015
DE Commercial Enterprises	\$8,409,949	\$0	\$0
DEGS	\$0	\$0	\$0
Duke Energy Business Services	\$81,420,226	\$86,226,594	\$88,331,166
Progress Energy Service Company	\$940,382	N/A	N/A
Duke Energy Carolinas	\$3,577,970	\$6,775,364	\$21,167,640
Duke Energy Florida	\$0	\$139,228	\$297,920
Duke Energy Indiana	\$162,405	\$414,618	\$106,666
Duke Energy Ohio	\$7,143,367	\$16,145,091	\$12,067,280
Duke Energy Progress	\$536,615	\$765,397	\$983,478
Non-Utility	\$0	\$190,054	\$1,619,479
Commercial Asset Management	\$0	\$0	\$23,701
Total Affiliate Charges (\$)	\$102,190,914	\$110,656,345	\$124,597,330

Breakdown of Charges from Affiliates to DEK Duke Energy Service Company*			
	2013	2014	2015
Total Affiliate Charges (\$)	\$82,360,608	\$86,226,594	\$88,331,166
Direct %	63.7%	72.4%	75.9%
Allocated %	36.3%	27.6%	24.1%
Total %	100.0%	100.0%	100.0%

Other Affiliates			
	2013	2014	2015
Total Affiliate Charges (\$)	\$19,830,306	\$24,429,751	\$36,266,164
Direct %	39.4%	52.0%	33.7%
Allocated %	23.1%	22.4%	17.0%
Convenience Payments %	16.7%	25.7%	49.4%
*Information Not Made Available%	20.7%		
Total %	100.0%	100.0%	100.0%

Source: Information Responses 3, 6, 65, and 66

*In 2013 Duke Energy Service Company was a combination of DEBS and PESC; however, in 2014 and 2015 it is only DEBS; the figures above do not necessarily agree with our prior 2013 audit report, as previously it was based on FERC Form filings (minimum of \$250,000 per item), but above, it is based on raw data.

Also, for 2013, breakdown of DEC and DEP between direct and allocated charges not made available.

In 2014 and 2015 in the Breakdown of Charges from Affiliates to DEK, it excludes accounting transactions, which are included in 2013.

Overall DEBS costs increased from 2013 to 2015. According to Duke Energy management, the direct costs charged to DEK increased mainly due to ancillary transmission costs. This was partially offset by allocated costs decreasing due to incorporation of allocations to Progress entities. The largest change in direct costs are related to DE Carolinas. A large number of capital invoices are being processed through that entity. This is offset somewhat by a decrease in costs related to DEO, specifically related to generation services.³¹ According to Duke Energy management, these decreasing costs are primarily due a much larger pool of costs, making very little going to DEK.³²



**Exhibit III-4
Affiliate Service Charges
2013 to 2015**

From DEK to Affiliates			
	2013	2014	2015
Duke Energy Business Services	\$43,896	\$2,062	\$21,596
Duke Energy CAM	\$0	\$37,720	\$95
Duke Energy Carolinas	\$0	\$75,715	\$66,295
Duke Energy Dicks Creek, LLC	\$0	\$297,233	\$6,836
Duke Energy Florida	\$0	\$108	\$35,711
Duke Energy Indiana	\$1,240,952	\$1,336,873	\$1,388,388
Duke Energy Investments	\$0	\$0	\$0
Duke Energy Miami Fort, LLC	\$0	\$169,910	\$3,186
Duke Energy Ohio	\$3,220,531	\$2,030,593	\$2,514,069
Duke Energy One , Inc./Cinergy Solutions-Utility Inc.	\$11,590	\$6,985	\$3,820
Duke Energy Progress	\$0	\$82,868	\$31,506
Duke Energy Zimmer, LLC	\$0	\$34,844	\$668
Duke Energy Power Company	(\$5,655)	\$0	\$0
KO Transmission	\$18,026	\$25,528	\$877,200
Duke Energy Beckjord, LLC	\$0	\$0	\$4,086
Total Affiliate Charges (\$)	\$4,529,341	\$4,100,440	\$4,953,455

Breakdown of Charges from DEK to Affiliates Duke Energy Service Company*			
	2013	2014	2015
Total Affiliate Charges (\$)	\$43,896	\$2,062	\$21,596
Direct %	-394.7%	20.7%	76.6%
Allocated %	0.0%	6.3%	23.4%
Convenience Payments %	494.7%	73.0%	0.0%
Total %	100.0%	100.0%	100.0%

Other Affiliates			
	2013	2014	2015
Total Affiliate Charges (\$)	\$4,485,445	\$4,098,378	\$4,931,859
Direct %	46.6%	-42.8%	42.5%
Allocated %	33.6%	36.6%	29.4%
Convenience Payments %	19.8%	106.2%	28.0%
Total %	100.0%	100.0%	100.0%

Source: Information Responses 3 and 6

*In 2013 Duke Energy Service Company was a combination of DEBS and PESC; however, in 2014 and 2015 it is only DEBS

Convenience Payments

Convenience payments (also referred to at Duke Energy as pass-through costs) typically include:³³

- ◆ Finance and accounting services
- ◆ Insurance premium expense
- ◆ Advertising expense
- ◆ Community relations projects
- ◆ Donations
- ◆ Employee benefits expense
- ◆ Dues/subscriptions
- ◆ Signage/publications/printing
- ◆ Research and development
- ◆ Miscellaneous lease/rent expense

Exhibit III-5, for example, illustrates convenience payments involving revenues recorded by the Commercial Power segment of DEO for charges to DEK for 2013, 2014, and 2015.³⁴

Exhibit III-5
DEO Commercial Power Convenience Payments
2013 to 2015

DEO Charges to DEK							
Description	2013 Total	2014 Total	2015			2015 Total	Grand Total
			1	2	3		
DE KY pays Ohio for Ohio owned MF7-8 Equipment (Direct Lease)	64,956.00	245,388.00	20,449.00	20,449.00	32,248.00	73,146.00	383,490.00
CD equipment leased to DE Ohio subleased to DE Kentucky. KY pays OH who pays DP&L for a percent of CD owned equipment - Reverse Lease.	191,268.00	182,076.00	15,173.00	15,173.00	11,729.00	42,075.00	415,419.00
	256,224.00	427,464.00	35,622.00	35,622.00	43,977.00	115,221.00	798,909.00

Source: Information Response 41

No entries of equipment leases between DEO and DEK were made for the period April 2015 through December 2015, due to the sale of the Commercial Power generating assets effective April 2, 2015. Also, no other entries (such as (a) step-up transformers (East Bend, Woodsdale & Miami For or (b) transmission expenses from MISO, which were included in our prior audit report) are shown in 2013, 2014, or 2015, as they ended in 2012.

According to Duke Energy management, the trend in convenience payments associated with the direct lease exists due to a credit adjustment recorded in July 2013. This adjustment was recorded due to the fact that an incorrect lease rate had been used in the 2012 calculation. A similar adjustment was not necessary in 2014 or in 2015. DEO sold its ownership interest in Miami Fort in April 2015 and therefore stopped recording convenience payments after March 2015.³⁵

In general numerous payments have been made by various affiliates on behalf of DEK in 2013, 2014, and 2015, or vice versa, as shown in *Exhibit III-6*.³⁶



**Exhibit III-6
General Convenience Payments
2013, 2014, and 2015**

By Affiliates to DEK

	2013	2014	2015
Duke Energy Business Services			
Duke Energy Carolinas		\$3,145,056.02	\$16,300,258.09
Duke Energy Florida		\$7,122.11	\$16,2376.80
Duke Energy Indiana	\$2,985.11	\$66,030.36	\$27,264.21
Duke Energy Ohio	\$335,613.06	\$3,003,543.82	\$1,320,549.19
Duke Energy Progress		\$50,175.09	\$245,517.12
Duke Power Company			
Duke Commercial Enterprises	\$2,972,385.44		
KO Transmission Company			
Total	\$3,310,983.61	\$6,271,927.40	\$17,909,825.84

By DEK to Affiliates

	2013	2014	2015
Duke Energy Business Services	\$217,132.00	\$1,506.04	
Duke Energy Carolinas		\$3,709,785.41	\$408.11
Duke Energy Florida			
Duke Energy Indiana	\$11,336.59	\$98,826.12	\$74,914.51
Duke Energy Ohio	\$866,467.78	\$537,013.40	\$1,180,915.30
Duke Energy Progress		\$8,084.51	
Duke Power Company	\$11,433.70		
Duke Commercial Enterprises			
KO Transmission Company			\$127,103.50
Total	\$1,106,370.07	\$4,355,215.48	\$1,383,341.42

Source: Information Responses 41 and 65

Personnel Transfers

Exhibit III-7 displays personnel transfers from/to DEK for 2013 to 2015,³⁷ which indicates that more employees came from affiliates to DEK than from DEK to affiliates over this time period.

**Exhibit III-7
Affiliate Personnel Transfers
2013 to 2015**

From Affiliates to DEK				
From Company	2013	2014	2015	Total 2013-2015
Duke Energy Carolinas	1	0	0	1
Duke Energy Business Services	14	11	34	59
Duke Energy Commercial	2	6	2	10
Duke Energy Ohio	9	9	18	36
Total	26	26	54	106
From DEK to Affiliates				
To Company	2013	2014	2015	Total 2013-2015
Duke Energy Carolinas	0	0	0	0
Duke Energy Business Services	14	13	16	43
Duke Energy Commercial	0	0	0	0
Duke Energy Ohio	2	5	8	15
Total	16	18	24	58

Source: Information Response 4

Exhibit III-8 illustrates the difference in average fringe rates by company by year from 2013 to 2015.³⁸

**Exhibit III-8
Average Fringe Rates by Year**

Company	2013	2014	2015
Duke Energy Carolinas	22.64%	18.49%	17.94%
Duke Energy Business Services	25.24%	21.27%	22.27%
Duke Energy Commercial	21.0%	20.48%	26.69%
Duke Energy Ohio	51.15%	32.15%	34.38%
Duke Energy Kentucky	38.06%	32.06%	32.10%

Source: Information Response 4



Asset Transfers

Exhibit III-9 displays asset transfers from/to DEK for 2013 to 2015.³⁹

Exhibit III-9			
Affiliate Asset Transfers			
(Based on Original Cost)			
2013 to 2015			
From Affiliates to DEK			
	2013	2014	2015
Inventory Stock	\$4,732,073.66	\$5,990,852.47	\$7,441,476.83
Meters			
Electric	\$411,978.63	\$602,566.37	
Gas	\$105,719.19	\$105,098.16	
Transformers	\$533,007.34	\$342,211.27	
Regulators	\$0.00		
Other Miscellaneous Items	\$0.00	\$1,959,275.24	\$251,236.60
Total	\$5,782,778.82	\$9,000,003.51	\$7,692,713.43
From DEK to Affiliates			
	2013	2014	2015
Inventory Stock	\$783,045.67	\$697,938.26	\$666,040.05
Meters			
Electric	\$104,516.58	\$110,588.51	
Gas	\$65,067.56	\$59,694.39	
Transformers	\$0.00		
Regulators	\$0.00		
Other Miscellaneous Items	\$0.00	\$10,900.25	\$102,706.32
Total	\$952,629.81	\$879,121.41	\$768,746.37

Source: Information Responses 5 and 64 and Interview 3

The 2015 transfers from DEK to affiliates (DEO) includes Gas-Mains/Land & Land Rights/Miscellaneous Equipment, while 2015 transfers from affiliates (DEO) to DEK includes Structure & Boiler Plant Equipment.

The 2013 to 2015 inventory stock figures do not include Accounting Store transactions. Specifically the data excludes Issue and Return transactions for a STORELOC labeled ACCTING Storeroom. An "Accounting Storeroom" is used in the Midwest when materials issued to one project are ultimately used on another project. While the materials are not returned to the warehouse, warehouse personnel administratively "return" and "re-issue" the materials to the project where the materials are used. This eliminates the need for a journal entry in the General Ledger. That's one of the reasons why 2013 inventory stock figures differed in the prior audit report, as it included these transactions. Also Direct Purchase materials may have been included in data provided to Schumaker & Company for our prior audit report, should not have been included, as 2013 this time does not.

In the past (2013 and prior) according to Duke Energy management, the reason for the continually increasing asset transfers of inventory from affiliates to DEK was primarily due to the location of the Brecon Warehouse in Ohio that serves both Ohio and Kentucky. However, the increases in inventory stock from DEK to affiliates and vice versa increased dramatically, as Duke Energy was trying to use what the company has, though it has subsequently reduced.⁴⁰ Then, in the 2013 to 2015 timeframe, the changes year over year in outbound transactions can be attributed to decreases in volume with certain locations, such as Erlanger, Wheatland, and Brecon. Fluctuations in volume were seen inbound from locations, such as Erlanger, Augustine, and Brecon. In addition, non-regulated assets were sold in early 2015, which reflects a decrease in transactions between Miami Fort (non-regulated units) and Miami Fort 6 (regulated unit).⁴¹

Separation

One of the expectations specified in affiliate relationships and transactions rules has to do with the physical separation of regulated and unregulated business and the sharing of information and assets between these entities. In fact, Kentucky regulatory standards provide the following guidelines shown in *Exhibit III-10*.⁴²



Exhibit III-10
KRS 278.2213 Separate recordkeeping for utility and affiliate -- Prohibited business practices --
Confidentiality of information -- Notice of service available from competitor
as of December 31, 2015

The provisions of this section shall govern a public utility company's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated activities.

1. A utility and its affiliate shall be separate corporate entities and maintain separate books and records. If a utility and nonregulated affiliate have common officers, directors, or employees, the fees, compensation, and expenses of the individuals involved shall be subject to the cost allocation requirements set forth in KRS 278.2203 and 278.2207. Any utility that provides nonregulated activities shall separately account for all investments, revenues, and expenses in accordance with its filed cost allocation manual.
2. A utility shall not provide advertising space in its billing envelope to its affiliates or for its nonregulated activities unless it offers the same to competing service providers on the same terms it provides to its affiliates. This subsection applies to nonregulated activities only.
3. A utility shall not attempt to persuade customers to do business with its affiliates by offering rebates or discounts on tariffed services.
4. All utility company employees engaged in the merchant function shall abide by all standards promulgated by applicable FERC orders and regulations.
5. No utility employee shall share any confidential customer information with the utility's affiliates unless the customer has consented in writing, or the information is publicly available or is simultaneously made publicly available.
6. All dealings between a utility and a nonregulated affiliate shall be at arm's length.
7. Employees transferring from the utility to an affiliate shall not disclose to the affiliate confidential information or take with them any competitively sensitive materials.
8. Neither a utility nor its employees or agents shall solicit business on behalf of an affiliate or for its nonutility services.
9. A utility that carries out any research and development or joint marketing and promotion with its affiliate for its nonregulated activities shall be subject to the cost allocation requirements set forth in KRS 278.2203.
10. Except as provided in subsection (5) of this section, if a utility is engaged in a nonregulated activity, marketing employees for the nonregulated activity shall not have access to the customer information provided to the utility when the customer places an order for regulated service.
11. A utility shall not provide any type of undue preferential treatment to a nonregulated affiliate to the detriment of a competitor.
12. A utility shall notify the customer that competing suppliers of a nonregulated service exist if:
 - a. The utility receives a request for a recommendation from a customer seeking a specific service which is offered by the utility's affiliate or by the utility itself; and
 - b. The utility mentions itself or its affiliate when making the recommendation to the customer.

The utility's name, trademark, brand, or logo shall not be used by a nonregulated affiliate in any type of visual or audio media without a disclaimer. The commission shall develop specifications for the disclaimer. The disclaimer shall be approved by the commission prior to use in any advertisement by the utility's affiliate.

13. A utility shall not enter into any arrangements for financing nonregulated activities through an affiliate that would permit a creditor upon default to have recourse to the assets of the utility.
14. A utility shall inform the commission of all new nonregulated activities begun by itself or by the utility's affiliate within a time to be set by the commission.
15. Start-up costs associated with the formation of a nonregulated affiliate shall not be included in the utility's rate base.
16. The commission may require the utility to file annual reports of information related to affiliate transactions when necessary to monitor compliance with these guidelines.

Source: KRS 278.2213

This section discusses Schumaker & Company's findings regarding compliance to the above non-accounting items in the Kentucky standards.

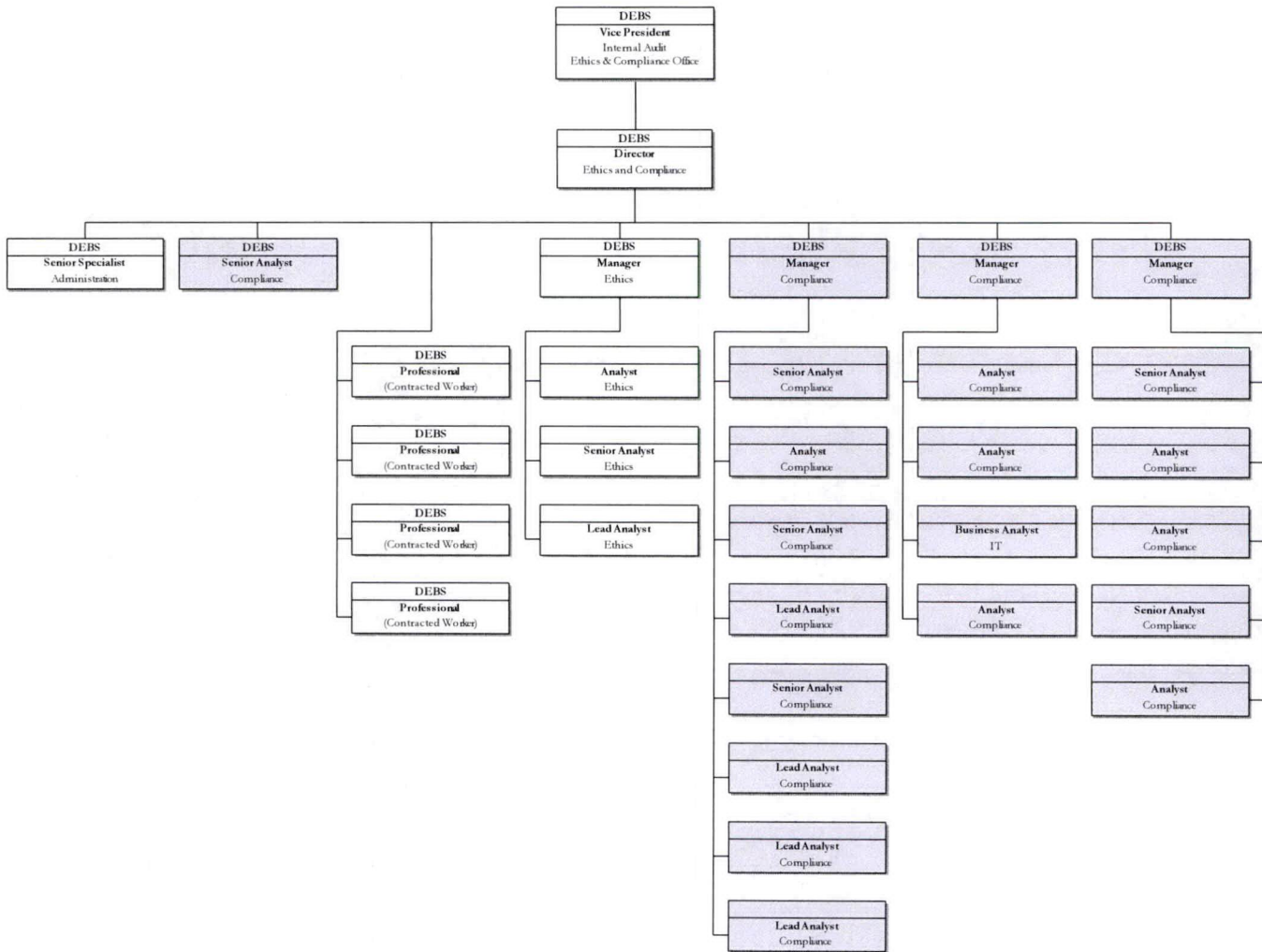
Ethics & Compliance Organization

Exhibit III-11 illustrates the 2015 DEBS Ethics & Compliance group, totaling 31 employees in Charlotte (NC), which reports to Audit Services (Internal Audit), and in turn the Chief Legal Officer. The three Compliance groups (highlighted in gray), plus the Senior Compliance Analyst, are responsible for state and federal regulatory compliance, including:⁴³

- ◆ State and federal regulatory requirements
- ◆ Monitoring regulatory compliance policies and procedures
- ◆ Providing guidance, such as affiliate standards training and advice, to Duke Energy employees in regulatory compliance matters

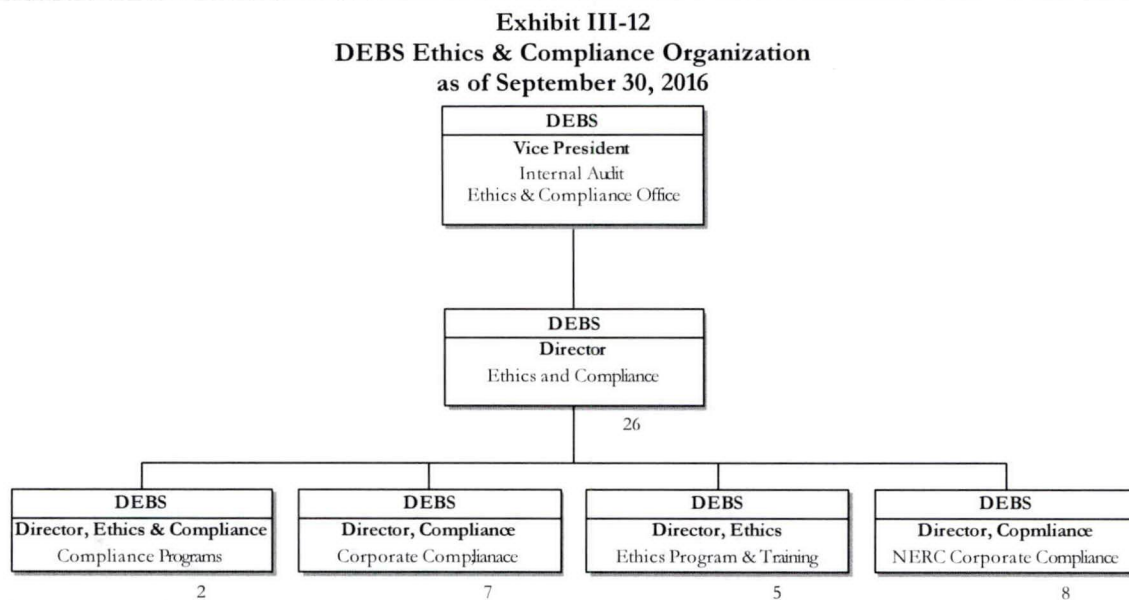


**Exhibit III-11
DEBS Ethics & Compliance Organization
as of December 31, 2015**



Source: Information Response 37 and Interviews 6 and 8

Exhibit III-12 illustrates that subsequently in 2016 that the number of employees is slightly down, plus the organization structure has been simplified.⁴⁴



Source: Interviews 6 and 8

The Open Pages system is used to track compliance issues, such as merger conditions, filings, or system access reviews, in which ownership of these issues is also kept. The Regulatory Compliance Manager handles any requests for clarification on Kentucky Affiliate Rules training requirements.⁴⁵

Other Organizations

At the time of Schumaker & Company’s prior audit, Duke Energy had two separate organizational groups that were responsible for regulated and unregulated power functions:⁴⁶

- ◆ The regulated electric business was located in Charlotte (NC). All of the offerings of generation resources into PJM or MISO and the requesting of day-ahead load requirements were handled from the Operations Center located in Charlotte (NC). The individual regulated generation units were dispatched from the Charlotte Operations Center and all trading activities were handled in the Charlotte Operations Center. Regulated wholesale sales were also handled in Charlotte (NC). The Operations Center was split between the Carolinas and Midwest (Kentucky and Indiana) organizations. At this time, there was another separate control centers for Duke Energy Progress located in Raleigh and another in Florida for the Florida properties.
- ◆ The unregulated electric business (Midwest Generation) was located in Cincinnati (OH). All of the offerings of generation resources into PJM Interconnection, LLC (PJM) and Midwest Independent System Operator (MISO) and the requesting of day-ahead load requirements were handled from the Operations Center located in Cincinnati (OH). The individual, formerly

regulated, generation units (which were in the process of being sold to Dynegy) were dispatched from the Cincinnati Operations Center and all trading activities were handled in the Cincinnati Operations Center. The Operations Center handled the dispatching of the former DEO generating plants, which were unregulated assets.

In early 2015, DEO closed on selling its generation assets in Ohio to Dynegy. Many of these assets were jointly owned with other utilities (primarily Dayton Power & Light Company and American Electric Power). Many of the personnel, dispatch, and trading functions went with the Dynegy acquisition. Thus Duke's Midwest unregulated electric business became for all purposes non-existent.⁴⁷

In the same timeframe, Miami Fort #6 (163 MW), a unit that was assigned to Kentucky, was retired. Then Kentucky acquired Dayton Power and Light's 31% interest in East Bend generating station resulting in 186 MW of generation. DEO's 69% interest was sold to Dynegy.⁴⁸

All dispatch and trading functions are located in Charlotte, NC. The unregulated generation business, which was located in Cincinnati, has been sold off resulting in the existence of no concern for regulated and unregulated generation, dispatch, and trading business being able to share facilities, equipment, and information. Kentucky now only has two generation units that are bid into PJM, specifically East Bend and Woodsdale Station (consisting of six simple cycle gas turbines).⁴⁹

DEK power transactions are handled out of Charlotte (NC) by a group of traders and dispatchers that only handle Kentucky and Indiana power transactions. There is a separate group of traders and dispatchers that handle the Carolinas power transactions in Charlotte (NC).⁵⁰

DEK's affiliated wholesale power marketers, as reported in the last audit operate separate from the regulated business. In many cases, they are located in other regulated jurisdictions and have purchase power agreements with power distributors in that geographic area. These entities were presented in the last management audit and little has changed since the last audit with the exception of the sales of certain generation assets to Dynegy.⁵¹

There is also no space occupied by DEK and non-regulated affiliated wholesale power marketers as defined. There are systems that are shared between DEK and the nonregulated affiliated wholesale power marketers, but there are controls in place to prevent information sharing. These two organizations operate independently. According to Duke Energy management, there were no situations during 2015 where DEK shared office space, computers, or any other assets with other Duke Energy affiliates. Schumaker & Company confirmed these statements by physical observations during our interviews.⁵²

Competitive or Sensitive Information

When asked to provide any formal policies or procedures documentation regarding access by DEK and any affiliate to competitive or sensitive information, a copy of Duke Energy's *Affiliate Restrictions – Information Disclosure Procedures* was provided, as shown in *Exhibit III-13*. Its purpose is to provide a

process for handling the disclosure of regulated market information to market regulated power sales affiliates.⁵³

Exhibit III-13
Affiliate Restrictions – Information Disclosure Procedure
 as of October 2015



Regulatory Compliance
 FERC Operations Manual

Affiliate Restrictions – Information Disclosure Procedure

Purpose: Document the process for handling the disclosure of regulated market information to market regulated power sales affiliates.

FERC Program Chapter:

Chapter 4 – Affiliate Restrictions & Standards of Conduct

Record Retention Rule:

Five years

Procedure:

- Legal shall be notified if regulated market information is shared with power sales affiliate employees, or if there are deviations from separation of functions, including during emergency situations.
- Legal will determine whether to make a posting of such information on its web site or a filing with the Commission, using procedures similar to those used for Standards of Conduct disclosures (see “Duke Energy FERC Page”).
- Legal or Federal Regulatory Compliance will meet with the business unit involved in the inappropriate disclosure to discuss and offer recommendations to mitigate future occurrences. This information (which may include compliance measures) will be maintained by Federal Regulatory Compliance.

Periodic Review of Procedures:

Automatic reminders are forwarded annually through OpenPages (compliance tool).

Key Contacts for this Procedure

- Legal
- Federal Regulatory Compliance

Revision History

Revision No.	Description	Date	Revised By
Original		10-4-13	bsr
Update	Refreshed titles	11-3-14	bsr
Update	Reviewed – No Change	10-6-15	bsr

Source: Information Response 25

Training materials used by Duke Energy’s or DEK’s employees on sharing of competitive or sensitive information and/or sharing of office space, computers, or any other assets includes the following information:⁵⁴

- ◆ Midwest (Kentucky, Indiana, and Ohio) state regulatory requirements for non-regulated products and services, including but not limited to:
 - The affiliate must be fully separated.
 - The affiliate must have separate accounting treatment.
 - The affiliate must not be given an unfair competitive advantage or be extended any undue preference by the utility (meeting guidelines, proprietary customer information/customer consent, customer leads/referrals, appropriate/inappropriate responses, etc.)
 - A code of conduct should be established that satisfies the commission rules.
- ◆ DEK expectations for customer care guidelines
- ◆ Non-regulated products and services comparison of Florida, Indiana, Kentucky, Ohio, and Carolinas.

Transfer Confidentiality Agreements

The Regulatory Compliance group manages and facilitates the employee transfer process from DEK to an affiliate.⁵⁵ Duke Energy's current process for informing employees of the regulatory conditions is to deploy annual training that explains entity separation, information sharing, joint marketing, regulated and non-regulated activities, and the regulatory conditions regarding each of these, respectively. There are materials in trainings that cover rules regarding the transfer of employees; therefore, Duke Energy does not currently use a process for employees to sign confidentiality agreements when transferring from the utility to an affiliate.⁵⁶

Identified individuals (and their managers) who transfer from the utility to an affiliate are required to complete and confirm that they have reviewed system access, physical access, and email distribution lists. Also, automated emails are forwarded to impacted managers with required actions items.⁵⁷

B. Findings & Conclusions

Affiliate Agreements

Finding III-1 **Only three affiliate agreements were changed in 2015 or the beginning of 2016.**

Exhibit III-14 summarizes existing affiliate agreements impacting DEK, including:⁵⁸

- ◆ Service Company Utility Service Agreement
- ◆ Amended and Restated Operating Company / Non-utility Companies Service Agreement
- ◆ Asymmetrically Priced Duke Energy Kentucky, Inc. / Nonutility Companies Service Agreement
- ◆ Operating Companies Service Agreement
- ◆ Amended and Restated Miami Fort 6 Operation Agreement
- ◆ Gas and Propane Services Agreement with Respect to Woodsdale Generating Station
- ◆ Utility Money Pool Agreement
- ◆ First Amendment to Second Amended and Restated Purchase and Sale Agreement with Cinergy Receivables (updated December 18, 2015)
- ◆ Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liabilities and Benefits
- ◆ Inter Company Asset Transfer Agreement
- ◆ Utility-Non-utility Asset Transfer Agreement

All of these agreements were established prior to 2015. Of these, only three (Service Company Utility Service Agreement, Amended and Restated Miami Fort 6 Operations Agreement, First Amendment to Second Amended and Restated Purchase & Sale Agreement with Cinergy Receivables) were changed in 2015 or the beginning of 2016.⁵⁹



Exhibit III-14
Existing Affiliate Agreements (Page 1 of 4)
as of December 31, 2015

Merger-Related-Service Agreements			
Agreement	Agreement Description	Effective	Compensation
Service Company Utility Agreement	DEBS and various utilities, including DEC, DEO, DEI, DEK, DEP, DEF, involving DEBS functions: information systems; meters; transportation; system maintenance; marketing/customer relations; T&D engineering/construction; power engineering/ construction; human resources; supply chain; facilities; accounting; power and gas planning and operations; public affairs; legal; rate design and analysis, finance; rights of way; internal auditing; environmental, health, and safety; fuels; investor relations; planning; executive; and nuclear development.	January 1, 2016 supersedes and replaces the Second Amended and Restated Utility Service Agreement dated December 1, 2011, as July 2, 2012 (third amendment) included in past audit still in progress.	Cost except otherwise required by IRS 482
Amended and Restated Operating Company/ Non-Utility Companies Service Agreement*	DEK/various Duke Non-Utility companies involving services (including loans of employees), such as: <ul style="list-style-type: none"> ◆ <i>DEK to Non-Utility</i>: engineering/construction; operation/maintenance; installation services; equipment testing; generation technical support; environmental, health/safety; and procurement services; plus use of assets, equipment, and facilities. ◆ <i>Non-Utility to DEK</i>: information technology services; monitoring, surveying, inspecting, constructing, locating, and marking of overhead and underground utility facilities; meter reading materials management; vegetation management; and marketing/customer relations. 	September 1, 2008 (amended and restated)	Cost except otherwise required by IRS 482
Asymmetrically Priced DEK/Non-Utility Companies Services Agreement*	DEK/various Duke Non-Utility companies involving services (including loans of employees), such as: <ul style="list-style-type: none"> ◆ <i>DEK to Non-Utility</i>: engineering/construction; operation/maintenance; installation services; equipment testing; generation technical support; environmental, health/safety; and procurement services; plus use of assets, equipment, and facilities. ◆ <i>Non-Utility to DEK</i>: information technology services; monitoring, surveying, inspecting, constructing, locating, and marking of overhead and underground utility facilities; meter reading materials management; vegetation management; and marketing/customer relations. 	October 1, 2009	FERC pricing mechanism
			Greater of cost or market for services provided by DEK to Non-Utility Companies
			Lesser of cost or market for services provided by Non-Utility Companies to DEK
Operating Companies Service Agreement	DEC, DEO, DEI, DEK, DEP, DEF, involving services (including loans of employees), such as engineering/ construction; operation/maintenance; installation services; equipment testing; generation technical support; environmental, health, and safety; and procurement services; plus use of assets, equipment, and facilities. It specifically excludes affiliate transactions involving sales or other transfers of assets, goods, energy commodities (electricity, natural gas, coal, and other combustible fuels), or thermal energy products.	July 2, 2012 (fourth amendment)	Cost based only; with DEC and DEP exceptions

Source: Information Responses 2 and 68

* The pricing in the Amended and Restated Operating Company/Non-Utility Agreement was in effect prior to FERC Order 707, which required any service or asset transfer involving a franchised utility and a non-utility affiliate to be priced using asymmetrical pricing. As Order No. 707 allows any pre-existing pricing between franchised utilities and non-utility affiliates to remain in effect and be grandfathered, thus, the Amended Agreement is considered a grandfathered agreement. The Asymmetrically Priced DEK/Non-Utility Companies Service Agreement was entered into after Order No. 707 went into effect.

**Exhibit III-14
Existing Affiliate Agreements (Page 2 of 4)
as of December 31, 2015**

Generation Acquisition Service Agreements			
Agreement	Agreement Description	Effective	Compensation
Amended and Restated Miami Fort 6 Operations Agreement	Permits Duke Energy Miami Fort, LLC to operate the Miami Fort 6 generating station, including procurement of fuel, on behalf of DEK.	March 31, 2015 Miami Fort 6 has been retired and is out of the regulatory structure on June 1, 2015	All reimbursable costs, operating costs, and fee*
Gas & Propane Services Agreement with Respect to Woodsdale Generating Station	Permits DEO to provide certain operations and maintenance support to DEK related to the natural gas and propane facilities at the Woodsdale generating station.	January 24, 2009 (first amendment)	Described in other agreement above.

Source: Information Response 2

* Reimbursable costs included: costs incurred in response to an emergency; a reasonably allocable portion of the cost of the insurance maintained by the Operator in accordance with Section 9.1 of the agreement; costs of third party advisors, consultants, attorneys, accountants and contractors retained and managed by the Operator in support of, and reasonable allocable to, the services; and any other cost designated by the parties as a reimbursable cost pursuant to the terms of the agreement. In no event shall Operator add any mark-up to the reimbursable costs.



Exhibit III-14
Existing Affiliate Agreements (Page 3 of 4)
as of December 31, 2015

Other Affiliate Agreements			
Agreement	Agreement Description	Effective	Compensation
Intercompany Asset Transfer Agreement	DEC, DEI, DEK, DEO, PEC, and Progress Energy Florida asset transfers, in which "assets" means parts inventory, capital spares, equipment and other goods except for commodities, such as the following: coal; natural gas; fuel oil used for electric power generation; emission allowances; electric power; and environmental control reagents.	July 2, 2012	Except to the extent otherwise required by Section 482 of the Internal Revenue Code or analogous state tax law, Recipient Operating Company shall compensate Transferor Operating Company for any assets transferred at cost; provided however that any transfers of electric generation-related assets between DEO, on the one hand, and DEI or DEK on the other hand, will be priced in accordance with FERC affiliate transaction pricing requirements. *
Utility-Non-Utility Asset Transfer Agreement	DEK/Non-Utility asset transfers, in which "assets" means parts inventory, capital spares, equipment and other goods except for commodities, such as the following: coal; natural gas; fuel oil used for electric power generation; emission allowances; electric power; and environmental control reagents.	January 1, 2009	Except to the extent otherwise required by Section 482 of the Internal Revenue Code or analogous state tax law, a Recipient party under this Agreement shall compensate the Transferor for any assets transferred in accordance with the FERC affiliate transaction pricing requirements. Accordingly, assets transferred from DEK to a Non-Utility Company shall be priced at the greater of cost or market, and assets transferred from a Non-Utility Company to DEK shall be priced at no more than market. Alternatively, to the extent that an asset may be transferred under this Agreement, the Transferor and Recipient may agree that the asset transferred to the Recipient be replaced in kind.

Source: Information Response 2

* Accordingly, generation-related assets transferred from DEI or DEK to DEO shall be priced at the greater of cost or market, and generation-related assets transferred from DEO to DEI or DEK shall be priced at no more than market. Alternatively, to the extent that an asset may be transferred under this Agreement, the Transferor and Recipient may agree that the asset transferred to the recipient be replaced in kind.

Exhibit III-14
Existing Affiliate Agreements (Page 4 of 4)
as of December 31, 2015

Agreement Title	Agreement Description	Effective	Compensation
Utility Money Pool Agreement	A money pool arrangement to manage cash and working capital requirements in which those companies with surplus short-term funds provide short-term loans to affiliates (other than Duke Energy, Progress Energy, and Cinergy) participating under this arrangement.	July 3, 2012	Depends on whether internal and/or external fund used.
First Amendment to Second Amended and Restated Purchase & Sale Agreement with Cinergy Receivables	Allows the operating companies (DEI, DEO, and DEK) to sell their retail accounts receivables to this affiliate.	December 18, 2015 (first amendment to November 5, 2010 agreement)	Fair market value of receivable on initial funding date
Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liability and Benefits	Tax liability is allocated to Duke Energy subsidiaries on the basis of the percentage of the total tax which the tax of such an entity, if computed on a separate return, would bear to the total amount of the taxes for all entities.	July 2, 2012 (second amendment)	

Source: Information Response 2

Affiliate Training

Finding III-2 **Significant improvements have been made regarding Duke Energy's affiliate training sessions and communications with its employees regarding these sessions.**

A new training strategy has been developed at Duke Energy. Generally the various training sessions are by topic, not by jurisdiction as previously done; however, topics are keyed if different requirements in states occur. For example, relative to Kentucky, the content of training differs due to slightly different Affiliate Rules in Kentucky, although they are very similar to Ohio rules. One difference is that DEK is required to specifically report asset transfers \$1 million or more to the Kentucky Public Service Commission (KPSC), but no differences regarding service charges involving Kentucky apply.⁶⁰

For regulatory training deployed by the Ethics & Compliance Department, Duke Energy has revised its standard deployment period from 60 days to 90 days and made significant changes to the reminder and past due escalation schedules.⁶¹



Employees receive a total of five (5) reminders prior to the due date, including the initial notice. Duke Energy has also increased the escalation and automated system reminders (from *MyTraining*), which are also sent to immediate managers earlier in the process, prior to the due date. Previously Duke Energy began escalation two (2) weeks after the due date with management and escalated weekly thereafter, until it notified senior management.⁶² Below is the current deployment reminder and escalation process now being used, which was started in June 2016:⁶³

- ◆ **DAY 1** – *MyTraining* > initial notice to individual
- ◆ **DAY 45** – *MyTraining* > reminder to individual
- ◆ **DAY 60** – *MyTraining* > reminder to individual and copy to manager
- ◆ **DAY 70** – Manual reminder and incomplete report to management
- ◆ **DAY 80** – *MyTraining* > reminder to individual, copying manager, and manual > incomplete report to management
- ◆ **DAY 89** – *MyTraining* > reminder to individual
- ◆ **DAY 91** – *MyTraining* > overdue to individual, copy to manager, and manual > incomplete report to senior management
- ◆ **DAY 98** (and weekly thereafter) – *MyTraining* > overdue to individual, copy to manager, and manual > incomplete report senior management until 100% complete

In the past, Duke Energy only knew if employees passed a training course, but now it knows which areas employees are struggling with. As test questions are incorporated into the training sessions, the Compliance group can review how many employees missed specific questions and see how long employees have been with the company, thereby allowing the group to decide what to do in response.⁶⁴

To identify the employees required to participate in training, Duke Energy identifies a deployment list, which is reviewed annually. It will also be updated throughout the year, if necessary. Those identified are not just Service Company employees but anyone within the Duke Energy organization whose function is likely to be impacted by Affiliate Rules requirements.⁶⁵

All of the following training courses were deployed via the *Learning Management System*:⁶⁶

- ◆ *State Regulatory – Compliance Standards Overview Training* – The State Regulatory Compliance Standards Overview Training (EC31115) is meant to serve as annual “awareness” training for targeted employees in all six regulated jurisdictions. The training course provides a high-level overview of the state regulatory requirements and rules affecting Duke Energy, its employees, and their interactions with affiliates/nonpublic utility operations as it relates to relationships, activities and transactions with the regulated utility business. The topics covered include corporate separation, customer information, marketing non-regulated products and services, asset transfers, affiliate transaction restrictions, and time reporting. Recipients will be those employees State Regulatory Compliance has determined as being:⁶⁷
 - Only those employees who need general awareness on affiliate rules, and
 - Those employees who will not be receiving a more specific targeted training.

- ◆ *State Regulatory for Business Customers - Midwest* – The State Regulatory for Business Customers Midwest Training (EC30215) covers the rules and regulations for non-regulatory products in Ohio, Kentucky, and Indiana. This training stresses the importance of following Duke Energy’s compliance standards specific to the jurisdiction. It included scenarios, questions, and facts around the rules and verbiage of the Midwest compliance standards for separation. It also provided specific points of contacts and referenced additional training materials on the State Regulatory Portal page. This training was deployed to large account managers and employees who deal with non-regulatory products and services within the Midwest jurisdiction. Recipients will be those employees State Regulatory Compliance has determined as being:⁶⁸
 - Responsible for developing, marketing, selling, or managing non-regulatory products and services, or
 - Serve as a dedicated customer account representative who interfaces directly with customers who may have interest in non-regulatory products and services
- ◆ *State Regulatory - Services and Goods* – The State Regulatory - Services and Goods Training (EC31215) explains the state regulatory affiliate transaction restrictions across all six regulated jurisdictions. Specifically, it provides information related to service agreements, eForms, affiliate transactions, the Cost Allocation Manual, time reporting, core utility functions, direct charging, and asset management. Recipients are those employees State Regulatory Compliance has determined as being:⁶⁹
 - Those employees who work directly with affiliate (service or asset transfer) transactions, or
 - Those employees who manage employees who review or perform affiliate (service or asset transfer) transactions
- ◆ *State Regulatory - Customer Information (Non Call Center)* – The State Regulatory Compliance Customer Information Training (EC31415) is meant to provide guidance on the use of customer information and how to appropriately handle requests for customer information in accordance with the regulatory requirements across the six regulated jurisdictions. Recipients are those employees State Regulatory Compliance has determined as being:⁷⁰
 - Those employees who have access to customer information, and
 - Those employees who manage employees that have access to customer information.
- ◆ *State Regulatory - Customer Information (Call Center)* – The State Regulatory Compliance Customer Information Training (EC31415C) is meant to provide guidance on the use of customer information and how to appropriately handle requests for customer information in accordance with the regulatory requirements across the six regulated jurisdictions. Recipients are those employees State Regulatory Compliance has determined as being:⁷¹
 - Those employees who have access to customer information, and
 - Those employees who manage employees that have access to customer information.

This specific training was deployed to the above employees that work in the call centers.



In 2015, as shown in *Exhibit III-15*, are statistics regarding these five training types.⁷²

Exhibit III-15
Duke Energy Training Sessions
2015

Training Type	Original Date Deployed	# Deployed	# Removed	# Completed	Dates Completed	# Completed > 90 Days
Compliance Standards Overview Training (EC31115)	11/04/2015	894	18	876	10/26/2015-2/09/2016	1
State Regulatory for Business Customers-Midwest (EC30215)	6/16/2015	83	0	83	6/17/2015-9/01/2015	
State Regulatory-Services and Goods (EC31215)	11/17/2015	1,532	98	1,434	11/17/2015-03/02/2016	7
State Regulatory-Customer Information (Non Call Center) (EC31415)	11/09/2015	761	49	712	11/10/2015-02/09/2016	
State Regulatory- Customer Information (Call Center) (EC31415C)	11/09/2015	1,520	247	1,273	11/10/2015-02/26/2016	27

Source: Information Response 19

Completed includes all employees that completed the training, even if they were not in the original deployment date shown above.

Some employees were deployed beyond the original date deployed, as they were not in the specific position at the time of the original deployment, so that's one of the reasons why some dates completed look like they were more than 90 days beyond the original date deployed. Therefore, the number of employees found to actually be more than 90 days is shown above in *Exhibit III-15* in the last column. For example, one (1) EC31115 employee was only seven days late, seven (7) EC31215) employees were up to 16 days late, and 27 EC31415C employees were only two days late. The number of days late is insignificant and completion subsequently occurred.

The focus of training is threefold, as follows:⁷³

- ◆ A discussion of why guidance regarding affiliate relationships is important, including risks if not followed.
- ◆ A direct description of what that means.
- ◆ A reminder that, if employees have questions, who they should contact for further guidance.

Additionally, Duke Energy has an ethics line that allows employees to call in, anonymously if they like, any concerns that they have, although the company has also added a state regulatory mailbox (stateregcompliance@duke-energy.com), which is focused on compliance issues. Duke Energy encourages employees to use the mailbox for any questions or concerns that employees have with regarding to compliance issues, but they can use either the ethics line or the mailbox. Advertisements for the ethics line and mailbox include posters in buildings and mention in code of business and affiliate training sessions.⁷⁴

Benchmarking

Finding III-3 Duke Energy recently performed various market assessment studies as a means to compare costs to market values for services performed.

Duke Energy targets its payroll rates to be median figures. If adjustments are made, individual employee's pay is not changed, but salary ranges are adjusted.⁷⁵ Therefore, annually Duke Energy performs assessments of core processes to review internal payroll rates versus external market rates, in which approximately $\frac{1}{3}$ are completed each year.⁷⁶ *Exhibit III-16* provides a listing of the latest benchmarking reports of DEBS' practice areas (both corporate/governance and transactional areas) involving cost and service competitiveness of these areas.⁷⁷ In 2015, for example, management positions only were included. As a result, very limited adjustments were made in 2015. In 2016 exempt professional positions were included, with non-exempt positions to be included in 2017.⁷⁸ The rate figures have been generally flat for several years, although changes are emerging in renewables (2015) and cybersecurity (2016).⁷⁹



Exhibit III-16
Latest DEBS Benchmarking Studies

Survey Code	Survey Name	Data Effective Date
ACR-IR15	ACR Investor Relations, 2015	2015-04-01
DIET-DD15	Dietrich Drafting & Design, 2015	2015-03-01
EAP-DIS15	Energy Technical Craft Clerical, 2015	2015-04-01
EMPS-ASST15	Empsight Executive Administrative Support, 2015	2015-03-01
EMPS-CA15	Empsight Finance and Compliance, 2015	2015-03-01
EMPS-DIG15	Empsight Digital Marketing / Marketing Results, 2015	2015-03-01
EMPS-GOV15	Empsight Gov't Relations & Corp Communications, 2015	2015-03-01
EMPS-HR15	Empsight Human Resources, 2015	2015-03-01
EMPS-LAW15	Empsight Law Large Company Edition, 2015	2015-03-01
EMPS-SITS15	Empsight IT & Security Large Company Edition, 2015	2015-03-01
EQU-EXE-DUKE15	Equilar Executive Compensation Survey (Duke Energy), 2015	2015-05-01
FOU-ENV15	Foushee Environmental, Health & Safety, 2015	2015-04-01
FOU-SEC15	Foushee Security & Compliance, 2015	2015-01-01
GBS-AV115	Gallagher Aviation, 2015	2015-02-01
HEW-EMT15	Aon Hewitt Energy Marketing and Trading, 2015	2015-03-01
HEW-EXE-T15	Aon Hewitt TCM Executive Total Comp by Industry Full Value LTI, 2015	2015-03-01
HEW-IEHRA15	Aon Hewitt IEHRA Energy Industry, 2015	2015-05-01
HEW-MP-IND-T15	Aon Hewitt TCM Mgmt & Prof Total Comp by Industry, 2015	2015-03-01
HEW-REN15	Aon Hewitt Renewable Energy, 2015	2015-05-01
HILD-LAW-DUKE15	Hildebrandt Law Department (Duke Energy), 2015	2015-03-15
MER-CON15	Mercer Contact Center, 2015	2015-03-01
MER-DCO15	Mercer US Digital Convergence Industry, 2015	2015-03-01
MER-EXE-R15	Mercer Executive - Revised, 2015	2015-03-01
MER-FAL-R15	Mercer Finance, Accounting & Legal - Revised, 2015	2015-03-01
MER-HRM-R15	Mercer Human Resources - Revised, 2015	2015-03-01
MER-ITS-R15	Mercer Information Technology - Revised, 2015	2015-03-01
MER-LSC-R15	Mercer Logistics & Supply Chain - Revised, 2015	2015-03-01
MER-MBC-NC-R15	Mercer Metro Benchmark - North Central - Revised, 2015	2015-03-01
MER-MBC-NE-R15	Mercer Metro Benchmark - Northeast - Revised, 2015	2015-03-01
MER-MBC-SC-R15	Mercer Metro Benchmark - South Central - Revised, 2015	2015-03-01
MER-MBC-SE-R15	Mercer Metro Benchmark - Southeast - Revised, 2015	2015-03-01
MER-MBC-WC-R15	Mercer Metro Benchmark - West Coast - Revised, 2015	2015-03-01
MER-SMC-R15	Mercer Sales, Mktg & Comm - Revised, 2015	2015-03-01
PER-PRO15	Perlin IT Professional - National, 2015	2015-01-01
TW-EMT15	Towers Watson CDB Energy Marketing and Trading, 2015	2015-03-01
TW-EXE15	Towers Watson CDB General Industry Executive, 2015	2015-03-01
TW-EXE-ES15	Towers Watson CDB Energy Services Executive, 2015	2015-03-01
TW-MMPS15	Towers Watson CDB Mid-Mgmt, Prof & Support, 2015	2015-03-01
TW-MMPS-ES15	Towers Watson CDB Energy Services Mid-Mgmt, Prof & Support, 2015	2015-03-01

Source: Information Response 16
Schumaker & Company reviewed a sampling of studies in Information Response 63

The DEBS State Regulatory Compliance team has also developed a market study methodology for annually assessing cost versus market for shared services based off the North Carolina Utilities Commission (NCUC) Regulatory Condition 5.2, as referenced in Duke Energy's procedure (2016 guidelines effective May 1, 2016):⁸⁰

DEC and DEP shall seek out and buy all goods and services from the lowest cost qualified provider of comparable goods and services, and shall have the burden of proving that any and all goods and services procured from their Utility Affiliates, Non-Utility Affiliates, and Nonpublic Utility Operations have been procured on terms and conditions comparable to the most favorable terms and conditions reasonably available in the relevant market, which shall include a showing that comparable goods or services could not have been procured at a lower price from qualified nonAffiliate sources or that neither DEC nor DEP could have provided the services or goods for itself on the same basis at a lower cost. To this end, no less than every four years DEC and DEP shall perform comprehensive, non-solicitation based assessments at a functional level of the market competitiveness of the costs for goods and services they receive from a Utility Affiliate, DEBS, PESC, another Non-Utility Affiliate, and a Nonpublic Utility Operation, including periodic testing of services being provided internally or obtained individually through outside providers. To the extent the Commission approves the procurement or provision of goods and services between and among DEC, DEP, and the Utility Affiliates, those goods and services may be provided at the supplier's Fully Distributed Cost.

To the extent they are allowed to provide such goods and services, DEC and DEP shall have the burden of proving that all goods and services provided by either of them to Duke Energy, a Non-Utility Affiliate, any other Affiliate, or a Nonpublic Utility Operation have been provided on the terms and conditions comparable to the most favorable terms and conditions reasonably available in the market, which shall include a showing that such goods or services have been provided at the higher of cost or market price. To this end, no less than every four years DEC and DEP shall perform comprehensive, non-solicitation based assessments at a functional level of the market competitiveness of the costs for goods and services provided by either of them to a Utility Affiliate, DEBS, another Non-Utility Affiliate, any other Affiliate, and a Nonpublic Utility Operation.

The periodic assessments required by subdivisions (a) and (b) of this subsection may take into consideration qualitative as well as quantitative factors. To the extent that comparable goods or services provided to DEC or DEP or by DEC or DEP are not commercially available, this Regulatory Condition shall not apply.

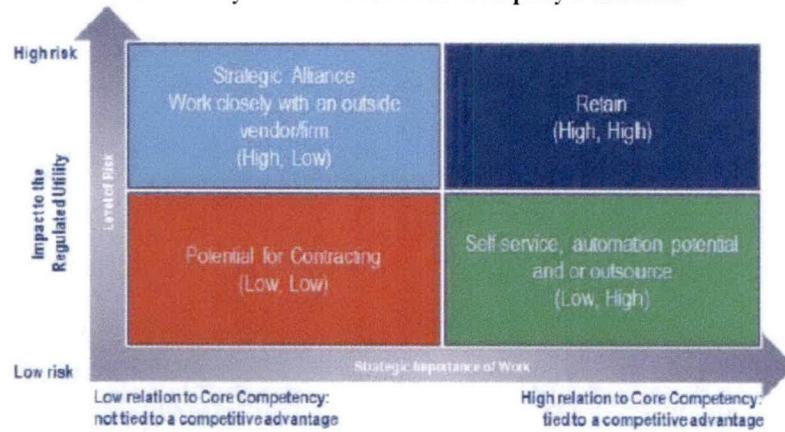
The process assesses all service functions for all regulated utilities, including DEK. Duke Energy expects to execute the process at least every four years and is scheduled to be completed by December 31, 2016. This process, paired with Human Resources (HR) Compensation's benchmarking process, will be used by Duke Energy to assess cost versus market for the respective services functions.⁸¹

The market study methodology includes:⁸²

- ◆ Insource versus outsource feasibility matrix for service company functions, as shown in *Exhibit III-17*, based on two ratings to compliance for service company functions:
 - Operational impact to the regulated utility (from 1(low risk) to 10 (high risk))
 - Relation to core competency (from 1 (low relation to core competency) to 10 (high relation to core competency))
- ◆ Instruction for documenting evidence of the study



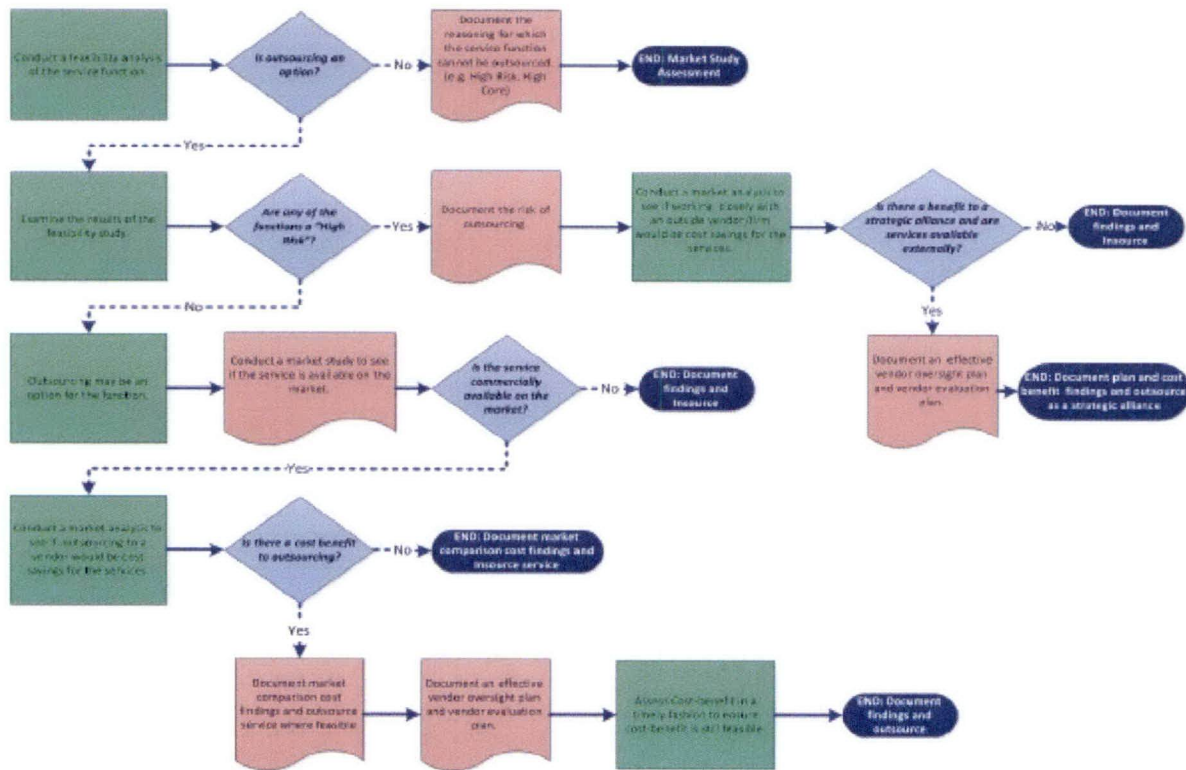
Exhibit III-17
Feasibility Matrix for Service Company Functions



Source: Information Response 14

Exhibit III-18 illustrates the process workflow diagram expected by Duke Energy.⁸³

Exhibit III-18
Process Workflow Diagram



Source: Information Response 14

The DEBS services shown in *Exhibit III-19* are to be reviewed in the market study assessment process.⁸⁴

Exhibit III-19
DEBS Services Part of Market Study Assessment Process
as of May 2016

Service	Official Description or Exception List
<i>Accounting</i>	Maintenance of financial books and records; preparation of financial and statistical reports and tax filings; supervision regarding compliance with related laws and regulations.
<i>Environmental Health and Safety</i>	Establishment of programs, policies and procedures, and governance framework for environmental and health and safety programs and compliance; provision of compliance support. Services related to the following functions: <ul style="list-style-type: none"> • Health & Safety • Duke Energy International EHS • EHS Risk Governance and Change Management • CCP Support • Meteorology • Env Svcs Midwest • Env Science • Env Projects and Programs • Env Permitting and Compliance Cars
<i>Executive</i>	Provision of general, administrative, and executive management oversight and direction; Services related to the following functions: integration and improvement, sustainability, emerging technologies, federal policy and government affairs.
<i>Facilities</i>	Operation and maintenance of office and service buildings; security and housekeeping for such buildings; procurement of office furniture and equipment.
<i>Finance</i>	Services associated with investments, financing, cash management, risk management, budgeting, financial forecasting, and economic analyses.
<i>Grid Solutions</i>	Grid modernization services: planning, outreach, technology and engineering planning and standards, project management and governance, project execution.
<i>Human Resources</i>	Establishment and administration of policies, and supervision of compliance with legal requirements, in the areas of employment, compensation, benefits and employee health and safety, payroll and employee benefits payment processing; supervision of contract negotiations and relations with labor unions.
<i>Information Systems</i>	Development and support of mainframe and distributed computer software applications; procurement and support of personal computers and related network and software applications; installation and operation of communication systems; and management and support of information systems.
<i>Internal Auditing</i>	Review of internal controls and procedures to ensure that assets are safeguarded and that transactions are properly authorized and recorded.
<i>Investor Relations</i>	Preparation of communications to investors and the financial community; performance of transfer agent and shareholder record keeping functions; administration of stock plans; regulatory reporting related to stock.
<i>Legal</i>	Services related to labor and employment law, litigation, contracts, rates and regulatory affairs, environmental matters, financing, financial reporting, real estate and other legal matters.
<i>Meters</i>	Procurement of meters.
<i>Nuclear Development</i>	Provision of design, engineering, project management and licensing for new operating units.
<i>Planning</i>	Facilitation of strategic and operating plans preparation; monitoring of trends; evaluation of business opportunities.
<i>Power Engineering and Construction</i>	Services related to the following functions: Enterprise Project Management Center of Excellence; Project Development and Initiation; Project Management and Construction fossil/hydro retrofits; major project Engineering and Construction Services; Commercial and International Project Management and Construction; performance improvement/management.
<i>Power Planning and Operations</i>	Production cost modeling and data management; Services related to the following functions: <ul style="list-style-type: none"> • Strategic Programs • Bus Svcs Workforce Strategy • Engineering Services • Doc Con/Config Mgmt • Technical Apps • NERC Compliance
<i>Public Affairs</i>	Preparation and dissemination of information to employees, customers, government official, communities, and the media; provision of associated communications materials.
<i>Rate Design and Analysis</i>	Services related to rate design and analysis, and rates support.
<i>Rights of Way</i>	Purchases, sales, management, surveying, and recording of real estate interests.
<i>Supply Chain</i>	Procurement of materials and contract services and related strategy and support
<i>Transportation</i>	Procurement and maintenance of aircraft and procurement and maintenance of vehicles and other power-operated equipment.

Source: Information Response 14

Separations

Finding III-4 There was no use of the DEK logo by any non-utility affiliate.

The Duke Energy Logo is shown in *Exhibit III-20*.⁸⁵ In the past, most Duke Energy entities used an older Duke Energy logo with a geographic identifier for the utility companies. However, now only the Duke Energy logo is used to identify the company, regardless of application or media. Other logos may not be created or used for offices, generating stations, facilities, departments or events. Only DEP (previously Progress Energy Carolinas) has “Progress” following the Duke Energy logo, also shown in *Exhibit III-20*.⁸⁶ The geographic identifiers shown in *Exhibit III-20* are to be used only in the following applications:⁸⁷

- ◆ Regulatory filings in the franchised jurisdictions and other public documents (press releases, fact sheets, etc.) referring to those filings
- ◆ Utility-specific reports presented to regulators
- ◆ Limited internal uses (financial reports, customer data, etc.)
- ◆ Business cards and stationery for large customer/regulator/legislator-facing employees in the respective utility organizations (this applies to all employees in the organizations reporting to the utility presidents)

Any non-regulatory communications, print or electronic, should refer to Duke Energy only and use the Duke Energy logo; geographic identifiers should not be used. Regional operations can be described in terms of “doing business in the Carolinas” or “the company’s Kentucky operations.” Geographic identifier logos should never be used on hard hats, apparel, vehicles, signage or company-branded merchandise.⁸⁸

According to Duke Energy management, DEK’s non-regulated affiliates do not use the DEK name, brand, trademark, or logo for any visual or audio media.⁸⁹

Exhibit III-20
Duke Energy Logos



Geographic Identifiers



Source: Information Response 49

Filings

Finding III-5 **There have been no KPSC filings in 2015 relative to service agreements.**

Only three (Service Company Utility Service Agreement, Amended and Restated Miami Fort 6 Operations Agreement, First Amendment to Second Amended and Restated Purchase & Sale Agreement with Cinergy Receivables) were changed in 2015 or the beginning of 2016.⁹⁰ Agreements that changed in 2015 were required to be submitted to the KPSC. Therefore, according to Duke Energy management, the agreements were most recently approved as part of the settlement of the Duke Energy/Progress Energy merger in Case No. 2011-00124. The minor modifications to the agreements that have occurred since then have been to remove affiliates or to provide clarification to language and have not resulted in a substantive change to require new KPSC approvals, so no additional submittals have been needed.⁹¹

C. Recommendations

Affiliate Agreements

None.

Affiliate Training

None



Benchmarking

Recommendation III-1 **Provide the KPSC in early 2017 a copy of the results from the market study assessments performed in 2016. (Refer to Finding III-3.)**

As new market study assessments have been performed in 2016 using the new market study methodology established in 2015 for assessing cost versus market for shared services included in service company functions, DEK should provide these results to the KPSC.

Separations

None.

Filings

None.

provided. This type of agreement seems even more essential in an affiliate relationship and, as we have indicated, does not exist for DEK.

Finding IV-3 Appropriate cost allocation factors are being used.

Four primary categories of cost allocations affect DEK and its affiliates, including:

- ◆ Cost allocations from service company, specifically DEBS, to DEK
- ◆ Cost allocations between DEK and DEO for common costs shared by both utility organizations
- ◆ Cost allocations between DEK and its sister regulated utilities and non-regulated utilities regarding various services and goods
- ◆ Administrative and general (A&G) cost allocations between its gas and electric operations for both capital and expense accounts

The allocation factors used at Duke Energy are illustrated in *Exhibit IV-4*, with those identified by function are illustrated in *Exhibit IV-5*. Schumaker & Company's review of factors used by function indicate that appropriate allocation factors are being used.

Finding IV-4 Appropriate levels of direct charging are generally occurring with regard to DEK's affiliate transactions.

For 2015, as well as the prior two years (2013 and 2014), the percentage of direct charges shown previously in *Exhibit III-3* and *Exhibit III-4* illustrate that generally a large portion of charges were directly charged, not allocated charges.

Finding IV-5 Sufficient policy and associated documentation has not been available in past years regarding accounting for asset loans.

Regarding asset loans, Duke Energy started (in 2012) considering putting a value on asset loans, but did not value them in 2011. The thought by DEBS management was to use the Storage, Freight, and Handling cost (Account # 163) as the value of an asset loan. Duke Energy also considered the use of the service eForm for services as management considers this more like a service (rental) than an asset transfer, especially for loans lasting less than three to four months. If it is longer than three to four months, then Duke Energy was considering selling the asset and buying it back on the associated entity's books. In 2012 during Schumaker & Company's prior audit, DEBS did not have a formal policy regarding asset loans nor sufficient documentation describing the proper accounting for such transactions.¹³⁶ Although no such loans occurred in 2013 involving asset loans from/to DEK, other Duke Energy entities, such as DEI, did have such loans. In 2014 during the Schumaker & Company 2013 audit, Duke Energy management indicated that DEK does not have a formal policy regarding asset loans; however, a slide discussing asset loans was incorporated into asset transfer training courses, but is not sufficient documentation describing the proper accounting for such transactions. However, Duke

IV. Affiliate Transactions and Cost Accumulation and Assignment

A. Background & Perspective

The primary Duke Energy Corporation (Duke Energy) accounting system is Financial Management Information System (FMIS), a PeopleSoft system with general ledger, accounts receivable, accounts payable, asset management, project costing (i.e., Power Plant), contract, and billing applications, plus feeder systems that also pass information to the general ledger. The FMIS processes charges to/from Duke Energy Business Service (DEBS) and Duke Energy Kentucky (DEK) affiliates.⁹² All legacy Progress Energy companies no longer used Oracle in 2015, which they had previously used.⁹³ Also, both PE Carolinas and PE Florida used the utility allocation factor unless direct billing used, when charging other affiliates.⁹⁴

The system has a terminology and method of operation, and each uses a code block/chart field that comprises a set of elements that classify financial information. The code block/chart field contains multiple elements that describe five aspects of a financial transaction as follows:⁹⁵

- ◆ *When* – defines the timing of the work performed
- ◆ *Who* – identifies who performed the work on whose behalf
- ◆ *What* – defines the nature of the work performed
- ◆ *How* – defines the resource used to perform the work
- ◆ *Where* – identifies the location the work was performed or performed for

The corporate organization is broken down into thousands of responsibility centers, which roll up into other higher level responsibility centers based on reporting responsibility. FMIS uses responsibility center (RC) codes to designate parties to a transaction. FMIS records an accounting entry for a direct charge transaction by designating an RC code that represents the work group performing the service and an Operating Unit (OU) code that represents the group for which the work was performed. The OU To code can be specific or not; for example, it can designate a particular plant or just fossil/hydro plants in general. The business unit receiving the charge designates the OU code to which the amount should be charged. The accounting entry also includes an account, process, project number, resource type (e.g., labor, materials, outside contractor), and amount; the FERC account number is usually embedded in the accounting code block numbering. For allocated charges, the OU code represents an allocation pool, such as governance or enterprise accounting. The FMIS system processes allocation pools at month-end, distributing the charges according to the appropriate allocation pool percentages.⁹⁶



Methodologies Used

Description of Transactions

Services

According to Duke Energy management, there has essentially been no changes regarding services since Schumaker & Company's prior audit report in 2013, nor any upcoming changes except system updates, although more detailed descriptions are now required than previously done.⁹⁷

For all cross affiliate services provided, an eForm, which is the same form throughout Duke Energy, is required. This process has been in place for approximately 12 years for most Duke Energy companies, except legacy Progress Energy companies, which began using prior to 2015.⁹⁸

The Allocations & Reporting – Corporate Accounting group for Ohio, Kentucky, and Indiana is responsible for month-end close, account reconciliation, data requests from audits, and management reporting.⁹⁹ Among the duties of the Allocations & Reporting – Corporate Accounting group for all Duke Energy entities is the responsibility for developing and maintaining a basis data binder used to allocate Service Company costs and tracking and reporting Service Company allocations to receiving departments, as well as answering requests from individual departments. The basis data used for developing allocation factors for a calendar year is updated annually based on the 12 months of actual results ending the prior June 30th of each year, or December 31st, if FERC Form 1 & 2 items. The only exception is for basis data involving capital expenditures (Electric T&D Engineering & Construction and Power Engineering & Construction), which the capital budget data for the upcoming year. June 30 data is available and used to update the basis data in the July through September time frame, so this data can be used to complete the budget for the upcoming year.¹⁰⁰

As shown later in *Exhibit IV-4*, Duke Energy uses approximately 20 factors for allocating Service Company costs. The allocation factors used do not change often because the methodologies have been agreed to and included in the various Service Company agreements. Adding a methodology/factor would require modifying the agreement documents and getting buy-in from the various states and regulatory bodies. A major change in business operations, such as the merger with Cinergy or Progress Energy, causes the methodologies (and the service agreements) to be modified. The real test of the methodologies used rests with the owners of the function. They have a vested interest in how the allocations are calculated and how much is allocated to affiliates in an area. A good example of different charge allocations using the same factor ratio is the Human Resources function based on number of employees ratio in which (a) governance activities are charged to all entities, including small portion to the international affiliates); (b) enterprise HR only is charged to all affiliates, except international ones, and (c) Utilities HR is charged only to the regulated industries.¹⁰¹

DEBS is basically a net \$ entity, in which most costs are charged to Duke Energy subsidiaries; exceptions include DEBS income tax, which is not allocated; selected interest charges that remain with

the service company entity; and return on DEBS assets area also excluded from DEBS charges to affiliates.¹⁰²

Departmental employees are directed to direct charge if they can and only include their costs in the allocation pools if they cannot direct charge. Duke Energy's time reporting system, *MyTime*, which has been used approximately three years, was fully implemented on an enterprise basis in April 2011. The time reporting system has a default for employees' time and it is charged unless changed. According to DEBS management, employees were trained to use the new system when it was implemented, so all employees should know how to change their time from the default. However, legacy Progress Energy employees did not use *MyTime* in 2013, but their own system, referred to as the *Corporate Time Entry* (CTE) system. Therefore, starting July 2, 2012 (when merger was effective), all legal Progress Energy employees had to submit timesheets. By the end of 2013 (employees converted over by group during 2013), all legacy Duke Energy employees (even exempt) also had to submit timesheets; however, in the beginning of 2013, exception time reporting was still used. All DEBS employees, including legacy Progress Energy employees, used *MyTime* in 2014 and 2015.¹⁰³

Timekeepers enter time into *MyTime* from approved employee timesheets, or in some areas the employee enters time into *MyTime* and the data is approved by the manager or delegate. The time data is extracted and exported to Aon Hewitt for biweekly pay processing through a series of programs, which loads the time data to the individual employee pay sheets in its HRMS system. Once the time data from *MyTime* has been processed to the individual employee pay sheets, a series of pay calculations occur in the payroll system to finalize the check process. Following the pay confirmation process, files are generated from the payroll system for processing through the Labor Distribution System (LDS). Aon Hewitt balances the labor files before sending the files and control totals to Duke Energy for labor distribution processing to the general ledger. All exempt employees are required to enter their vacation taken into *MyTime* and each business unit determines other time reporting requirements for their area. Some employees enter actual time data, while other employees have their time data generated based on their standard schedule and their default labor allocation. The time data, both entered and generated, is extracted and exported to LDS for processing to the general ledger.¹⁰⁴

For allocated charges, one of the following three methodologies is used for recording intercompany transactions, as identified in Duke Energy's *Accounting for Intercompany Transactions Policy* documentation effective February 25, 2015.¹⁰⁵ According to Duke Energy management, revisions to simplify reporting roll-ups and settlements were also made subsequent to this audit period starting January 14, 2016.¹⁰⁶

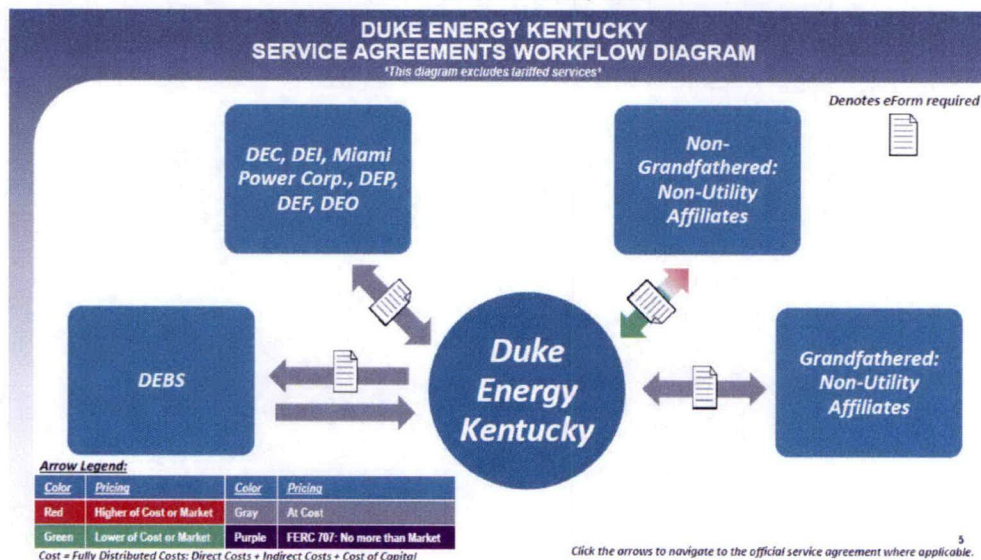
- ◆ *Auto-generating*: Intercompany transactions required for recording loans, cash sweeps, or that generate the booking of revenue and generation of a receivable where both affiliates are on the enterprise PeopleSoft ledger may be recorded using the auto-generating methodology. It only handles US\$ transactions; therefore, any non US\$ transactions are exempt from using this methodology. This methodology automatically generates the *purchaser/receiver* transaction based on the *seller/sender* transaction and is available to all Duke Energy business units using the enterprise PeopleSoft general ledger.



- ◆ **Manual Balancing:** Although manual balancing is not the preferred methodology 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-US\$ transactions, or, in the case where the transaction is with an affiliate who is not on the enterprise-wide PeopleSoft general ledger. Prior to recording inter-business unit transactions using the manual balancing methodology, both the *seller/sender* and *purchaser/receiver* must submit a request for approval (including the reason for using this methodology and documentation of the mitigating controls in place to ensure compliance with policy) to the Enterprise Intercompany Process Owner (IPO), defined as the person who is in the role of IPO for all of Duke Energy and its consolidated subsidiaries.
- ◆ **Automated Crossbill:** All intercompany transactions that are required for recording allocations or expense/revenue transfers between corporate/business units are to be recorded using the automated crossbill methodology. Allocations or expense/revenue transactions recorded using this methodology may be recorded to third-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.

Exhibit IV-1 illustrates a summary for affiliate service charges.

Exhibit IV-1
Summary Pricing Guide
Services
as of December 31, 2015



Source: Information Response 42

Exhibit IV-2 illustrates the prior summary pricing guide for services, which was included in Schumaker & Company’s prior audit report. Although it still applies, when new training was implemented by Duke Energy (as discussed in the Training section of *Chapter III – Affiliate Relationships*), the Compliance group decided to make the guide simpler for inclusion in training.¹⁰⁷

**Exhibit IV-2
Summary Pricing Guide
Services
as of December 31, 2013**

		TRANSFER TO										
		DE Carolinas	DE Indiana	DE Kentucky	DE Ohio (T&D)	Miami Power	PE Carolinas	PE Florida	DE Ohio (Gen)	other non-reg utility ³	non-utility ⁴ (excl. Svc. Co.)	Service Company
TRANSFER TO	DE Carolinas	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Indiana	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost ⁴	At Cost
	DE Kentucky	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost ⁴	At Cost
	DE Ohio (T&D)	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	At Cost ⁴	At Cost
	Miami Power	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost ⁴	At Cost
	DE Progress	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Florida	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Ohio (Gen)	Lower Cost / Mkt	Lower Cost / Mkt ¹	At Cost ⁵	At Cost	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Negotiated Rates	At Cost ⁴	At Cost	At Cost
	other non-reg utility ²	Lower Cost / Mkt	Lower Cost / Mkt ¹	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Negotiated Rates	Negotiated Rates	Negotiated Rates	Negotiated Rates
	non-utility ³ (excl. Svc. Co.)	Lower Cost / Mkt	At Cost ⁵	At Cost ⁵	At Cost ⁵	At Cost ⁵	Lower Cost / Mkt	Lower Cost / Mkt	At Cost ⁵	Negotiated Rates	Negotiated Rates	Negotiated Rates
	Service Company	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost

Footnotes:

1. The IRUC requires DE Indiana to follow FERC’s asymmetrical pricing rules. However, since several of the Duke regulated utilities must follow more restrictive state pricing rules, it has been recommended that DEI affiliate transfers be priced at the more restrictive pricing.

2. Non-Regulated Utility Affiliates currently include: DEO-Generation, St. Paul Cogeneration, DE Trading & Marketing, Duke Energy Commercial Asset Management, Inc, CnCap IV, CnCap V, Duke Energy Commercial Enterprises, Inc., Happy Jack Windpower, North Allegheny Wind, Silver Sage Wind, Three Buttes Windpower, LLC., Kit Carson Windpower, LLC., Top of the World Windpower, LLC., Duke Energy Retail Sales, LLC, Duke Energy Lee, II, LLC, Duke Energy Hanging Rock II, LLC and Duke Energy Fayette II, LLC, Cimarron Windpower II, LLC, Laurel Hill Windpower and Ironwood Windpower II, LLC.

3. Non-Utility Affiliates are all other affiliates not identified in footnote 3 or the regulated utilities: DE Carolinas, DE Progress, DE Florida, DE Indiana, DE Kentucky, DE Ohio (T&D) and Miami Power.

4. If the affiliate is NOT party to the service agreement in place prior to 3/30/08, Services Provided must be at the Higher of Cost / Mkt. Be certain a subsequent agreement is in place authorizing the services even at asymmetrical pricing. Per Order No. 707, services provided to counterparties under service agreements in effect prior to 3/30/08 can be provided at cost pricing as provided in those service agreements.

5. FERC No Action Letter allows DEO Gen to provide services to DEK Plants (Woodsdale, EastBend, and Miami Fort Unit 6) at cost.

6. If the affiliate is NOT party to the service agreement in place prior to 3/30/08, Services Received must be at the Lower of Cost / Mkt. Be certain a subsequent agreement is in place authorizing the services even at asymmetrical pricing. Per Order No. 707, services provided to counterparties under service agreements in effect prior to 3/30/08 can be provided at cost pricing as provided in those service agreements.

Source: Schumaker & Company prior audit report

Asset Transfers

According to Duke Energy management, there has been no changes regarding asset transfers since Schumaker & Company’s prior audit report in 2013, nor any upcoming changes.¹⁰⁸

The FERC accounts in which asset transfers (e.g. utility, emission allowances, materials and supplies) between DEK and its affiliates are recorded as follows:¹⁰⁹

- ◆ *Utility Plant in Service:* 300 level electric plan accounts
- ◆ *Emission Allowances:* 158 emission allowance inventory account

- ◆ *Materials and Supplies:* Although transactions of materials and supplies could be recorded in capital accounts and O&M accounts, the following accounts were used in recording materials and supplies asset transfers between DEK and its affiliates in 2011:
 - 107000 Construction Work in Process
 - 154100 Plant Materials and Operating Supplies

The asset transfer rules for DEK and other Duke Energy utilities in the Midwest are different from the rules that govern asset transfers in the Carolinas. Transfers in the Carolinas require the use of eForms (a burdensome form that is needed to comply with specific regulations in the Carolinas). Because of the number of transfers within the Midwest, Duke Energy put in a process that did not require the use of eForms in these states, unless dollars associated with asset transfers exceed \$1 million. Duke Energy uses an IBM Maximo system, previously called eMax, to track inventory stock-to-stock transfers between entities, although Progress Energy didn't start using it until 2014. DEK generally carries a smaller amount of inventory stock on its books than the other Midwest entities. Transfers of in-service assets are tracked in other systems, typically PowerPlant, which DEK uses. Asset transfers typically occur fossil plant to fossil plant or nuclear plant to nuclear plant as the part needs are similar. Typical transfers are low cost items, such as pumps or valves, although (as shown in *Exhibit III-9*) transfers may also include meters, transformers, regulators, and other miscellaneous items, which are not considered inventory stock transfers.¹¹⁰ According to Duke Energy management, the biggest change in asset transfers due to the Duke Energy/Progress Energy merger was in the Carolinas with regard to e-Forms caused by the nuclear service agreement. In 2013 Progress Energy's nuclear organization used Passport software, but was expected to be converting to eMax, which occurred in 2015.¹¹¹

Additionally, any individual asset transfers involving DEK that are \$1 million or higher must be reported to the KPSC for approval, as follows:¹¹²

- ◆ In KRS 278.218 (approval of commission for change in ownership or control of assets owned by utility) indicates the following:
 - 1) No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars (\$1,000,000) or more and:
 - a) The assets are to be transferred by the utility for reasons other than obsolescence; or
 - b) The assets will continue to be used to provide the same or similar service to the utility or its customers.
 - 2) The commission shall grant is approval if the transaction is for a proper purpose and is consistent with public interest.
- ◆ Also, regarding the KPSC Order in Case No. 2008-122, DEK agreed to be bound by KRS 278.218 for transactions involving its gas utility assets.

The KPSC grants its approval if the transaction is for a proper purpose and is consistent with the public interest.¹¹³

The IBM Maximo system is used for all inventory issues, returns, and transfers, regardless of entity.¹¹⁴ It includes inventory stock transfers (Account # 154-Plant Materials and Operating Supplies in the sending entity to Account # 154 in the receiving entity); at the end of the month an automatic charge from Account # 163 (Storage, Freight, and Handling) of the sending entity is also transferred to Account # 163 in the receiving entity. On a monthly basis, in the Midwest, Duke Energy generates a report from the system and uses it to determine if fair market value is to be calculated and, where appropriate, book the differential between fair market value and cost to comply with asset transfer standards. The asset valuation of fair market value for the transfers is done in one of three ways:¹¹⁵

- ◆ If goods were acquired using a blanket purchase order, the value is the blanket average unit price (AVP).
- ◆ If not acquired using a blanket purchase order, Duke Energy uses a recent purchase order (typically less than six months old but no longer than a year) cost for the item.
- ◆ If there is no purchase order, Duke Energy will get quotes; there is no prescribed number of quotes that must be received.

Transfers of assets not in inventory, such as capital spares, are performed in PowerPlant by the Asset Accounting organization. Similarly, on a quarterly basis, Duke Energy generates a report from PowerPlant, and uses it to if fair market value is to be calculated and, where appropriate, book the differential between fair market value and cost (original cost minus depreciation reserve equals net book value cost) to comply with asset transfer standards.¹¹⁶

Cost is handled automatically in the systems; market rate differentials must be handled via a journal entry. The reports for transfers, both inventory stock and in-service assets, go to the Manager, Asset Accounting and a General Ledger journal entry (multiple lines) is created, if necessary. For transfers of in-service assets between regulated and non-regulated entities, rather than simply make a transfer, Asset Accounting retires the asset from the sending entity and adds it formally to the receiving entity, creating a salvage amount to reflect the market differential amount.¹¹⁷

Following the Duke Energy/Progress Energy merger, according to DEBS management, there's been more opportunity for transferring capital assets. Both Duke Energy and Progress Energy used PowerPlant for non-inventory assets; however, they were on different versions. Therefore, manual entry was needed for transferring assets between versions. Then in 2014, both began using the same version, resulting in more system-generated transfers.¹¹⁸

Affiliate transfers of assets are governed by Federal Energy Regulatory Commission (FERC) 707 and asset transfer agreements. FERC 707 requires that transfers between regulated and non-regulated affiliates be priced using asymmetrical pricing. This requires that transfers from DEK to a non-regulated affiliate must be valued at the higher of cost or market, and transfers from non-regulated

affiliates to DEK be valued at the lower of cost or market price, referred to as asymmetrical pricing. Therefore, if a transfer is regulated to non-regulated and a market value adjustment is needed, then a gain is added via a journal entry. Conversely if a transfer is non-regulated to regulated, an adjustment via a journal entry is made, if needed. For regulated-to-regulated transfers, asymmetrical pricing is not required, but is done at cost.¹¹⁹

There's a No Action letter in Kentucky. In 2006 Duke Energy made a request to FERC, when it transferred Miami Fort Unit 6 from DEO (then CG&E) to DEK (then ULH&P), to allow inventory stock transfers at "at cost" rather than "asymmetrical pricing," even though they would be transferred from a non-regulated entity, such as DEO Miami Fort 7/8, to a regulated entity, such as DEK. If any inventory stock transfers go from DEK to DEO, however, "asymmetrical pricing" is required.¹²⁰

Exhibit IV-3 illustrates a summary pricing guide for affiliate asset transfers.¹²¹

**Exhibit IV-3
Summary Pricing Guide
Asset Transfers
as of December 31, 2015**

		TRANSFER TO								
		DE Carolinas ^{1A, 1B}	DE Indiana	DE Kentucky	DE Ohio (T&D)	PE Carolinas	PE Florida	DE Ohio (Gen)	other non-reg utility ³	non-utility ⁴
TRANSFER FROM	DE Carolinas ⁵		At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}
	DE Indiana	At Cost ^{1A}		At Cost	At Cost	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Kentucky ⁶	At Cost ^{1A}	At Cost		At Cost	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Ohio (T&D)	At Cost ^{1A}	At Cost	At Cost		At Cost ^{1A}	At Cost ^{1A}	At Cost	Higher Cost / Mkt	Higher Cost / Mkt
	DE Progress	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}		At Cost ^{1A}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}
	DE Florida	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}		Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}
	DE Ohio (Gen)	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ²	At Cost ⁷	At Cost	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ^{1B}		Negotiated Rates	Higher Cost / Mkt
	other non-reg utility ³	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ²	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ^{1B}	Negotiated Rates	Negotiated Rates	Negotiated Rates
	non-utility ⁴	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ²	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt	Negotiated Rates	Negotiated Rates
	(excl. Svc. Co.)	At Cost / Mkt ^{1B}	At Cost / Mkt ²	At Cost / Mkt	At Cost / Mkt	At Cost / Mkt ^{1B}	At Cost / Mkt ^{1B}	At Cost / Mkt	Negotiated Rates	Negotiated Rates

Footnotes:

1A: Goods may be transferred 'At Cost' with regulated utility affiliates. LEGAL MUST BE CONTACTED when a transfer is >\$100K so that a separate legal agreement can be developed and filed. All Goods Transfers >\$ 1mm require SC Commission Approval.

1B: Prior to transferring goods at the Higher of Cost / Mkt or receiving goods at the Lower of Cost / Mkt, DE Carolinas must file an agreement, CONTACT LEGAL.

2: The IRUC requires DE Indiana to follow FERC's asymmetrical pricing rules. However, since several of the Duke regulated utilities must follow more restrictive state pricing rules, it has been recommended that DEI affiliate transfers be priced at the more restrictive pricing.

3: Non-Regulated Utility Affiliates currently include: DEO-Generation, Duke Energy Beckjord, Duke Energy Conesville, Duke Energy Dicks Creek, Duke Energy Killen, Duke Energy Miami Fort, Duke Energy Stuart, Duke Energy Zimmer, St. Paul Cogeneration, DE Trading & Marketing, Duke Energy Commercial Asset Management, Inc, CinCap IV, CinCap V, Duke Energy Commercial Enterprises, Inc., Happy Jack Windpower, North Allegheny Wind, Silver Sage Wind, Three Buttes Windpower, LLC, KIL Carson Windpower, LLC., Top of the World Windpower, LLC., Duke Energy Retail Sales, Duke Energy Lee, II, LLC, Duke Energy Hanging Rock II, LLC and Duke Energy Fayette II, LLC, Cimarron Windpower II, LLC, Laurel Hill Windpower and Ironwood Windpower II, LLC.

4: Non-Utility Affiliates are all other affiliates not identified in footnote 3 or the regulated utilities: DE Carolinas, DE Progress, DE Florida, DE Indiana, DE Kentucky, DE Ohio (T&D) and Miami Power. Confirmation must be made that they are party to the existing agreements. If not, CONTACT LEGAL.

5: Transfers from DE Carolinas involving an asset over \$1 million must be approved by the SCPSC.

6: DE Kentucky cannot transfer assets valued at \$1 million or more without prior approval of the KYPSC.

7: FERC No Action Letter allows DEO Gen to provide services to DEK Plants at cost.

Source: Information Response 42

Cost Accumulation, Assignment, & Allocation

When a DEBS employee performs services for a client company, costs are to be directly assigned or allocated. Duke Energy uses 20 factors, as shown in *Exhibit IV-4*, for allocating Service Company costs. The allocation factors used do not change often because the methodologies have been agreed to and included in the various Service Company agreements. Adding a methodology/factor would require modifying the agreement documents and getting buy-in from the various states and regulatory bodies. A major change in business operations, such as when the merger with Cinergy or Progress Energy happened in the past, causes the methodologies (and the service agreements) to be modified. The real test of the methodologies used rests with the owners of the function. They have a vested interest in how the allocations are calculated and how much is allocated to affiliates in an area. A good example of different charge allocations using the same factor ratio is the Human Resources function based on number of employees ratio in which (a) governance activities are charged to all entities, including small portion to the international affiliates); (b) enterprise HR only is charged to all affiliates, except international ones, and (c) Utilities HR is charged only to the regulated industries.¹²²



Exhibit IV-4
Allocation Factors
as of December 31, 2015

Factor	Utility	Non-Utility
Circuit miles of electric transmission lines	Yes	No
Construction expenditures	Yes	Yes
Electric peak load	Yes	Yes
Generating unit MW capability/maximum dependable capacity (MDC)	Yes	Yes
Gross margin	Yes	Yes
Inventory	Yes	Yes
Labor dollars	Yes	Yes
Miles of distribution lines	Yes	No
Millions of instructions per second (MIPS) (previously number of central processing unit (CPU) seconds used)	Yes	Yes
Number of customers	Yes	Yes
Number of employees	Yes	Yes
Number of information systems servers	Yes	Yes
Number of meters	Yes	No
Number of personal computer (PC) work stations	Yes	Yes
O&M expenditures	Yes*	Yes*
Procurement spending	Yes	Yes
Revenues	Yes	Yes
Sales	Yes	Yes
Square footage	Yes	Yes
Total property, plant, and equipment	Yes	Yes

Source: Information Responses 2 and 8 and Interview _

* Although a valid factor for charging service company costs to utility companies, it is not used by Duke Energy.

For allocated services, the Service Company Utility Service Agreement prescribes 24 functions with their associated allocation methodologies, as follows:¹²³

Exhibit IV-5
DEBS Allocation Factors by Function
as of December 31, 2015

Information Systems	<ul style="list-style-type: none"> ◆ Millions of Instructions per Second Ratio ◆ Number of Personal Computer Workstations Ratio ◆ Number of Information Systems Servers Ratio ◆ Number of Employees Ratio
Meters	<ul style="list-style-type: none"> ◆ Number of Customers Ratio
Transportation	<ul style="list-style-type: none"> ◆ Number of Employees Ratio ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
System Maintenance	<ul style="list-style-type: none"> ◆ Circuit Miles of Electric Transmission Lines Ratio ◆ Circuit Miles of Electric Distribution Lines Ratio ◆ Labor Dollars Ratio (Gas Distribution) (Kentucky)
Marketing and Customer Relations	<ul style="list-style-type: none"> ◆ Number of Customers Ratio
T&D Engineering & Construction	<ul style="list-style-type: none"> ◆ Electric Transmission Plant Construction - Expenditures Ratio ◆ Electric Distribution Plant Construction - Expenditures Ratio
Power Engineering & Construction	<ul style="list-style-type: none"> ◆ Electric Production Plant Construction - Expenditures Ratio
Human Resources	<ul style="list-style-type: none"> ◆ Number of Employees Ratio
Supply Chain	<ul style="list-style-type: none"> ◆ Procurement Spending Ratio ◆ Inventory Ratio
Facilities	<ul style="list-style-type: none"> ◆ Square Footage Ratio
Accounting	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E) ◆ Generating Unit MW Capability Ratio (certain merger related costs associated with nuclear organizations in Progress Florida, Progress Carolinas, and Duke Energy Carolinas)
Power and Gas Planning and Operations	<ul style="list-style-type: none"> ◆ Electric Peak Load Ratio ◆ Construction - Expenditures Ratio (Gas Distribution Planning and Operations-KY) ◆ Sales Ratio ◆ Weighted Average of Circuit Miles of Electric Distribution Lines Ratio and the Electric Peak Load Ratio ◆ Weighted Average of Circuit Miles of Electric Transmission Line Ratio and the Electric Peak Load Ratio ◆ Generating Unit MW Capability/MDC Ratio
Public Affairs	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E) ◆ Weighted Average of Number of Customers Ratio and Number of Employees Ratio
Legal	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Rate Design and Analysis	<ul style="list-style-type: none"> ◆ Sales Ratio
Finance	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Rights of Way	<ul style="list-style-type: none"> ◆ Circuit Miles of Electric Transmission Lines Ratio ◆ Circuit Miles of Electric Distribution Lines Ratio (added 2014) ◆ Electric Peak Load Ratio (added 2014, but not used in 2014 or 2015)
Internal Auditing	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Environmental, Health and Safety	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E) ◆ Sales Ratio
Fuels	<ul style="list-style-type: none"> ◆ Sales Ratio
Investor Relations	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Planning	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Executive	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Nuclear Development	<ul style="list-style-type: none"> ◆ Directly assigned/charged to participating jurisdictions

Source: Information Responses 2 and 8 and Interview 1



Billing Mechanisms

During Year

Most affiliate billing mechanisms are automatically performed at month-end (based on direct charges and allocations) with offsetting entries to the charging entity (A/R) and receiving entity (A/P). This information is rolled up and summarized, then sent to Treasury, who in turn moves monies between the associated bank accounts. For regulated entities, settlement is required monthly, although some transactions happen more frequently, such as payroll or supply chain, which typically happen weekly. For non-regulated entities, such as commercial renewables or international organizations, it is not done until a capital infusion is required.¹²⁴

True-up Procedures

Labor and Overhead Items

The Duke Energy Financial Management Information System (FMIS) automatically applies labor loaders for fringe benefits, payroll taxes, unproductive time, incentives, and Service Company overhead (O/H) allocations. Accounting personnel enter into FMIS the percentage for each labor loader item each month. These rates typically remain constant for most of the year. Accounting personnel record actual costs for the four labor-related costs in separate accounts that they monitor to make sure that the rates it has been applying are staying in line with actual costs. They typically adjust loader rates in the fourth quarter to clear any residuals compared to actual costs. Any journal entries recorded after monthly allocations run are either manually allocated in the current month or recorded in the following month.¹²⁵ Only DEC and DEP do not incorporate these items into transactions between each other.¹²⁶

Late Journal Entries

Any journal entries recorded after the monthly allocations run are either manually allocated in the current month or recorded in the following month. As Duke Energy employees can only enter JEs until the second business day following month-end, large items after the second business day are manually allocated, while small items may be delayed to the next month. At year-end, however, any missing items, regardless of size, must be manually allocated.¹²⁷

B. Findings & Conclusions

Finding IV-1 The DEK cost allocation manual includes KPSC requirements, but continues to miss key elements of comprehensive CAM documentation used by other utility organizations.

Kentucky Revised Statutes (KRS) 278.2205 provides that any Kentucky utility engaged in non-regulated activities, which produce aggregate revenue exceeding the lesser of two percent (2%) of the utility's total

revenue or one million dollars (\$1,000,000) annually, shall develop and file a cost allocation manual (CAM) with the KPSC. The DEK CAM is based solely on KPSC requirements; it does not include various elements, which would make it more useful, such as those discussed in the recommendation associated with this finding.¹²⁸

DEK's 2015 CAM was developed during the first quarter of 2015 and the affidavit for the 2015 CAM is dated March 29, 2016. Consistent with KRS 278.2205, DEK revises its CAM periodically for material changes. DEK also conducts an annual comprehensive review during the first quarter of each year to determine if there are any changes (both material and non-material) that need to be reflected. DEK conducts this CAM review along with its preparation of various annual financial and statistical reports that are filed with the KPSC on or about March 31st of each year. These additional annual reports include, but are not limited to, vegetation and reliability, resource planning updates, non-regulated revenues, and other reports required pursuant to various KPSC Administrative proceedings.¹²⁹ The 2015 changes primarily account for changes in names to parties and the clarification of definitions and terms, which were inadvertently omitted from the prior version, plus updates recommended by Schumaker & Company in our prior audit report.¹³⁰ The 2015 changes also reflect updates to the various reporting requirements of non-regulated activities and changes in the percentage for cost allocation details, not new steps.¹³¹

DEK's CAM includes the following segments:¹³²

- ◆ Description of Duke Energy and DEK
- ◆ Policies and procedures/guidelines for transactions between DEK and its affiliates, including four primary categories of cost allocations involving DEK, such as:
 - Guidelines for charging DEK for costs originating with service company
 - Cost allocations from DEBS, a wholly-owned subsidiary service company of Duke Energy
 - Cost allocations between DEK and DEO for common costs shared by DEO and DEK
 - Cost allocations for goods and services provided between and among Duke Energy Kentucky and its sister regulated utilities.
 - Additionally, DEK, as a combination gas and electric utility, also receives administrative and general (A&G) cost allocations between its gas and electric operations for both capital and expense accounts.
- ◆ Cost distribution processes for affiliate transactions
 - Guidelines and procedures for charging affiliates for costs originating with DEK
 - Guidelines and procedures for charging DEK for costs originating with utility affiliates, excluding the service company
 - Guidelines and procedures for charging DEK for costs originating with non-regulated affiliates

- Typical transactions between DEK and affiliates covered under separate agreements
- Audit principles and guidelines
- ◆ CAM requirements, including:
 - KRS 278.2205 (2) (a): A listing of regulated and non-regulated divisions within the utility (not applicable, as DEK does not have any non-regulated divisions).
 - KRS 278.2205 (2) (b): A listing of all regulated and non-regulated affiliates of the utility to which the utility provides services or products and where the affiliates provide non-regulated activities, as defined in KRS 278.010 (21) (CAM Appendix O, with further description in agreements)
 - KRS 278.2205 (2) (c): A listing of services and products provided by the utility, and identification of each as regulated or non-regulated, and the cost allocation methodology generally applicable to each category
 - KRS 278.2205 (2) (d): A listing of incidental, non-regulated activities that are subject to the provisions of KRS 278.2203 (4)
 - KRS 278.2205 (2) (e): A description of the nature of transactions between the utility and its affiliates
 - KRS 278.2205 (2) (f): For each Uniform System of Accounts (USofA) account and subaccount, a report that identifies whether the account contains costs attributable to regulated operations and non-regulated operations, including an identification of whether the costs are joint costs that cannot be directly identified; if allocated a description of the methodology used, which are subject to the provisions of KRS 278.2203
- ◆ Appendices
 - Kentucky revised statutes
 - Affiliate agreements, including:
 - Service Company Utility Service Agreement
 - Amended and Restated Operating Company / Non-utility Companies Service Agreement
 - Asymmetrically Priced Duke Energy Kentucky, Inc. / Nonutility Companies Service Agreement
 - Operating Companies Service Agreement
 - Amended and Restated Miami Fort 6 Operation Agreement
 - Gas and Propane Services Agreement with Respect to Woodsdale Generating Station
 - Utility Money Pool Agreement
 - Second Amended and Restated Purchase and Sale Agreement (updated October 27, 2010)

- Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liabilities and Benefits
- Inter Company Asset Transfer Agreement
- Utility-Non-utility Asset Transfer Agreement
- Report of 2015 inventory transfers
- Shared service cost distribution detail
- Listing of DEK affiliates
- Incidental non-regulated activities and associated revenue (2015)
- FERC uniform system of accounts
- FERC affiliate transactions report

Although DEK's CAM has significantly improved, several key elements of a comprehensive CAM are still missing from DEK's CAM, including (but not limited to) elements such as:¹³³

- ◆ Detailed description of cost accumulation, assignment, and allocation (direct and allocated charges) methodologies
- ◆ Detailed description of allocation methodologies and listing of factors
- ◆ Detailed policies, guidelines, and procedures, even though a summary level of policies and procedures/guidelines has been added since the prior audit
- ◆ Detailed description of processes and systems used for affiliate charges, etc.

Previously Duke Energy management indicated that it was evaluating transferring the maintenance of the CAM to the Rates Department for revision consistent with how the North Carolina CAM is maintained; however, it is still being performed by the Legal Department.¹³⁴

Finding IV-2 DEK does not have service level agreement documentation included in its agreements with affiliates.

Schumaker & Company looked for a service level agreement or similar documentation that would specify standards of performance by affiliates providing services to DEK. DEK confirms that there is no service level agreements between DEK and its affiliates.¹³⁵

A service level agreement is important and, in recent years, it is a commonly used document that defines a certain "level" of service that is to be provided by one organization to another. This agreement is expressed as a set of defined tasks and processes, each party's roles and responsibilities, and associated metrics of performance. Many companies, in utility industries, operating in a shared-services environment now have service level agreements in place that specify the resources dedicated to a specific unit. They also typically have clear metrics that define the quality and efficiency of the services

Energy management indicated that it is currently the company's practice not to loan assets.¹³⁷ Therefore, in 2015, no asset loans involving DEK were made.¹³⁸

As each asset loan is considered unique; therefore, a company-wide policy does not exist and Duke Energy does not believe it would be beneficial. Each asset loan requires significant discussions between legal, asset accounting, and supply chain to determine the best strategy and ensure all affiliate requirements are met. As Duke Energy has affiliate transfer training, this training program includes information about asset loans. Given the rarity of an asset loan, Duke Energy believes this information is sufficient to ensure all affiliate guidelines are followed when there is an asset loan. Supply Chain is not aware of any loans in 2015 for any jurisdiction.¹³⁹

C. Recommendations

Recommendation IV-1 Continue to develop an improved formal comprehensive cost allocation manual that brings together all required elements of such documentation. (Refer to Finding IV-1)

As described in *Finding IV-1*, many improvements have been incorporated into DEK's CAM documentation; however, DEK is still in need of improved formal documentation, such as that used by DEC, which in one package with any associated appendices comprehensively describes its affiliate relationships/organization structure; affiliate standards to which it is subject; affiliate agreements; description of cost accumulation, assignment, and allocation (direct and allocated charges); allocation methodologies and factors; policies, guidelines, and procedures; description of processes and systems used for affiliate charges; etc.

Among the requirements of further CAM documentation are to include:

- ◆ Detailed description of cost accumulation, assignment, and allocation (direct and allocated charges) activities
- ◆ Detailed description of allocation methodologies and factors, including how calculated and results of year's calculations
- ◆ Detailed description of policies, guidelines, and procedures, even though a summary level of policies and procedures/guidelines has been added since the prior audit
- ◆ Detailed description of processes and systems used for affiliate charges; etc.

Duke Energy should continue to include KPSC requirements, but also incorporate recommended changes.

Recommendation IV-2 Develop service level agreements for key functions providing affiliate services to DEK. (Refer to Finding IV-2.)

For example, DEBS is a shared service provider to Duke Energy affiliates. In addition to its service agreements, Duke Energy should have specific service level agreements (SLAs) as its standard in shared services environments. The SLA should specify the services provided and the standards associated with the service. These standards should specify volume, time, and condition (quality) of service. Performance metrics and associated results should be reported regularly and the agreement should be modified periodically. Specifically, a good SLA includes topics such as the following:

- ◆ Introduction, including scope and objectives; definition of business partners, including the function providing services to DEK and DEK business units served by the function; associated roles and responsibilities of both types of business partner, plus governance committee roles and responsibilities, and corporate/executive roles and responsibilities; plus the agreement's underlying assumptions.
- ◆ A detailed listing of target metrics, including metric, metric calculation, goal, target, owner, responsible department, and explanation (if necessary), with the reporting structure and frequency identified.
- ◆ Required management activities, such as:
 - Identification of material variance and corrective actions
 - Performance accountability for function employees providing services to DEK
 - Process to be followed for period reviews of the SLAs
 - Methodology for revision of service levels relative to changing service needs and priorities
 - Results of annual business performance surveys
- ◆ Business partner signatures

By implementing such an SLA, the organization providing services to DEK is formally required to be accountable to business units for its activities on their behalf.

Recommendation IV-3 Develop a formal policy and associated documentation regarding process for handling asset loans, so that they exist going forward in situations where asset loans are actually done. (Refer to Finding IV-5.)

Even though asset loans are extraordinarily rare, they have been incorporated in summary form into training materials and they are handled on a case-by-case basis similar to asset transfers, Duke Energy should also develop a formal policy and associated written documentation describing the process for how and why it handles asset loans among affiliates, as it has performed such activities in the past, although it indicated that it is currently not done. Nevertheless, Duke Energy should ensure that it develops a formal policy and create such procedural documentation, so that they exist going forward in situations where asset loans are actually done.

V. Financial Arrangement/Obligation Compliance

This chapter reviews the financial arrangement/obligation compliance between Duke Energy Kentucky (DEK) and its affiliates, including its parent organizations.

A. Background & Perspective

The specific governing regulatory section that is addressed in this chapter is KRS # 278.2207 - Transactions between utility and affiliates – Pricing requirements – Request for deviation, as follows:

1. The terms for transactions between a utility and its affiliates shall be in accordance with the following
 - a. Services and products provided to an affiliate by the utility pursuant to a tariff be at the tariffed rate, with nontariffed items priced at the utility's fully distributed cost but in no event less than market, or in compliance with the utility's existing (United States Department of Agriculture) USDA, Securities & Exchange Commission (SEC), or Federal Energy Regulatory Commission (FERC) approved cost allocation methodology.
 - b. Additionally, services and products provided to the utility by an affiliate are to be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.
2. A utility may file an application with the commission requesting a deviation from the requirements of this section for a particular transaction or class of transactions, but the utility has the burden of demonstrating that the requested pricing is reasonable. The commission may grant the deviation if it determines the deviation is in the public interest.
3. Nothing in this section should be construed to interfere with the commission's requirement to ensure fair, just, and reasonable rates for utility services.

The financial services and products provided to DEK by affiliates and provided by DEK to its affiliates consist of long-term and short-term debt and investments.

Long-term Debt

Long-term Debt Composition

DEK's long-term debt at the end of calendar year 2015 consisted of capital leases, first mortgage bonds, pollution control bonds, and unsecured debt totaling \$319 million. The long-term debt balance for the entire Duke family of affiliated companies was almost \$40 billion. Details of the long-term debt for DEK and its affiliates at the end of 2015 are shown in *Exhibit V-1*.¹⁴⁰



Exhibit V-1
Duke Energy Long-Term Debt
as of December 31, 2015

Entity	Balance (\$000)
Duke Energy Kentucky	319,027,487
Duke Energy Business Services	139,100,582
Duke Energy Carolina	8,437,433,330
Duke Energy Indiana	3,767,344,337
Duke Energy Ohio	1,278,506,197
Duke Energy Corporation	6,413,320,653
Duke Energy International	701,300,923
Commercial Portfolio	1,093,611,244
Duke Energy Progress	6,518,115,446
Duke Energy Florida	4,266,296,112
Progress Energy, Inc.	3,679,189,590
Cinergy Receivables	324,616,791
Purchase Accounting Adjustments	2,701,510,597
Total	39,569,373,289

Source: Duke Energy Web Site, Fixed Income Investors, Long-Term Debt Details

Duke Energy Corporation (Duke Energy) and its subsidiaries issued 11 long-term debt instruments in 2014 and 2015. Schumaker & Company auditors reviewed the documentation from all the long-term debt instruments issued during these two years. Although DEK did not issue any long-term debt in those two years, this review was made to determine if the debt documentation contained clauses or covenants that could possibly expose DEK to financial damage or risk. The long-term debt instruments reviewed are shown in *Exhibit V-2*.¹⁴¹

Exhibit V-2
Sampled Long-term Debt Instruments
as of December 31, 2015

No.	Entity	Description	Amount (\$Millions)	Rate	Type	Settlement Date	Maturity Date
2015 Issuances							
1	Duke Energy Corporation	Unsecured Notes	400	3.75%	Fixed	11/19/15	4/15/24
2	Duke Energy Corporation	Unsecured Notes	600	4.80%	Fixed	11/19/15	12/15/45
3	Duke Energy Progress	First Mortgage Bonds	500	3.25%	Fixed	8/13/15	8/15/25
4	Duke Energy Progress	First Mortgage Bonds	700	4.20%	Fixed	8/13/15	8/15/45
5	Duke Energy Carolinas	First Mortgage Bonds	500	3.75%	Fixed	3/12/15	6/1/45
	Total 2015 Issuances		2,700				
2014 Issuances							
6	Duke Energy Progress	First Mortgage Bonds	500	4.15%	Fixed	11/20/14	12/1/44
7	Duke Energy Progress	First Mortgage Bonds	200	(1)	Floating	11/20/14	11/20/17
8	Duke Energy Corporation	Senior Notes	400	(2)	Floating	4/4/14	4/3/17
9	Duke Energy Corporation	First Mortgage	600	3.755	Fixed	4/4/14	4/15/24
10	Duke Energy Progress	First Mortgage Bonds	400	4.375%	Fixed	3/6/14	3/30/44
11	Duke Energy Progress	First Mortgage Bonds	250	(1)	Floating	3/6/14	3/6/17
	Total 2014 Issuances		2,350				
	TOTAL ISSUANCES		5,050				
Notes:							
(1) 3 month LIBOR plus 20 Basis Points							
(2) 3 month LIBOR plus 38 Basis Points							

Source: Duke Energy Web Site, Fixed Income Investors, Recent Issuances & Prospectuses

Credit Ratings

DEK's credit ratings for its senior unsecured debt at the end of 2015 was listed as "A-" by Standard & Poor's (S&P), "Baa1" by Moody's Investor Service (Moody's), and "A-" by Fitch Ratings, Inc. (Fitch). The Outlook for DEK was "Negative" from S&P and "Stable" from Moody's and Fitch. These ratings and outlook designations were comparable to those of DEK's affiliates. In 2015 S&P raised the ratings on Duke Energy and its subsidiaries, including DEK, from BBB+ to A-. Also in 2015, S&P lowered its Outlook for Duke Energy and its subsidiaries, including DEK, from "Positive" to "Negative". The S&P ratings increase was based on Duke's exit from the U.S. merchant generation and retail marketing business, thus reducing its business risk and management's distraction and allowing increased focus on its regulated utility business. The Outlook revision to "Negative" reflected the potential for lower ratings if the company's financial profile weakens because of its proposed acquisition of Piedmont Natural Gas. DEK's credit rating and Outlook was based on the consolidated credit profile of Duke Energy and reflected the consolidated credit profiles of all the Duke Energy domestic operating subsidiaries. Moody's and Fitch mention strong credit metrics, cash flow, and financial coverage, supportive and constructive Kentucky regulation, and corporate support as strengths and positive

factors in supporting DEK's rating. Both these credit rating agencies listed DEK's expected increase in the level of capital expenditures and its relatively small size as challenges or limitations to credit ratings.¹⁴²

Ratings for all the Duke Energy operating companies at December 31, 2015 are shown in *Exhibit V-3*.¹⁴³

Exhibit V-3
Duke Energy Credit Ratings
as of December 31, 2015

Entity	December 31, 2015		
	S&P	Moody's	Fitch
Duke Energy Kentucky			
Outlook	Negative	Stable	Stable
Senior Unsecured	A-	Baa1	A-
Duke Energy Corporation			
Outlook	Negative	Negative	Watch-N
Corporate Credit Rating	A-	Baa1	BBB+
Senior Unsecured	BBB+	Baa1	BBB+
Junior Subordinate Debt	BBB	Baa2	BBB-
Commercial Paper	A-2	P-2	F-2
Duke Energy Carolinas			
Outlook	Negative	Stable	Stable
Senior Secured	A	Aa2	AA-
Senior Unsecured	A-	A1	A+
Duke Energy Florida			
Outlook	Negative	Stable	Stable
Senior Secured	A	A1	A
Senior Unsecured	A-	A3	A-
Duke Energy Indiana			
Outlook	Negative	Stable	Positive
Senior Secured	A	Aa3	A
Senior Unsecured	A-	A2	A-
Duke Energy Ohio			
Outlook	Negative	Stable	Stable
Senior Secured	A	A2	A
Senior Unsecured	A-	Baa1	A-
Progress Energy			
Outlook	Negative	Stable	Stable
Senior Unsecured	BBB+	Baa2	BBB
Duke Energy Progress			
Outlook	Negative	Stable	Stable
Senior Secured	A	Aa3	A+

Source: Information Response 24

Short-Term Debt

DEK's short-term debt requirements are managed by Duke Energy's Treasury Department in a consolidated manner for all of Duke Energy's utility industry companies. Short-term cash requirements for the Duke Energy companies are fulfilled through use of a consolidated money pool arrangement.¹⁴⁴

Money Pool

Duke's Utility Money Pool Agreement (Agreement), dated July 2, 2012, authorizes DEK and its utility and nonutility affiliates to participate in a short-term borrowing and lending arrangement to help manage their cash and working capital requirements. Under this Agreement, short-term funds borrowed may be from either internal or external sources. Internal funds come from Agreement participants with surplus short-term funds. External funds come from the sale of commercial paper.¹⁴⁵

Each Agreement participant can contribute funds to the Money Pool. Each participant's chief financial officer, Treasurer, or their designee determines the amount of excess cash that is available to be contributed to the Money Pool daily. Any participant may withdraw their funds from the Money Pool at any time with notice given to Duke Energy Business Services (DEBS) as administrative agent of the Money Pool.¹⁴⁶

All Agreement participants, except Duke Energy, Progress Energy, and Cinergy, are authorized to borrow cash on a short-term basis from the Money Pool, subject to the availability of funds. The decision to borrow from the Money Pool is made by the borrower's chief financial officer, treasurer, or their designee. If a Money Pool participant is authorized to borrow from other sources (banks or by the sale of its own commercial paper) it cannot be required to borrow from the Money Pool if it is determined that money can be borrowed at a lower cost from other sources.¹⁴⁷

The participants in the Duke Energy Money Pool Agreement are shown in *Exhibit V-4*.¹⁴⁸

Exhibit V-4
Duke Energy Money Pool Participants
as of December 31, 2015

No.	Participant	State of Registration	Relationship	Money Pool Rights	
				Lend	Borrow
1	Duke Energy	Delaware	Parent	X	
Holding Companies					
2	Cinergy	Delaware	Sub of Duke Energy	X	
3	Progress Energy	North Carolina	Sub of Duke Energy	X	
Public Utility Companies					
4	Duke Energy Kentucky	Kentucky	Sub of Duke Energy Ohio	X	X
5	Duke Energy Ohio	Ohio	Sub of Cinergy	X	X
6	Duke Energy Indiana	Indiana	Sub of Cinergy	X	X
7	Duke Energy Carolinas	North Carolina	Sub of Duke Energy	X	X
8	Miami Power	Indiana	Sub of Duke Energy Ohio	X	X
9	Progress Energy Carolinas	North Carolina	Sub of Progress Energy	X	X
10	Progress Energy Florida	Florida	Sub of Progress Energy	X	X
Service Companies					
11	Duke Energy Business Services	Delaware	Sub of Duke Energy	X	X
12	Progress Energy Service Company	Florida	Sub of Progress Energy	X	X
Nonutility Company					
13	KO Transmission Company	Kentucky	Sub of Duke Energy Ohio	X	X

Source: Information Response 23

The source of funds available in the Money Pool to be borrowed comes from the following sources:¹⁴⁹

- ◆ *Internal funds* – surplus funds from other participants in the Money Pool Agreement. Borrowers borrow their funds from each Money Pool lending party in proportion to the amount loaned to the Money Pool by each lender in relation to the total amount loaned at any one time. If only internal funds are borrowed, the interest rate applied to the loan is the CD yield equivalent of the 30-day Federal Reserve “AA” Industrial Commercial Paper Composite Rate.
- ◆ *External funds* – proceeds from borrowings by participants, including the sale of commercial paper by Duke Energy, Progress Energy, Cinergy, Duke Energy Carolinas (DEC), Duke Energy Indiana (DEI), Duke Energy Ohio (DEO), DEK, Progress Energy Carolinas, and Progress Energy Florida. If the source of funds is external, the interest rate applied to the loan is the lending party’s cost of acquiring the funds. If the borrowed funds come from several external sources this can be a composite rate (weighted average of cost incurred by all parties involved).

If the borrowed funds come from a combination of internal and external sources, the interest rate charged would be a composite or blended rate. In all cases, the rate charged is to be the Money Pool’s cost of the money borrowed, and there is no fee added to the rate charged.¹⁵⁰

During four months in 2015, DEK lent over \$1.1 billion in short term funds to five of its affiliates through the Money Pool. The period of each loan was one day except for weekends, which were three or four days. The annual interest rate charged by DEK ranged from 0.13% to 0.26%, with a weighted average annual interest rate of 0.18%. DEK received \$8,133 in interest in 2015.¹⁵¹

A summary of funds lent by DEK through the Money Pool are shown in *Exhibit V-5*.¹⁵²

Exhibit V-5
Money Pool Funds Lent by DEK
as of December 31, 2015

Borrower	Period	Principal Amount Lent (\$)	Average Daily Amount Lent (\$)	Weighted Par Value (\$)	Interest Received (\$)	Weighted Average Annual Interest Rate
Duke Energy Business Services	4/06/2015 – 7/31/2015	934,167,000	12,421,342	1,341,505,000	6,692	0.1796%
Duke Energy Progress	4/06/2015 – 7/31/2015	86,149,000	1,123,665	121,358,000	607	0.1800%
Duke Energy Florida	4/06/2015 – 7/31/2015	86,101,000	1,201,320	120,132,000	614	0.1840%
Duke Energy Indiana	4/10/2015 – 6/23/2015	28,425,000	556,890	40,653,000	205	0.1814%
Duke Energy Ohio	4/10/2015 – 6/23/2015	1,998,000	282,400	2,824,000	15	0.1913%
Totals/Weighted Average		1,136,840,000		1,626,472,000	8,133	0.1800%

Source: Information Response 23, Attachment 1

Throughout 2015 DEK borrowed over \$10 billion in short-term funds from seven of its affiliates through the Money Pool. More than 75% of short-term funds borrowed by DEK were provided by its parent, Duke Energy. The period of each loan was one day except for weekends, which were three days and in a few instances four days. The annual interest rate charged to DEK ranged from 0.12% to 0.7545%, with a weighted average annual interest rate of 0.4631%. The rate charged by Duke Energy Corporation was more than double the rate charged to DEK by its other affiliates, reflecting the source of the funds - the cost of commercial paper for the funds from Duke Energy vs the CD yield equivalent of the 30-day Federal Reserve "AA" Industrial Commercial Paper Composite Rate for the funds from the other affiliates. DEK paid a total of \$189,031 in interest in 2015.¹⁵³

A summary of Money Pool funds borrowed by DEK in 2015 is shown in *Exhibit V-6*.¹⁵⁴

Exhibit V-6
Money Pool Funds Borrowed by DEK
as of December 31, 2015

Lender	Period	Principal Amount Borrowed	Average Amount Lent (\$)	Weighted Par Value (\$)	Interest Paid (\$)	Weighted Average Annual Interest Rate
Duke Energy Corporation	12/31/2014 – 1/04/2016	7,674,694,000	20,402,498	11,098,959,000	167,412	0.5430%
Duke Energy Carolinas	12/31/2014 – 1/04/2016	1,072,943,000	6,129,406	1,556,869,000	9,407	0.2175%
Duke Energy Progress	12/31/2014 – 12/31/2015	555,075,000	4,187,605	816,583,000	4,858	0.2142%
Progress Energy Service Company	12/31/2014 – 12/31/2015	525,400,000	3,030,578	775,828,000	4,827	0.2240%
Duke Energy Indiana	3/12/2015 – 1/04/2016	174,817,000	1,377,253	256,169,000	1,649	0.2318%
Duke Energy Ohio	12/31/2014 – 8/19/2015	127,093,000	1,619,435	186,235,000	860	0.1663%
Duke Energy Florida	3/11/2015 – 8/26/2015	2,923,000	387,222	3,485,000	18	0.1877%
Totals/Weighted Average		10,132,945,000		14,694,128,000	189,031	0.4631%

Source: Information Response 23, Attachment 1

Credit Facility

Duke Energy has a \$7.5 billion master Credit Agreement (Amendment No. 2, dated January 30, 2015) that includes DEK, and its affiliates: DEC, DEO, DEI, Duke Energy Progress (DEP), and DEF as borrowers and 32 international banks as lenders. The participating banks involved are shown in *Exhibit V-7*.¹⁵⁵

Exhibit V-7
Duke Energy Credit Agreement Participants
as of December 31, 2015

Bank	Participation	
	Position in Agreement	Commitments (\$)
Wells Fargo Bank, National Association	Administrative Agent and Swingline Lender	340,000,000
Bank of America, N.A.	Issuing Lender	340,000,000
Royal Bank of Scotland PLC	Issuing Lender	340,000,000
Bank of China, New York Branch	Issuing Lender	340,000,000
Barclays Bank PLC	Issuing Lender	340,000,000
Citibank, N.A.	Issuing Lender	340,000,000
Credit Suisse AG, Cayman Islands Branch	Issuing Lender	340,000,000
JPMorgan Chase Bank, N.A.	Issuing Lender	340,000,000
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	Issuing Lender	340,000,000
UBS AG, Stamford Branch	Issuing Lender	340,000,000
BNP Paribas	Lender	264,000,000
Goldman Sachs Bank USA	Lender	264,000,000
Mizuho Bank, Ltd.	Lender	264,000,000
Morgan Stanley Bank, N.A.	Lender	264,000,000
Royal Bank of Canada	Lender	264,000,000
Sun Trust Bank	Lender	264,000,000
The Bank of Nova Scotia	Lender	264,000,000
U. S. Bank National Association	Lender	264,000,000
Banco Bilbao Vizcaya Argentaria, SA, NY Branch	Lender	142,000,000
Industrial and Commercial Bank of China, Limited	Lender	142,000,000
KeyBank National Association	Lender	142,000,000
The Bank of New York Mellon	Lender	142,000,000
The Northern Trust Company	Lender	142,000,000
Fifth Third Bank	Lender	142,000,000
Credit Agricole Corporate and Investment Bank	Lender	142,000,000
PNC Bank, National Association	Lender	142,000,000
Santander Bank, N.A.	Lender	142,000,000
TD Bank, N.A.	Lender	142,000,000
Canadian Imperial Bank of Commerce, NY Branch	Lender	142,000,000
DNB Bank ASA, Grand Cayman Branch	Lender	142,000,000
HSBC Bank USA, National Association	Lender	142,000,000
Sumitomo Mitsui Banking Corporation	Lender	142,000,000
TOTAL COMMITMENTS		7,500,000,000

Source: Duke Energy Website, Fixed-Income Investors, Credit Facility & Liquidity, Master Credit Facility Agreement

DEK's maximum sublimit in this agreement is \$175 million. This is less than the limits assigned to DEO (\$725 million), DEI (\$1 billion), DEI (\$1.2 billion), DEP (\$1.4 billion), DEC (\$1.8 billion), and Duke Energy (\$4.7 billion). The interest rate that applies to each loan from the Credit Facility is dependent on the type of loan and the credit rating of the borrower. Credit ratings are based on the borrower's non-credit-enhanced, senior unsecured long-term debt and must be issued by S&P, Moody's, or Fitch. Credit ratings used are based on the following rules:¹⁵⁶

- ◆ If ratings issued by two of the rating agencies are the same and one differs, the pricing level is determined based on the two ratings that are the same
- ◆ If none of the ratings are the same, the pricing level is determined based on the middle rating
- ◆ If only two ratings exist and they differ by one level, then the pricing level for the higher of such ratings applies
- ◆ If only two ratings exist and they differ by more than one level, then the pricing level that is one level lower than the pricing level of the higher rating applies
- ◆ If only one rating exists, the pricing level is determined based on that rating
- ◆ If no such rating exists then a corporate credit rating from S&P and the issuer ratings from Moody's and Fitch should be used

The interest and facility fee rates that apply to borrowings based on the borrower's credit rating are shown in *Exhibit V-8*.¹⁵⁷

Exhibit V-8
Duke Energy Credit Agreement Pricing Schedule
as of December 31, 2015
(Basis Points per Annum)

Borrower's	S&P or Fitch	Moody's	S&P or Fitch	Moody's	S&P or Fitch	Moody's	S&P or Fitch	Moody's	S&P or Fitch	Moody's	S&P or Fitch	Moody's
	≥ A+	≥ A1	≥ A	≥ A2	≥ A-	≥ A3	≥ BBB+	≥ Baa1	≥ BBB	≥ Baa2	< BBB	< Baa2
Facility Fee Rate	7.5		10.0		12.5		17.5		22.5		27.5	
Applicable Margin Euro-Dollar and Swingline Loans	80.0		90.0		100.0		107.5		127.5		147.5	
Base Rate Loans	0.0		0.0		0.0		7.5		27.5		47.5	

Source: Duke Energy Website, Fixed-Income Investors, Credit Facility & Liquidity, Master Credit Facility Agreement

Capital Structure

Dividend Payouts

Duke Energy dividend policy, subject to approval of the Board of Directors, is a long-term payout to shareholders of approximately 65% to 70% of adjusted diluted earnings per share. DEK and the other utility subsidiaries are also expected to follow this policy over time, but have flexibility to vary their annual dividends to their parent based on their capital structure and capital spending requirements.¹⁵⁸ Dividend policy is governed by desire to keep the DEK capital structure approximately 50% debt and

50% equity. Targets are consistent with the equity percentages allowed by state regulators.¹⁵⁹ A schedule displaying DEK's dividend payouts to Duke Energy over the past nine years is shown in *Exhibit V-9*.¹⁶⁰

Exhibit V-9
DEK's Dividend Payout History
2007 to 2015

Financial Data	Years								
	2007	2008	2009	2010	2011	2012	2013	2014	2015
Dividend/(Infusion) (\$ millions)	(3.1)	30.0	0	0	135.0	10.0	40.0	0	55.0
Net Income (\$ millions)	33.5	37.5	28.1	43.3	24.3	28.2	45.1	35.3	46.2
Payout Ratio	N/A	80%	0%	0%	555%	36%	89%	35.3%	119%

Source: Information Responses 12 and 58

Capitalization

DEK's capital structure over the past five years is shown in *Exhibit V-10*.¹⁶¹

Exhibit V-10
DEK's Capital Structure History
2011 to 2015

Financial Data	For Years Ended December 31									
	2011		2012		2013		2014		2015	
	\$ Millions	%	\$ Millions	%	\$ Millions	%	\$ Millions	%	\$ Millions	%
Debt	337.6	49	336.2	47	335.0	47	318.8	44	317.3	44
Equity	354.7	51	372.9	53	377.9	53	413.3	56	404.4	56
Total Capitalization	692.3	100	709.1	100	712.9	100	732.1	100	721.7	100

Source: Information Response 59

B. Findings & Conclusions

Finding V-1 The long-term indebtedness DEK or that of its affiliates does not expose DEK or its ratepayers to undue risk.

Duke Energy and its subsidiaries issued 11 long-term debt instruments in 2014 and 2015. DEK did not issue any long-term debt in this time period. A review of the documentation of 100% of the long-term debt instruments issued during these two years was conducted to determine if the debt documentation contained clauses or covenants that could expose DEK to financial damage or risk. The value of the debt instruments reviewed represented approximately 13% of the value of the long-term debt issues for

all the Duke Energy entities, and the number of debt instruments reviewed was approximately 5% of the total number of Duke Energy debt instruments outstanding at December 31, 2015.

Documentation for each of these long-term debt obligations was reviewed to identify any clauses or codicils that might affect DEK or could possibly require DEK to assume some future obligation because of an action or inaction by one of its affiliates. There was no indication DEK or its ratepayers were at greater risk due to its long-term debt obligations or those held by its affiliates. Additionally, Duke Energy asserted that DEK did not have any financial instruments that included credit-rating triggers or provisions leading to collateral calls.

Finding V-2 The financial agreements in which DEK is a participant do not obligate or increase the financial risk for DEK.

DEK is a participant in the Duke Energy Utility Money Pool Agreement and the \$7.5 billion master Credit Agreement. Neither of these agreements obligate DEK to come to the financial aid of, or otherwise support, the other Duke affiliates. DEK was listed as lender and borrower in the Duke Energy Money Pool Agreement and as borrower in the Credit Agreement. There was no terminology in either document to indicate that DEK was responsible for credit or funds extended to the other participants in the agreements.

Finding V-3 During 2014 and 2015 DEK has not issued any security for the purpose of financing the acquisition, ownership, or operation of an affiliate.

DEK long-term debt as of the end of 2015 consisted of capital leases, pollution control bonds, unsecured debt, and commercial paper treated as long-term debt. In 2014 and 2015 DEK did not issue any debt instruments.

Finding V-4 DEK has not assumed any obligation or liability as guarantor, endorser, surety, or otherwise in respect of any security of an affiliate.

Reviews of funding agreements and sampled debt obligation documentation did not reveal any instance in which DEK was listed as guarantor, endorser, surety, or was otherwise obligated to assume the debt of one of its affiliates. An attestation from Duke Energy's Director of Corporate Finance and Assistant Treasurer, responsible for the establishment of treasury/capitalization policies for the corporation and research/execution of corporate financing transactions (including credit facilities for DEK and its affiliates), verified that DEK does not have any financial instruments that include credit-rating triggers or provisions leading to collateral calls.

Finding V-5 DEK has not pledged, mortgaged, or otherwise used as collateral any of its assets for the benefit of an affiliate.

A review of Duke's funding agreements (Utility Money Pool Agreement and Credit Agreement), sampled debt obligation documents, and DEK's financial statements did not reveal any instance of DEK pledging, mortgaging, or otherwise using as collateral any of its assets for the benefit of an

affiliate. An attestation from Duke Energy's Director of Corporate Finance and Assistant Treasurer, responsible for the establishment of treasury/capitalization policies for the corporation and research/execution of corporate financing transactions (including credit facilities for DEK and its affiliates), verified that DEK does not have any financial instruments that include credit-rating triggers or provisions leading to collateral calls.

Finding V-6 DEK has maintained a consistent credit rating since mid-2012.

DEK's credit ratings for its senior unsecured debt at the end of 2015 was listed as A- by Standard & Poor's (S&P), Baa1 by Moody's Investor Service (Moody's), and A- by Fitch Ratings, Inc. (Fitch). The Outlook for DEK was "Negative" from S&P and "Stable" from Moody's and Fitch. These ratings and outlook designations were comparable to those of DEK's affiliates. Moody's rating and outlook has remained unchanged since 2009, and Fitch has maintained the same rating since it started rating DEK in mid-2012. S&P's rating was increased from BBB+ (where it has been since 2012) to A- in 2015. S&P's Outlook for DEK and all the Duke Energy companies was listed as "Negative" reflecting the proposed acquisition of Piedmont Natural Gas by Duke Energy.

Finding V-7 DEK's Money Pool transactions in 2015 have caused it to incur unnecessary expense.

During 2015 DEK received \$8,133 in interest for \$1.1 billion in short-term funds lent (usually for 1-day periods) to five of its affiliates, and paid \$189,031 in interest for \$10 billion borrowed (also usually for 1-day periods) from seven of its affiliates. DEK lent funds during four months of the year (April through July), while it borrowed funds during every month in 2015.

During the April through July period, DEK lent a total of \$1,136,840,000 to DEBS, Duke Energy Progress, Duke Energy Florida, DEO, and DEI at interest rates that ranged from 0.13% to 0.26%, and borrowed \$1,925,000,000 from Duke Energy at interest rates that ranged from 0.4871% to 0.6466%. During this four-month period DEK borrowed more money than it needed and lent out the excess money to its affiliates at less than its cost for the funds. Comparing interest rates of funds borrowed and lent on the same day reveals that DEK paid \$12,209.56 in excess interest charges for funds borrowed from its parent that were then lent out to its affiliates.

C. Recommendations

Recommendation V-1 Change the way DEK calculates interest expense for the use of excess borrowed short-term funds. (Finding V-7)

Comparing interest rates of funds borrowed and lent on the same day reveals that DEK could have saved \$12,209.56 in interest charges by either not borrowing funds that were not needed from Duke Energy or by charging the affiliates to whom it lent the excess funds the same interest rates that it paid for the funds. DEK lent out funds to its affiliates at the “Internal Funds” rate (CD yield equivalent of the 30-day Federal Reserve “AA” industrial Commercial Paper Composite Rate) that it had borrowed at the “External Funds” rate (the lending party’s cost for such External Funds). DEK should have lent out the funds at the “External Funds” rate or its cost, or it should have limited its borrowing to the amount of funds that it actually needed.

VI. Internal Controls

A. Background & Perspective

In 2011, Duke Energy Ohio, Inc. (DEO), the parent company of Duke Energy Kentucky (DEK), merged with Progress Energy, Inc. (Progress). As part of its approval of the merger in Case No. 2011-00124, DEK was ordered to adhere to 46 merger commitments the Kentucky Public Service Commission (KPSC) established in Case No. 2005-00228, of which four (4), specifically Commitments 10, 11, 12, and 13 specifically relate directly to this audit. They apply as follows:

- ◆ DEK is in compliance with its Commitment 10, which requires proper accounting of costs (accounting and reporting system used by Duke Energy Kentucky will be adequate to provide assurance that directly assignable utility and non-utility costs are accounted for properly and that reports on the utility and non-utility operations are accurately presented).
- ◆ DEK is in compliance with its Commitment 11, which requires that it implement and maintain appropriate cost allocation procedures that will accomplish the objective of preventing cross-subsidization, and be prepared to fully disclose all allocated costs, the portion allocated to Duke Energy Kentucky, complete details of the allocations methods, and justification for the amount and the method, plus giving the Commission 30 days' advance notice of any changes in cost allocation methods set forth in agreements approved as part of the merger transactions.
- ◆ DEK is in compliance with its Commitment 12, which requires that it commit to third-party independent audits of the affiliate transactions under the affiliate agreements approved as part of the merger transaction.
- ◆ DEK is in compliance with its Commitment 13, which requires that it protect against cross-subsidization in transactions with affiliates.

Also within the scope of this audit is DEK's compliance with KPSC regulations, including:

- ◆ 807 KAR 5:080 SECTION 2 — Annual reports
- ◆ 807 KAR 5:080 SECTION 3 — Filing of cost allocation manual and amendments
- ◆ 807 KAR 5:080 SECTION 4 — Notice of establishment of new non-regulated activity

With the approval of the merger of Duke Energy with Progress Energy Corporation (Progress Energy), the KPSC imposed three additional conditions on its approval of the merger, specifically:

- ◆ Duke Energy Kentucky must continue to offer a full range of cost-effective energy conservation and efficiency programs.
- ◆ The Board of Directors of the combined company must include at least one non-employee member who resides in the company's service territory in Kentucky, Indiana, or Ohio.
- ◆ No merger costs may be passed on to Duke Energy Kentucky ratepayers.

Refer to *Chapter II – Merger Order Requirements* for a discussion of Duke Energy's responses.

SOx Controls

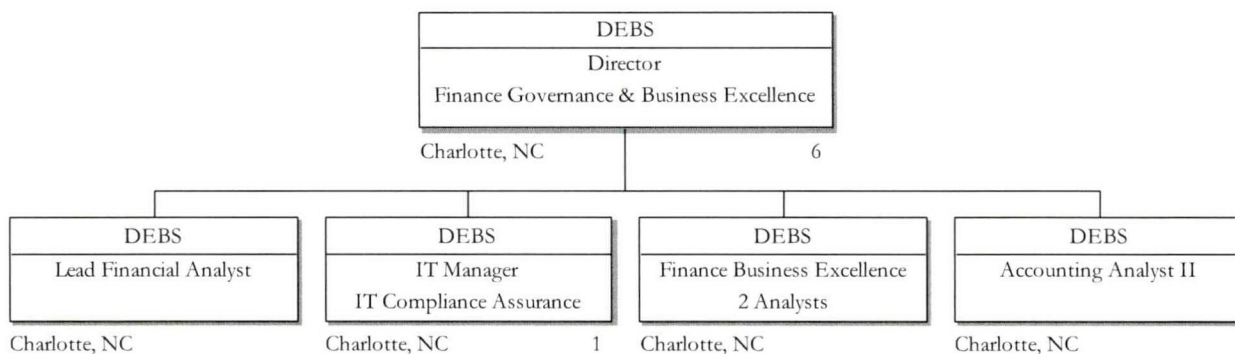
SOx controls were the ultimate result of an act passed by U.S. Congress in 2002 to protect investors from the possibility of fraudulent accounting activities by corporations. The Sarbanes-Oxley Act mandated strict reforms to improve financial disclosures from corporations and prevent accounting fraud. As a part of this Act, year-end financial reports were mandated to contain an assessment of the effectiveness of the internal controls and the company's auditing firm would be required to attest to that assessment. This has resulted in public companies registered with the SEC to list specific controls and test them regularly and determine that the controls are operating effectively and as intended. These listed controls are referred to as SOx controls.

The Duke Energy organization has approximately 1,500 SOx controls in 2015 (and is reduced again in 2016 to approximately 1,100 controls). Of these controls, approximately 10 are directly applicable to affiliate relationships and charges and the USF&G OH/KY group and three of these were tested in 2015. The controls tested were considered "effective," none were "ineffective" or "undetermined." Also, the SOx controls regarding accounting for services and asset transfers, such as inventory stock transfers, are generic and not specifically focused on affiliate charges, as affiliate charges do not impact Duke Energy's consolidated financial statements, since affiliate charges are eliminated during consolidation.¹⁶²

SOx Testing

SOx testing occur at random and specific times during the year. When the Director of Accounting, Internal Controls, notifies the SOx representatives, each SOx representative verifies that the SOx control owners for which they are responsible are still valid. Once validity is confirmed, the SOx representative directs the control owners to begin the SOx testing. The testing results are documented ultimately in the Open Pages system with a narrative and any supporting documentation needed to confirm that the control is working as intended. When the documentation is complete in Open Pages, the SOx representative reviews the information provided. The Internal Controls group, referred to as the Finance Governance & Business Excellence organization shown in *Exhibit VI-1*, also monitors this activity and documentation on an ongoing basis.¹⁶³

Exhibit VI-1
Finance Governance & Business Excellence Organization
2015



Source: Information Response 37 and Interview 9

Duke Energy has approximately ten SOx controls that apply to the affiliate relations and charges, and the USFE&G Ohio/Kentucky group. The controls have been relabeled between 2013 and 2015. The newly labeled controls are:¹⁶⁴

- ◆ Affiliate Overhead Run Report
- ◆ Affiliate Allocations Phire Form
- ◆ Balance Sheet Review (previously called Subregistrant Balance Sheet Review)
- ◆ Subregistrant Financial Results Summary (FRS)
- ◆ Intercompany Balances Review
- ◆ Intercompany Elimination Review
- ◆ Intercompany Elimination Review
- ◆ Composite Rates are Entered Correctly in FMIS
- ◆ Service Company Allocations Posted Properly
- ◆ Corporate Allocation Calculation Review

Subregistrant Financial Results Summary and Corporate Allocation Review were the two controls selected for testing and determined to be operating effectively during 2013,¹⁶⁵ while Subregistrant Financial Results Summary (FRS), Balance Sheet Review, and Corporate Allocation Calculation Review were the three controls selected for testing and determined to be operating effectively during 2015,¹⁶⁶ as illustrated in *Exhibit VI-2*.¹⁶⁷



Exhibit VI-2
2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group
Page 1 of 4

Entity Name	Control Name	Description	Control Description	Selected for Testing	Operating Effectiveness	Test Steps (if applicable)
FCR_Franchised	FCR-ALLC02	Affiliate Overhead Run Control Report	Regulated Utilities Accounting reviews the Run Control Report during the month-end close process to verify no errors have occurred in the running of the allocations for the Affiliate Overhead.	No	Undetermined	NA
FCR_Franchised	FCR-ALLC04	Affiliate Allocations Phire Form	Regulated Utilities Accounting contacts Functional User Support (via a CR Phire form) in order to make affiliate overhead allocation rate changes within PeopleSoft.	No	Undetermined	NA
FCR_Franchised	FCR-FEG 08 DEO	Balance Sheet Review	Monthly, a Balance Sheet Review is prepared by an Analyst for DEO. On quarter end months the analysis compares current month to December (year to date) and on nonquarter months the analysis compares current month to prior month (month to date). Variances greater than 5% and over \$10 million are explained. The analysis is reviewed by the respective Accounting Manager, or designee, then a review is conducted with the respective Director, or Director-level designee.	Yes	Effective	<ol style="list-style-type: none"> 1. Select two months for testing (ensure to select one quarter end and one non-quarter end month). 2. For the months selected for testing, obtain a listing of the analyses of key financial data prepared by each subregistrant's (DEO) Accounting Regulated Group. 3. Verify that Balance Sheet Variances of \$10 million and 5% are explained. 4. Verify that the comparisons for the quarter months are for quarter-end vs. December of the prior year and for the non-quarter months are current month vs. prior month. 5. Examine the analyses to verify that they were reviewed by the Director of Regulated Accounting in a timely manner. 6. Evaluate reports, queries, spreadsheets, or databases used in performing the control. If there are reports, queries, spreadsheets, or databases, review and update the EUT Questionnaire.

Source: Information Response 36

Exhibit VI-2
2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group
Page 2 of 4

Entity Name	Control Name	Description	Control Description	Selected for Testing	Operating Effectiveness	Test Steps (if applicable)
FCR_Franchised	FCR-FEG 07 DEO	Subregistrant Financial Results Summary (FRS)	Each of the subregistrant's Accounting and Reporting groups prepare their respective Financial Results Summary (FRS) which supports the RU Adjusted Segment Income reporting. In the FRS, significant AvB variances for month and YTD are discussed monthly and AvA variances for QTD and YTD are discussed quarterly. All subregistrants' FRSs are reviewed with the respective Director, or Director-level designee.	Yes	Effective	<ol style="list-style-type: none"> 1. Select a quarter for testing. 2. For the period selected for testing, obtain a listing of the analyses of key financial data prepared by each of the USFE&G Subregistrant's Financial Reporting and General Accounting group. 3. Verify that for the additional variance analysis schedules (support for Adjusted Segment Income, including O&M), variances deemed material are explained. 4. Verify that the AvA variances for quarter and YTD are prepared and discussed quarterly. 5. Examine the analyses to verify that they were reviewed by the Director of Regulated Accounting in a timely manner. 6. Evaluate reports, queries, spreadsheets, or databases used in performing the control. If there are reports, queries, spreadsheets, or databases, review and update the EUT Questionnaire.
FCR_Shared	FCR-CON- 07	Intercompany Balances Review	The EIPO, or designee, reviews out of balance reports to ensure out of balances are resolved or deemed immaterial. If balances exist, EIPO reviews the final disputed balances with Corporate Controller.	No	Undetermined	NA

Source: Information Response 36

Exhibit VI-2
2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group
Page 3 of 4

Entity Name	Control Name	Description	Control Description	Selected for Testing	Operating Effectiveness	Test Steps (if applicable)
FCR_Shared	FCR-CON-08	Intercompany Elimination Review	Monthly, the Corporate Consolidations Manager or designee, ensures that all intercompany balances eliminate to zero on the consolidated financial statements.	No	Undetermined	NA
FCR_Shared	FCRA-ASC44	Composite Rates are Entered Correctly in FMIS	The Business Analyst runs a Business Objects query monthly to verify allocation percentages entered into PeopleSoft total 100% for each cost pool to ensure accuracy.	No	Undetermined	NA
FCR_Shared	FCRA-ASC45	Service Company Allocations Posted Properly	The Business Analyst reviews the allocation results (run control) report monthly sent by e-mail from the PeopleSoft Financials Support Team. This report identifies errors received from the allocations run. This report also indicates whether or not any entries were posted to the allocations suspense account. Any errors or postings to the suspense account, are identified and investigated by the Business Analyst and the correct accounting is communicated to the appropriate people for correction via journal entry.	No	Undetermined	NA

Source: Information Response 36

Exhibit VI-?
2015 Sox Controls Involving Affiliate Relationships and Charges and OH/KY Group
Page 4 of 4

Entity Name	Control Name	Description	Control Description	Selected for Testing	Operating Effectiveness	Test Steps (if applicable)
FCR_Shared	FCRA-ASC46	Corporate Allocations Posted Properly	The Business Analyst runs a Business Objects query monthly to verify that the job ran without errors, completely and accurately. The query is used to determine if the dollars allocated to the BUs and offset the cost pools appropriately. A Hyperion Financial Management report is also run to review the EBIT impact for Service Company.	No	Undetermined	NA
FCR_Shared	FCRA-ASC50	Corporate Allocation Calculation Review	Annually, the service company allocation calculations undergo the prepare/review process to ensure accuracy and completeness.	Yes	Effective	<ol style="list-style-type: none"> 1) Obtain the service company allocation calculations for the test period. 2) Verify that the service company allocation calculations contain evidence of review and approval. 3) Verify that the service company allocation calculations are complete and accurate. 4) Note and investigate calculations that were not approved. 5) Note the date the calculation was prepared and approved. Note and investigate any time lags. 6) Evaluate reports, queries, spreadsheets, or databases used in performing the control. If there are reports, queries, spreadsheets, or databases, review and update the existing EUT Questionnaire.

Source: Information Response 36

Internal Audits

Three internal audits regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been conducted in the last three years. The Corporate Audit Services group did not specifically perform any audits regarding the Kentucky/Ohio Accounting & Reporting group in 2013 through 2015; however, routine internal control reviews have been performed during this time period, and three audits were conducted that pertained to affiliated relationships or transactions. These audits are briefly described in *Exhibit VI-3*.¹⁶⁸

Exhibit VI-3
Internal Audits Associated with Affiliate Relationships/Transactions
2013 to 2015

Audit #	Audit Title	Date Completed
113042	Annual Audit of Affiliate Transactions-12 month period ended September 30, 2013	December 20, 2013
114011	Annual Audit of Affiliate Transactions-12 month period ended September 30, 2014	January 30, 2015
115027	Annual Audit of Affiliate Transactions-12 month period ended September 30, 2015	February 2, 2016

Source: Information Response 15

According to the Director, Corporate & Commercial Audit – Internal Audit and as documented in the audit memorandums listed in *Exhibit VI-3*, no recommendations were made that required management action. Actions specified were to continue process as is, with few changes.¹⁶⁹

In accordance with condition 5.12 of the Regulatory Conditions required by the North Carolina Utilities Commission, an annual audit is conducted of affiliate transactions by Duke Corporate Audit Services (CAS) which includes a detailed review of those transactions for a one-year period ending September 30. This audit has been conducted three times over the last years with minor findings only. Per discussions with the Director, Corporate & Commercial Audit – Internal Audit, it is due to the ongoing work of Financial Planning and Analysis (FP&A) who is responsible for ongoing monthly review of all affiliate transactions and will adjust for coding and pricing issues on an ongoing basis.¹⁷⁰ Each audit and the findings are detailed on the following pages. Note the audits included transactions with DEK, but were not only DEK transactions. Specific findings below, may or may not have been related to DEK.¹⁷¹

Annual Audit of Affiliate Transactions-2013 #113042

During the 2013 audit, it was determined that two employees incorrectly charged time to DEC for one pay period by entering an incorrect code on their timesheet. These two mistakes were corrected with journal entries.¹⁷² Also, another employee related instance had employees transferred but their default labor allocations were not updated to reflect the change. A detailed review was performed to capture all similar instances and a journal entry posted to correct.¹⁷³

Based on the findings in this audit memorandum, several actions were called for. New requirements were communicated regarding employee payroll company changes to management of FP&A, Regulated Utility Financial Planning (RUFPP), HR Business Partners, and HR Business Staffing for employee transfers. The new requirements provided additional assurance that employee's labor charges will indeed originate from the appropriate entity. Additionally, enhanced Business Object queries were developed to assist in monitoring, researching, and if necessary, correcting affiliate transactions. Lastly, improved guidance will be given for time reporting including training, reference materials, and other communications to evaluate roles and responsibilities in the performance of SOX controls around default labor.¹⁷⁴

Annual Audit of Affiliate Transactions-2014 #114011

During the 2014 audit, eight of 80 transactions were determined to have been coded incorrectly and two of these led to cross-subsidization of \$2,539. One of these errors was an expense coding error and the other was a labor coding error. Both were determined to be isolated human error. A deep dive to uncover other errors with similar attributes led to an additional \$9,979 being identified and corrected.¹⁷⁵

No new actions were deemed to be necessary, based on the findings in this audit memorandum. Monthly review and analysis will continue as well as ongoing adjustments based on those monthly reviews.¹⁷⁶

Annual Audit of Affiliate Transactions-2015 #115027

During the 2015 audit of affiliate transactions, 60 transactions were selected and of those 60, two were found to have coding errors with immaterial dollar impact, less than \$1,000 in total. Additional analysis was performed and \$6,249 determined to be the total dollar amount of similar errors.

Like the previous year, no new recommendations were made. The "Next Steps" section of the memorandum notes that FP&A will review and enhance areas of the Monthly Affiliate Transaction Review process documentation that require some additional clarification. Further, the next steps section notes that FP&A will continue to perform the Monthly Affiliate Transaction Review and respond to monthly findings with correcting journal entries and additional guidance for proper guidance, as necessary.

B. Findings & Conclusions

Finding VI-1 Internal audit reports regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been addressed by DEBS staff in a timely manner.

For each of the audits identified previously in *Exhibit VI-3*, Schumaker & Company investigated if the resulting audit recommendations were addressed by DEBS staff in a timely manner. The Director of Audit Services confirmed during this audit that all corrective actions were completed and implemented by the agreed upon completion dates.