COLUMBIA GAS OF KENTUCKY, INC.
RESPONSE TO STAFF'S SECOND REQUEST FOR INFORMATION
DATED JULY 8, 2016

55. Refer to the Direct Testimony of Austin M. Schauer, page 8, lines 9-17, regarding the Federal Energy Regulatory Commission's audit of NCSC. Provide a copy of the audit report.

Response:

Please see Staff 2-55 Attachment A for a copy of the October 24, 2012 FERC audit report.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA11-5-000
October 24, 2012

NiSource Inc.
Attention: Stephen P. Smith
Executive Vice President and Chief Financial Officer
801 East 86th Ave.
Merrillville, IN 46410

Dear Mr. Smith:

1. The Division of Audits within the Office of Enforcement (OE) has completed the audit of NiSource Inc. (NiSource or Company) and its associated companies from January 1, 2009 through December 31, 2010. The enclosed audit report explains our audit findings and recommendations.

2. On August 21, 2012, you notified us that NiSource agrees with our findings and recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit findings and recommended corrective actions. Within 30 days of this letter order, NiSource should submit a plan to comply with the corrective actions. NiSource should make quarterly filings describing how and when it plans to comply with the corrective actions, including dates it has completed each corrective action. The submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

3. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.311 (2011). This letter order constitutes final agency action. Your Company may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713 (2011).

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

5. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Bryan K. Craig, Director and Chief Accountant, Division of Audits at (202) 502-8741.

Sincerely,

Norman C. Bay

Norman C. Bay
Director
Office of Enforcement

Enclosure

Federal Energy Regulatory Commission

Audit of NiSource Inc. Affiliate Transactions, including its Compliance with:

- Cross-Subsidization Restrictions on Affiliate Transactions;
- Regulations Under the Public Utility Holding Company Act of 2005; and
- Uniform System of Accounts for Public Utilities and Natural Gas Companies' Accounting for Service Company Transactions

Docket No. FA11-5-000
October 24, 2012

Office of Enforcement
Division of Audits

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I. Executive Summary

A. Overview

The Division of Audits within the Office of Enforcement has completed an audit of NiSource Inc. (NiSource or the Company) including its service companies, and associated companies (collectively Companies). The audit was initiated to evaluate the Companies' compliance with the Federal Energy Regulatory Commission's (FERC or the Commission's): (1) cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35 (2010); (2) accounting, recordkeeping, and reporting requirements under 18 C.F.R. Part 366 (2010); (3) Uniform System of Accounts (USofA) for centralized service companies under 18 C.F.R. Part 367 (2010); (4) preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368 (2010); and (5) FERC Form No. 60 Annual Report requirements under 18 C.F.R. Part 369 (2010).

The audit also evaluated the associated public utility and natural gas companies' compliance with the Commission's accounting requirements for transactions with associated companies under 18 C.F.R. Parts 101 and 201 (2010), and the applicable reporting requirements in the FERC Form Nos. 1 and 2. The audit period covered January 1, 2009 through December 31, 2010.

B. NiSource Inc.

NiSource, headquartered in Merrillville, IN, is an energy holding company whose subsidiaries provide natural gas, electricity, and other products and services to approximately 3.8 million customers in a corridor that runs from the Gulf Coast through the Midwest to New England.

NiSource is organized into three primary business segments. The Gas Transmission and Storage Operations business segment operates interstate natural gas pipelines and storage facilities. NiSource's natural gas transmission subsidiaries include Columbia Gulf Transmission Company (CGT), Columbia Gas Transmission Company (TCO), Granite State, and others. NiSource's electric operation segment generates, transmits, and distributes electricity through its domestic public utility subsidiary, Northern Indiana Public Service Company (NIPSCO), to approximately 458,000 customers in 20 counties in northern Indiana. NiSource's natural gas distribution operations segment serves more than 3.3 million customers in seven states and operates approximately 59,000 miles of pipeline.

NiSource affiliates are served by two traditional centralized service companies, NiSource Corporate Services Company (NCSC) and NiSource Gas Transmission & Storage Company (NGTSC). Both service companies generally provide human capital services that include accounting, human resources, legal, and information technology support. NCSC provides human capital services to all of NiSource's subsidiaries, whereas NGTSC provides human capital services to only Columbia Gulf Transmission Company, one of NiSource's interstate gas transmission pipeline and storage companies.

C. Summary of Compliance Findings

Audit staff's compliance findings are summarized below. Details are in section IV of this report. Audit staff found eight areas of noncompliance:

- *Electric Public Utility's Accounting for Billings from the Service Company:* NIPSCO did not record some of the costs it received from NCSC in the appropriate accounts as required by the Commission's accounting regulations.

- *Prepayment for the use of Finance and Accounting Transformation Servers:* NCSC improperly accounted for a prepayment for the use of accounting servers in Account 186, Miscellaneous Deferred Debits, when it should have accounted for this prepayment in Account 165, Prepayments.

- *Accounting for Over-Funding of a Single-Employer, Defined Post-Retirement Benefit Plan:* NCSC inappropriately recorded the overfunding of a single-employer, defined post-retirement life insurance benefit plan in Account 186, Miscellaneous Deferred Debits, for 2009 and 2010. The Company should have recorded the overfunded status in Account 128, Other Special Funds.

- *Improperly Recorded Transferred Employee Benefits:* NCSC improperly recorded transferred employee benefits in Account 186, Miscellaneous Deferred Debits, for 2009 and 2010. The Company should have recorded these benefits in Account 146, Accounts Receivable from Associated Companies, until they were paid.

- *FERC-61Reporting:* NiSource did not submit FERC-61, Narrative Description of Service Company Functions, filings for three special-purpose companies between 2006 and 2010, as the Commission regulations require.

- *Untimely Filing for Cash Management Agreement:* NiSource did not file changes to its cash management agreement within 10 days of the change in one occurrence during the audit period, as Commission regulations require.

- *Reporting of Transactions with Associated (Affiliated) Companies:* NiSource's public utility affiliate, NIPSCO, did not report the required information on page 429, Transactions with Associated (Affiliated) Companies, in the FERC Form No. 1s filed in 2009 and 2010. NiSource's natural gas pipeline and storage affiliates, TCO and CGT, did not report the required information on page 358, Transactions with Associated (Affiliated) Companies, in the FERC Form No. 2s filed in 2009 and 2010. Specifically, each entity did not report the accounts charged or credited for certain non-power goods and services provided for or by affiliates.

- *Miscellaneous Accounting Classification Errors:* NCSC improperly classified certain expenses in the wrong FERC accounts. NCSC should have classified these transactions in the proper accounts as the USofA for centralized service companies prescribed under 18 C.F.R. Part 367.

D. Summary of Recommendations

Audit staff's recommendations to remedy these findings are summarized below. Details are discussed in section IV of this report. To address each area of non-compliance, audit staff recommends that NiSource:

- Develop and implement policies and procedures to ensure that NCSC and NIPSCO comply with the Commission's accounting regulations for billings from NCSC.

- Conduct a study from the beginning of the audit period to present to determine the accuracy of the accounts that NIPSCO used to reallocate and record service company billings, and submit the results of this study to audit staff. NiSource should complete this study and submit it to the DA no later than 180 days after the date this audit report is issued.

- Make correcting entries to NIPSCO's accounting records to properly classify all charges the service company billed from the beginning of the audit period to present, and submit these journal entries to audit staff.

- Require NCSC to reclassify the remaining noncurrent prepayment portion of the finance and accounting transformation servers to Account 165.

- Reclassify the overfunded portion of its postretirement life insurance benefit from Account 186 to Account 128 for compliance with Docket No. IA07-1-000.

- Develop policies to ensure that long-term disability insurance for transferred employees is properly accounted for in Account 146.

- Develop and implement a process that periodically reviews all corporate entities that require a FERC-61 filing.

- Develop and/or strengthen policies and procedures for submitting its cash management agreements and subsequent changes or modifications to ensure compliance with Commission filing requirements.

- Strengthen its policies and procedures for submitting data on its FERC Form Nos. 1 and 2 to ensure accurate and complete reporting.

- Implement accounting policies, processes, and procedures to ensure the types of transactions indentified above are recorded according to Commission regulations.

- Post correcting entries to NCSC's accounting records to properly classify all lobbying and political activity charges from the beginning of the audit period to present.

E. Compliance and Implementation of Recommendations

Audit staff further recommends that NiSource:

- Submit its plans for implementing audit staff's recommendations for audit staff's review. NiSource should provide its plan to audit staff within 30 days of the issuance of the final audit report in this docket.

- Submit all correcting entries to the Division of Audits within 30 days of the issuance of the final audit report in this docket, including all correcting entries affecting the books of the service company and associated franchised public utility (FPU).

- Submit quarterly reports to the Division of Audits describing the Companies' progress in completing each corrective action recommended in the final audit report in this docket. NiSource should make its quarterly filings no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the final audit report in this docket is issued, and continuing until NiSource completes all recommended corrective actions.

- Submit copies of any written policies and procedures developed in response to the recommendations in the final audit report. These policies and procedures should be submitted for audit staff's review in the first quarterly filing after the Companies complete these items.

II. Background

A. Service Agreements, Cost Allocations, and Corporate Accounting System

The provisions of the General Service Agreement (GSA) between NCSC and NiSource's affiliates serve as the source of accounting policy and practice for billings of non-power goods and services. A regulated or nonregulated affiliate may select any or all of the services under the GSA. NCSC and its NiSource affiliates review their service agreements annually and agree on what NCSC services will be provided through budgeting. Such goods and services between affiliates are priced at fully allocated cost and to the extent possible, directly charged to the client or clients benefiting from a service. Any remaining charges that cannot be directly charged to an affiliate are allocated between the companies receiving the benefit of the service.

NCSC uses a central accounting system, also known as a work order system, to accumulate costs. This system is used to create and maintain all NCSC work orders, which receive all NCSC costs to bill the proper NiSource affiliate for work performed. The system also assigns a 10-digit alphanumeric code to the project or projects that details how expenses will be charged. The Company said much "front-end" work occurs in meetings between a department head working with an affiliate and NCSC personnel. These meetings help management build a consensus on how a new project's costs will be allocated to NiSource affiliates. Attendees at these meetings discuss the work that will take place to accurately determine which costs should be included in the work order system, the cost allocation base that should be used for the project, which companies benefit from the costs, and the portion of the cost each affiliate should receive and record in its accounting records.

Once NiSource management agrees to the basics of the newly created work order system project, costs are assigned using one of the base allocations[1] the Security and Exchange Commission (SEC) previously approved, or a direct company billing code. The work order system is designed so base allocations never change, but the companies that receive the costs can and do change. NCSC reviews and updates the amounts allocated to its affiliates every six months or

[1] The SEC approved all of NiSource's base allocations, and no other base allocations have been created since the Energy Policy Act of 2005 went into effect.

before, if an affiliated company is sold or no longer receives NCSC services.[2] Both the Company's external and internal auditors analyze the cost allocators yearly, and state public utility commissions also review the Company's cost allocations as they pertain to filed rate cases. The Company said NiSource has never had a cost allocation refused by a regulatory authority.

NCSC's total billings to associated companies for 2009 were $377,469,976. Of that, $276,719,054 was direct-charged (73.3 percent); $99,430,359 (26.3 percent) was indirectly charged; and $1,320,563 (0.3 percent) was compensation for the use of capital. Compensation for the use of capital represents interest expense paid on long-term intercompany notes.

NCSC's total billings to associated companies for 2010 were $409,702,831. Of that, $302,753,123 was direct-charged (73.9 percent); $105,629,146 (25.8 percent) was indirectly charged; and $1,320,562 (0.3 percent) was compensation for the use of capital.

B. Internal Audit Role and Reporting

NiSource's Internal Audit department (Internal Audit) is responsible for reviewing accounting systems, source documents, allocation bases, and billing procedures NCSC used to allocate costs to NiSource's parent holding company and all of its subsidiaries.

Annually, Internal Audit reviews cost allocation bases and billing procedures NCSC uses and recommends improvements to allocation and billing processes. For 2010, the primary business risks associated with these activities were that:

- Allocation factors may not be updated regularly to reflect current statistical data to ensure that NCSC charges are billed relative to current operations;
- Contract and convenience billings may not be properly billed to affiliates;
- Holding company costs may not be properly segregated and paid by the holding company;

[2] If an affiliate that receives allocated costs is sold, the cost allocations it participates in are updated. When an update occurs, the entire allocation system is updated.

- Executive time allocation may not accurately reflect the companies benefiting from their services;

- Not all indirect costs may be appropriately allocated to affiliates monthly; and

- Intercompany payables and receivables may not be billed and settled accurately and on time.

The Internal Audit department performed the annual audit and concluded that the methods and procedures used to allocate costs/expenses and bill subsidiary Companies, including the holding company, were reasonable.

C. Formula Rates

NiSource has one electric FPU jurisdictional to FERC with formula rates, and that company is NIPSCO. NIPSCO is a combination electric and natural gas public utility company that is a transmission-owning member of the Midwest Independent Transmission Service Operator, Inc. (MISO), whose transmission rates are set under formula rate in Attachment O of the MISO Open Access Transmission Energy and Operating Reserve Energy Markets Tariff. Attachment O uses data from the FERC Form No. 1 as inputs to calculate certain transmission rates for service.

To provide rate stability and certainty, rates are updated May 1 of each year, and are not updated out of cycle or recalculated retroactively due to late submissions of information. When MISO is informed of an error in a rate calculation, it reviews and corrects the error prospectively. At the request of the transmission owner, MISO will retroactively recalculate rates, and make refunds and/or charges for the current billing year.

III. Introduction

A. Objectives

The audit's objectives were to evaluate whether the Companies complied with Commission: (1) cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35 (2010); (2) accounting, recordkeeping, and reporting requirements under 18 C.F.R. Part 366 (2010); (3) Uniform System of Accounts (USofA) for centralized service companies under 18 C.F.R. Part 367 (2010); (4) preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368 (2010); and (5) FERC Form No. 60 Annual Report requirements under 18 C.F.R. Part 369 (2010).

The audit also evaluated associated public utility and natural gas companies' compliance with Commission accounting requirements for transactions with associated companies under 18 C.F.R. Parts 101 and 201 (2010), respectively; and, the applicable reporting requirements in FERC Form Nos. 1 and 2, respectively. The audit covered January 1, 2009 through December 31, 2010.

B. Scope and Methodology

To address audit objectives, audit staff:

- Reviewed NCSC's FERC Form No. 60 Annual Reports and NiSource's notification of holding company status FERC-65 filing. Audit staff reviewed these reports and filings to ensure that the information was reliable, accurate, and complete.

- Reviewed publicly available materials to understand NiSource operations, including select filings to the SEC (10-K and 10-Q), FERC Form Nos. 1, 2, and 2-A filings, prior audits, and other filings with the Commission.

- Identified the standards and criteria for evaluating Company compliance with each of the objectives of the audit scope. These standards and criteria include FERC rules, regulations, letter orders, and other requirements for holding and service companies, and FERC accounting regulations related to public utilities and natural gas companies.

- Conducted one site visit to NiSource offices in Columbus, OH. The site visit helped staff to understand NiSource's structure, activities, functions, systems, and processes used in its operations. While on site, audit staff reviewed and tested the supporting details for NCSC's cost allocation methods; sampled and selected supporting documents to ensure that NCSC's billings and the FPU's accounting comply with the USofA; sampled and selected supporting documents to ensure that NCSC's accounting complies with the USofA; and ensured that NiSource and NCSC comply with preservation of records requirements.

- Held numerous discussions with Company employees to clarify and supplement Company responses to data requests and provide additional information on other areas of concern.

- Reviewed relevant audit reports and working papers of NiSource's Internal Audit department and external audit firm, Deloitte and Touche. Audit staff also reviewed several prior SEC audit reports.

- Conferred with officials from the Indiana Utility Regulatory Commission who have jurisdiction over NCSC's associated FPU.

- Conferred with other Commission staff on various compliance issues to ensure that audit findings would be wholly consistent with Commission precedent and policy. For example, audit staff conferred with staff from other divisions within the Office of Enforcement, and with technical and legal staff from other Commission offices, including the Office of Energy Market Regulation and Office of General Counsel.

Besides these actions, audit staff reviewed NiSource's regulatory compliance program. Audit staff assessed the compliance program for the audit scope areas consistent with prior Commission orders and policy statements. Specifically, audit staff:

- Reviewed NiSource's regulatory compliance program structure, including its authority and responsibilities for overseeing corporate compliance and the delegation of compliance responsibilities at the department level.

- Reviewed NiSource's Internal Audit department structure, including chain-of-command and access to the Board of Directors through the Audit Committee to assess the effectiveness and independence of the audit process.

- Interviewed executives, managers, and operational employees to evaluate their knowledge and application of NiSource's compliance program.

Audit staff performed several specific actions to evaluate the Companies' compliance with all relevant requirements of audit objectives. A summary of these actions include:

Cross-subsidization Restrictions

To evaluate compliance with Commission's cross-subsidization restrictions on affiliate transactions, audit staff:

- Reviewed policies, procedures, and practices as to the sale of non-power goods and services;

- Interviewed NiSource employees, particularly those who work in accounting and supply chain management on transfers of non-power goods and services;

- Reviewed and tested pricing methods for transferring non-power goods and services between the FPU, market-regulated power sales affiliates, and non-utility affiliates; and

- Sampled charges and payments to determine accurate pricing for the sale of goods and services to verify compliance with Commission pricing rules.

Accounting, Recordkeeping, and Financial Reporting

To evaluate compliance with the FERC's books, records, and filing requirements, audit staff reviewed NCSC's FERC Form No. 60 Annual Reports, NiSource's Notification of Holding Company Status – FERC-65 filing, and the FERC Form Nos. 1, 2, and 2-A reports of the associated FPU and natural gas companies. Select, electronically filed information in the FERC Form No. 60 was verified with supporting documentation to ensure that required information was reported accurately and consistently. Select information in the FERC Form No. 1 was also compared to the FERC Form No. 60 to ensure it was reported accurately.

To facilitate our review of NCSC's compliance with the USofA, audit staff reviewed, sampled, analyzed, and tested electronic data of NCSC's books to ensure that centralized service company accounting follows the USofA. When necessary, audit staff followed up with additional data requests and interviews.

With respect to the jurisdictional FPU's compliance with the Commission's USofA, audit staff selected and reviewed associated FPU accounts for NCSC's billed costs. Audit staff reviewed the charges billed and identified the accounts the FPU used to ensure that the jurisdictional FPU was properly accounting for service company costs.

We also reviewed NCSC's associated FPU accounting with the FERC Form No. 1 to ensure that NCSC billings for non-power goods and services were properly recorded and reported.

Preservation of Records

To evaluate compliance with preservation of records requirements for NiSource, audit staff interviewed the Company's Corporate Management Records officials responsible for complying with Commission requirements. Audit staff created a sample test for records to ensure that the Company's policies and procedures were being followed.

Cost Allocation and Billings

To facilitate our review of NCSC's cost allocation methods and costs NCSC billed to the associated FPU, audit staff identified all SEC-approved cost allocation methods by NCSC. Audit staff also inquired about any new allocation methods created after the Energy Policy Act of 2005 was implemented. Audit staff reviewed and tested supporting details of select cost allocation methods by reviewing select service company billings and corresponding jurisdictional utilities' accounting entries to determine compliance with the USofA.

IV. Findings and Recommendations

1. Electric Public Utility's Accounting for Billings from the Service Company

Northern Indiana Public Service Company (NIPSCO) did not record some of the costs it received from NCSC in the appropriate accounts as required by the Commission's accounting regulations.

Pertinent Guidance

18 C.F.R. Part 101 Account 163, Stores expense undistributed, states:

> A. This account shall include the cost of supervision, labor and expenses incurred in the operation of general storerooms, including purchasing, storage, handling and distribution of materials and supplies.

18 C.F.R. Parts 101 Account 182.3, Other regulatory assets, states in part:

> A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies. (*See* Definition No. 30.)

18 C.F.R. Parts 201 Account 182.3, Other regulatory assets, states in part:

> A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies. (*See* Definition No. 31.)

18 C.F.R. Parts 101 and 201 Account 923, Outside services employed, state in part:

> A. This account shall include the fees and expenses of professional consultants and others for general services which are not applicable to a particular operating function or to other accounts. It shall include also the pay and expenses of persons engaged for a special or temporary administrative or general purpose in circumstances where the person so engaged is not considered as an employee of the utility.

18 C.F.R. Part 201, Account 870, Operation supervision and engineering, states:

> This account shall include the cost of labor and expenses incurred in the general supervision and direction of distribution system operations. Direct supervision of specific activities such as load dispatching, main operation, removing and resetting meters, etc., shall be charged to the appropriate account.

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

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

Order No. 684 Paragraph 124 states in part:

> Therefore, we will require centralized service companies to record the expenses it incurs for conducting operation and maintenance activities related to generation, transmission, distribution and customer services in the same expense accounts public utilities are required to use to record these costs. Using the 500 and 800 series of accounts also provides better assurance that costs are properly assigned because like items will be identified and measured in the same way regardless of the entity performing the work.

Order No. 684 Paragraph 125 states:

> In responding to NARUC's concern, we will not prohibit the recording of charges in Account 923, Outside services. Prohibiting the use of this account would be overly prescriptive. It is possible that some service company costs would be accurately reported in Account 923. However, we believe that it is appropriate for utilities that receive bills from service companies to classify those costs in the appropriate accounts. Utilities would not be in compliance with Part 101, General Instruction 14, if they do otherwise. Specifically, General Instruction 14 requires that transactions with associated companies be recorded in the appropriate accounts for transactions of the same nature. We will require that centralized service companies performing services such as operation and maintenance services related to generation, distribution, transmission, and customer service on behalf of service companies to use the appropriate accounts for those services performed.

Order No. 684 Paragraph 126 states in part:

> As discussed above, the use of the 500 and 800 accounts provides clarity about the types of services performed by centralized service companies and the costs of providing those services. Proper classification of service company costs facilitates proper classification of the costs at the utility. Therefore, we will require centralized service companies to use the 500 and 800 series of accounts as proposed.

Background

During the course of the audit, audit staff tested NIPSCO's accounting for billings received from NCSC, NiSource's primary service company. Audit staff sampled NCSC's transactions and costs billed to NIPSCO to determine how each company accounted for the billed costs. Audit staff discovered inconsistencies between how NCSC and NIPSCO recorded these costs. These inconsistencies occurred because NIPSCO reclassified these billed costs into accounts that differed from how NCSC accounted for these costs.

For example, NCSC billed certain costs to NIPSCO that it accounted for in Account 923, but NIPSCO reclassified some of these costs to Accounts 163, 870, and 182.3. Audit staff is concerned with NIPSCO's reclassifying these costs because the accounting used did reflect the appropriate accounting based on the description of the costs incurred. The costs reflected in the billings from the NCSC are of the nature of outside services that should be properly classified in Account 923. This would be consistent in how NCSC originally accounted for these costs.

Also, audit staff discovered the same inconsistency in NCSC's billings of amounts included in Account 426.1 to NIPSCO. NCSC billed NIPSCO for donations in Account 426.1, which is a below-the-line account,[3] but NIPSCO reclassified these billings to FERC operational Accounts 923 and 163. These transactions not only concern audit staff because the reclassification of service company billings did not result in the appropriate accounting for such costs, but in this instance NIPSCO reclassified these costs from a below-the-line to above-the-line accounts. Since NIPSCO recovers it costs under the MISO formula rate

[3] The "line" is the net utility operating income on the income statement. Above-the-line accounts refer to costs that are recovered by the ratepayer and are accounted for as part of net utility operating income. Below-the-line accounts record costs that are the responsibility of the shareholder and are accounted for on the income statement below net utility operating income.

recovery mechanism, this reclassification was improperly recovered from wholesale customers.

NiSource believes it has complied with Order No. 684 because it allows service companies to use the 500 and 800 accounts to record charges related to generation, transmission, distribution operations, and customer service in the same expense accounts public utilities are required to use to record these costs. Audit staff agrees that Order No. 684 allows service companies to use the 500 and 800 accounts, but it does not circumvent General Instruction 14. Instead, Order No. 684 reaffirms General Instruction 14. Specifically, the instruction requires that transactions with associated companies be recorded in the appropriate accounts for transactions of the same nature. Audit staff determined that NiSource should have accounted for costs billed by NCSC in the appropriate accounts based on the Commission's accounting regulations, which means that it should have accounted for the outside services in Account 923 and donations in Account 426.1. The misclassifications resulted in a *de minimus* increase on NIPSCO's formula rate revenue requirement and did not result in refunds.

Recommendations

We recommend NiSource:

1. Develop and implement policies and procedures to ensure that NCSC and NIPSCO comply with the Commission's accounting regulations for billings from NCSC.

2. Conduct a study from the beginning of the audit period to present to determine the accuracy of the accounts that NIPSCO used to reallocate and record service company billings, and submit the results of this study to audit staff. NiSource should complete this study and submit it to the Division of Audits no later than 180 days after the date this audit report is issued.

3. Make correcting entries to NIPSCO's accounting records to properly classify all charges the service company billed from the beginning of the audit period to present, and submit these journal entries to audit staff.

2. Prepayment for the Use of Finance and Accounting Transformation Servers

NCSC improperly accounted for a prepayment for the use of accounting servers in Account 186, Miscellaneous Deferred Debits, when it should have accounted for this prepayment in Account 165, Prepayments.

Pertinent Guidance

18 C.F.R. § 367.1860 (a) Account 186, Miscellaneous deferred debits, states:

> (a) This account must include all debits not provided for elsewhere, such as miscellaneous work in progress, and unusual or extraordinary expenses, not included in other accounts, that are in the process of amortization and items the proper final disposition of which is uncertain.

18 C.F.R. § 367.1650 Account 165, Prepayments, states:

> This account must include amounts representing prepayments of insurance, rents, taxes, interest and miscellaneous items, and must be kept or supported in a manner so as to disclose the amount of each class of prepayment.

Background

As part of the audit, audit staff tested select accounts that had large increases or decreases during the audit period, or warranted further review due to unusual explanations or circumstances discussed in the notes for the FERC Form No. 60. During this process, audit staff learned that in 2005 NiSource wanted to outsource specific services in finance and accounting, IT, metering cash, human resources, supply chain, and storage services, and asked for bids from several companies that NiSource believed could adequately perform these services. IBM won the contract. These services were known as "towers," and these six towers made up the services IBM provided to NiSource. The 10-year term of the contract expires in June 2015.

From June 2005 to the fall of 2007, NiSource and IBM executed 22 amendments to this agreement. Due to the number of amendments to the 2005 agreement and other issues, NiSource and IBM agreed to negotiate to restructure the nature and manner of services being provided under the original agreement. NiSource and IBM agreed to execute the First Amended and Restated Agreement in December 2007.

In the First Amended and Restated Agreement, NiSource moved back in-house several functions originally outsourced to IBM in June 2005. They included, but were not limited to, finance and accounting, human resources, and supply chain. The cost of the original agreement was adjusted down to reflect the services provided by the newly scaled-back agreement. The term of the new agreement was for the original 10 years and will expire in June 2015.

When this transition occurred, both NiSource and IBM agreed to a financial settlement that included: (1) termination fees of $9.8 million paid to IBM and expensed immediately by NiSource in December 2007; (2) "wind-down" fees (IBM's fee to move work back to NiSource) of approximately $1 million that were immediately expensed on NiSource's books in December 2007 and another $1.2 million expensed over the time it took for the specific functions to be moved back to NiSource; (3) purchases of $2.4 million for meter-to-cash equipment, and $17.5 million for finance and accounting transformation software that NiSource capitalized; and (4) a $12 million prepayment for the future use and support of finance and accounting transformation servers in which the current monthly amortized portion was recorded in Account 165, Prepayments, and the noncurrent portion was accounted for in Account 186, Miscellaneous Deferred Debits. This prepayment is expensed monthly over the remaining term of the IBM contract (91 months) starting back in December 2007, or $131,868 per month ($12,000,000/91 months = $131,868).

Audit staff concluded that the Company should record the current portion of the prepayment in Account 165, but the remaining noncurrent portion should not be accounted for in Account 186. The remaining noncurrent portion of the prepayment should also be accounted for in Account 165.

Recommendations

We recommend NiSource:

4. Require NCSC to reclassify the remaining noncurrent prepayment portion of the finance and accounting transformation servers to Account 165; and

5. Develop policies and procedures to ensure that prepayments are accounted for in Account 165.

3. Accounting for Overfunding of a Single-Employer, Defined Postretirement Benefit Plan

NCSC inappropriately recorded the overfunding of a single employer, defined postretirement life insurance benefit plan in Account 186, Miscellaneous Deferred Debits, for 2009 and 2010. The Company should have recorded the overfunded status in Account 128, Other Special Funds.

Pertinent Guidance

18 C.F.R. § 367.1860 (a) Account 186, Miscellaneous deferred debits, states:

> (a) This account must include all debits not provided for elsewhere, such as miscellaneous work in progress, and unusual or extraordinary expenses, not included in other accounts, that are in the process of amortization and items the proper final disposition of which is uncertain.

18 C.F.R. § 367.1280 (a) Account 128, Other special funds, states:

> (a) This account must include the amount of cash and book cost of investments that have been segregated in special funds for insurance, employee pensions, savings, relief, hospital, and other purposes not provided for elsewhere. This account must also include unrealized holding gains and losses on trading and available-for-sale types of security investments. A separate account with appropriate title, must be kept for each fund.

Docket No. AI07-1-000; To All Jurisdictional Public Utilities and Licensees, Natural Gas Companies, Oil Pipeline and Companies and Centralized Service Companies, states in No. 2:

2. Accounts for Recording the Overfunded or Underfunded Status of Postretirement Defined Benefits Plans states in part:

   Question 2A: What FERC accounts should jurisdictional entities use to record an asset for the overfunded status of one or more employee postretirement benefit plans?

   Response: Public utilities and licensees, natural gas companies, oil pipeline companies and centralized service companies should use the accounts shown below to record assets for the overfunded status of their employees postretirement benefit plans. Separate subaccounts should be maintained for each postretirement benefit plan and overfunded plans should not be netted against underfunded plans, consistent with paragraph number 4 of SFAS No. 158.

Jurisdictional Entity	**FERC Accounts**
Public utilities and licensees (Major)	Account 129, Special funds
Public utilities and licensees (Nonmajor)	Account 128, Other special funds, or Account 129, Special funds
Natural gas companies	Account 128, Other special funds
Oil pipeline companies	Account 22, Sinking and other funds
Centralized service companies	
▪ Periods prior to January 1, 2008	Account 124, Other investments, or Account 128, Other special funds
▪ January 1, 2008 and subsequent periods	Account 128, Other special funds

Background

During the testing and verification of service company accounts, audit staff learned that NCSC provided a retiree life insurance benefit for its employees through Prudential Insurance Company (Prudential). An employee's premium is paid by NiSource to Prudential, which provides the benefit. This benefit is available to any active NiSource employee who is 55 years of age and has 10 years of service at retirement. The benefit amount is determined by employee classification (e.g., exempt, nonexempt, nonunion, and by each separate union). A retiree's beneficiary receives life insurance proceeds directly from Prudential.

Aon Hewitt, NiSource's actuary, provides actuarial services at least once annually for NiSource, as ASC 715 (formally SFAS 106) requires, to determine the funded status of NiSource's Postretirement Welfare Plans, for which health care and life insurance benefits are determined separately. Aon Hewitt receives from NiSource the fair value of trust assets on December 31 and determines the obligation associated with the retiree life insurance benefit. The net overfunded status is recorded as a net asset on a respective subsidiary's books, or conversely, the unfunded amount would be recorded as a net liability. NCSC accounted for this overfunding of contributions in Account 186.

Audit staff concluded that the overfunded status of retiree life insurance benefits should not be posted in Account 186. The Company should follow the instructions in Docket No. IA07-1-000 for the overfunded status of one or more employee postretirement benefit plans and use Account 128, Other Special Funds.

Recommendations

We recommend NiSource:

6. Reclassify the overfunded portion of its postretirement life insurance benefit from Account 186 to Account 128 for compliance with Docket No. IA07-1-000; and

7. Properly account for future over- and under-funding of its postretirement life insurance benefit under the requirements in Docket No. IA07-1-000.

4. Improperly Recorded Transferred Employee Benefits

NCSC improperly recorded transferred employee benefits in Account 186, Miscellaneous Deferred Debits, for employees who transferred from Columbia Energy Group (CEG) to NCSC in both 2009 and 2010. The Company should have recorded these benefits in Account 146, Accounts Receivable from Associated Companies, until they were paid.

Pertinent Guidance

18 C.F.R. § 367.1860 (a) Account 186, Miscellaneous deferred debits, states:

> (a) This account must include all debits not provided for elsewhere, such as miscellaneous work in progress, and unusual or extraordinary expenses, not included in other accounts, that are in the process of amortization and items the proper final disposition of which is uncertain.

18 C.F.R. § 367.1460 (a) Account 146, Accounts receivable from associate companies, state:

> (a) This account must include notes and drafts upon which associate companies are liable, and that mature and are expected to be paid in full not later than one year from the date of issue, together with any related interest thereon, and debit balances subject to current settlement in open accounts with associate companies. Items that do not bear a specified due date but that have been carried for more than twelve months and items that are not paid within twelve months from due date must be transferred to account 123, Investment in associate companies (§367.1230).

Background

During review and testing of several select service company accounts, audit staff learned that all NiSource employees are eligible on the date of hire to receive long-term disability (LTD) benefits. Each year, NiSource calculates the LTD estimate based on future medical, dental, and life insurance costs for the next 15 years. Each LTD employee's birthdate is used to determine how much money to accrue per LTD employee per company because employees are eligible to receive these benefits only until age 65. Aon Hewitt, NiSource's actuary, provides the actuarial services for this annual true-up calculation.

NiSource pays an employee's premium for LTD insurance to Prudential. If the employee becomes disabled, Prudential provides LTD coverage and pays benefits directly to the employee.

If an employee transfers to a different affiliate within the NiSource holding company system, the LTD liability balance associated with that employee is also transferred and accounted for in Account 186, Miscellaneous Deferred Debits. In this instance, employees transferred from CEG to NCSC.

Audit staff concluded that the Company's use of Account 186 as an associate company's accounts receivable account was inappropriate. The Company should use Account 146, Accounts Receivable from Associate Companies, for this type of transaction.

Recommendations

We recommend NiSource:

8. Develop policies and procedures to ensure that LTD insurance for transferred employees is properly accounted for in Account 146; and

9. Transfer any remaining LTD amounts for transferred employees to the appropriate account.

Corrective Action

During the audit, NCSC calculated the total deferred debit related to employee transfers and transferred these amounts to Account 146, Accounts Receivable from Associated Companies. NCSC also provided audit staff with journal entries and computer screen images of the completed transactions.

5. FERC-61 Reporting

NiSource did not submit FERC-61, Narrative Description of Service Company Functions, filings for three special-purpose companies between 2006 and 2010, as required under the Commission's regulations.

Pertinent Guidance

18 C.F.R. Part 366.23 (a)(2), FERC Form No. 60, Annual reports of centralized service companies, and FERC-61, Narrative description of service company functions, states:

> (a)(2) FERC–61. Unless otherwise exempted or granted a waiver by Commission rule or order pursuant to §§366.3 and 366.4, every service company in a holding company system, including a special-purpose company (e.g., a fuel supply company or a construction company), that does not file a FERC Form No. 60 shall instead file with the Commission by May 1, 2007 and by May 1 each year thereafter, a narrative description, FERC–61, of the service company's functions during the prior calendar year. In complying with this section, a holding company may make a single filing on behalf of all such service company subsidiaries.

18 C.F.R. Part 366.1, Definitions, codifies the definitions of "goods" and "service" under PUHCA 2005:

> *Goods.* The term "goods" means any goods, equipment (including machinery), materials, supplies, appliances, or similar property (including coal, oil, or steam, but not including electric energy, natural or manufactured gas, or utility assets) which is sold, leased, or furnished, for a charge.
>
> *Service.* The term "service" means any managerial, financial, legal, engineering, purchasing, marketing, auditing, statistical, advertising, publicity, tax, research, or any other service (including supervision or negotiation of construction or of sales), information or data, which is sold or furnished for a charge.

18 C.F.R. Part 367.1, Definitions, codifies the definitions of "centralized service company" and "service company":

> (a)(7) *Centralized service company* means a service company that provides services such as administrative, managerial, financial, accounting, recordkeeping, legal or engineering services, which are sold, furnished, or otherwise provided (typically for a charge) to other companies in the same holding company system. Centralized service companies are different from other service companies that only provide a discrete good or service.
>
> (a)(45) *Service company* means any associate company within a holding company system organized specifically for the purpose of providing non-power goods or services or the sale of goods or construction work to any public utility or any natural gas company, or both, in the same holding company system.

In Order No. 667, the Commission further clarified the distinction between centralized service companies and special-purpose companies:

> "Our adoption of different policies for traditional, centralized service companies compared to special-purpose companies could make the distinction between the two more important than it has been previously. We view the former as performing generally corporate administration functions and the latter as providing generally a single input to utility operations, such as fuel supply, construction, or real estate."[4]

Background

Audit staff reviewed all the entities in NiSource's corporate structure to identify any special-purpose companies. Audit staff discovered that NiSource did not submit a FERC-61 describing non-power goods or services provided by CNS Microwave, Inc., NiSource Insurance Corporation, Inc. (insurance company), and NIPSCO Accounts Receivable Corporation (financing subsidiary) for 2009 or 2010.

CNS Microwave, Inc. leases space on communication towers for its customers, including two of NiSource's interstate pipelines, to install antennas. Also, the company leases ground space in the tower compound for customers to place shelters or cabinets with ground equipment. NiSource Insurance Corporation, Inc. (NICI) is a wholly owned insurance subsidiary of NiSource, Inc. NICI was set up for the purpose of decreasing the reliance on commercial insurance markets to reduce price and coverage volatility, provide stable insurance costs and programs, and reduce the long-term cost of risk for NiSource as a whole.

[4] Order No. 667 at n. 178.

NICI participates as a reinsurer within the NiSource insurance program for NiSource companies, including their interstate pipelines and jurisdictional electric company, on these lines of coverage: Property, Workers' Compensation, General Liability, Auto Liability, Long-Term Disability, and Group Life Insurance. NIPSCO Accounts Receivable Corporation is a wholly owned financing subsidiary that buys trade receivables from NIPSCO and sells them to the Royal Bank of Scotland PLC.

After discussions with NiSource's staff, audit staff concluded that these entities should have made FERC-61 filings to the Commission since they provided goods or services to its public utilities or natural gas companies, or both, within NiSource's corporate structure.

NiSource stated that it inadvertently failed to submit FERC-61 filings for their special-purpose companies due to a lack of formal processes and procedures for identifying them.

Recommendations

We recommend NiSource:

10. Submit FERC-61 filings to the Commission for these special-purpose companies in 2009 and 2010;

11. Develop and implement a process that periodically reviews all corporate entities that require a FERC-61 filing; and

12. Submit copies of any written policies and procedures developed in response to this recommendation to the Commission, within 30 days of the issuance of the final report in this docket.

Corrective Actions

On June 10, 2011, NiSource submitted FERC-61 filings to the Commission for its three special-purpose companies for the calendar years 2006 through 2010 under Docket Nos. HC07-7-000, HC08-7-000, HC09-7-000, HC10-7-000, and HC11-7-000.

6. Untimely Filing for Cash Management Agreement

NiSource did not file changes to its cash management agreement within 10 days of the change in one occurrence during the audit period, as Commission regulations required.

Pertinent Guidance

18 C.F.R. § 141.500 Cash management programs states:

> Public utilities and licensees subject to the provisions of the Commission's Uniform System of Accounts prescribed in part 101 and § 141.1 or § 141.2 of this title that participate in cash management programs must file these agreements with the Commission. The documentation establishing the cash management program and entry into the program must be filed within 10 days of the effective date of the rule or entry into the program. Subsequent changes to the cash management agreement must be filed with the Commission within 10 days of the change.

Background

NiSource operates a cash management program known as "the money pool" to facilitate short-term loans to its affiliates. NiSource's cash management agreement provides the terms and conditions that govern money pool contributions and loans. The cash management agreement contains borrowing and lending terms and conditions, and a listing of companies authorized to participate in the money pool, as well as the handling of excess money pool funds and deficiencies.

NiSource files its cash management agreements with the Commission under Docket No. RM02-14. During the audit, audit staff identified five cash management agreements that NiSource filed. However, when audit staff compared the effective dates of the agreements to the filing dates, it was determined that NiSource filed one cash management agreement 14 days after the effective date and not within the 10 days the Commission requires. NiSource stated that the reason for the late filing was due to an oversight on the part of the company.

Recommendation

13. We recommend NiSource develop and/or strengthen policies and procedures for submitting its cash management agreements and subsequent changes or modifications to ensure compliance with Commission filing requirements.

7. Reporting of Transactions with Associated (Affiliated) Companies

NiSource's electric affiliate, NIPSCO, did not report the required information on page 429, Transactions with Associated (Affiliated) Companies, in the FERC Form No. 1s filed in 2009 and 2010. Similarly, NiSource's gas affiliates, Columbia Gas Transmission Company (TCO) and Columbia Gulf Transmission Company (CGT), did not report the required information on page 358, Transactions with Associated (Affiliated) Companies, in the FERC Form No. 2s filed in 2009 and 2010. Specifically, they did not report the accounts charged or credited for certain non-power goods and services provided for or by affiliates.

Pertinent Guidance

In Order No. 715,[5] the Commission added a new schedule on page 429 of the 2008 FERC Form No. 1 to provide further transparency and improve the detection of cross-subsidization. The new schedule, "Transactions with Associated (Affiliated) Companies," provides information concerning affiliate transactions which includes:

> (1) a description of the good or service charged or credited; (2) the name of the associated (affiliated) company; (3) the USofA account charged or credited; and (4) the amount charged or credited.

In Order No. 710,[6] the Commission added a new schedule on page 358 of the 2008 FERC Form No. 2 to provide further transparency and improve the detection of cross subsidization. The new schedule, "Transactions with Associated (Affiliated) Companies," provides information concerning affiliate transactions which includes:

> (1) a description of the good or service transacted; (2) the name of the associated (affiliated) company; (3) the FERC account charged or credited; and (4) the amount charged or credited.

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[5] Revisions to Forms, Statements and Reporting Requirements for Electric Utilities and Licensees, Order No. 715, FERC Stats. & Regs. ¶ 31,277 (2008).

[6] Revisions to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines, Order No. 710, FERC Stats. & Regs. ¶ 31,267 (2008).

Background

NiSource's holding company includes one regulated electric utility and two regulated gas pipelines. As part of the audit scope relating to affiliate transactions, audit staff reviewed page 429 of NIPSCO's FERC Form No. 1 and page 358 of TCO and CGT's FERC Form No. 2s.

FERC Form No. 1, page 429, requires electric utilities to disclose the non-power goods and services provided by or for affiliates during the calendar year, including a description of services, an affiliate's name, the accounts used to record the services, and the dollar amount of the services. Specifically, column C requires the company to list the accounts used to record services and prohibits it from using general terms such as "various." For 2009 and 2010, NIPSCO reported the accounts in column C as "various" for multiple charges for both non-power goods provided by and for affiliates. NIPSCO should have either listed the accounts used or footnoted them in the notes following page 429.

FERC Form No. 2, page 358, requires jurisdictional gas pipelines to disclose the non-power goods and services provided by or for affiliates during a calendar year, including a description of services, an affiliate's name, the accounts used to record the services, and the dollar amount of the services. As in the FERC Form No. 1, column C of FERC Form No. 2 requires gas pipelines to list the accounts used to record services and prohibits the company from using general terms such as "various." For both 2009 and 2010, TCO and CGT reported the accounts in column C as "various" for multiple charges for both non-power goods provided by and for affiliates. TCO and CGT should have either listed the accounts used or footnoted the accounts in the notes following page 358.

Recommendations

We recommend NiSource:

14. Strengthen its policies and procedures for submitting data on its FERC Form Nos. 1 and 2 to ensure accurate and complete reporting.

15. Resubmit its 2011 FERC Form Nos. 1 and 2 to correct pages 429 and 358, respectively.

8. Miscellaneous Accounting Classification Errors

NCSC improperly classified certain expenses in the wrong FERC accounts. NCSC should have classified these transactions in the proper accounts as the USofA for centralized service companies prescribed under 18 C.F.R. Part 367.

Pertinent Guidance

18 C.F.R. § 367.2 (a) Companies for which this system of accounts is prescribed, states in part:

(a) Unless otherwise exempted or granted a waiver by Commission rule or order pursuant to §§366.3 and 366.4 of this chapter, this Uniform System of Accounts applies to any centralized service company operating, or organized specifically to operate, within a holding company system for the purpose of providing non-power services to any public utility or any natural gas company, or both, in the same holding company system.

Background

As part of the audit, audit staff tested a sample of transactions to determine if the service company's accounting system was accurately charging the proper amounts to the appropriate FERC accounts. Audit staff identified various income statement items in several accounts. In particular, the errors related to:

Description	Account Used	Proper Account
Charitable Contributions	807.2	426.1
	870	426.1
	921	426.1
	930.2	426.1
Lobbying	930.1, then reclassified to 930.2	426.4
Employee Dues and Memberships	408	921
	923	921
	930.2	921

Description	Account Used	Proper Account
Meals and Entertainment	923	921
	930.2	921
	932	921
Company Dues and Memberships	870	930.2
	885	930.2
	903	930.2
	921	930.2
	923	930.2
	932	930.2

NiSource should have classified these transactions mentioned above in the proper account as prescribed by the USofA for centralized service companies under 18 C.F.R. Part 367. Audit staff has determined that such misclassifications are immaterial and have no effect on transmission formula rate billings.

Recommendations

We recommend NiSource:

16. Implement accounting policies, processes, and procedures to ensure the types of transactions indentified above are recorded according to Commission regulations; and

17. Post correcting entries to NCSC's accounting records to properly classify all lobbying and political activity charges from the beginning of the audit period to present.

Appendix

NiSource

August 21, 2012

200 Civic Center Drive
Columbus, OH 43215

Bryan K. Craig
Director and Chief Accountant
Division of Audits
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street, NE, RM 5K-13
Washington, DC 20426

RE: Audit of NiSource Inc.
Docket No. FA11-5-000

Dear Mr. Craig:

Thank you for the opportunity to review and comment on the August 6, 2012 Draft Audit Report covering the period January 1, 2009 through December 31, 2010, issued to NiSource Inc. ("NiSource") in the above-referenced docket. NiSource has carefully reviewed audit staff's report addressing NiSource's compliance with the Commission's: 1) cross subsidization restrictions on affiliate transactions; (2) accounting, recordkeeping, and reporting requirements; (3) Uniform System of Accounts (USofA) for centralized service companies; (4) preservation of records requirements for holding companies and service companies; (5) FERC Form No. 60 Annual Report requirements, and the associated public utility and natural gas companies' compliance with the Commission's accounting requirements for transactions with associated companies and the applicable reporting requirements in the FERC Form Nos. 1 and 2. NiSource generally agrees with the findings and recommendations included in the Draft Report. As noted in the detail below, NiSource has already implemented many of the corrective actions recommended therein.

With respect to the specific findings and recommendations, NiSource offers the following response and comment, as requested.

1. Electric Public Utility's Accounting for Billings from the Service Company: NiSource agrees with this finding and recommendation. NiSource will develop and implement procedures to ensure that NiSource Corporate Services Company ("NCSC") and Northern Indiana Public Service Company ("NIPSCO") comply with the Commission's accounting regulations for billings from NCSC. NiSource will provide these procedures to the Division of Audits within 30 days of the issuance of the final audit report in this docket. NiSource has conducted a study from the beginning of the audit period to the present to determine the accuracy of the accounts that NIPSCO used to reallocate and record service company billings specifically for Accounts 163, 870, and 182.3 that NCSC accounted for in Account 923. Based on the study conducted by NiSource and per discussion with FERC audit staff, these items were all charged to the income statement and rolled to retained earnings in a prior calendar period. Thus, FERC correcting entries to NIPSCO's retained earnings for prior year amounts is not deemed necessary based on the materiality of the amounts charged to these accounts in 2009, 2010, and 2011. Going forward, NIPSCO will record the items previously recorded to Accounts 163, 870, and

182.3 to Account 923. NIPSCO calculated the amount that would be refunded under the MISO formula rate recovery mechanism for the billings of amounts for Account 426.1 which was included by NIPSCO above the line. The amount calculated is immaterial (less than $1800 for all three years 2009, 2010 and 2011) and would not materially impact rates. NiSource has provided copies of the refund calculation herein as "Finding 1_Att A_MISO calc 2009.pdf," "Finding 1_Att B_MISO calc 2010.pdf," and "Finding 1_Att C_MISO calc 2011.pdf." In subsequent reporting periods, NIPSCO will record the items previously recorded to Account 923 for donations to 426.1 as recorded by NCSC.

2. Prepayment for the Use of Finance and Accounting Transformation Servers: NiSource generally agrees with this finding and recommendation. NCSC recorded a long-term prepaid balance in Account 186, Miscellaneous Deferred Debits, as it interpreted the USofA Part 367, Subpart F-Balance Sheet Chart of Accounts, 18 C.F.R. § 367.1650, Account 165 Prepayments, to be designated only for "Current and Accrued Assets" as noted under Subpart F. For regulatory accounting, NCSC did reclassify the entire non-current prepayment balance for the use of Finance and Accounting transformation servers at 12/31/11 from Account 186 to Account 165 as noted in the 2011 FERC Form No. 60, page 110, Line No. 4 footnote. The reclassification entry completed at December 31, 2011 is provided herein as "Finding 2_Att. A_165 Transformation.pdf." The prepayment for the use of Finance and Accounting transformation servers will be fully amortized as of June 30, 2015.

3. Accounting for Overfunding of a Single-Employer, Defined Postretirement Benefit Plan: NiSource generally agrees with this finding and recommendation. NCSC had recorded its overfunding of its defined postretirement benefit in Account 186, Miscellaneous Deferred Debits, which is a noncurrent asset account in compliance with ASC 715-20, *Compensation-Retirement Benefits, Defined Benefit Plans*. Further, per 18 C.F.R. § 367.1280(b), "amounts deposited with a trustee under the terms of an irrevocable trust agreement for pensions or other employee benefits must not be included in Account 128." Therefore, based on the Section 367.128(b), NCSC felt it was in compliance with Title 18 C.F.R. Part 367 – Uniform System of Accounts for Centralized Service Companies as NCSC funds its postretirement benefits through an irrevocable trust agreement. The Commission's Chief Accountant issued a guidance letter in Docket No. AI07-1-1000 in March 2007, which states that centralized service companies should use Account 128 to record assets for the overfunded status of their employee postretirement benefit plans. Based on audit staff's explanation that the guidance letter issued in Docket No. AI07-1-1000 supersedes 18 C.F.R. § 367.1280(b), NCSC made a regulatory accounting reclassification of the overfunding amount in Account 186 to Account 128 to be in full compliance with the guidance issued in Docket No. AI07-1-000. The reclassification entry completed at December 31, 2011 is provided herein as "Finding 3_Att. A_128 Overfunding.pdf." Further, NCSC's 2011 FERC Form No. 60, page 110, Line 5, shows the 186 balance to be $0 at December 31, 2011. At December 31, 2011, and thereafter, NCSC is properly accounting for future over- and underfunding of its postretirement life insurance benefit under the guidance issued in Docket No. AI07-1-000.

4. Improperly Recorded Transferred Employee Benefits: NiSource agrees with this finding and recommendation. As noted in the Corrective Actions listed on page 23 of the Audit Report, NiSource has provided audit staff with journal entries and screen images of the completed transactions. In addition, NiSource's 2011 FERC Form No. 60, page 110, Line 5, shows the 186 balance to be $0 at December 31, 2011. NCSC did develop a new policy and procedure in December of 2011 to ensure that LTD insurance for transferred employees is properly accounted for in Account 146. A copy of the written policies and procedures developed in response to this recommendation is provided herein as "Finding 4_Att. A_LTD Benefits Policy.doc."

5. **FERC-61 Reporting for Special Purpose Companies:** NiSource agrees with this finding and recommendation. As noted in the Corrective Actions listed on page 26 of the Audit Report, NiSource has submitted the FERC-61 filings required for the years 2006 – 2009 for its special-purpose service companies. NiSource has updated its policies and procedures to now include the filing of FERC-61 reports in its regulatory compliance program so that these documents are filed in a timely manner. Copies of the written policies and procedures developed in response to this recommendation are included herein as "Finding 5_Att. A_FERC Holding Co. Policy.pdf" and "Finding 5_Att. B_FERC Service Co. Policy.pdf".

6. **Untimely Filing of Cash Management Programs:** NiSource agrees with this finding and recommendation. NiSource submitted one cash management agreement within 10 business days (14 calendar days), and not within the 10 calendar days as required by the Commission's regulations (18 C.F.R. § 141.500). NiSource has discussed its process internally and commits to strengthen its policies and procedures to ensure that all employees involved in the preparation and filing of cash management agreements are aware of the filing requirements. There have been no other instances of late filings.

7. **Reporting of Transactions with Affiliated Companies:** NiSource agrees with this finding and recommendation. NiSource will resubmit its 2011 FERC Form No. 2 for Columbia Gas Transmission, LLC, and Columbia Gulf Transmission Company to correct page 358 by replacing the term "various" with a listing of accounts used to record the services. Filings will be resubmitted by the end of the third quarter 2012. NIPSCO strengthened its procedures during 2011 and filed the 2011 FERC Form No. 1, page 429, properly by providing a listing of accounts used to record services rather than "various" as done in its 2009 and 2010 filings. Included herein is attachment "Finding 7_Att A_Form 1.pdf" which is a copy of NIPSCO's 2011, Form 1, page 429. NiSource's interstate pipelines have completed their documentation of compliance procedures for each of their Form No. 2 pages. Included herein is attachment "Finding 7_Att B_Form 2 p. 358 procedures.pdf" which is a copy of the NiSource's compliance procedures specifically for p. 358 of Form No. 2. Upon request, NiSource will make copies of all compliance procedures for all pages of its Form No. 2 available to FERC.

8. **Miscellaneous FERC Account Classification Errors:** NiSource agrees with this finding and recommendation. Starting in the third quarter of 2011, NCSC strengthened its policies and procedures for ensuring that expenses were in the proper FERC accounts. A copy of the policy implemented by NCSC is included herein as "Finding 8_Att. A_FERC Classification Policy.docx." In compliance with its policy, NCSC is performing an analysis and making reclassification entries on a quarterly basis to ensure proper recording to FERC accounts. The quarterly reclassification entries made to properly record to FERC accounts are included herein as "Finding 8_Att. B_Q3 2011 FERC Reclass.pdf," "Finding 8_Att. C_Q4 2011 FERC

Reclass.pdf," "Finding 8_Att. D_Q1 2012 FERC Reclass.pdf," and "Finding 8_Att. E_Q2 2012 FERC Reclass.pdf." Amounts recorded for lobbying and political activities for the audit period were immaterial in nature ($748 in 2009 and $10,436 in 2010), have rolled to retained earnings in a prior calendar period, and thus NiSource deems prior period entries unnecessary.

Until all corrective actions have been implemented, NiSource will make the recommended quarterly progress reports no later than 30 days after the end of each calendar quarter.

NiSource appreciates the professionalism and transparency of audit staff assigned to this audit. NiSource takes its compliance obligations very seriously, and we continually strive to improve and enhance our regulatory compliance efforts. Should you have any questions regarding this response, please do not hesitate to contact Susanne M. Taylor, Controller of NiSource Corporate Services Company, at 614-460-4686. Thank you for your time and attention in this matter.

Sincerely,

Stephen P. Smith
Executive Vice President and Chief Financial Officer

cc: Gerald Williams

Attachments Enclosed on CD:
Finding 1 _Att A_MISO calc 2009.pdf
Finding 1_Att B_MISO calc 2010.pdf
Finding 1_Att C_MISO calc 2011.pdf
Finding 2_Att. A_165 Transformation.pdf
Finding 3_Att. A_128 Overfunding.pdf
Finding 4_Att. A_LTD Benefits Policy.doc
Finding 5_Att. A_FERC Holding Co. Policy.pdf
Finding 5_Att. B_FERC Service Co. Policy.pdf
Finding 7_Att A_Form 1.pdf
Finding 7_Att B_Form 2 p. 358 procedures.pdf
Finding 8_Att. A_FERC Classification Policy.docx
Finding 8_Att. B_Q3 2011 FERC Reclass.pdf
Finding 8_Att. C_Q4 2011 FERC Reclass.pdf
Finding 8_Att. D_Q1 2012 FERC Reclass.pdf
Finding 8_Att. E_Q2 2012 FERC Reclass.pdf