AEP
AMERICAN ELECTRIC POWER

Date April 24, 2006

Subject Accounting for Conditional Asset Retirement Obligations

From T. E. Mitchell, J. E. Henderson and S. M. Hannis

To File

This memo documents the implementation of FASB Interpretation 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47), in the 4th quarter of 2005.

In March 2005, the FASB issued FIN 47, which interprets the application of SFAS 143, *Accounting for Asset Retirement Obligations*. FIN 47 clarifies that the term conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Entities are required to record a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

FIN 47, Appendix A, contains illustrative examples which clarify that a liability for asbestos removal and disposal should be recorded when it can be reasonably estimated. While the specific amount of asbestos present in AEP's general buildings and generating plants is not known, Generation and Workplace Services were able to provide an estimated cost of asbestos removal and disposal. A liability was not recorded for Transmission and Distribution asbestos, due to immateriality.

We recorded an unfavorable cumulative effect of $26 million ($17 million net of tax) for our non-regulated operations related primarily to asbestos removal in the Utility Operations segment. The cumulative effect related to asbestos removal for our regulated operations was generally charged to a regulatory liability (Account 1080013, which is mapped to a regulatory liability for SEC reporting). A regulatory asset was recorded for a Dolet Hills ash pond.

AEP's Legal Department completed a review of potential conditional AROs and identified the following, which were not recorded due to immateriality:

- PCB disposal
- Computer equipment disposal
- Underground storage tank closure

In the implementation of SFAS 143, AEP identified, but did not recognize, asset retirement obligation liabilities related to electric transmission and distribution assets, as a result of certain easements on property upon which we have assets. Generally such easements are perpetual (renewal is not required) and the retirement and removal of our assets is only required upon the cessation of the property's use. We continue to conclude that the retirement obligation is not estimable for such easements since we plan to use our facilities indefinitely. The retirement obligation would only be recognized if and when we abandon or cease the use of specific easements.

A summary evaluation of each of the potential conditional asset retirement obligations reviewed is attached.

The following discount and inflation rates were applied to compute the FIN 47 ARO obligation:

Discount Rate	Inflation Rate
%	%
6.20	3.09

Notes:
- Discount rate provided by Finance.
- 3.09% inflation rate was based on the average change in the CPI index 1983-2004.

The capitalized asset retirement cost is generally allocated to expense over the expected useful life of the related asset using straight-line depreciation. In instances where there is an in-place retirement of an asset with an associated asset retirement obligation, we ensure that the ARO asset is fully depreciated and the ARO liability will continue to be accreted until the settlement date. We remove the ARO asset and the related ARO accumulated depreciation when the associated ARO liability is fully discharged.

Pro forma net income and earnings per share were not presented for the years ended December 31, 2004 and 2003 because the pro forma application of FIN 47 would result in pro forma net income and earnings per share not materially different from the actual amounts reported for those periods. The pro forma liability as of December 31, 2004 and 2003, $52.1 million and $49 million, respectively, calculated as if FIN 47 had been adopted at the beginning of each period was disclosed.

Note that because there is no receipt or payment of cash for increases in assets resulting from capitalizing asset retirement costs, they should not be reflected in the statement of cash flows as cash flows used for investing activities.

As asbestos settlements are incurred, AEP will continue to apply EITF Issue 02-6, *Classification in the Statement of Cash Flows of Payment Made to Settle an Asset Retirement Obligation within the Scope of FASB Statement No. 143*, which requires that a cash payment made to settle an asset retirement obligation be classified as an operating activity in the statement of cash flows.

Property Accounting will coordinate an annual reassessment of AROs to determine whether a change in estimate is necessary if there are indicators that the cash flows have changed materially (similar to the approach under FAS 144).

Generally ARO accounting is offset by specific Schedule M treatment with deferred taxes.

c. G. Adams
J. B. Bartsch
S. S. Bennett
J. M. Buonaiuto
D. A. Davis
S. E. Higginson
D. G. Hummel
J. R. Huneck
B. E. Hutchins
M. J. Kelley
M. N. Kelly
R. A. Mueller
M. A. Pyle
O. J. Sever
T. G. St. Pierre
M. J. Sullivan
J. Williams
Deloitte

Attachment

General Property (Asbestos)

Asbestos is present in many of AEP's general buildings (asbestos is generally presumed to be present in buildings constructed prior to 1980). The specific amount of asbestos present in each building is not known, so removal costs were estimated based on building size.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique?
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    Yes. Workplace Services estimated asbestos removal costs to be spent in 5, 10, 20 or 30 years. A more precise estimate by year is not reasonable based on available information.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    Yes.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    N/A.

Business Contacts: Jeff Parlet, Jim Vought

Generation Property (Asbestos)

Asbestos is present in most of AEP's generating plants. The specific amount of asbestos present in each plant is not known, so plant personnel estimated the amount based on available information. Below is the process generation used to estimate asbestos removal costs for the plants AEP operates (excluding the TNC mothballed plants). Since demolition estimates (including asbestos abatement) were already prepared for the TNC plants those existing estimates were used. Similar methods were used to estimate the cost for all of the plants, with the primary difference being the baseline estimate used for extrapolation.

1. Determine which AEP facility/unit had the most detailed asbestos records, and had measured their quantities removed or existing, by cubic yards. This information served as a baseline for the rest of the fleet.
2. Survey the plants as to the level of unit asbestos information they had.
3. From their information, estimate on a total unit basis the percentage of asbestos existing or removed.
4. Mathematically apply a baseline factor of (cubic yds asbestos / % / MW) to each fleet unit estimate to achieve total cubic yards of asbestos/unit.
5. Multiply a current market rate for asbestos removal and disposal per cubic yard to each fleet unit total.
6. Add all unit $s to determine total fleet exposure cost.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique?
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    Yes. Because there are no current plans for asbestos abatement projects at generating plants that are still in-service, estimated settlement dates after retirement of the plants was used. A 60-year plant life was used for most plants, based on Generation's current planned operating life. Plants are now rated as 60 years by Generation, due in part to the addition (and anticipated addition) of pollution control equipment that permits their continued economic usage versus other alternative sources of fuel such as gas. We believe the best estimate of the settlement date for asbestos abatement is 7 years after the expected plant life. Given the limited history of plant demolition at AEP, we do not believe asbestos abatement is likely to occur sooner than 7 years after retirement and we also believe extension beyond 7 years is generally not reasonable.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    Yes.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    N/A.

Business Contacts: John Mazzone

Distribution Property (Asbestos)
Asbestos is present in AEP's Distribution Secondary Networks in two forms:

1) An asbestos covering was applied to the outside of many network cables to minimize damage in the event of a fire within a vault or manhole. The asbestos covering is measured in linear feet of cable covered.

2) Manufacturers commonly used asbestos inside older network protectors. Network protectors are similar to circuit breakers, but unlike most circuit breakers they are submersible and the controls are integral to the protector. Typically older network protectors have internal panels and interrupters that use asbestos.

An ARO was not recorded due to immateriality.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique?
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    Yes.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    Yes.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    N/A.

Business Contacts: Steve Early

Transmission Property (Asbestos)

Asbestos containing material is present in some AEP substation relay panels. An ARO was not recorded due to immateriality.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique?
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    No. There are no scheduled substation retirements or panel replacement programs. Transmission management believes the amount is very minor.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    Yes.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    N/A.

Business Contact: Eric Engdahl

PCB Removal

There are approximately 700 PCB T/R sets currently in service in the system. The estimated cost for PCB handling/disposal for the T/R sets in use now is approximately $1.4 million.

AEP has approximately 520 PCB capacitors in use across the system. These units typically weigh about 40 pounds each. Current disposal costs are approximately $2 per pound for PCB capacitors. So, the future obligation for disposal of PCB capacitors is approximately $42,000.

AEP disposes of about 40,000 pieces of used electrical equipment each year (east and west combined). Traditionally about 1% of our scrap units have >500 ppm PCBs in them, with a disposal cost of approximately $13,000 per year.

An ARO was not recorded due to immateriality.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique?
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    Yes.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    Yes.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    N/A.

Business Contact: Marty Leedy

Underground Storage Tanks

Underground storage tanks must be emptied, cleaned and removed or filled when they cease being used permanently. Clean-up resulting from a leak is not an asset retirement obligation, since it doesn't result from normal operations. Jim Pappas noted that the useful life of underground storage tanks that have been properly used is indefinite. No one is aware of any current plans for removal of underground storage tanks.

An ARO was not recorded due to immateriality.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique?
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    Yes.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    Yes.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    N/A.

Business Contact: Jim Pappas

Treated wood poles

Used wood (i.e., poles, railroad ties, decks, etc.) treated with arsenic-based pesticides, pentachlorophenol, or creosote is not hazardous waste.

Arsenic Based Treated Wood –

Arsenic-based pesticides include chromated copper arsenate (CCA), ammoniacal copper arsenate (ACA), and ammoniacal copper zinc arsenate (ACZA). CCA is the most common and is the green tinted wood sold by Lowes and Home Depot for decks and fences. Arsenic treated wood is exempt from the hazardous waste regulations.

Pentachlorophenol Treated Wood –

The TCLP regulatory level for pentachlorophenol is 100 mg/l. Past testing by the utility industry (EPRI) has shown that pentachlorophenol treated wood poles and crossarms do not exceed the 100 mg/l limit (all 47 tests were less than 10 mg/l of pentachlorophenol). Therefore, pentachlorophenol treated wood poles are designated as nonhazardous solid waste and can be discarded as such. No further testing is required. Generator knowledge citing the above EPRI data can be used to make the non-hazardous determination.

Creosote Treated Wood –

The chemicals of concern from a hazardous waste aspect for creosote treated poles are cresols. The TCLP regulatory level for total cresols is 200 mg/l. Past TCLP testing by EPRI has shown that creosote treated wood does not exceed the 200 mg/l hazardous waste level (all 54 tests were below 15 mg/l total cresols). Therefore, creosote treated wood poles and cross arms are designated as nonhazardous waste and can be discarded as such. No further testing is required and the EPRI data can be cited in making the non-hazardous waste determination.

Treated wood that won't be reused and is to be disposed must be done so in compliance with all applicable State solid waste regulations. Options would include disposal in a licensed solid waste landfill, demolition debris landfill, or incinerator.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  No.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset? N/A
- Does an active market exist for the transfer of the obligation?
  N/A
- Does sufficient information exist to apply an expected present value technique? N/A
  - Have the settlement date and method of settlement been specified by others?
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?

Business Contacts: Kevin Mack, Tom Webb

Computer Disposal

AEP leases most of its computer equipment through capital leases and does not return the equipment to the lessor at the end of the lease term. AEP uses a single vendor, Redemtech, for computer disposal (including laptops, desktops, servers, monitors and printers). Redemtech picks up the equipment and manages disposal. Equipment may be resold or recycled. If a computer will be resold, AEP pays to clear the drives and gets 75% of the resale amount.

Contaminated materials present in the equipment include mercury in circuit boards, nickel-cadmium batteries, and lead in monitors (particularly older ones). If the material is recycled as scrap metal, it is exempt from hazardous material disposal regulations.

Jeff Kramer, Redemtech Client Relationship Manager, provided an overview of Redemtech and the process used to handle AEP computer equipment. Redemtech never disposes of AEP equipment in a landfill; equipment that is not sold is recycled and does not fall under the regulations for hazardous waste.

Jeff Kramer later provided a document showing the components of the costs outlined in AEP's Service Agreement, in order to identify the incremental cost related to the legal obligation to dispose of the equipment properly.

An ARO was not recorded due to immateriality.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique? Yes.
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    Yes.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    Yes.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    Yes.

Business Contacts: Mark Balyeat, Paul Grimes

Rights-of-way

We have legal obligations related to electric transmission and distribution assets as a result of certain easements on property on which we have assets. Generally, such easements are perpetual and require only the retirement and removal of our assets upon cessation of the property's use. Because there is no plan to cease use, the settlement date cannot be estimated.

- Is there a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity?
  Yes.
- Is it evident that the fair value of the obligation is embodied in the acquisition price of the asset?
  No.
- Does an active market exist for the transfer of the obligation?
  No.
- Does sufficient information exist to apply an expected present value technique? No.
  - Have the settlement date and method of settlement been specified by others?
    No.
  - Is information available to reasonably estimate the settlement date or range of potential settlement dates?
    No.
  - Is information available to reasonably estimate the settlement method or potential methods of settlement?
    No.
  - Is information available to reasonably estimate the probabilities associated with the potential settlement dates and methods of settlement?
    No.

Business Contact: Tom St. Pierre