AMERICAN ELECTRIC POWER

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Date March 24, 1994

Subject **Adoption of Statement of Financial Accounting Standard (SFAS) No. 112, "Employers' Accounting for Postemployment Benefits"**

From G. S. Campbell/L. L. Dieck

4/6/94

To
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I. Background and Purpose

SFAS No. 112, which was effective **January 1, 1994, adopts accrual** accounting for postemployment, preretirement benefits. Previously, many companies recognized the expense for postemployment, preretirement benefits as the benefits were paid (the pay-as-you-go method). Postemployment, preretirement benefits include disability-related benefits, continuation of health care benefits and life insurance, supplemental unemployment benefits, severance benefits and other salary continuation plans.

The AEP Companies follow accrual accounting for many postemployment, preretirement benefits (i.e., workers' compensation and severance pay). However, a liability is not currently reflected on the books for the following uninsured postemployment, preretirement benefits provided to AEP employees:

Long-Term Disability (LTD) Plan for Non-United Mine Workers of America (UMWA) Plans -

- Medical, and basic and supplemental life insurance continuation

UMWA Plans -

- Layoff Benefits:
  Medical and basic life insurance continuation
- Sickness & Accident Benefits:
  Income replacement
  Medical and basic life insurance continuation
- Disabled Pensioner Benefits:
  Medical insurance continuation before age 55

Intra-System

The purpose of this memorandum is to set forth the accounting instructions for adopting the new standard for the AEP System's regulated and non-regulated operations and to confirm the entries recorded in February 1993 business by Appalachian Power Company (APCo) and Ohio Power Company (OPCo) related to the SFAS No. 112 liability for their inactive coal subsidiaries. Indiana Michigan Power Company (I&M) does not have an SFAS No. 112 liability for its inactive coal subsidiary.

II. Accounting Implications

In general, SFAS No. 112 requires that the obligation for postemployment, preretirement benefits be recognized in accordance with SFAS No. 43, "Accounting for Compensated Absences" if four conditions are met: (1) the obligation is attributable to employees' service already rendered; (2) employees' rights to those benefits vest or accumulate; (3) payment of the benefit is probable; and (4) the amount can be reasonably estimated. SFAS No. 43 requires that the obligation be recognized over the service life of the employees. If the above four conditions of SFAS No. 43 are not met, the employer would account for these benefits when it is probable that a liability has been incurred and the amount can be reasonably estimated in accordance with SFAS No. 5, "Accounting for Contingencies." SFAS No. 112 permits discounting of the postemployment, preretirement benefit liabilities provided the payment period is determinable.

The benefits provided by AEP as listed above do <u>not</u> meet the criteria of SFAS No. 43. Accordingly, at the time of adoption of SFAS No. 112, a liability equivalent to the net present value of the estimated payments to be made to those individuals currently receiving benefits under the above listed plans must be recorded. We have engaged Towers Perrin to prepare the actuarial valuations of the liabilities under the previously listed benefit plans. For all such costs applicable to regulated operations, we will record the previously unrecognized SFAS No. 112 liability and a corresponding regulatory asset pursuant to the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), since we expect to recover these actual payments from customers over time through the ratemaking process. In addition, **we will continue to recognize the expense on the pay-as-you go basis**, i.e., the recorded liability and regulatory asset will only be adjusted when a new actuarial valuation is prepared by Towers Perrin (see discussion below regarding the timing of subsequent studies).

Recordation of a regulatory asset is appropriate because the AEP Operating Companies have been on the pay-as-you-go method for both financial reporting and ratemaking purposes and have consistently recovered the pay-as-you-go expenses in rates. In addition, we do not expect to encounter the same problems we had with recording regulatory assets for SFAS No. 106, "Postemployment Benefits Other Than Pensions." The SFAS No. 106 liabilities are long-term in nature and continue to grow, absent special measures such as COLI programs, whereas the SFAS No. 112 liability will remain relatively constant and is generally short-term in nature. In addition, the total amounts involved in the accounting for SFAS No. 112 liabilities clearly are much less significant than the amounts involved with OPEBs. Paragraphs 48 and 49 in Appendix B of SFAS No. 71 address the accounting for compensated absences under SFAS No. 43, "Accounting for Compensated Absences" and since SFAS No. 112 is an extension of the requirements of SFAS No. 43, these paragraphs apply to SFAS No. 112 items and thereby provide further support for the recordation of a regulatory asset.

The **inactive coal companies** currently have some disabled employees who are receiving benefits under the plans listed above. Since these companies are inactive and no longer regulated entities there is no basis to establish a regulatory asset. Therefore, the inactive coal companies will expense the liability and bill their parent companies, APCo and OPCo, for the liability in the monthly shut-down billing. APCo and OPCo will expense the shut-down billing in the month billed. **Subsequent payments for these benefits will first reduce the liability and any benefit payments in excess of the liability will be expensed when incurred.**

Since we are recording a regulatory asset in most cases, and the inactive coal subsidiaries' SFAS No. 112 liability is not significant, we will engage Towers Perrin to recalculate the liability on an annual basis only. We will then inform you of any adjustments to your recorded liabilities.

III. Journal Entries

A. All Companies Excluding the Inactive Coal Companies - The following journal entry should be recorded in **March 1994** business for all companies except the inactive coal subsidiaries. The amounts to be recorded are included on the attached schedule for your company(ies).

Account No.	Description	Debit	Credit
182.3	**Other Regulatory Assets**	$ XXX	
228.4	Accumulated Miscellaneous Operating Provisions		$ XXX
	To record the liability and related regulatory asset for the previously unrecorded liability under SFAS No. 112.		

Note: Since the Service Corporation and the Coal Companies have not yet received permission from the Securities and Exchange Commission to use Account 182.3, they should charge Account 186, Miscellaneous Deferred Debits.

Note: The standard billing procedures should be followed where appropriate for the liability for I&M River Transportation Division, Ohio Power - Cardinal, Ohio Power - Cook, Ohio Power - Kammer and Ohio Power - Tidd.

Since the regulated companies will continue to recognize expense on the pay-as-you-go basis and the SFAS No. 112 accruals are not deductible for tax purposes until paid there are no deferred federal income tax entries required.

B. **Entries Recorded and to Be Recorded by APCo and OPCo Related to Their Inactive Coal Subsidiaries -** The following journal entry was recorded in **February 1994** business by APCo and OPCo (APCo - $1,333,000 and OPCo - $731,000) to reflect one-half of the SFAS No. 112 liability of the inactive coal subsidiaries:

Account No.	Description	Debit	Credit
426.5	Other Deductions	$ XXX	
253	Other Deferred Credits		$ XXX
	To record a provision for one-half of the liability of the inactive coal subsidiaries for the previously unrecorded liability under SFAS No. 112.		

The following reversing journal entry should be recorded in **March 1994** business by APCo and OPCo as the inactive coal subsidiaries will record the entire liability and bill the respective companies in March:

Account No.	Description	Debit	Credit
253	Other Deferred Credits	$ XXX	
426.5	Other Deductions		$ XXX
	To reverse the provision recorded in February 1994 for one-half of the liability of the inactive coal subsidiaries for the previously unrecorded liability under SFAS No. 112, since the entire liability was billed by the inactive coal company subsidiaries in March 1994, and appropriately expensed below-the-line.		

The tax treatment of the above two entries is the same as the book treatment due to the short reversal period. Accordingly, no deferred federal income tax entries were provided.

C. **Journal Entries to Be Recorded by the Inactive Coal Subsidiaries**
The inactive coal companies should record the following entry in **March 1994** business. The amounts to be recorded are set forth on Attachment A.

Account No.	Description	Debit	Credit
425.99	Miscellaneous Nonoperating Expense	$ XXX	
242	Miscellaneous Current and Accrued Liabilities		$ XXX
253	Other Deferred Credits		XXX
	To record the liability for the previously unrecorded liability under SFAS No. 112.		

For tax purposes, the SFAS No. 112 expense is not deductible until paid. Accordingly, there is a Schedule M addback for which deferred federal income taxes should be provided at the statutory rate of 35%. The following deferred federal income tax entry will be recorded through the mechanized tax system:

Account No.	Description	Debit	Credit
190.2	Accumulated Deferred Federal Income Taxes	$ XXX	
411.2	Provision for Deferred Federal Income Taxes - Credit		$ XXX
	To record deferred federal income taxes associated with the SFAS No. 112 liability which is not deductible for tax purposes until paid.		

When the benefits are actually paid, there will be a Schedule M deduction and the appropriate amount of deferred federal income taxes should be reversed or fed back at the statutory rate of 35%. The following feedback of the deferred federal income tax will be recorded through the mechanized tax system.

Account No.	Description	Debit	Credit
410.2	Provision for Deferred Federal Income Taxes	$ XXX	
190.2	Accumulated Deferred Federal Income Taxes		$ XXX
	To reverse the deferred federal income taxes associated with the SFAS No. 112 liability as the actual benefits are paid.		

If you have any questions please contact the undersigned.

L. L. Dieck

G. S. Campbell/L. L. Dieck

GSC:LLD:ca

Attachment

cc: M. S. Ackerman - Lancaster
L. V. Assante
G. C. Dean
H. W. Fayne
G. P. Maloney
R. A. Mueller
R. H. Strahan/R. D. Shock
A. P. Varley
Deloitte & Touche

(Fasten Attachments Here) KENTUCKY POWER COMPANY Page No. 1 of 1

JOURNAL ENTRY VOUCHER Month and Year Mar/94 J.E.No. 034-J339

SHORT ACCOUNT TITLE	ACCOUNT	DESCRIPTION	CONTRA-ACCT	DEBIT	CREDIT
ORA-POST EMP/PRE RET BEN	18239	RECORD SFAS 112 LIAB	22840	2,330,161.00	
ACM PRV-POST EMP/PRE RET	22840	RECORD SFAS 112 LIAB	18239		2,330,161.00
JOI/bc 04/13/1994				2,330,161.00	2,330,161.00

EXPLANATION: To record the liability and related regulatory asset for the previously unrecorded liability under SFAS No. 112. Reference: March 24, 1994 letter of G.S. Campbell/L.L. Dieck, copy attached.

Acct. Dept. Approvals:
Compiled By____________ Approved By____________ Key Entered____________

Form TRY-25 KY Rev. 1/91