COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF	)	
KENTUCKY UTILITIES COMPANY FOR AN	)	**CASE NO. 2018-00294**
ADJUSTMENT OF ITS ELECTRIC RATES	)	

RESPONSE OF
KENTUCKY UTILITIES COMPANY
TO
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION
DATED SEPTEMBER 19, 2018

FILED: OCTOBER 12, 2018

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **Daniel K. Arbough**, being duly sworn, deposes and says that he is Treasurer for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Daniel K. Arbough

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of October 2018.

Notary Public

My Commission Expires:
Judy Schooler
Notary Public, ID No. 603967
State at Large, Kentucky
Commission Expires 7/11/2022

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **Lonnie E. Bellar**, being duly sworn, deposes and says that he is Chief Operating Officer for Louisville Gas and Electric Company and Kentucky Utilities Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Lon E Bellar
Lonnie E. Bellar

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of October 2018.

Judy Schooler
Notary Public

My Commission Expires:
Judy Schooler
Notary Public, ID No. 603967
State at Large, Kentucky
Commission Expires 7/11/2022

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **Kent W. Blake**, being duly sworn, deposes and says that he is Chief Financial Officer for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

KtWBlake
Kent W. Blake

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of October 2018.

Judy Schooler
Notary Public

My Commission Expires:
Judy Schooler
Notary Public, ID No. 603967
State at Large, Kentucky
Commission Expires 7/11/2022

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **Robert M. Conroy**, being duly sworn, deposes and says that he is Vice President, State Regulation and Rates, for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Robert M. Conroy

Robert M. Conroy

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of October 2018.

Judy Schooler

Notary Public

My Commission Expires:

Judy Schooler
Notary Public, ID No. 603967
State at Large, Kentucky
Commission Expires 7/11/2022

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **Christopher M. Garrett**, being duly sworn, deposes and says that he is Controller for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Christopher M. Garrett

____
Christopher M. Garrett

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of October 2018.

Judy Schooler

____
Notary Public

My Commission Expires:
Judy Schooler
Notary Public, ID No. 603967
State at Large, Kentucky
Commission Expires 7/11/2022

VERIFICATION

STATE OF TEXAS	)	
	)	**SS:**
COUNTY OF TRAVIS	)	

The undersigned, **Adrien M. McKenzie**, being duly sworn, deposes and says he is President of FINCAP, Inc., that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Adrien M. McKenzie

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 10th day of October 2018.

_______________ (SEAL)
Notary Public

My Commission Expires:

10/3/2021

NOTARY PUBLIC STATE OF TEXAS

PATRICK CRUISE
NOTARY PUBLIC STATE OF TEXAS
MY COMM. EXP. 10/03/2021
NOTARY ID 12436110-9

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **Gregory J. Meiman**, being duly sworn, deposes and says that he is Vice President, Human Resources for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Gregory J. Meiman

Gregory J. Meiman

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of October 2018.

Judy Schooler

Notary Public

My Commission Expires:

Judy Schooler
Notary Public, ID No. 603967
State at Large, Kentucky
Commission Expires 7/11/2022

VERIFICATION

STATE OF NORTH CAROLINA)
)
COUNTY OF BUNCOMBE)

The undersigned, **William Steven Seelye**, being duly sworn, deposes and states that he is a Principal of The Prime Group, LLC, that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his ~~information~~, knowledge and belief.

____
William Steven Seelye

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 10 day of October 2018.

Ryan Ridenour (SEAL)
Notary Public
Ryan Ridenour

My Commission Expires:

7-29-23

Ryan Ridenour
NOTARY PUBLIC
BUNCOMBE COUNTY, NC
MY COMMISSION EXPIRES 7/29/23

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **David S. Sinclair**, being duly sworn, deposes and says that he is Vice President, Energy Supply and Analysis for Kentucky Utilities Company and Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

David S. Sinclair

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 11th day of October 2018.

Notary Public

My Commission Expires:

Judy Schooler
Notary Public, ID No. 603967
State at Large, Kentucky
Commission Expires 7/11/2022

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 1

Responding Witness: Robert M. Conroy

Q-1. Provide a copy of the current bylaws. Indicate any changes made to the bylaws since the utility's last general rate case.

A-1. See attached for a copy of Kentucky Utilities Company's ("KU") current bylaws. There have been no changes made to the bylaws since KU's last rate case.

BY-LAWS

OF

KENTUCKY UTILITIES COMPANY

Dated April 28, 1998
(as amended through June 2, 1999)
(as amended through December 16, 2003)

BY-LAWS

OF

KENTUCKY UTILITIES COMPANY

ARTICLE I

STOCK TRANSFERS

Section 1. Each holder of fully paid stock shall be entitled to a certificate or certificates of stock stating the number and the class of shares owned by such holder, provided that, the Board of Directors may, by resolution, authorize the issue of some or all of the shares of any or all classes or series of stock without certificates. All certificates of stock shall, at the time of their issuance, be signed by the Chairman of the Board, the President or a Vice-President and by the Secretary or Assistant Secretary, and may be authenticated and registered by a duly appointed registrar. If the stock certificate is authenticated by a registrar, the signatures of the corporate officers may be facsimiles. In case any officer designated for the purpose who has signed or whose facsimile signature has been used on any stock certificate shall, from any cause, cease to be such officer before the certificate has been delivered by the Company, the certificate may nevertheless be adopted by the Company and be issued and delivered as though the person had not ceased to be such officer.

Section 2. Shares of stock shall be transferable only on the books of the Company and upon proper endorsement and surrender of the outstanding certificates representing the same. If any outstanding certificate of stock shall be lost, destroyed or stolen, the officers of the Company shall have authority to cause a new certificate to be issued to replace such certificate upon the receipt by the Company of satisfactory evidence that such certificate has been lost, destroyed or stolen and of a bond of indemnity deemed sufficient by the officers to protect the Company and any registrar and any transfer agent of the Company against loss which may be sustained by reason of issuing such new certificate to replace the certificate reported lost, destroyed or stolen; and any transfer agent of the Company shall be authorized to issue and deliver such new certificate and any registrar of the Company is authorized to register such new certificate, upon written directions signed by the Chairman of the Board, the President or a Vice-President and by the Treasurer or the Secretary of the Company.

Section 3. All certificates representing each class of stock shall be numbered and a record of each certificate shall be kept showing the name of the person to whom the certificate was issued with the number and the class of shares and the date thereof. All certificates exchanged or returned to the Company shall be cancelled and an appropriate record made.

Section 4. The Board of Directors may fix a date not exceeding seventy days preceding the date of any meeting of shareholders, or the date fixed for the payment of any dividend or distribution, or the date of allotment of rights, or, subject to contract rights with respect thereto, the date when any change or conversion or exchange of shares shall be made or go into effect, as a record date for the determination of the shareholders entitled to notice of and to vote at any such meeting, or entitled to receive payment of any such dividend, or allotment of rights, or to exercise the rights with respect to any such change, conversion or exchange of shares, and in such case only shareholders of record on the date so fixed shall be entitled to notice of and to vote at such meeting, or to receive payment of such dividend or allotment of rights or to exercise such rights, as the case may be, notwithstanding any transfer of shares on the books of the Company after the record date fixed as aforesaid. The Board of Directors may close the books of the Company against transfer of shares during the whole or any part of such period. When a determination of shareholders entitled to notice of and to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment thereof except as otherwise provided by statute.

ARTICLE II

MEETINGS OF STOCKHOLDERS

Section 1. An Annual Meeting of Stockholders of the Company shall be held at such date and time as shall be designated from time to time by the Board of Directors. Each such Annual Meeting shall be held at the principal office of the Company in Kentucky or at such other place as the Board of Directors may designate from time to time.

Section 2. Special meetings of the stockholders may be called by the Board of Directors or by the holders of not less than 51% of all the votes entitled to be cast on each issue proposed to be considered at the special meeting, or in such other manner as may be provided by statute. Business transacted at special meetings shall be confined to the purposes stated in the notice of meeting.

Section 3. Notice of the time and place of each annual or special meeting of stockholders shall be sent by mail to the recorded address of each stockholder entitled to vote not less than ten or more than sixty days before the date of the meeting, except in cases where other special method of notice may be required by statute, in which case the statutory method shall be followed. The notice of special meeting shall state the object of the meeting. Notice of any meeting of the stockholders may be waived by any stockholder.

Section 4. At an Annual Meeting of the Stockholders, only such business shall be conducted as shall have been properly brought before the meeting in accordance with the procedures set forth in these By-laws. To be properly brought before the Annual Meeting, business must be (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (b) otherwise properly brought before the meeting by or at the direction of the Board of Directors, or (c) otherwise be a proper matter for consideration and otherwise be properly requested to be brought before the meeting by a stockholder as hereinafter provided. For business to be properly requested to be brought before an Annual Meeting by a stockholder, a stockholder of a class of shares of the Company entitled to vote upon the matter requested to be brought before the meeting (or his designated proxy as provided below) must have given timely and proper notice thereof to the Secretary. To be timely, a stockholder's notice must be given by personal delivery or mailed by United States mail, postage prepaid, and received by the Secretary not fewer than sixty calendar days prior to the meeting; provided, however, that in the event that the date of the meeting is not publicly announced by mail, press release or otherwise or disclosed in a public report, information statement, or other filing made with the Securities and Exchange Commission, in either case, at least seventy calendar days prior to the meeting, notice by the stockholder to be timely must be received by the Secretary, as provided above, not later than the close of business on the tenth day following the day on which such notice of the date of the meeting or such public disclosure or filing was made. To be proper, a stockholder's notice to the Secretary must be in writing and must set forth as to each matter the stockholder proposes to bring before the Annual Meeting (a) a description in reasonable detail of the business desired to be brought before the Annual Meeting and the reasons for conducting such business at the Annual Meeting, (b) the name and address, as they appear on the Company books, of the stockholder proposing such business or granting a proxy to the proponent or an intermediary, (c) a representation that the stockholder is a holder of record of stock of the Company entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice, (d) the name and address of the proponent, if the holder of a proxy from a qualified stockholder of record, and the names and addresses of any intermediate proxies, (e) the class and number of shares of the Company which are beneficially owned by the stockholder, and (f) any material interest of the stockholder or the proponent in such business. The chairman of an Annual Meeting shall determine whether business was properly brought before the meeting, which determination absent manifest error will be conclusive for all purposes.

Section 5. The Chairman of the Board, if present, and in his absence the President, and the Secretary of the Company, shall act as Chairman and Secretary, respectively, at each stockholders meeting, unless otherwise provided by the Board of Directors prior to the meeting. Unless otherwise determined by the Board of Directors prior to the meeting, the Chairman of the stockholders' meeting shall determine the order of business and shall have the authority in his discretion to regulate the conduct of any such meeting, including, without limitation, by imposing restrictions on the persons (other than stockholders of the Company or their duly appointed proxies) who may attend any such stockholders' meeting, by determining whether any stockholder or his proxy may be excluded from any stockholders' meeting based upon any determination by the Chairman, in his sole discretion, that any such person has unduly disrupted or is likely to disrupt the proceedings thereat, and by regulating the circumstances in which any person may make a statement or ask questions at any stockholders' meeting.

Section 6. The Company shall be entitled to treat the holder of record of any share or shares as the holder in fact thereof and, accordingly, shall not be bound to recognize any equitable or other claim to or interest in such share on the part of any other person whether or not it shall have express or other notice thereof, except as expressly provided by law.

Section 7. The Board of Directors may postpone and reschedule any previously scheduled annual or special meeting of stockholders and may adjourn any convened meeting of stockholders to another date and time as specified by the chairman of the meeting.

ARTICLE III

BOARD OF DIRECTORS

Section 1. The Board shall be composed of such number of Directors as shall be set by resolution of the Board. The number of Directors may be changed from time to time by resolution of the Board of Directors or by amendment to these By-laws, but no decrease in the number of Directors shall have the effect of shortening the term of any incumbent Director. Unless a Director dies, resigns or is removed, he shall hold office until the next annual meeting of the shareholders or until a successor is elected, whichever is later. Directors need not be shareholders of the corporation or residents of the Commonwealth of Kentucky or of the Commonwealth of Virginia. Except as otherwise expressly provided by the Articles of Incorporation, the Board of Directors may fill, until the first annual election thereafter and until the necessary election shall have taken place, vacancies occurring at any time in the membership of the Board by death, resignation or otherwise. Written notice of such resignation shall be made as provided by law.

Section 2. Nominations for the election of directors may be made by the Board of Directors or a committee appointed by the Board of Directors or by any stockholder entitled to vote in the election of directors generally. However, any stockholder entitled to vote in the election of directors generally may nominate one or more persons for election as directors at a meeting only if the stockholder has given timely and proper notice thereof to the Secretary. To be timely, a stockholders notice must be given by personal delivery or mailed by United States mail, postage prepaid, and received by the Secretary not fewer than sixty calendar days or more than ninety calendar days prior to the meeting; provided, however, that in the event that the date of the meeting is not publicly announced by mail, press release or otherwise or disclosed in a public report, information statement or other filing made with the Securities and Exchange Commission, in either case, at least seventy calendar days prior to the meeting, notice by the stockholder to be timely must be so received by the Secretary, as provided above, not later than the close of business on the tenth day following the day on which such notice of the date of the meeting or such public disclosure or filing was made. To be proper, a stockholder's notice of nomination to the Secretary must be in writing and must set forth as to each nominee: (a) the name and address, as they appear on the Company books, of the stockholder who intends to make the nomination or granting a proxy to the proponent or an intermediary; (b) the name and address of the person or persons to be nominated; (c) a representation that the stockholder is a holder of record of stock of the Company entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (d) a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the stockholder; (e) such other information regarding each nominee proposed by such stockholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the Securities and Exchange Commission, had the nominee been nominated, or intended to be nominated, by the Board of Directors, provided that (i) such information does not in any way violate any applicable Securities and Exchange Commission regulation, including regulations concerning public availability of information, and (ii) any information withheld on such basis shall be provided by separate notice at such time as would not be in violation of any applicable Securities and Exchange Commission regulation, such notice to be a supplement to the notice otherwise required herein; (f) the class and number of shares of the Company which are beneficially owned by the stockholder; and (g) the signed consent of each nominee to serve as a director of the Company if so elected.

Section 3. If the Chairman of the meeting for the election of Directors determines that a nomination of any candidate for election as a director at such meeting was not made in accordance with the applicable provisions of these By-laws, such nomination shall be void.

Section 4. The Board of Directors may adopt such special rules and regulations for the conduct of their meetings and the management of the affairs of the Company as they may determine to be appropriate, not inconsistent with law or these By-laws.

Section 5. A regular meeting of the Board of Directors shall be held as soon as practicable after the annual meeting of stockholders in each year. In addition, regular quarterly meetings of the Board may be held at the general offices of the Company in Kentucky, or at such other place as shall be specified in the notice of such meeting on the last Monday of January, July and October in each year. Written notice of every regular meeting of the Board, stating the time of day at which such meeting will be held, shall be given to each Director not less than two days prior to the date of the meeting. Such notice may be given personally in writing, or by telegraph or other written means of electronic communication, or by depositing the same, properly addressed, in the mail.

Section 6. Special meetings of the Board may be called at any time by the Chairman of the Board, or the President, or by a Vice-President when acting as President, or by any two Directors. Notice of such meeting, stating the place, day and hour of the meeting shall be given to each Director not less than one day prior to the date of the meeting. Such notice may be given personally in writing, or by telegraph or other written means of electronic communication, or by depositing the same, properly addressed, in the mail.

Section 7. Notice of any meeting of the Board may be waived by any Director.

Section 8. A majority of the Board of Directors shall constitute a quorum for the transaction of business at any meeting of the board, but a less number may adjourn the meeting to some other day or sine die. The Board of Directors shall keep minutes of their proceedings at their meetings. The members of the Board may be paid such fees or compensations for their services as Directors as the Board, from time to time, by resolution, may determine.

Section 9. The Chairman of the Board, if such person is present, shall serve as Chairman at each regular or special meeting of the Board of Directors and shall determine the order of business at such meeting. If the Chairman of the Board is not present at a regular or special meeting of the Board of Directors, the Vice Chairman of the Board shall serve as Chairman of such meeting and shall determine the order of business of such meeting. The Board of Directors may elect one of its members as Vice Chairman of the Board.

ARTICLE IV

COMMITTEES

Section 1. The Board of Directors may, by resolution passed by a majority of the whole Board, appoint an Executive Committee of not less than three members of the Board, including the Chairman of the Board, if there be one, and the President of the Company. The Executive Committee may make its own rules of procedure and elect its Chairman, and shall meet where and as provided by such rules, or by resolution of the Board of Directors. A majority of the members of the Committee shall constitute a quorum for the transaction of business. During the intervals between the meetings of the Board of Directors, the Executive Committee shall have all the powers of the Board in the management of the business and affairs of the Company except as limited by statute, including power to authorize the seal of the Company to be affixed to all papers which require it, and, by majority vote of all its members, may exercise any and all such powers in such manner as such Committee shall deem best for the interests of the Company, in all cases in which specific directions shall not have been given by the Board of Directors. The Executive Committee shall keep regular minutes of its proceedings and report the same to the Board at meetings thereof.

Section 2. The Board of Directors may appoint other committees, standing or special, from time to time from among their own number, or otherwise, and confer powers on such committees, and revoke such powers and terminate the existence of such committees at its pleasure.

Section 3. Meetings of any committee may be called in such manner and may be held at such times and places as such committee may by resolution determine, provided that a meeting of any committee may be called at any time by the Chairman of the Board or by the President. Notice of such meeting, stating the place, day and hour of the meeting shall be given to each Director not less than one day prior to the meeting. Such notice may be given personally in writing, or by telegraph or other written means of electronic communication, or by depositing the same, properly addressed, in the mail. Members of all committees may be paid such fees for attendance at meetings as the Board of Directors may determine.

ARTICLE V

OFFICERS

Section 1. The officers of the Company shall be a Chief Executive Officer, President, Chief Operating Officer, Chief Financial Officer, Chief Administrative Officer, one or more Vice Presidents, Secretary, Treasurer, Controller or such other officers (including, if so directed by a resolution of the Board of Directors, the Chairman of the Board) as the Board or the Chief Executive Officer may from time to time elect or appoint. Any two of the offices may be combined in one person, but no officer shall execute, acknowledge, or verify any instrument in more than one capacity. If practicable, officers are to be elected or appointed by the Board of Directors or the Chief Executive Officer at the first meeting of the Board following the annual meeting of stockholders and, unless otherwise specified, shall hold office for one year or until their successors are elected and qualified. Any vacancy shall be filled by the Board of Directors or the Chief Executive Officer. Except as provided below, officers shall perform those duties usually incident to the office or as otherwise required by the Board of Directors, the Chief Executive Officer, or the officer to whom they report. An officer may be removed with or without cause and at any time by the Board of Directors or by the Chief Executive Officer.

Section 2. The Chief Executive Officer of the Company shall have full charge of all of the affairs of the Company and shall report directly to the Board of Directors.

Section 3. The President, should that office be created and filled, shall exercise such functions as may be delegated by the Chief Executive Officer and shall exercise the functions of the Chief Executive Officer during the absence or disability of the Chief Executive Officer.

Section 4. The Chief Operating Officer, should that office be created and filled, shall have responsibility for the management and direction of the Company, subject to the direction and approval of the Chief Executive Officer.

Section 5. The Chief Financial Officer, should that office be created and filled, shall have responsibility for the financial affairs of the Company, including maintaining accurate books and records, meeting all financial reporting requirements and controlling Company funds, subject to the direction and approval of the Chief Executive Officer.

Section 6. The Chief Administrative Officer, should that office be created and filled, shall have responsibility for the general administrative and human resources operations of the Company, subject to the direction and approval of the Chief Executive Officer.

Section 7. The Vice President or Vice Presidents, should such offices be created and filled, may be designated as Vice President, Senior Vice President or Executive Vice President, as the Board of Directors or Chief Executive Officer may determine.

Section 8. The Secretary shall be present at and record the proceedings of all meetings of the Board of Directors and of the stockholders, give notices of meetings of Directors and stockholders, have custody of the seal of the Company and affix it to any instrument requiring the same, and shall have the power to sign certificates for shares of stock of the Company.

Section 9. The Treasurer, should that office be created and filled, shall have responsibility for all receipts and disbursements of the Company and be custodian of the Company's funds.

Section 10. The Controller, should that office be created and filled, shall have responsibility for the accounting records of the Company.

ARTICLE VI

MISCELLANEOUS

Section 1. The funds of the Company shall be deposited to its credit in such banks or trust companies as are selected by the Treasurer, subject to the approval of the chief executive officer. Such funds shall be withdrawn only on checks or drafts of the Company for the purpose of the Company, except that such funds may be withdrawn without the issuance of a check or draft (a) to effect a transfer of funds between accounts maintained by the Company at one or more depositaries; (b) to effect the withdrawal of funds, pursuant to resolution of the Board of Directors, for the payment of either commercial paper promissory notes of other entities or government securities purchased by the Company; (c) to effect a withdrawal of funds by the Company pursuant to the terms of any agreement or other document, approved by the Board of Directors, which requires or contemplates payment or payments by the Company by means other than a check or draft; or (d) to effect a withdrawal of funds for such other purpose as the Board of Directors by resolution shall provide. All checks and drafts of the Company shall be signed in such manner and by such officer or officers or such individuals as the Board of Directors, from time to time by resolution, shall determine. Only checks and drafts so signed shall be valid checks or drafts of the Company.

Section 2. No debt shall be contracted except for current expenses unless authorized by the Board of Directors or the Executive Committee, and no bills shall be paid by the Treasurer unless audited and approved by the Controller or some other person or committee expressly authorized by the Board of Directors or the Executive Committee, to audit and approve bills for payment. All notes of the Company shall be executed by two different officers of the Company. Either or both of such executions may be by facsimile.

Section 3. The fiscal year of the Company shall close at the end of December annually.

ARTICLE VII

INDEMNIFICATION OF DIRECTORS, OFFICERS, EMPLOYEES AND AGENTS

Section 1. Unless prohibited by law, the Company shall indemnify each of its Directors, officers, employees and agents against expenses (including attorneys fees), judgments, taxes, fines and amounts paid in settlement, incurred by such person in connection with, and shall advance expenses (including attorneys fees) incurred by such person in defending any threatened, pending or completed action, suit or proceeding (whether civil, criminal, administrative or investigative) to which such person was, is, or is threatened to be made a party by reason of the fact that such person is or was a Director, officer, employee or agent of another domestic or foreign corporation, partnership, joint venture, trust, other enterprise, or employee benefit plan. Advancement of expenses shall be made upon receipt of a written statement of his good faith belief that he has met the standard of conduct as required by statute and a written undertaking, with such security, if any, as the Board may reasonably require, by or on behalf of the person seeking indemnification, to repay amounts advanced if it shall ultimately be determined that such person is not entitled to be indemnified by the Company.

Section 2. In addition (and not by way of limitation of) the foregoing provisions of Section 1 of this Article VII and the provisions of the Kentucky Business Corporation Act, each person (including the heirs, executors, administrators and estate of such person) who is or was or had agreed to become a Director, officer, employee or agent of the Company and each person (including the heirs, executors, administrators and estate of such person) who is or was serving or who had agreed to serve at the request of the Directors or any officer of the Company as a Director, officer, employee, trustee, partner or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise shall be indemnified by the Company to the fullest extent permitted by the Kentucky Business Corporation Act or any other applicable laws as presently or hereafter in effect. Without limiting the generality or the effect of the foregoing, the Company is authorized to enter into one or more agreements with any person which provide for indemnification greater or different than that provided in this Article VII. Any repeal or modification of this Article by the stockholders of the Company shall not adversely affect any indemnification of any person hereunder in respect of any act or omission occurring prior to the time of such repeal or modification.

Section 3. The Company may purchase and maintain insurance on behalf of any person who is or was entitled to indemnification as described above, whether or not the Company would have the power or duty to indemnify such person against such liability under this Article VII or applicable law.

Section 4. To the extent required by applicable law, any indemnification of, or advance of expenses to, any person who is or was entitled to indemnification as described above, if arising out of a proceeding by or in the right of the Company, shall be reported in writing to the stockholders with or before the notice of the next stockholder' meeting.

Section 5. The indemnification provided by this Article VII: (a) shall not be deemed exclusive of any other rights to which the Company's Directors, officers, employees or agents may be entitled pursuant to the Articles of Incorporation, any agreement of indemnity, as a matter of law or otherwise; and (b) shall continue as to a person who has ceased to be a Director, officer, employee or agent and shall inure to the benefit of such person's heirs, executors and administrators.

ARTICLE VIII

AMENDMENT OR REPEAL OF BY-LAWS

These By-laws may be added to, amended or repealed at any meeting of the Board of Directors, and may also be added to, amended or repealed by the stockholders.

o:\board\corp\corp-doc\kentucky utilities bylaws.doc

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 2

Responding Witness: Christopher M. Garrett

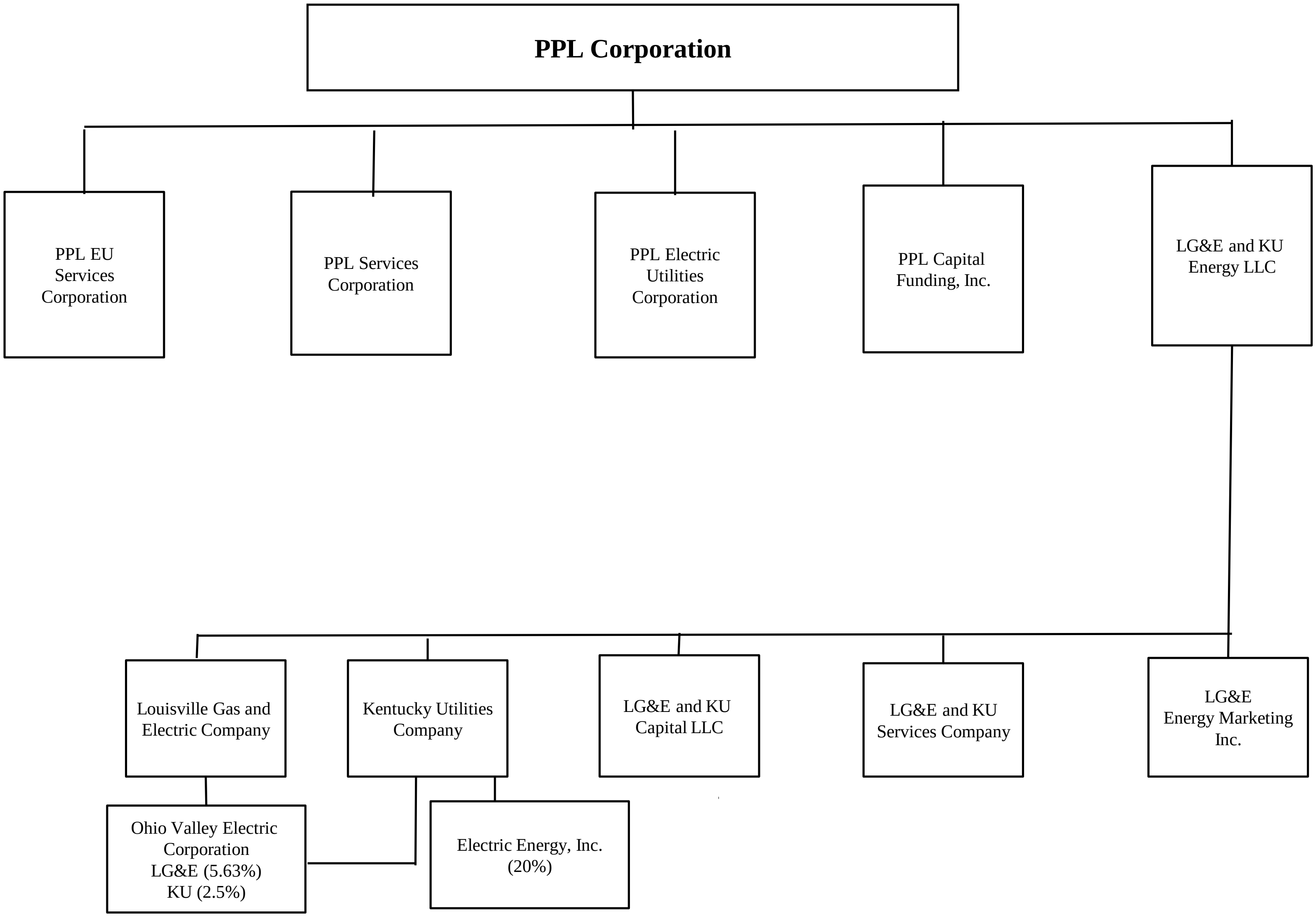
Q-2. Provide the current organization chart, showing the relationship between the utility and any affiliates, divisions, etc. Show the relative positions of all entities and affiliates with which the utility routinely has business transactions.

A-2. A current organization chart is attached showing the relationship from KU to its ultimate parent company, PPL Corporation ("PPL"). The chart also shows relationships with PPL and LG&E and KU Energy LLC entities and affiliates with which KU routinely has business transactions, namely:

- LG&E and KU Energy LLC ("LKE") – Parent company of KU and wholly owned subsidiary of PPL.
- Louisville Gas and Electric Company ("LG&E") – Electric and gas utility subsidiary of LKE and sister utility company of KU.
- LG&E and KU Services Company ("LKS") – Centralized service company as permitted under FERC rules and regulations and a wholly owned subsidiary of LKE. Also acts as payment agent for certain transactions for LKE affiliates.
- LG&E and KU Capital LLC – Non-regulated holding company and wholly owned by LKE.
- LG&E Energy Marketing, Inc. – Inactive power marketing company and wholly owned by LKE.
- Electric Energy, Inc. – An entity that owns and operates a coal-fired plant and a natural gas facility in which KU owns a 20% interest. KU has no business transactions with Electric Energy, Inc.
- Ohio Valley Electric Corporation – An entity that owns and operates two coal-fired power plants in which KU owns a 2.5% stockholder interest. LG&E is also a stockholder in OVEC.
- PPL Corporation – Parent company of LKE and parent of U.S. income tax filing group.
- PPL Electric Utilities Corporation – Electric utility and a wholly owned subsidiary of PPL.
- PPL Services Corporation – Centralized service company of PPL that provides administrative, management and support services to PPL and its subsidiaries.

- PPL EU Services Corporation – Centralized service company of PPL as permitted under FERC rules and regulations that provides support primarily to PPL Electric Utilities Corporation.
- PPL Capital Funding, Inc. – a subsidiary of PPL. Provides letter of credit services for PPL affiliates.

Corporate Organizational Chart (Extract)
October 2018



Entities/affiliates with which utility has routine transactions. (Electric Energy Inc. shown for completeness only.)

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 3

Responding Witness: Daniel K. Arbough

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

A-3. See attached.

Kentucky Utilities Company
Case No. 2018-00294

Question No. 3

Responding Witness: Daniel K. Arbough

Comparative Capital Structures (Excluding JDIC)
For the Periods as Shown
"000 Omitted"

Schedule 3a

		2008		2009		2010		2011		2012	
Line No.	Type of Capital	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1	Long-Term Debt	$ 1,513,752	46.24%	$ 1,630,952	44.55%	$ 1,806,360	46.41%	$ 1,807,216	45.92%	$ 1,810,590	44.62%
2	Short-Term Debt	16,247	0.50%	77,975	2.13%	10,434	0.27%	-	0.00%	69,992	1.73%
3	Preferred Stock	-	0.00%	-	0.00%	-	0.00%	-	0.00%	-	0.00%
4	Common Equity	1,743,493	53.26%	1,951,966	53.32%	2,075,467	53.32%	2,128,238	54.08%	2,176,783	53.65%
5	Other	-	-	-	-	-	-	-	-	-	-
6	Total Capitalization	$ 3,273,492	100.00%	$ 3,660,893	100.00%	$ 3,892,261	100.00%	$ 3,935,454	100.00%	$ 4,057,365	100.00%

		2013		2014		2015		2016		2017		Latest Available Quarter 06/30/2018	
Line No.	Type of Capital	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
1	Long-Term Debt	$ 2,060,555	44.33%	$ 2,062,562	42.11%	$ 2,311,299	45.87%	$ 2,313,016	45.84%	$ 2,315,328	45.31%	$ 2,316,551	44.07%
2	Short-Term Debt	149,967	3.23%	235,592	4.81%	47,997	0.95%	15,999	0.32%	44,958	0.88%	133,430	2.54%
3	Preferred Stock	-	0.00%	-	0.00%	-	0.00%	-	0.00%	-	0.00%	-	0.00%
4	Common Equity	2,437,296	52.44%	2,599,430	53.08%	2,679,353	53.18%	2,716,575	53.84%	2,749,497	53.81%	2,806,866	53.39%
5	Other	-	-	-	-	-	-		-		-	-	-
6	Total Capitalization	$ 4,647,818	100.00%	$ 4,897,584	100.00%	$ 5,038,649	100.00%	$ 5,045,590	100.00%	$ 5,109,783	100.00%	$ 5,256,847	100.00%

Note: Total long-term debt includes the short-term portion of long-term debt.
Numbers may not foot to total due to rounding.

Kentucky Utilities Company
Case No. 2018-00294

Question No. 3

Responding Witness: Daniel K. Arbough

Calculation of Average Capital Structure
12 Months Ended December 31, 2017
"000 Omitted"

Schedule 3b

Line No.	Item (a)	Total Capital (b)	Long-Term Debt (c)	Long-Term	Unamortized Debt Expesne	Unamortized Loss	Short-Term Debt (d)	Preferred Stock (f)	Common Stock (g)	Retained Earnings (h)	Total Common Equity (i)
1	Beginning Balance	5,045,590	2,313,016	2,341,674	(19,222)	(9,436)	15,999	-	889,864	1,826,711	2,716,575
2	Jan-17	5,080,233	2,312,931	2,341,716	(19,404)	(9,381)	23,000	-	889,864	1,854,438	2,744,302
3	Feb-17	5,024,552	2,313,163	2,341,758	(19,263)	(9,332)	17,999	-	889,864	1,803,526	2,693,390
4	Mar-17	5,059,713	2,313,437	2,341,804	(19,088)	(9,279)	35,996	-	891,677	1,818,603	2,710,280
5	Apr-17	5,065,343	2,313,699	2,341,848	(18,922)	(9,227)	25,998	-	891,677	1,833,969	2,725,646
6	May-17	5,054,894	2,313,977	2,341,894	(18,745)	(9,172)	37,998	-	891,677	1,811,242	2,702,919
7	Jun-17	5,090,795	2,314,245	2,341,938	(18,573)	(9,120)	50,991	-	891,677	1,833,882	2,725,559
8	Jul-17	5,094,035	2,314,522	2,341,984	(18,396)	(9,066)	24,000	-	891,677	1,863,836	2,755,513
9	Aug-17	5,036,253	2,314,797	2,342,029	(18,220)	(9,012)	-	-	891,677	1,829,779	2,721,456
10	Sep-17	5,056,720	2,314,610	2,342,074	(18,504)	(8,960)	-	-	891,677	1,850,433	2,742,110
11	Oct-17	5,070,603	2,314,872	2,342,119	(18,332)	(8,915)	-	-	891,677	1,864,054	2,755,731
12	Nov-17	5,034,382	2,315,095	2,342,164	(18,198)	(8,871)	-	-	891,677	1,827,610	2,719,287
13	Dec-17	5,109,782	2,315,328	2,342,209	(18,055)	(8,826)	44,957	-	891,677	1,857,820	2,749,497
14	Total	65,822,895	30,083,692				276,938	-	11,586,362	23,875,903	35,462,265
15	Average Balance	5,063,300	2,314,130				21,303	-	891,259	1,836,608	2,727,867
16	Average Capitalization Ratios		45.70%				0.42%	0.00%	17.60%	36.27%	53.88%
17	End-of-period Capitalization Ratios		45.31%				0.88%	0.00%	17.45%	36.36%	53.81%

Note: (1) Common Stock (g) includes Common Stock, Common Stock Expense, Paid in Capital, and Other Comprehensive Income.
Numbers may not foot to total due to rounding.

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 4

Responding Witness: Daniel K. Arbough

Q-4. Provide the following:

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

b. An analysis of short-term debt as shown in Schedule 4b as of the end of the latest calendar year.

A-4.

a. See attached.

b. See attached.

Kentucky Utilities
Case No. 2018-00294

Question No. 4a

Responding Witness: Daniel K. Arbough

Schedule of Outstanding Long-Term Debt
For the Year Ended December 31, 2017

Schedule 4a

Line No.	Type of Debt Issue (a)	Date of Issue (b)	Date of Maturity (c)	Amount Outstanding (5) (d)	Coupon Interest Rate (1) (e)	Cost Rate at Issue (2) (f)	Cost Rate at Maturity at 12/31/2017 (3) (g)	Bond Rating at Issuance (4) (h)	Type of Obligation (i)	Annualized Cost Col. (d) x Col. (g) (j)
1	Pollution Control Bond (Variable Rate)	5/19/2000	5/1/2023	12,900,000	1.630%	1.630%	2.750%	AAA; Aaa	Secured	$ 354,699
2	Pollution Control Bond (Variable Rate)	5/23/2002	2/1/2032	20,930,000	1.250%	1.250%	1.542%	A-/A2; A1/P-1	Secured	322,839
3	Pollution Control Bond (Variable Rate)	5/23/2002	2/1/2032	2,400,000	1.250%	1.250%	1.638%	A-/A2; A1/P-1	Secured	39,311
4	Pollution Control Bond (Variable Rate)	5/23/2002	2/1/2032	2,400,000	1.250%	1.250%	1.934%	A-/A2; A1/P-1	Secured	46,405
5	Pollution Control Bond (Variable Rate)	5/23/2002	2/1/2032	7,400,000	1.050%	1.050%	1.364%	A-/A2; A1/P-1	Secured	100,967
6	Pollution Control Bond (Variable Rate)	10/20/2004	10/1/2034	50,000,000	1.700%	1.700%	2.670%	AAA; Aaa	Secured	1,334,878
7	Pollution Control Bond (Variable Rate)	2/23/2007	10/1/2034	54,000,000	1.740%	1.740%	2.608%	AAA; Aaa	Secured	1,408,222
8	Pollution Control Bond	5/24/2007	2/1/2026	17,875,000	5.750%	5.750%	5.936%	AAA; Aaa	Secured	1,061,133
9	Pollution Control Bond	5/24/2007	3/1/2037	8,927,000	6.000%	6.000%	6.180%	AAA; Aaa	Secured	551,685
10	Pollution Control Bond (Variable Rate)	10/17/2008	2/1/2032	77,947,405	1.730%	1.730%	2.650%	BBB+/A-2; A2/VMIG 1	Secured	2,065,753
11	Pollution Control Bond (Put Rate)	8/25/2016	9/1/2042	96,000,000	1.050%	1.050%	1.501%	A; A1	Secured	1,440,791
12	First Mortgage Bond	11/16/2010	11/1/2020	499,462,301	3.250%	3.288%	3.376%	A; A2	Secured	16,859,554
13	First Mortgage Bond	11/16/2010	11/1/2040	743,798,159	5.125%	5.161%	5.238%	A; A2	Secured	38,958,710
14	First Mortgage Bond	11/14/2013	11/15/2043	248,447,874	4.650%	4.674%	4.175%	A-; A2	Secured	10,371,820
15	First Mortgage Bond	9/28/2015	10/1/2025	249,916,787	3.300%	3.304%	3.948%	A; A1	Secured	9,867,539
16	First Mortgage Bond	9/28/2015	10/1/2045	249,808,137	4.375%	4.378%	4.810%	A; A1	Secured	12,016,314
17	Revolving Credit Facility									890,389
18	Letter of Credit Facility									177,214
19	Called Bond Expense									5,821
20										
21										
22	Total Long-Term Debt and Annualized Cost			$ 2,342,212,662						$ 97,874,043
23										
24	Annualized Cost Rate (Total col (j) / Total Col. (d))			4.179%						

(1) Nominal Rate. (For Variable Rate Bonds - Nominal Rate is interest rate as of 12/31/2017)
(2) Nominal Rate Plus Discount or Premium Amortization
(3) Nominal Rate Plus Discount or Premium Amortization and Issuance and Credit Enhancement Cost
(4) Standard and Poor's / Moody's
(5) Bonds are shown net of discount.

Kentucky Utilities Company
Case No. 2018-00294

Question No. 4b

Responding Witness: Daniel K. Arbough

Schedule of Outstanding Short-Term Debt
For the 12 Months Ended December 31, 2017

Line No.	Type of Debt Instrument (a)	Date of Issue (b)	Date of Maturity (c)	Amount Outstanding (d)	Nominal Interest Rate (e)	Effective Interest Rate (f)	Annualized Interest Cost Col. (f) x Col. (d) (g)
1	Commercial Paper Program	Various	Various	$ 44,957,426	Various	1.999%	$ 898,834
2	Total Short-Term Debt and Annualized Cost			$ 44,957,426			$ 898,834
3	Annualized Cost Rate (Total col (g) / Total Col. (d))			1.999%			
4	Actual Interest Paid or Accrued on Short-Term Debt During the Year						226,694
5	Average Short-Term Debt, Test-Year						18,580,719
6	Test-Year Interest Cost Rate (Actual Interest / Average Short-Term Debt)						1.220%

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 5

Responding Witness: Daniel K. Arbough

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

A-5. There were no outstanding issues of preferred stock during the twelve months ended December 31, 2017.

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 6

Responding Witness: Daniel K. Arbough

Q-6. Provide the following:

a. List all issues of common stock in the primary market during the ten most recent calendar years as shown in Schedule 6a.

b. The common stock information on a quarterly and yearly basis for the five most recent calendar years available, and through the latest available quarter as shown in Schedule 6b.

c. The market prices for common stock for each month during the five most recent calendar years and for succeeding months through the date the application is filed. List all stock splits and stock dividends by date and type.

A-6.

a. There were no issues of KU common stock during the 10 most recent calendar years.

b. See attached schedule.

c. All KU outstanding common stock is held by LG&E and KU Energy LLC, is not listed on a stock exchange, and thus does not have a market price. There have been no stock splits or stock dividends during the five most recent calendar years and for the succeeding months through the date the application is filed.

Kentucky Utilities
Case No. 2018-00294

Question No. 6b

Responding Witness: Daniel K. Arbough

Quarterly and Annual Common Stock Information
For the Periods as shown

Period Equity	Average Number of Shares Outstanding	Book Value ($)	Earnings Per Share (1) ($)	Dividend Rate per Share (2) ($)	Return on Average Common (3) (%)
2013 Calendar Year:					
1st Quarter	37,817,878	308,139,978	1.70	0.34	2.89%
2nd Quarter	37,817,878	308,139,978	1.14	1.11	1.88%
3rd Quarter	37,817,878	308,139,978	1.67	0.74	2.70%
4th Quarter	37,817,878	308,139,978	1.52	1.08	2.40%
Annual	37,817,878	308,139,978	6.03	3.28	9.85%
2014 Calendar Year:					
1st Quarter	37,817,878	308,139,978	2.02	0.98	3.08%
2nd Quarter	37,817,878	308,139,978	1.07	1.30	1.61%
3rd Quarter	37,817,878	308,139,978	1.47	0.69	2.18%
4th Quarter	37,817,878	308,139,978	1.24	0.95	1.82%
Annual	37,817,878	308,139,978	5.80	3.91	8.67%
2015 Calendar Year:					
1st Quarter	37,817,878	308,139,978	2.07	0.79	2.98%
2nd Quarter	37,817,878	308,139,978	1.03	1.35	1.47%
3rd Quarter	37,817,878	308,139,978	1.90	0.66	2.70%
4th Quarter	37,817,878	308,139,978	1.17	1.24	1.65%
Annual	37,817,878	308,139,978	6.17	4.05	8.81%
2016 Calendar Year:					
1st Quarter	37,817,878	308,139,978	1.98	1.69	2.79%
2nd Quarter	37,817,878	308,139,978	1.45	1.30	2.03%
3rd Quarter	37,817,878	308,139,978	2.06	2.22	2.87%
4th Quarter	37,817,878	308,139,978	1.53	1.35	2.13%
Annual	37,817,878	308,139,978	7.02	6.56	9.82%
2017 Calendar Year:					
1st Quarter	37,817,878	308,139,978	1.64	1.85	2.28%
2nd Quarter	37,817,878	308,139,978	1.46	1.06	2.03%
3rd Quarter	37,817,878	308,139,978	2.05	1.61	2.84%
4th Quarter	37,817,878	308,139,978	1.65	1.45	2.27%
Annual	37,817,878	308,139,978	6.80	5.98	9.42%
2018 Calendar Year:					
1st Quarter	37,817,878	308,139,978	2.32	2.09	3.19%
2nd Quarter	37,817,878	308,139,978	1.60	1.51	2.18%

(1) Kentucky Utilities Company does not report earnings per share numbers, these are calculated for this response.

(2) LG&E and KU Energy LLC (LKE) is Kentucky Utilities Company's sole shareholder. Kentucky Utilities Company pays dividends to LKE.

(3) Return on average common equity is calculated using two point average for quarterly calculations and five point average of common equity for annual calculations.

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 7

Responding Witness: Daniel K. Arbough

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

A-7. The calculation of the fixed charge coverage ratio using the Securities and Exchange Commission method is attached.

Kentucky Utilities Company
Case No. 2018-00294

Question No. 7

Responding Witness: Daniel K. Arbough

Computation of Fixed Charge Coverage Ratios
For the Periods as Shown
"000,000 Omitted"

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Earnings:										
Net income	157	133	175	178	137	228	220	234	265	259
Additions										
Federal income taxes - current	46	(5)	59	(8)	(20)	51	(95)	(21)	31	-
State income taxes - current	10	1	12	4	(1)	12	6	1	5	7
Federal income taxes - deferred	(9)	43	24	101	91	63	212	143	110	138
State income taxes - deferred	(3)	7	3	10	11	8	14	19	19	16
Investment tax credit	25	21	-	(3)	(3)	(2)	(2)	(2)	(2)	(2)
Mark to market impact of derivative instruments	(1)	1	-	-	-	-	-	-	-	-
Undistributed income of Electric Energy, Inc.	-	11	(4)	(1)	33	(1)	(1)	(1)	(1)	1
Fixed charges	77	79	82	73	72	73	80	86	100	100
Income Available for Fixed Charge Coverage	302	291	351	354	320	432	434	459	527	519
Fixed charges:										
Interest expense	74	76	79	70	69	70	77	82	96	96
Preferred Stock dividends per statements of income	-	-	-	-	-	-	-	-	-	-
Estimated interest component of operating rentals	3	3	3	3	3	3	3	4	4	4
Fixed Charges	77	79	82	73	72	73	80	86	100	100
Fixed Charge Coverage Ratio	**3.92**	**3.68**	**4.28**	**4.85**	**4.44**	**5.92**	**5.43**	**5.34**	**5.27**	**5.19**

KENTUCKY UTILITIES COMPANY

Response to Commission Staff's First Request for Information
Dated September 19, 2018

Case No. 2018-00294

Question No. 8

Responding Witness: Christopher M. Garrett

Q-8. Provide utility's internal accounting manuals, directives, and policies and procedures.

A-8. See attached.

Kentucky Utilities

Case No. 2018-00294

Internal Accounting Policies Index

Policy #	**Subject**
250	Balance Sheet Account Reconciliation
251	Journal Entries Policy
251	Journal Entries Policy Appendix A
253	Intercompany Billing and Settlement Policy
254	Consolidation Process Policy
255	Related Party Transactions
354	Materiality Policy
354	Materiality Policy Appendix A
354	Materiality Policy Appendix B
355	SEC Reporting Requirements
356	Subsequent Events Policy
357	Asset Liability Classification
358	Waived Adjustments
359	Financial Statements Disclosures and Filing Requirements
359	Appendix 1 Back Up Certification Organization Chart
450	Derivatives and Hedging
451	Contractual Review
452	Goodwill
454	Leases
455	Contingencies
456	Pension and Postretirement Plans
550	Chart of Accounts and GLAFF Updates
551	Oracle System Interface Balancing
552	EiS Governance Policy and Procedures
650	Capital Additions and Retirements Policies and Procedures
651	Capital AFUDC Policy and Procedures
651	AFUDC Appendix
652	Capital Asset Retirement Obligations Policy and Procedures
653	Capital Depreciation Policy
654	Asset Impairment
654	Impairment Questionnaire Part A
654	Impairment Questionnaire Part B
655	Capital Hardware and Software Capitalization
656	Capitalized Property Taxes
658	Joint Ownership-Use Assets
658	Appendix A LKE Allocation

660	Contract Retainage
750	Oracle Burdening Process
751	AP-Manual Accrual
751	Manual Accrual Appendix A
850	Form for Excess or Obsolete Inventory Reviews
850	Inventory Management
950	Spreadsheet Policy
953	Reserve for Bad Debts
954	Coal Inventory Valuation
959	Escheatment
960	Discounting
961	CSV of Key Man Life Insurance
962	Compliance with GAAP
963	Certain Investments in Debt and Equity Securities
964	Debt and Interest Risk Management
965	Century Receivable
966	Intracompany Interest
967	Prepaids
968	Discontinued Operations Policy
969	Liquidated Damages
970	Lower Cost and Net Realizable Inventory
971	Sundry Billing
1050	Purchase Accounting
1051	Emission Allowances
1055	Regulatory Assets and Liabilities
1055	Regulatory Asset Liability Policy Appendix A
1057	Guarantees
1058	Variable Interest Entities
1059	Unbilled Revenues
1060	Regulatory Compliance
1061	Renewable Energy Certificates
1150	Technical Research and Whitepapers
1150	Technical Research and Whitepapers Template
1151	Policy and Procedure Development & Maintenance
---	Tax Audits
---	Income Tax Provision
---	Tax Return Compliance
---	Sales and Use Tax

250 - Balance Sheet Account Reconciliation

(Note: Text in italics indicates a key SOX control.)

Policy: All LG&E and KU Energy LLC ("LKE" or the "Company") (including its subsidiaries) balance sheet accounts will be reconciled and reviewed at least quarterly.

Procedure: The balance sheet reconciliation procedure is performed per the detailed instructions below.

Scope: All Company balance sheet accounts (referenced as simply "accounts" in the remainder of this policy), other than accounts belonging to Oracle consolidation companies since they have mitigating controls (see cycle/transaction 80.07 Control Activity 2 in the Sarbanes-Oxley Compliance documentation) and since Hyperion Financial Management is the system of record for consolidation.

Objective of Procedure: The objective of reconciling balance sheet accounts is to detect any misclassifications or omissions made through journal entries or integrated systems within the balance sheet accounts and to ensure completeness and accuracy of the accounts. The procedure assists the accountants in identifying and investigating unusual items in the accounts. Assignment of accounts to be reconciled to specific accountants is made consistent with appropriate segregation of duties.

General Requirements:

Detailed Procedures Performed:

1. See the 354 – Materiality Policy for determining quantitative and qualitative measures for purposes of this policy.

2. All accounts[1] must be reviewed for reconciliation procedures:
   - All open accounts must be assigned on the account control listing to a department to ensure that reconciliations are performed or that accounts are open only because other companies need them. (If an account is open for one Oracle company, it must be open for all Oracle companies. In order to detect a coding error, open accounts that should have a zero balance must be verified.)
   - All closed accounts must be either analyzed or contain a zero balance. (Accounts in Oracle can be closed even if they have a balance. Closed accounts can be reopened, if necessary, to continue processing of other systems (e.g., PeopleSoft) where projects have been charged using a closed account in order to prevent delays during monthly closings.) Closed accounts requiring analysis will be included on the balance sheet reconciliation checklist.
   - *An account-level trial balance must be run monthly by Corporate Accounting to determine the completeness of the account control listing. (See cycle/transaction 080.05 Control Activity 9 in the Sarbanes-Oxley Compliance documentation.)* If the books are reopened

[1] Please note an exception exists for account activity and balances associated with the consolidation elimination companies. Management has determined that these company-account combinations do not need to be reconciled and do not have assigned risks or department owners.

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(Note: Text in italics indicates a key SOX control.)

after the control listing has been prepared, the balances in the control listing must be updated and the control listing re-balanced to ensure that it nets to zero when including the current year net income.

3. Periodically (annually at a minimum) all accounts meeting the criteria above will be reviewed to determine their risk ranking. The manager of the department assigned to each account will review the previous rankings and determine if they need to be changed. Both quantitative and qualitative factors will be used to determine an overall risk ranking to be applied to the account, as follows:

	High Risk	Medium Risk*	Low Risk
Material balance	Yes	Yes or No	No
Material activity	Yes	Yes or No	No
Material qualitative factor	Yes	Yes or No	No

*Any combination including both Yes's and No's is Medium Risk.

A **material balance** is defined as having greater absolute value than the threshold per the 354 – Materiality Policy identifying High-Risk or complex journal entries and key SOX controls, which is 1.75% of full year pretax income from LG&E, KU or LKE, from the current year budget/forecast as stated in the waived adjustment file for the most recent quarter ended at the time of the risk assessment. This materiality threshold will be stated in the risk assessment file and used to calculate risk level.

Material activity is defined as having average annual debits or average annual credits which are greater than the materiality threshold as defined above. The average annual debits and credits are calculated using the totals of the most recent twelve months' transactions as of the month used for the risk assessment, divided by 12[2].

Material qualitative factor is defined as the calculated average of the seven qualitative factors listed in the 354 – Materiality Policy (not including the "risk level of the account involved"), as ranked from 1 to 3, where the average is >2.5.

Managers may override the risks to a lower level than determined per the table above at their discretion, but must document the justification for their override in the risk assessment file. Overrides of High Risk must be approved via e-mail by the Director, Accounting and Regulatory Reporting or the Controller. Documentation of such approval must be retained in

[2] In the case of new accounts that have existed for less than twelve months, the average will be calculated based on the number of months the account has existed.

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(Note: Text in italics indicates a key SOX control.)

the folder where the risk assessment file is saved. Approval is required only when the initial override occurs and will be carried forward in subsequent updates to the file.

4. When new accounts are requested, an Account Segment Change Request Form is prepared. One section of that form is the qualitative risks (for balance sheet reconciliation ranking). New accounts are required to be ranked on a low, medium, high scale for seven criteria and an eighth segment asks if the account should be given a qualitative risk ranking of 3 (high) regardless of the responses to the seven preceding questions. These rankings are then entered into a master file detailing the rankings of all accounts by an Accounting Analyst in Corporate Accounting and the risk as determined is entered into Oracle by the Senior Accounting Systems Support Analyst.

5. Changes in financial statement classification for existing accounts also require an Account Segment Change Request Form. The risk section of the form must be completed for these changes. These rankings are then entered into a master file detailing the rankings of all accounts by an Accounting Analyst in Corporate Accounting and the risk as determined is entered into Oracle by the Senior Accounting Systems Support Analyst.

6. Subsequent to the risk assessment, managers may become aware of significant changes in the usage, activity and/or balance of an account which may indicate a change needed to the risk level. The manager should submit any needed changes in risk via e-mail to the Senior Accounting Systems Support Analyst who will make the changes in Oracle.

7. Managers must notify the reconciliation preparers of any change in risk.

8. A centralized control listing of all open balance sheet accounts will be created monthly by an Accounting Analyst in Corporate Accounting and saved to the shared drive fs1\acctpolicies\Account Recs Procedures. The Accounting Analyst will compare the total row count from all individual tabs against the total rows generated in the trial balance above to ensure completeness. The listing will contain (at a minimum) the account number, the account description, the current month balance, the department name, the reviewer's initials and date reviewed, the U.S. GAAP financial statement line item and the FERC (Utility) financial statement line item. Optional columns for the preparer's initials and date prepared will also be included. This listing will identify accounts according to their risk, per Item 3 above:
   - *High – These accounts must be reconciled before noon on the 7th work day. Reviews must be completed by noon on the 7th work day of each month following the quarter end and by the 9th work day of each month following non-quarter-end months.*
   - *Medium – These accounts must be reconciled and the reconciliation reviewed by the 14th work day of each month following the quarter end and by the last working day following non-quarter-end months.*

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(Note: Text in italics indicates a key SOX control.)

- *Low – These accounts must be reconciled and the reconciliation reviewed at least quarterly by the end of the month following the quarter end, or by one working day prior to the issue date of the 10-Q or 10-K, whichever is sooner, except for bank reconciliations which must be reconciled and reviewed monthly per the Cash Reconciliation Policy. However, for reconciliations not complete by the 14th work day following quarter end, a review of the balance must take place with documentation of such review signed and dated by an Accounting Analyst or Associate in each department and then attached to the final reconciliation when it is complete.* Low risk accounts will be marked with "N/A" in the non-quarter-end months. However, if a preparer wishes to prepare them on a non-quarter, the "N/A" can be overridden.

(See cycle/transaction 080.05 Control Activity 9 in the Sarbanes-Oxley Compliance documentation.)

For zero-balance accounts (other than ZBA bank accounts), a reconciliation does not have to be prepared separately, but only require a reviewer's sign-off on the checklist to confirm that the balance is zero and should be zero, quarterly. (See cycle/transaction 080.05 Control Activity 9 in the Sarbanes-Oxley Compliance documentation.)

All account reconciliations, including the process for zero-balance accounts, must be completed and reviewed by the end of the month following the quarter-end, or by one working day prior to the issue date of the 10-Q or 10-K, whichever is sooner. *The checklist is reviewed monthly for completeness, with resolution of any open items needed to complete the checklist by the last business day of each month, or by one working day prior to the issue date of the 10-Q or 10-K, whichever is sooner. (See cycle/transaction 080.05 Control Activity 9 in the Sarbanes-Oxley Compliance documentation.)*

9. The Accounting Analyst or Associate responsible for the reconciliation will review the monthly transactions in each active balance sheet account and prepare a reconciliation of the account. Reconciling items must be evaluated and resolved in a timely manner.

10. *Reconciliations will be maintained in hard copy in a file or binder and contain the following elements, at a minimum* (alternative formats may be appropriate, but these elements must still be contained on each reconciliation): *(See cycle/transaction 080.05 Control Activity 9 in the Sarbanes-Oxley Compliance documentation*.)
    - *The company name;*
    - *The month;*
    - *The general ledger account name;*
    - *The general ledger account number;*
    - *A brief description of the account and its use;*
    - *The ending balance per the general ledger,*
    - *Support of the general ledger balance.* The best, most independent source should be used:

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(Note: Text in italics indicates a key SOX control.)

i. Examples include – subsidiary ledgers, bank statements, support prepared by other departments, source documentation from other systems, invoices, contracts, or rate orders; or

ii. In cases where the balance cannot be tied to a specific source, evidence of analysis of what makes up the account balance, ensuring that the transactions in the account appear to be reasonable.

iii. Electronic evidence which is used to calculate, develop or support the amounts in the SEC financial statements, including disclosures and Management's Discussion and Analysis, must be provided to document the following:
   - Verification of query parameters for reports run from an IT system to document time periods, accounts, business unit, etc. used as parameters;
   - Tie out to an independent source, when available and appropriate;
   - Tie out to a general ledger balance, when available and appropriate; and/or
   - Changes made to source data downloaded from an IT system.
      - When multiple queries are exported to a spreadsheet, each query, in its original form, must be included on a tab in the spreadsheet and a lead sheet must be used to perform relevant calculations from those tabs.
      - See also PPL's guidance regarding Electronic Evidence Requirements.

- Evidence of reconciliation of the ending balance per the general ledger to the supporting documentation. The preparer must also agree the ending balance per the general ledger to the balance on the control listing. *The reconciling items, individually listed*, including a detailed explanation of the item, whether the item is the result of an error (errors must be evaluated based on the 354 - Materiality Policy), a status update of the last action taken and the date the item is expected to be resolved;
- The source of all amounts presented on the reconciliation;
- Column headings and line item descriptions for all data presented;
- The file path and file name; and
- The sign-off and date signed for both the preparer and the reviewer. (The reviewer will generally be the responsible manager or a delegate assigned by the manager). The reviewer's sign-off indicates that the balance sheet reconciliation was completed according to the requirements listed above and that the balance on the reconciliation ties to the control listing.

In addition, the following items are required for high risk reconciliations:

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(Note: Text in italics indicates a key SOX control.)

- *An account overview describing how the account is used, a description of the activity recorded in the account and documentation of any triggering event that would cause an unusual adjustment to the account.*
- *Documentation that analysis of unusual activity and subledger data, if applicable, has been performed.*
- *Performance of trend analysis, if appropriate,* with fluctuations documented at least quarterly if there is a significant change in the account balance versus the expected balance. Thresholds should be determined based on the preparer's and reviewer's knowledge of the account activity. The EiS report "LKE High Risk BS Trending" may be used for this purpose.
- *Re-performance and documentation of critical calculations, if appropriate,* from spreadsheets without spreadsheet controls[3] used in the reconciliation. The rationale for calculations selected for testing must be documented.
- *Evidence of annual confirmation that support provided by a line of business has been vetted with appropriate personnel from the line of business and that its accounting use has been explained to them.*
    - Note: The accounting impact to ratemaking mechanisms is covered by other controls (e.g., the 3 month review of the Gas Supply Clause, the 6 month review of the Fuel Adjustment Clause, the 6 month and 2 year reviews of the Environmental Cost Recovery mechanism, the annual review of the Gas Line Tracker and Demand Side Management mechanism and the transmission rates from the municipal formula-based rate calculations)

NOTE: Electronic evidence is defined as reports, queries, spreadsheets, e-mails or other data generated by an IT application, reporting database or End User Computing Tool (EUCT) that is used in the performance of internal controls over financial reporting that are in the scope of the company's Sarbanes-Oxley assessment. EUCTs are applications that usually reside on an end user's desktop, and therefore are not traditionally subject to rigorous application and general computer controls. Microsoft Excel spreadsheets and Access databases are examples of common EUCTs.

11. *A manager or a delegate assigned by the manager will evaluate all unreconciled items or reconciling errors monthly to determine whether further action should be taken.* Reconciling items may be written off at the manager's discretion. Reconciling items requiring write off are to be appropriately documented and are subject to review and approval consistent with the limits contained in the Authority Limit Matrices.

12. *The preparer and reviewer must have requisite knowledge of the account* to ensure the balance is appropriate and reasonable, is properly classified, including either short-term or long-term,

[3] See the 950 – Spreadsheet Policy for more information on spreadsheet controls.

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(Note: Text in italics indicates a key SOX control.)

on the Balance Sheet, and is presented in accordance with GAAP, SEC and FERC and other regulatory guidance, as applicable. The reviewer must be an Analyst level or above.

13. Each calendar year, approximately mid-year, Corporate Accounting will perform the following process to affirm review of and compliance with the policies around journal entries and account reconciliations by all individuals who prepare such.
    - Corporate Accounting will contact HR to obtain from PeopleSoft a list of the current employees of the departments that prepare or review journal entries and account reconciliations.
    - Based on that list, Corporate Accounting will send to the members of those departments an email with a requested response date and voting buttons. The voting options will state:
        - I confirm that I have read and understand the 251 - Journal Entries Policy and the 250 – Balance Sheet Account Reconciliation Policy. I am in compliance with those policies and with the related SOX controls.
        - I have no duties related to the preparation or review of journal entries or account reconciliations.
    - Corporate Accounting will follow up with any members of those departments who do not respond.
    - Corporate Accounting will document and retain the responses in a checklist based on the initial PeopleSoft list.

Reports Generated and Recipients:

- Balance sheet reconciliations.
- Balance sheet reconciliation control listing on fs1\acctpolicies\Account Recs Procedures
- EiS report "LKE High Risk BS Trending"
- All reconciliations are stored on a shared drive accessible by all of the members of a given department.

Additional Controls or Responsibility Provided by Other Procedures:
None

Regulatory Requirements:
None

Reference:
Authority Limit Matrix Company Policy
Cash Reconciliation Company Policy
354 – Materiality Policy
950 – Spreadsheet Policy
Guidelines for Spreadsheets and Other End User Computing Tools (see PPL Policies directory on the acctrestricted drive)

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(Note: Text in italics indicates a key SOX control.)

Electronic Evidence Requirements (see PPL Policies directory on the acctrestricted drive)

Key Contact:
Manager, Corporate Accounting

Corresponding PPL Policy No. and Name:
200 – Analysis of Key Account

Administrative Responsibility:
Controller
Director, Accounting and Regulatory Reporting

Date created: 9/30/04
Dates revised: 10/29/04, 8/19/05, 12/02/05, 6/16/06, 4/8/09, 9/1/09, 4/20/11, 8/5/11, 3/4/13, 11/12/13, 12/17/13, 7/16/14, 8/27/14, 3/17/15, 3/11/16, 6/16/17

251 - Journal Entries Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: Manual journal entries are necessary to record transactions which are not included in the Oracle General Ledger via an automated interface, to record non-customer related transactions in the Customer Care Solution ("CCS"), and to record consolidation entries in the Hyperion Financial Management (HFM) system in order to complete the financial statements.

Procedure: Journal entries are prepared, entered and posted in Oracle, CCS and HFM by authorized personnel per the detailed instructions below.

Scope: Includes journal entries for companies on Oracle either uploaded via Application Desktop Integrator ("ADI") (with a source of Spreadsheet) or entered directly into Oracle (with a source of Manual), manual journal entries for companies on CCS and manual journal entries entered into HFM. Excludes automated journal entries created by interfaces, Oracle mass allocations and Oracle project allocations.

Objective of Procedure: Journal entries must be authorized, accurate, timely and complete.

General Requirements

Detailed Procedures Performed:

Two all-inclusive checklists are maintained by Corporate Accounting on a shared drive accessible to all departments. The "MMYY JE Checklist Standard.xlsx" file contains one tab each for standard Oracle journal entries (routine monthly entries), CCS standard entries (LG&E & KU only) and HFM entries. The "MMYY JE Checklist Non Standard.xlsx" file contains a non-standard journal entry tab (ad hoc, non-routine entries). The two checklists include the journal entry number, general description, the initials of the persons who prepared and approved the entry, the date posted, and optional comments. If a standard entry does not need to be completed for a certain month, this fact is indicated by "N/A".

Supporting documents needed to prepare journal entries are sent to or compiled by the department responsible for the entries. *Electronic evidence which is used to calculate, develop or support the amounts in the SEC financial statements, including disclosures and Management's Discussion and Analysis, must be provided to document the following:*

- *Verification of query parameters for reports run from an IT system to document time periods, accounts, business unit, etc. used as parameters;*
- *Tie out to an independent source, when available and appropriate;*
- *Tie out to a general ledger balance, when available and appropriate; and/or*
- *Changes made to source data downloaded from an IT system. (See cycle/transaction 080.05, Control Activity 1 in the Sarbanes Oxley Compliance documentation.)*

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(Note: Text in italics indicates a key SOX control.)

When multiple queries are exported to a spreadsheet, each query, in its original form, must be included on a tab in the spreadsheet and a lead sheet must be used to perform relevant calculations from those tabs.

Electronic evidence is defined as reports, queries, spreadsheets, e-mails or other data generated by an IT application, reporting database or End User Computing Tool (EUCT) that is used in the performance of internal controls over financial reporting that are in the scope of the company's Sarbanes-Oxley assessment. EUCTs are applications that usually reside on an end user's desktop, and therefore are not traditionally subject to rigorous application and general computer controls. Microsoft Excel spreadsheets and Access databases are examples of common EUCTs.

See also PPL's guidance regarding Electronic Evidence Requirements.

If the journal supporting documents contain confidential information, the documents will be maintained in the originating department and a footnote indicating the location of the documents will be contained on the lower left side of the journal.

Oracle Journal Entries:

Oracle journal entries are prepared using an ADI template spreadsheet unless the journal entry needs to be keyed directly into Oracle as an exception, as discussed below. The ADI template is a standard form which may not be changed without approval from the Manager, Corporate Accounting and the Senior Oracle Business Support Analyst. All journal entries must include a description of the transaction and/or the reason for the journal entry.

The ADI spreadsheet should contain the elements listed in Appendix A.

ADI journal entries are printed and all supporting documentation must be attached, such that a knowledgeable third party could understand the journal entry. If the supporting documentation is too voluminous to be attached or confidential, the entry shall state where the detailed information is maintained.

The journal entries are then uploaded into Oracle. Validation occurs at two stages. The first stage is based on General Ledger validation and prevents the journal entry from being uploaded to the interface table until all corrections are made to the ADI template. General Ledger validation includes the following: The category, source, currency, reversal period, and each account segment value are compared against tables containing valid and enabled lists of values. The accounting date is checked to ensure that it falls within an open period. Cross-validation rules control which account segment values can be used together. If the journal entry does not balance, a warning is given to the user who must correct the entry to be in balance. An unbalanced entry cannot be uploaded to Oracle.

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(Note: Text in italics indicates a key SOX control.)

The second stage of journal entry validation occurs against set-up values within the Project Accounting system and occurs after the journal entry is uploaded to the interface table. The system checks to ensure that the specified project and task numbers exist and are not closed. Also, the system compares the account segment values set up on the projects and tasks to the General Ledger account number on the same journal entry line to ensure that they match. In addition, certain accounts require a project and task and the system verifies that a project and task are entered for all journal entry lines containing the project-required accounts. Errors in this stage of the validation result in yellow warnings.

The person uploading the journal entry reviews the upload error report and if there are yellow warning errors, must query all journal entries under his user id and delete them from the interface table before correcting the errors and re-uploading. Therefore, it is recommended that only one journal entry be uploaded at a time with a review of the error report for each one before uploading the next one.

An additional validation occurs to ensure that intercompany lines on the journal entry are in balance by company and by intercompany segment, and that the expenditure orgs on these lines belong to the affiliate listed in the intercompany segment. Errors in this stage of the validation result in red warnings which automatically clear from the interface table.

After the journal entry is uploaded with no errors, the Concurrent ID number of the upload job is written on the appropriate line of the journal entry hard copy. The journal entry is then available for posting. The person selects the journal entries to be posted in Oracle, submits the posting job, and views the job on the Concurrent Requests screen. If the job does not complete successfully, the person who uploaded the journal entry views the job output report, corrects the errors, resubmits the posting job and checks the job output report again. When there are no errors, the Concurrent ID number of the posting job is written on the appropriate line of the hard copy of the journal entry.

On occasion, in order to correct errors, certain journal entries may need to be booked which override the validation between the General Ledger and the Project Accounting system. These entries are always non-standard entries and are therefore always reviewed and approved.

Managers are not to be the direct preparer of journal entries or journal entry support, except as authorized by their respective senior manager or officer.

Reversals of Journal Entries

Journal entries uploaded into Oracle may be reversed in Oracle by clicking the Reverse button on the journal entry, or they may be auto-reversed as a batch if they have been uploaded as Reversing with the Reversal Period specified. Entries posted in Oracle can be reversed in the current or the next accounting period. Entries should be reversed in Oracle instead of by

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(Note: Text in italics indicates a key SOX control.)

preparing a new manual reversing entry. Reversals of journal entries should be noted on the journal entry form by adding the following information to the footer section of the original copy of posted journal entry:

- Reversal Upload/Concurrent ID: The Concurrent ID number for the journal entry reversal job in Oracle must be written here when the reversal is successful.
- Posted By: The person posting the auto-reversal
- Date: The date the auto-reversal was posted
- Reversal Posted/Concurrent ID: The Concurrent ID number for the Oracle posting job (on the reversal) is written here after the job report is checked on-line to ensure that there are no posting errors.

In some cases the original copy of the posted journal entry may have already been imaged into Quest and sent to off-site storage. This most likely occurs when an entry has been posted in one period and is being reversed in a subsequent period and it was not known at the time of the posting of the original entry that it would be subsequently reversed. In these cases, a copy of the original entry and supporting documentation should be printed from Quest and the information addressed above included on the copy of the entry. If the reversing entry is not to be included in the support of a current period entry, the reversing entry should be separately logged on the checklist in a separate Reversal section at the bottom as “Reversal of [original journal entry number] and imaged into Quest.

Out of Period Adjustments and Reclassifications

Out-of-period adjustments are entries which pertain to and should have been booked in a different month. These adjustments may include reclassifications or other entries, including system entries which are out of scope for this policy. Preferably, these entries should be booked as separate non-standard journal entries using the “Prior Period Adjustment” journal category with the amounts and months they relate to clearly identified in the journal lines. In some situations, it may not be practical to separate an out-of-period adjustment component from a standard entry. In these situations, the out-of- period component along with the month(s) to which it pertains must be provided to the Regulatory Accounting and Reporting Department if LG&E or KU are affected. (Note that entries booked to an LKS allocable project will likely affect LG&E and KU when the charges are allocated.)

Reclassifications which are non-routine and non-recurring must not be added to a standard journal entry, but must be booked using a non-standard journal entry. The Manager, Financial Reporting must be notified of any significant reclassifications between financial statement line items which affect prior reporting periods if no update to the waived adjustments file is required.

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(Note: Text in italics indicates a key SOX control.)

The sign-off by the preparer and the reviewer of out-of-period and reclassification journal entries indicates an assessment of the potential Sarbanes-Oxley impact was performed (e.g., an adjustment not timely identified by an internal control could indicate a potential internal control deficiency) and any potential internal control deficiency was communicated to the Sarbanes-Oxley Compliance Department. The sign-off by the preparer and the reviewer also indicates the entry was placed in the waived adjustments file for the quarter if it was above the materiality threshold for consideration of waived adjustments.

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(Note: Text in italics indicates a key SOX control.)

High-Risk Journal Entries

A high-risk journal entry is a standard or non-standard manual journal entry that requires specialized knowledge for preparation and review. It may also require significant management judgment and estimation and imposes significant risk to the financial statements. Entries with total activity (total debits) of the entry exceeding the accounting threshold used to identify high-risk journal entries[1] using the lowest of the LKE registrants (see the Materiality Thresholds tab of the Waived Adjustments file) AND which are determined to be complex are designated as high-risk.

The centralized journal entry checklists contain the listing of high-risk journal entries. New entries must be risk-assessed when they are added to the checklist, and existing standard entries must be monitored on an on-going basis to determine if their status has changed.

High-risk journal entries require additional support, as follows: (See cycle/transaction 080.05, Control Activity 1 in the Sarbanes Oxley Compliance documentation.)

- *An executive summary describing the purpose of the journal entry in sufficient detail that the reviewer can effectively understand why the journal entry is being made and the sources of data being used to prepare the journal entry. May also include a lead sheet that summarizes the amounts on the journal entry by financial statement line item.*
- *Support for calculations used to derive journal entry amounts.*
- *Trend analysis on standard entries with documentation of unusual or significant fluctuations with conclusion and rationale for thresholds used.*
- *Evidence of annual confirmation that support provided by a line of business has been vetted with appropriate personnel from the line of business and that its accounting use has been explained to them.*
    - Note: The accounting impact to ratemaking mechanisms is covered by other controls (e.g., the 3 month review of the Gas Supply Clause, the 6 month review of the Fuel Adjustment Clause, the 6 month and 2 year reviews of the Environmental Cost Recovery mechanism, the annual review of the Gas Line Tracker and Demand Side Management mechanism and the transmission rates from the municipal formula-based rate calculations)

Review and Approval of Entries

All journal entries must be reviewed. (See cycle/transaction 080.05, Control Activity 1 in the Sarbanes Oxley Compliance documentation.)

The Accounting Manager or her/his delegate must review and approve all non-standard journal entries, any new standard entries the first time that they are prepared and any entry (standard or

[1] This threshold is calculated annually in the first quarter based on the previous year's 10-K.

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(Note: Text in italics indicates a key SOX control.)

non-standard) with total debits exceeding the accounting threshold used to identify high-risk journal entries using the lowest of the LKE registrants (see the Materiality Thresholds tab of the Waived Adjustments file), prior to closing the books. If a journal entry changes for any reason after it has been reviewed and approved, it must be re-reviewed and re-approved by the manager or her/his delegate.

Journal entries, which meet any of following criteria, must be reviewed and approved by the respective Director or Officer AND the Controller, or their respective delegate, prior to closing the books:

- *Non-recurring entries that have a financial statement line item impact exceeding the accounting threshold used to identify high-risk journal entries using the lowest of the LKE registrants (see the Materiality Thresholds tab of the Waived Adjustments file.) Entries that meet the threshold will be considered for inclusion on the monthly closing highlights provided to PPL. An entry shall not be broken into several pieces to avoid meeting the threshold.*
- *Entries posted after noon on workday 5 (with the exception of recurring consolidation and STAT only entries) or the reversal of any entries into the current month after noon on workday 5.*

If the entry is greater than the thresholds above, but only reclassifies between different GLAFFs that roll up to the same financial statement line, it is exempt from the process above.

Any Director or Officer, including the Controller should not be the first level reviewer of any entries unless he or she has an individual contributor direct report who is the Journal Entry Preparer.

Each individual who signs off on a journal entry is signing as to performing the following functions:

I. Journal Entry Preparer sign-off indicates:

- The preparer has requisite knowledge of the subject matter and the entry is prepared in accordance with GAAP and regulatory requirements.
- All the relevant information has been included in the journal entry. Calculations provided by other departments or information provided by other departments have been verified.
- A description is included in the entry, identifying the purpose of the entry and any unusual or non-recurring items for that entry.
- Line items are consistent with and all details have been agreed to supporting documentation.

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(Note: Text in italics indicates a key SOX control.)

- All spreadsheets prepared by the Journal Entry Preparer and used in the preparation of the entry are maintained in accordance with the 950 – Spreadsheet Policy and PPL's Guidelines for Spreadsheets and Other End User Computing Tools.
- Information prepared by others which is used in the preparation of the entry requires the following:
    - Internally prepared spreadsheets require confirmation from the source that the spreadsheet complies with the requirements in the 950 – Spreadsheet Policy and PPL's Guidelines for Spreadsheets and Other End User Computing Tools.
    - Information provided by third parties must have adequate support[2]. Also, the journal entry preparer must perform and document review procedures to provide reasonable assurance that the information is complete and accurate, if total debits of the entry exceed the Manual Accrual, Third-Party Spreadsheet and Waived (Out-of-Period) Adjustment materiality threshold using the lowest of the LKE registrants from the prior quarter except for January which uses the third quarter threshold from the prior year, other than for reversing accounts payable accruals, for which individual accrual journal entry line items must be reviewed and certified by knowledgeable operational personnel if they exceed this threshold. (See the Materiality Thresholds tab of the Waived Adjustments file).
- For out-of-period or reclassification journal entries, potential internal control deficiencies have been communicated to the Sarbanes-Oxley Compliance Department.

(See cycle/transaction 080.05, Control Activity 1 in the Sarbanes Oxley Compliance documentation:)
II. Journal Entry Reviewer/Approver (first level review, could be a manager, a manager's delegate, or a Director/ Officer who has an individual contributor direct report who is the Journal Entry Preparer) sign-off indicates:

- *The reviewer/approver has requisite knowledge of the subject matter.*
- *Known issues associated with the journal entry have been addressed.*
- *The journal entry has been prepared in accordance with GAAP and regulatory requirements.*
- *The accounts affected in the entry are reasonable considering the purpose of the entry.*
- *The journal entry description is complete, relevant to the journal and factually correct.*
- *Line items are consistent with and all details have been agreed to supporting documentation, including verification or review of calculations or other information received from outside departments.*
- *For out-of-period or reclassification journal entries, potential internal control deficiencies have been communicated to the Sarbanes-Oxley Compliance Department.*

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[2] Adequate support will vary depending on the circumstances and requires the user's professional judgment or consultation with a knowledgeable employee to determine its adequacy.

- *For high-risk journal entries, the reviewer confirms that required support as described above has been prepared, performs a detailed tie-back and re-performs critical calculations used to derive journal entry amounts if prepared in a spreadsheet without spreadsheet controls. Calculations selected to test must be documented.* (Per the 950 - Spreadsheet Policy, all spreadsheets used for a high-risk journal entry must be classified as a high-risk spreadsheet with all required spreadsheet controls.)

III. Manager Review/Approval (required when above manager-level approval is required) sign-off indicates:

- *The journal entry has been prepared in accordance with GAAP and regulatory requirements.*
- *The Balance Sheet and Income Statement effects are reasonable based on the purpose of entry.*
- *The journal entry description is complete and factually correct.*
- *The journal entry addresses known outstanding issues associated with the entry.*

IV. Director or Officer and Controller Review/Approval sign-off indicates:

- *The journal entry has been prepared in accordance with GAAP and regulatory requirements.*
- *The Balance Sheet and Income Statement effects are reasonable based on the purpose of entry.*
- *The journal entry addresses known outstanding issues associated with the entry.*

During close, an Accounting Analyst in Corporate Accounting runs an EiS report that list the entries that require further review/approval and provides the list to the Controller and the Director, Accounting and Regulatory Reporting so that they can perform the necessary reviews/approvals. The Accounting Analyst in Corporate Accounting keeps track of the journal entries reviewed to ensure that all of the required entries have been approved before the closing meeting with PPL on workday 7. All entries that meet the first three criteria under Review and Approval of Entries above are included on a monthly summary to PPL developed from the EiS report.

During close, each Accounting Manager or his or her delegate reviews the centralized journal entry checklist saved on the \\fs1\acctpolicies share drive and filtered by his or her department to ensure that all necessary journal entries have been completed. *Once all entries have been completed for a department, the Accounting Managers or their delegates then send an e-mail to the Manager and Accounting Analyst in Corporate Accounting confirming that all entries have been posted for the month. (See cycle/transaction 080.05, Control Activity 2 in the Sarbanes Oxley Compliance documentation.)*

251 - Journal Entries Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

On workday 4, an Accounting Analyst in Corporate Accounting reviews the journal entry checklist to ensure that all necessary journal entries have been posted to Oracle by running a list of posted entries from EiS reports and comparing it in Excel to the printed company checklists. After open journal entry sign-offs are resolved, the checklists incorporating the query result are signed by the Accounting Analyst and approved and signed by the Manager, Corporate Accounting or his/her delegate. These EiS reports are run again by the Accounting Analyst in Corporate Accounting on workday 5 and when all entries, including STAT entries, are completed showing only entries posted after workday 4. The Accounting Analyst compares the queries to the updated centralized journal entry checklist to ensure that all journal entries have been posted to Oracle and the queries are signed by the Accounting Analyst and approved by the Manager, Corporate Accounting or his/her delegate. (See cycle/transaction 080.05, Control Activity 3 in the Sarbanes Oxley Compliance documentation.)

All journal entries are compiled with their support and are maintained in the accounting departments until they are sent to Xerox for document imaging into Quest normally by the middle of each month. Prior to sending the journal entries to Xerox for document imaging, the Senior Secretary and/or Assistant to the Controller performs a final comparison of the journal entry checklist to the Oracle listing of posted entries. The Senior Secretary and/or Assistant to the Controller also ensures that all entries listed on the checklist are included for imaging. After all of the journal entries are imaged in Quest, they are sent to off-site storage.

CCS Journal Entries:

CCS journal entries should contain the elements described in Appendix A. Supporting documents needed to prepare journal entries in CCS are sent to or compiled by Corporate Accounting or Revenue Accounting. Journal entries are then entered directly into CCS by the accounting staff.

The CCS journal entries are printed and all supporting documentation must be attached, such that a knowledgeable third party could understand the journal entry.

After the journal entry is entered and “saved as completed”, the document number of the saved entry is written on the bottom of the journal entry hard copy. The journal entry is then available for posting. After approving, the Accounting Manager or her/his delegate selects the journal entries to be posted in CCS and releases (posts) them. When the entry posts, the initials of the person posting are written on the bottom of the entry with the date the entry was posted.

As a final step, a check of CCS is done to ensure all entries are posted. A screenshot is taken and printed to confirm that no other entries are waiting to be posted, and a copy of screenshot is attached to the journal entry and filed with the journal entry checklist. The Manager, Corporate

(Note: Text in italics indicates a key SOX control.)

Accounting or his/her delegate reviews the journal entry checklist to ensure that all necessary journal entries have been completed and signs the checklist.

All CCS journal entries are compiled with their support and are filed in Corporate Accounting.

HFM Journal Entries:

HFM journal entries should contain the elements described in Appendix A.

On workday 5, an Accounting Analyst in Corporate Accounting reviews the HFM journal entry checklist to ensure that all necessary journal entries have been posted to HFM by comparing a report from HFM (JOURReport 1, section L0800), which lists all posted HFM entries for LKE for the current month, to the printed company checklist. The Accounting Analyst also reviews the checklist to ensure that all listed entries are either signed off or marked as not applicable. After any open journal entry sign-offs are resolved, the checklist is signed by the Accounting Analyst and approved and signed by the Manager, Corporate Accounting or his/her delegate.

All HFM journal entries are compiled with their support and are filed in Financial Reporting.

Confirmation of Compliance with the Policy

Each calendar year, approximately mid-year, Corporate Accounting will perform the following process to affirm review of and compliance with the policies around journal entries and account reconciliations by all individuals who prepare such.

- Corporate Accounting will contact HR to obtain from PeopleSoft a list of the current employees of the departments that prepare or review journal entries and account reconciliations.
- Based on that list, Corporate Accounting will send to the members of those departments an email with a requested response date and voting buttons. The voting options will state:
  - I confirm that I have read and understand the 251 - Journal Entries Policy and the 250 – Balance Sheet Account Reconciliation Policy. I am in compliance with those policies and with the related SOX controls.
  - I have no duties related to the preparation or review of journal entries or account reconciliations.
- Corporate Accounting will follow up with any members of those departments who do not respond.

Corporate Accounting will document and retain the responses in a checklist based on the initial PeopleSoft list.

251 - Journal Entries Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Reports Generated and Recipients:

- ADI journal entries (scanned into Quest and available to accounting staff, external auditors, budgeting users and other users who have been granted access.)
- Journals-Enter standard Oracle report (scanned into Quest; used by accounting staff upon the rare occasion that a journal entry is keyed directly into Oracle)
- Posted journal entry download report (used by Corporate Accounting)
- Journal entry checklists (used by all preparers of journal entries)
- CCS journal entries (used and maintained by Corporate Accounting and Revenue Accounting and Analysis departments)
- CCS unposted document check (used by Corporate Accounting and Revenue Accounting and Analysis departments)
- Report of manual entries posted in CCS (used by Corporate Accounting and Revenue Accounting and Analysis departments)
- Report listing the journal entries which meet dollar thresholds for additional review/approval (used by the responsible accounting managers and directors/officers)
- HFM journal entries (filed in a binder in Financial Reporting)
- HFM JOURReport1 which lists journal entries posted in HFM for the current month

Additional Controls or Responsibility Provided by Other Procedures:

Before the books are closed, accounting managers review financial statements and/or trial balances to identify any material misstatements. (See the Materiality Policy and Procedures for a definition of the criteria for a misstatement to be considered material and the subsequent actions to be taken.) Also, CCS is checked to ensure all entries have been posted (see CCS Journal Entry Job Aid). A report is run from the CCS Business Intelligence ("BI") system to show all entries posted in CCS. The Controller and/or Director, Accounting and Regulatory Reporting will review any unusual accounting entries with the CFO monthly.

Regulatory Requirements:

Journal entries use the FERC chart of accounts.

Reference:

354 - Materiality Policy and Procedures
358 - Waived Adjustments
Waived Adjustments File located at \\fs2\acctshare\Waived Adjustments\[YYYY QTR]\ErrorCorrecting EntriesUSGAAP[MonYY].xlsx
751 – AP – Manual Accrual Policy
950 - Spreadsheet Policy

251 - Journal Entries Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Guidelines for Spreadsheets and Other End User Computing Tools (see PPL Policies directory on the acctrestricted drive)
CCS Journal Entry Job Aid
Electronic Evidence Requirements (see PPL Policies directory on the acctrestricted drive)

Corresponding PPL Policy No. and Name:

201 - Preparation and Review of High Risk / Complex Journal Entries

Key Contact:
Manager, Corporate Accounting

Administrative Responsibility:
Controller

Date Created: 12/31/04
Date Revised: 1/16/08; 6/24/11, 7/3/12, 8/3/12, 11/28/12, 3/28/13, 6/28/13, 12/17/13, 3/27/14, 5/22/14, 7/3/14, 8/1/14, 1/27/15, 3/16/15, 3/11/16, 6/12/17, 6/27/18, 9/5/18

251 - Journal Entries Policy and Procedures Appendix A: Journal Entry Elements

(Note: Text in italics indicates a key SOX control.)

Oracle (ADI) Journal Entries

ADI Journal Entry Header Information:

- Category: Describes the type of journal entry, based on a predefined list in Oracle selected by the user, except that "Prior Period Adjustment" must be used as the Category if the entry should have been made in another period and "Accrual" must be used for accounts payable accruals which affect Accounts 107 or 108. In the event that an accounts payable accrual is also a prior period adjustment, the Accrual journal category must be used.
- Source: Describes how the journal entry was input into Oracle. Journal entries uploaded from ADI must have a Spreadsheet source.
- Currency: Lists the type of currency in which the journal entry is being booked. The only currency allowed is USD (U.S. Dollars) or STAT for statistics.
- Accounting Date: Lists the date which determines the General Ledger period in which the journal entry will be posted. This field is normally limited to the current open period for which the books are being closed and to the next open period. Occasionally, the books are reopened to allow posting to a prior period.
- Group ID: The employee number of the person uploading the journal entry, excluding the leading letter and leading zeros.
- Batch Name: The originating department code and preparer initials in ALL-CAPS, separated by a hyphen with no spaces or underscores. The Corporate Accounting Department maintains the list of valid originating department codes.
- Journal Name: The journal entry number stored in Oracle, using the following syntax: J###-cccc-mmyy, where ### = 3 digit journal entry number from the journal entry checklist, cccc = 4 digit company number, mm = 2 digit month and yy = 2 digit year.
- Journal Description: A short description of the journal entry.
- Reverse Journal: Yes, if set to auto-reverse in Oracle; No, or null, if not set to auto-reverse in Oracle
- Reversal Period: Completed only if Reverse Journal is set to Yes; defines the General Ledger period in which the auto-reversal will post in Oracle. This field is limited to the current open period for which the books are being closed and the next open period.

Each ADI journal entry must contain a cover page in OCR A Extended font used for scanning into Quest. The row height must be at least 28 and a divider bar code must be at the top on rows 3 – 5 with a line above and below. All of the above elements must be included on the cover page, as well as the following:

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(Note: Text in italics indicates a key SOX control.)

- Ledger – The Oracle set of books. Only one set of books is set up for LKE in Oracle: LGE ENERGY LLC.
- General Ledger Period – the month to which the transaction is posted in the general ledger in the format MMM-YYYY.

ADI Journal Entry Line Information:

- Upload flag column: All lines to be uploaded must be populated with a flag.
- General Ledger Accounting Flexfield (“GLAFF”) Columns: These columns make up the account number to which the journal entry will be posted.
    - Company: Four-digit code with a leading zero, generally representing the legal entity or other entity set up in Oracle.
    - Product: Three-digit code, generally denoting whether the charge relates to electric, gas, common or wholesale products.
    - Organization: Six-digit code with a leading zero, representing the cost center which is being charged or credited by the transaction.
    - Expenditure Org: Six-digit code with a leading zero, representing the cost center which is the source of the transaction.
    - Account: Six-digit code for the natural account number based on the Federal Energy Regulatory Commission (“FERC”) chart of accounts, as expanded by LG&E and KU Energy LLC.
    - Intercompany: Four-digit affiliate company code populated on all intercompany transaction journal entry lines. This field is populated with zeros on non-intercompany journal entry lines.
    - Expenditure Type: Four-digit code with a leading zero further describing the type of transaction.
    - Location: Four-digit code representing the physical location of the transaction.

- Debit and Credit: Dollar amount of the transaction. An amount can only be entered in either the debit or credit column. Although Oracle will accept negative debit and credits, they should be entered as positive numbers.
- Line Description: Specific journal entry line description of the transaction. May use journal entry header description, if no other specific description needed. This field must always be populated in order to send the journal entry description to Project Accounting.
- Stat Amount: Only populated when posting statistical data (i.e., tons, mmbtu).
- Line DFF Segment for a Web ADI template:
    - Line DFF column is segregated by a period/decimal point – Yes if transaction is project-related. Example: Yes.Project.Task (no period after Task).

251 - Journal Entries Policy and Procedures Appendix A: Journal Entry Elements

(Note: Text in italics indicates a key SOX control.)

- o If no project/task is being charged, type No in the column or leave the column blank.

ADI Journal Entry Footer Information:

- Description: This field must contain a complete description of the journal entry. It must provide enough information for someone unfamiliar with the transaction to understand the purpose of the entry.
- Prepared By: The person preparing the journal entry signs or initials here (include the date prepared).
- Upload/Concurrent ID: The Concurrent ID number for the journal entry upload job in Oracle must be written here when the upload is successful.
- Approved By: The approver of the journal entry signs or initials here (include date approved). All non-standard journal entries and standard journal entries with total debits greater than $50,000 must be approved either by the manager or by another person with the requisite level of knowledge. Each manager may determine whether approval is required and at what level for standard journal entries with total debits less than or equal to $50,000.
- Posted By: The person posting the journal entry, if different than person who uploaded it, signs or initials here (include posted date).
- Posted/Concurrent ID: The Concurrent ID number for the Oracle posting job is written here after the job report is checked on-line to ensure that there are no posting errors.

251 - Journal Entries Policy and Procedures Appendix A: Journal Entry Elements

(Note: Text in italics indicates a key SOX control.)

CCS Journal Entries

CCS Journal Entry Header Information:

- Document Date: Lists the date the entry is entered into CCS.
- Posting Date: Lists the effective date for the entry.
- Reference: The unique journal entry number assigned to the entry, using the following syntax: C###-cccc-mmyy, where ### = 3 digit journal entry number from the journal entry checklist, cccc = 4 digit company number, mm = 2 digit month and yy = 2 digit year.
- Doc Header Text: Provides a general description of the purpose of the journal entry.

CCS Journal Entry Line Information:

- G/L acct: Six-digit code for the natural account number based on the Federal Energy Regulatory Commission ("FERC") chart of accounts, as expanded by PPL.
- D/C: Lists if the line is a debit or credit.
- Amount in doc. Curr.: Provides the amount of the entry for the specific line. All numbers are entered as positives within CCS.
- Assignment no.: Displays additional information. Any project and task information can be included for reference. This is a free character field.

251 - Journal Entries Policy and Procedures Appendix A: Journal Entry Elements

(Note: Text in italics indicates a key SOX control.)

HFM Journal Entries

HFM Journal Entry Header Information:

- Label: The unique journal entry number stored in HFM, using the following syntax: ddd###-ccccc, where aaa means data type, ### means journal entry number, and ccccc means company number.
- Group: A three-character abbreviation of the data type of the entry.
- Balance type: Indicates whether the entry is balanced, unbalanced, or balanced by entity.
- Security: Indicates the security level of the entry.
- Description: A short description of the journal entry.

HFM Journal Entry Line Information:

- Entity: In the case of LKE, the four-digit Oracle company number preceded by an "L."
- Account: In the case of LKE, the six-digit code for the natural account number based on the Federal Energy Regulatory Commission ("FERC") chart of accounts, as expanded by LG&E and KU Energy LLC.
- ICP: The affiliate company code populated on all intercompany transaction journal entry lines. This field is populated with "[ICP None]" on non-intercompany journal entry lines.
- Data type: The data type of the journal-entry line.
- Custom 2, Custom 3, and Custom 4: Not used currently, but must be filled in with "[None]."
- Description (Optional): A description of the journal-entry line.
- Debit and Credit: Dollar amount of the transaction.

Date Created: 3/11/16
Dates Revised:

253 – Intercompany Billing and Settlement

(Note: Text in italics indicates a key SOX control.)

Policy: Intercompany transactions among LG&E and KU Energy LLC's ("LKE" or the "Company") affiliates will be billed and cash settled as required for compliance with various state-approved service agreements. Amendments to the agreements approved by the state regulatory agencies are necessary to further amend this policy.

Procedure: The intercompany billing and settling procedures are performed per the detailed instructions below. Procedures are outlined below for intercompany transactions among the following:

- Regulated affiliates and non-regulated affiliates (intracompany)
- A regulated affiliate and another regulated affiliate (intracompany)
- Non-regulated affiliates and non-regulated affiliates (intracompany)
- LKE affiliates and non LKE affiliates (PPL/intercompany)

Scope: All intercompany transactions among LKE's affiliates and PPL affiliates.

Objective of Procedure: The objective of proper billing and settling of intracompany and intercompany transactions is to maintain compliance with various state-approved service agreement related to such transactions.

General Requirements:

<u>Detailed Procedures Performed:</u>

A. LKE regulated affiliates and non-regulated affiliates (intracompany)

1. *The following reports are utilized to determine whether the intracompany account balances are in agreement among all companies using the Oracle system. Balances must be in agreement before the billing process can begin.*
    a. *EiS report – "LKE Auto IC Account Balances" This report is run during the month to determine if any intracompany account balances exist where the intercompany segment of the General Ledger Accounting Flex Field (GLAFF) is not populated and, as a result, the intracompany balances are not identifiable by company.*
    b. *EiS report – "LKE GL JE Lines with Account 146100 and 234100." The report is run when the EiS report indicates incorrect balances. It identifies the sources of the transactions which resulted in improper intercompany segment coding to a specified company's intracompany receivable and payable accounts. (NOTE: Item (b) is referred to as the "export file.")*
2. *The above-mentioned reports are run during the closing process to ensure there are no improper intracompany account balances. All companies' intracompany balances must indicate proper intercompany segment, to accurately identify the other party with whom*

the intracompany balances exist. All intracompany balances must be offset by a corresponding intracompany balance on another company's books. (See cycle/transaction 80.06 Control Activity 1 in the Sarbanes-Oxley Compliance documentation.)

3. Once it is determined that the intracompany accounts within Oracle are in agreement, an entry is posted to net the payables and receivables for balance sheet presentation. *Upon posting of the netting entry, the export file is re-run and used to identify transaction data to be billed for the month. The export file is also used for reconciling the accounts to the general ledger to ensure completeness and accuracy before billing. (See cycle/transaction 80.06 Control Activity 4 in the Sarbanes-Oxley Compliance documentation.*)
4. The export file is saved in each company's electronic billing file (in Excel). The data is sorted as necessary, to segregate transaction data by company, for use as supporting documentation to the intercompany billings. The supporting documentation consists of a summary of the intercompany transactions that occurred during the month, by the source of such transactions (labor and burdens, A/P vouchers, and miscellaneous journal entries). This supporting documentation is segregated to show the intercompany activity each company has with each other company.
5. Transactions between the regulated and non-regulated affiliates are billed and settled through LG&E and KU Services Company ("LKS").
6. Intracompany billings are processed the month following the transaction activity, after the current month has been closed. According to the service agreements, intracompany billings must be completed by the 25th of the month. However, all final intracompany billings are prepared by Accounting Analyst(s) in Corporate Accounting and are due no later than the close of business on the 10th work day of each month to facilitate intracompany cash management.
7. According to the service agreements, intracompany billings are required to be settled by the 30th of the month. However, intracompany billings are required to be cash settled on a monthly basis, no later than the 13th work day of the month, following the month in which the intracompany transactions occurred to facilitate intracompany cash management.
8. All billings through LKS are settled on a net basis. For instance, LKS's billing to LG&E includes the amount in LKS's intracompany receivable account with LG&E, plus amounts in any other non-regulated affiliates' intracompany receivables accounts with LG&E, netted with LKS's intracompany payable account balance with LG&E, plus amounts in any other non-regulated affiliates' intracompany payables accounts with LG&E. The amount settled is the net amount due to LKS.
9. Intracompany billings are settled by disbursement requests and are required to be completed and submitted to the Accounts Payable department for processing. Disbursement requests are due to the Accounts Payable department no later than 3:00 pm

253 – Intercompany Billing and Settlement

(Note: Text in italics indicates a key SOX control.)

two work days prior to the payment date for ACHs and one work day prior to the payment date for wire transfers. Wire transfer is the preferred method of payment for the larger (greater than $1 million) payments to facilitate cash management between the LKE subsidiaries and must be used for payments from the utilities to LKS. Disbursement requests for intracompany settlements are to be completed by indicating the entire GLAFF on the form for A/P to manually enter into the system. Projects and tasks must not be used in the processing of these disbursement requests because the intercompany segment must be coded on the form, and it cannot be indicated when projects and tasks are used. Disbursement requests that are not coded properly will result in the intracompany balances (by GLAFF) not being relieved by the settlement. Thus, further correcting entries will be required in the following month before closing.

10. Treasury may also request that Corporate Accounting include certain large dollar settlements in the current month. For example, fuel advance payments are made by LG&E and KU to LKS throughout the current month whenever the cumulative amount paid by LKS exceeds $1 million to ensure no company bears the interest costs of the other's operations. Standard journal entries or other transactions may be excluded from the intercompany settlements. These items do not require settlement because they will be paid outside of the intercompany settlement process. An example of this is entries made for intercompany dividends declared.
11. Cash receipts are recorded via journal entry in the month the settlements are received. The intracompany billing file and bank statements are used to reconcile these receipts with the billings before posting of the journal entry.

B. LKE regulated affiliates (intracompany)

1. Follow detailed procedures numbered 1-4, 6-7 and 9-11 in Item A above for "LKE regulated affiliates and non-regulated affiliates" (intracompany).
2. Per various state-approved service agreements, intracompany transactions between regulated affiliates may be billed directly to one another. Intracompany transactions between the regulated affiliates are billed and settled on a net basis. Copies of such intracompany billings are kept on file in Corporate Accounting for documentation purposes. Treasury may also request that Corporate Accounting include certain large dollar settlements in the current month.
3. The regulated affiliates are required to complete a credit slip for intracompany settlements to be received, which serves as supporting documentation behind the journal entry to record the cash receipt.

C. LKE non-regulated affiliates (intracompany)

1. Follow detailed procedures numbered 1 through 4 in Item A above for "Regulated affiliates and non-regulated affiliates (intracompany).

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(Note: Text in italics indicates a key SOX control.)

2. Intracompany transactions among non-regulated affiliates are not required to be billed or settled.
3. Intracompany activity among non-regulated affiliates, however, must be reconciled monthly, in accordance with the Balance Sheet Accounts Reconciliation Policy, as amended.

D. LKE affiliates and non-LKE affiliates (PPL/intercompany)

1. LKE charges to PPL Groups – Expense
   LKE personnel will send a summary of expense charges via e-mail to PPL due no later than the 3rd work day following the end of the month and journalize the activity in Oracle. An invoice will also be forwarded to appropriate PPL personnel for payment processing and approval.
2. LKE charges to PPL – Capital
   LKE personnel will send a summary of charges related to capital projects via e-mail to PPL due no later than the 3rd work day following the end of the month and journalize the activity in Oracle. An invoice will also be forwarded to appropriate PPL personnel for payment processing and approval.
3. PPL charges LKE for both direct and indirect expenses monthly. Throughout the month, PPL will send details of direct charges to LKE to be recorded in LKE's general ledger. In addition, before the end of the 4th work day, PPL will send a report of indirect charges from various PPL support groups for LKE to record.
4. *The following reports are utilized in confirming intercompany balances between LKE and non-LKE affiliates.*
   a. *Excel Report "PPL Day 4 Balance Check MM-YYYY.xlsx". This report is sent to PPL Accounting by LKE Corporate Accounting prior to closing of the books on Day 4 for intercompany balance confirmation purposes. This report is reviewed and intercompany balances are confirmed. If a discrepancy arises, PPL and LKE work together to resolve the differences between the recorded intercompany balances. (See cycle/transaction 80.06 Control Activity 2 in the Sarbanes-Oxley Compliance documentation*.)
5. If LKE is in a net payable position to PPL, excluding auto-reversing entries and mutual assistance charges billed from LG&E or KU to PPL Electric Utilities, LKE will initiate payment to PPL via a disbursement request sent to Accounts Payable Department for processing. Auto-reversing entries are accrual journal entries booked in advance of receiving actual invoices and will not be settled until the invoices are received. Mutual assistance billings from LG&E or KU to PPL Electric Utilities are settled separately by PPL Electric Utilities. If LKE is in a net receivable position, PPL will initiate payment to LKE.

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(Note: Text in italics indicates a key SOX control.)

6. Payment of intercompany billings is to be made on the 20th of each month. If the 20th of the month falls on the weekend or a holiday, the settlements will be processed the next work day.
7. Cash receipts by LKE are recorded via journal entry in the month the settlements are received.

Reports Generated and Recipients:

- Intercompany Bills
- EiS Report – "LKE Auto IC Account Balances"
- EiS Report – "LKE GL JE Lines with Account 146100 and 234100."
- Accounts Payable Disbursement Requests
- Credit Slips

Additional Controls or Responsibility Provided by Other Procedures:

Intercompany account balances are reconciled on a monthly basis, per the Balance Sheet Accounts Reconciliation Policy.

Regulatory Requirements:

Various state service agreements require that all transactions with LKS and/or with the regulated utilities be cash-settled monthly.

Reference:
Balance Sheet Accounts Reconciliation Policy

Corresponding PPL Policy No. and Name:
203 Interunit Settlements

Key Contact:
Manager, Corporate Accounting

Administrative Responsibility:
Controller

Date Created: 7/26/05
Dates Revised: 10/11/05, 12/12/07, 4/14/08, 3/31/11, 8/9/11, 6/30/12,11/30/12, 03/28/13, 03/5/14, 3/26/14, 3/30/16

253 – Intercompany Billing and Settlement

(Note: Text in italics indicates a key SOX control.)

254 - Consolidation Process Policy and Procedures

Policy:

A consolidation of LG&E and KU Energy LLC and its subsidiaries' income statements and balance sheets will be performed monthly, including elimination of all intercompany activity and consistent with quarterly and annual publicly issued financial statements.

Procedures:

Preparing the consolidated balance sheet and income statement consists of preparing and posting journal entries in HFM and Oracle each month to:

(1) eliminate investments in subsidiaries,
(2) eliminate intercompany receivables/payables, sales/purchases, and interest income/expense,
(3) reclassify Western Kentucky Energy Corp.'s (WKE) income statement to discontinued operations,
(4) record the consolidated effective rate income-tax adjustment (January through November only),
(5) Net income taxes payable and receivable, if necessary, and
(6) Net current deferred income taxes payable and receivable, if necessary.

Procedures also include generating reports that contain the balance sheet and income statement consolidation worksheets.

Scope:

LG&E and KU Energy LLC ("LKE" or the "Company") and all of its subsidiaries.

Objective of Procedure:

To establish a policy for the consolidation process that ensures all subsidiaries are properly included in the consolidation and all elimination and reclassification entries are properly performed to ensure the accuracy of the consolidated financial statements.

General Requirements:

1. LKE consolidates its financial results of all companies in which it has a controlling interest in each month in accordance with the closing calendar.
2. Investments in 20% to 50% owned entities are accounted for as an Equity Method Investment and will follow the Accounting Standards Codification 323, *Investments – Equity Method and Joint Ventures.* See memo *"Electric Energy, Inc. (EEI) Equity*

254 - Consolidation Process Policy and Procedures

Investment Impairment" dated February 28, 2013 noting the impairment to zero of LKE's only equity method investment EEI.

3. Investments in 20% or less- owned companies are accounted for as Cost Investments. Cost Investments are recorded and carried at cost in the consolidated balance sheet under the caption "Investments" – current cost investments include the Ohio Valley Electric Corporation, an entity in which LKE indirectly owns an 8.13% interest (consists of Louisville Gas & Electric Company's 5.63% and Kentucky Utility Company's 2.50% interests).
   - Dividends received that are distributed from net accumulated earnings of the investee are recognized as "Other Non-operating Income, Net". Dividends received in excess of earnings are considered a return of investment.
4. As of the date of this policy, LKE does not have any Variable Interest Entities (VIE). VIE means entities as defined in Accounting Standard codification, 810, *Consolidation*. Variable interests are contractual, ownership, or other pecuniary interests in an entity that change with changes in the entity's net asset value. Equity interests with or without voting rights are considered variable interests if the entity is a variable interest entity.
   - If it is determined that LKE controls a VIE through a voting equity interest (which is typically also evidence of a controlling financial interest), the entity would be consolidated in the consolidated financial statements.

Detailed Procedures Performed:

1. After the individual company books are closed each month, the following entries are performed in Oracle to before the upload into Hyperion Financial Management (HFM):
   - Investment in Subsidiaries – entry to ensure each investment-in-consolidated-subsidiary account equal the total of the related subsidiary's
      i. common stock,
      ii. common stock expense,
      iii. additional paid-in capital,
      iv. accumulated OCI (excluding accounts 219010 (ACCUM OCI - EQUITY INVEST EEI) and 219110 (DEFERRED TAX - OCI - EQUITY INVEST EEI)), (see also discussion of EEI impairment above) and
      v. prior-year ending retained earnings (net of current year-to-date dividends declared).
   - Effective Tax Rate – calculation and recording of the effective tax rate at the ultimate parent level.

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- Reclassification of Discontinued Operations – entry to reclassify the balances in Western Kentucky Energy Corp.'s income-statement accounts to discontinued operations.

2. Once the three entries mentioned above are recorded in Oracle each month, the year-to-date account balances of each company (except the elimination companies and the FERC only companies) are uploaded into HFM. The Consolidation process in HFM eliminates all intercompany activity, as well as equity ownership and the reclassification of deferred tax assets to liabilities. See SOX transaction documentation 80.07, *Consolidation*, for detailed discussion on the manual and automated journal entries in HFM and Oracle, which result in the consolidation of LKE and its subsidiaries.

Reports Generated and Recipients:

This procedure generates the consolidated Balance Sheet and Income Statement from HFM. Oracle is also used to produce reports that contain balance-sheet consolidation worksheets as well as income-statement consolidation worksheets. The reports reside in \\fs2\acctshare\ConsolidationWorksheets\MMMMYYYY. Anyone who has access to this folder can open and view them.

Regulatory Requirements:

None

Reference:

FASB Accounting Standards Codification 810, Consolidation

Corresponding PPL Policy No. and Name:

204, HFM Equitization & Consolidation and Related Functional Processes

Key Contact:

Manager, Financial Reporting

Administrative Responsibility:

Controller

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Date Created: 3/31/11
Dates Revised: 8/5/11,
9/19/13

255 – Related Party Transactions

(Note: Text in italics indicates a key SOX control.)

Policy: Related party transactions are disclosed in the LG&E and KU Energy LLC (LKE), Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (the Company or collectively, the Companies) financial statements, if required.

Procedure: Related parties are identified and transactions with those parties are reviewed as to their nature and value per the detailed instructions below.

Scope: All transactions between identified related parties and LKE, LG&E and KU.

Objective of Procedure: The objective of these procedures is to document management's process to identify related parties to the Companies and related party relationships and transactions.

General Requirements:

Background**:**

In June 2014, the Public Company Accounting Oversight Board (PCAOB) adopted a new auditing standard, AS18, and amended other auditing standards to require auditors of public companies' financial statements to perform increased audit procedures around three areas effective for fiscal years beginning on or after December 15, 2014:

- Related party transactions
- "Significant unusual transactions"
- Financial transactions and relationships with its executive officers.

The PCAOB views these as critical areas that "historically have represented increased risks of material misstatement in company financial statements." Therefore, AS18 requires auditors to obtain evidence to substantiate management assertions regarding the nature of related party transactions (e.g., if disclosed to be at "arms length.")

This policy and these procedures address the first and third bullet points. Note that the third bullet point, executive officers, are, by definition below, considered related parties. The second bullet point is covered by the review of Company highlights per Accounting Policy 359 – Financial Statement Disclosures and Filing Requirements.

Definitions:

Management uses the FASB Accounting Standards Codification (ASC), SEC rule 404 and management's interpretations of these rules to define various terms that are used throughout this policy.

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(Note: Text in italics indicates a key SOX control.)

Related parties (per the ASC Master Glossary)

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of ASC 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests

(The following additional parties are defined in SEC rule 404 - Note: the definition of related parties per the SEC rule 404 is more stringent and more than what is required for the related parties footnote disclosure):

h. A director or executive officer of the company and his or her immediate family members
i. Any nominee for director and the immediate family members of any nominee for director
j. A security holder known to the company to beneficially own more than five percent of any class of the company's voting securities or any immediate family member of any such person, when a transaction in which such security holder or family member had a direct or indirect material interest occurred or existed

Section 16 Officers (per Code of Federal Regulations, Title 17, Chapter II, Part 240, Section 16a-1(f))

The term "officer" shall mean an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other functions for the issuer. Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer.

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(Note: Text in italics indicates a key SOX control.)

Note: "Policy making function" is not intended to include policy-making functions that are not significant…

Affiliate (per the ASC Master Glossary)

A party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an entity.

Control (per the ASC Master Glossary)

The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise.
Immediate family (per the ASC Master Glossary)

Family members who might control or influence a principal owner or a member of management, or who might be controlled or influenced by a principal owner or a member of management, because of the family relationship.

(The following additional parties are defined in SEC rule 404):

Immediate family include any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.

Management (per the ASC Master Glossary)

Persons who are responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management normally includes members of the board of directors, the chief executive officer, chief operating officer, vice presidents in charge of a principal business functions (such as sales, administration, or finance), and other persons who perform similar policy making functions. Persons without formal titles also may be members of management.

Principal owners (per the ASC Master Glossary)

Owners of record or known beneficial owners of more than 10 percent of the voting interests of the entity.

Related party transaction (per SEC rule 404)

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(Note: Text in italics indicates a key SOX control.)

Broadly includes, but is not limited to, any financial transaction, arrangement or relationship or any series of similar transactions, arrangements or relationships. The term also includes indebtedness and guarantees of indebtedness.

(The following additional transactions are defined in ASC 850-10-50-5):

Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated.

Arm’s length transaction (Investopedia)

The description of an agreement made by two parties freely and independently of each other, and without some special relationship, such as being a relative, having another deal on the side or one party having complete control of the other. It becomes important to determine if an agreement was freely entered into to show that the price, requirements, and other conditions were fair and real. The concept of an arm’s length transaction is to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure or duress from the other party.

Disclosure Requirements

Controls over financial statement disclosures as set forth in accounting policy and procedure 359 - Financial Statement Disclosures and Filing Requirements.

Following are the disclosure requirements on the related party transactions:

“ASC 850-10-50-1 Financial statements shall include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. However, disclosure of transactions that are eliminated in the preparation of consolidated or combined financial statements is not required in those statements. The disclosures shall include:

a. The nature of the relationship(s) involved
b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements

255 – Related Party Transactions

(Note: Text in italics indicates a key SOX control.)

c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period
d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement
e. The information required by paragraph ASC 740-10-50-17

ASC 850-10-50-2 Notes or accounts receivable from officers, employees, or affiliated entities must be shown separately and not included under a general heading such as notes receivable or accounts receivable.

ASC 850-10-50-3 In some cases, aggregation of similar transactions by type of related party may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party shall be disclosed.

ASC 850-10-50-4 It is not necessary to duplicate disclosures in a set of separate financial statements that is presented in the financial report of another entity (the primary reporting entity) if those separate financial statements also are consolidated or combined in a complete set of financial statements and both sets of financial statements are presented in the same financial report.

Disclosures about Arm's-Length Bases of Transactions

ASC 850-10-50-5 Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated.”

Detailed Procedures Performed:

I. Compilation of Listing of Potential Related Parties

1. Obtain the latest Corporate Book from the Legal Department (or receive confirmation that it has not changed since the prior quarter)
2. Obtain the latest PPL related party listing from PPL Financial Reporting.
3. Obtain and review responses to the SOX 302 questionnaire from Audit Services for answers that indicate the following:

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(Note: Text in italics indicates a key SOX control.)

a. Whether an employee has served as an officer or director for any for-profit organization other than PPL Corporation or any of its affiliates.
b. Whether an employee or any member of their immediate family had a material ownership interest (10% or more) or operating responsibility for, any partnerships or other for-profit entities, including leasing transactions with variable interest entities, that conduct business with PPL Corporation or any of its affiliates.

4. Obtain a listing of benefit plan trusts from the Risk Management Department which are managed by or under the trusteeship of management, or confirm that there are no changes from the prior quarter, and also confirm the listing or that there are no changes with HR. Note that LKE's 401(k) plan trusts are not managed by or under the trusteeship of management, but are included because the investment choices are controlled by management.
5. A Sr. Corporate attorney reviews the minutes of the Board of Directors meetings for each of the Companies and informs Corporate Accounting of any new related parties or related party transactions.

The following additional procedures are performed annually:

6. Obtain and review the Annual Independence Survey results from the Sarbanes-Oxley Department which lists PPL officer board interests which are included in LKE's Oracle Accounts Payable transactions during the year.
7. Determine through discussion with a member of the Compliance department whether any related party transactions were reported by Company employees during the annual Standards of Integrity survey.
8. Obtain and review the Director & Officer External Positions report from the Compliance Department to identify related parties of officers.
9. Obtain a listing of Variable Interest Entities from the Financial Accounting and Analysis Department to identify potential related parties.
10. Obtain the Officers' Annual Questionnaire from the Legal Department to identify related parties of officers.

11. Prepare a list of all potential related parties identified through this process.

    The following will not be listed as potential related parties, although all could technically meet the definition of a related party:
    a. All employees, including retirees who are still receiving company benefits.
    b. All non-Section 16 officers.

    Transactions between any of the Companies and members of management, employees, retirees, customers, vendors for the delivery of electricity and natural gas in the ordinary course of business will not be reported on the related party transaction listing. The prices charged for these services are based on tariffs set by regulators and would always be considered "arms-length" transactions, and, due to their nature, would never be considered quantitatively or qualitatively material to the financial statements of any of the Registrant companies.

12. Analyze each potential related party to determine whether it has the ability to exercise significant influence over LKE, LG&E or KU; or vice versa. This analysis may include such steps as assessing board representation, ownership percentage or control over a given entity. If a determination is made that significant influence is not present, the rationale must be documented in the potential related parties listing. The Manager, Financial Reporting, or delegate, reviews the completed potential related party listing for completeness, accuracy and the determination of significant influence.

II. Compilation of Related Parties List

Using the potential related parties listing, compile the related parties list, by including all parties having significant influence. At a minimum, related parties listed will include all legal entities for which PPL has an ownership interest, as well as all Section 16 officers and board members of these entities. For purposes of this list, immediate family members (using the definition in ASC 850) of Section 16 officers and members of the boards of LKE, LG&E and KU, which includes the executive officers of these companies, are also considered related parties. (Note: Since LKE, LG&E and KU are separate SEC registrants, the definition of Section 16 officers will be applied at that level versus at the PPL level. LKE, LG&E and KU Section 16 officers are determined to be the members of the Governance and Financial Oversight Committee). *The Manager, Financial Reporting, or delegate, reviews the related party listing for completeness.*

III. Compilation of Related Parties Transaction List

1. Complete the PPL IC Charges Excel file which lists all transactions by month with PPL affiliates.
2. Run the EiS report: "LKE GL JE Lines with Account 146100 and 234100" for each month of the quarter, which lists all LKE Oracle auto-intercompany receivables and payables. Create pivot table by source and LKE affiliate.
3. Obtain transactions for the LG&E and KU Foundation Inc. with any related party from the Tax Department.
4. Obtain transactions for the benefit trusts which are managed by or under the trusteeship of management from the Risk Management Department.
5. Obtain transactions with all other related parties identified above, through running the query used for the Annual Independence Survey quarterly.

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(Note: Text in italics indicates a key SOX control.)

6. Review the transactions to determine whether they were performed at arms-length. Document the rationale used for the conclusion. We will investigate all transactions with a particular counterparty in which the quarterly transactions are greater than 25% of the waived adjustment threshold for the registrant with the lowest waived adjustment threshold. For determination of waived adjustment thresholds see 354 – Materiality Policy. Note: All transactions including related party transactions are executed in accordance with the Authority Limits Matrix.
7. *The Manager, Financial Reporting, or delegate, reviews the lists above to identify any unusual transactions or transactions that should be disclosed in accordance with ASC 850.*

Reports Generated and Recipients:

- Compiled list of potential related parties which is prepared by the Assistant to the Controller and maintained by Corporate Accounting.
- Compiled list of related parties, which is prepared and maintained by Corporate Accounting.
- Compiled list of related party transactions which is prepared and maintained by Corporate Accounting.

Additional Controls or Responsibility Provided by Other Procedures:

- Corporate Policy: External Board or Officer Service (CP 109)
- Officer Questionnaires in support of FERC interlock reporting by the Legal Department
- Preparation of the Corporate Book by the Legal Department
- Accounting Policy 359 – Financial Statement Disclosures and Filing Requirements
- Accounting Policy 250 – Balance Sheet Reconciliation Policy
- Standards of Integrity annual questionnaire
- SOX 302 quarterly questionnaire
- Authority Limits Matrix
- SOX transaction: 80.08 – Reporting

Regulatory Requirements:

None

Reference:

- ASC 850
- SEC Rule 404

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(Note: Text in italics indicates a key SOX control.)

- SEC Regulation S-X

Corresponding PPL Policy No. and Name:

307 – Related Party Transactions

Key Contacts:

Manager, Financial Reporting

Administrative Responsibility:

Controller

Date Created: 1-1-16
Dates Revised: 8-19-2016

354 - Materiality Accounting Policy and Procedures

(Note: Text in italics indicates key SOX control 80.08.08)

Policy:

LG&E and KU Energy LLC (“LKE”) and its subsidiaries will timely and accurately record all financial transactions into the affected companies’ general ledgers and disclose certain non-financial information in its financial statement filings with regulatory authorities, the U.S. Securities & Exchange Commission (“SEC”), and other authoritative bodies unless deemed immaterial and supported by appropriate documentation of such conclusion.

Procedure:

Materiality will be assessed at the reporting company level throughout the organization as of the date financial statements are externally produced for investor or financial institution use. The assessment will be made at quarter- and year-end for each SEC registrant. During quarterly reporting, materiality will also be assessed for the full year financial statements using the most current of the current year budget or current financial forecast, as appropriate.

Scope:

This policy applies to all items having an impact on the relevant financial statements as defined below, including adjustments that are not recorded in the general ledgers of the affected company or companies, as of the date the respective period’s books are closed. The relevant financial statements include those of LKE’s parent company, PPL Corporation (“PPL”), LKE consolidated, Louisville Gas and Electric Company (“LG&E”) and Kentucky Utilities Company (“KU”). Financial statements for PPL, LKE, LG&E and KU are issued quarterly and annually for investor and financial institution use.

Objective of Procedure:

The objective of the materiality accounting policy and procedures is to ensure that the process for determining materiality is defined relevant to the companies reported and communicated to individuals responsible for determining whether each identified adjustment may be waived as immaterial. These adjustments must also be analyzed on a company-wide basis to ensure all waived adjustments are not material to the financial statements of the companies.

General Requirements:

FASB Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information, defines materiality as “the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.” This definition implies that more than just

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(Note: Text in italics indicates key SOX control 80.08.08)

quantitative factors should be considered when determining materiality. LKE will include both quantitative and qualitative factors in making sound decisions regarding materiality for purposes of financial statement reporting.

The SEC Staff Accounting Bulletin: Topic 1 (Financial Statements), Item M (Materiality), Subtopic 1 (Assessing Materiality) (SAB Topic 1-M-1) indicates that “materiality concerns the significance of an item to users of a registrant’s financial statements. A matter is ‘material’ if there is a substantial likelihood that a reasonable person would consider it important.” There is no “bright line” test. Materiality is determined on the basis of all relevant facts and circumstances.

As indicated in SAB Topic 1-M-1, in determining whether multiple misstatements cause the financial statements to be materially misstated, a registrant should consider each misstatement separately and the aggregate effect of all misstatements.

Reclassifications / Changes Affecting Comparability

The FASB Accounting Standards Codification (ASC) 205 Presentation of Financial Statements (ASC 205) notes the following:

> “205 Presentation of Financial Statements
> 205-10-50 Disclosure
> General
> Changes Affecting Comparability
> 50-1 If, because of reclassifications or for other reasons, changes have occurred in the manner of or basis for presenting corresponding items for two or more periods, information shall be furnished that will explain the change. This procedure is in conformity with the well- recognized principle that any change in practice that affects comparability of financial statements shall be disclosed.”

Financial Reporting will evaluate changes in the current year’s classifications of items on the balance sheet and income statement to determine if they represent material misstatements of the prior periods’ financial statements. For example a reclassification of debt from long-term to short-term or reclassifications of cash flows from the operating activities category to the financing activities category, might occur because those items were incorrectly classified in the previously issued financial statements. These types of reclassification, if material could be considered a correction of a misstatement. Or, a reclassification could occur when an item is broken out from a financial statement line caption, for example an item previously included in Accounts Payable is reclassified to Other Current Liabilities. If a material reclassification has occurred, the prior year’s financial statements will be reclassified and appropriate disclosure will be made in the financial statement footnotes.

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(Note: Text in italics indicates key SOX control 80.08.08)

The ‘GLAFF Change Request Form - Account’ contains a field to require the individual completing the form to disclose the fact whether or not the account (new or existing) has a prior period balance. LKE will assess the need to reclassify the issued prior period financial statements based on the individual requests and in the aggregate. The Financial Reporting department will maintain a schedule of all reclassifications (recorded and unrecorded) to evaluate the comparability of the financial statements and to determine if the issued prior year balances should be changed. Recorded reclassifications are those that are automatically performed in Oracle, for example a request to remap an account will automatically remap the prior year, versus a request to create a new account for an item which had a prior year balance will not change prior year mapping.

When the ‘GLAFF Change Request Form - Account’ is completed and the change involves an account with a prior period balance, the department Manager approving the request must contact the Manager, Financial Reporting. The Manager requesting the change will provide the Manager, Financial Reporting with support for the prior period amount and document the reason for change. The Manager, Financial Reporting, along with the requesting Manager will make a preliminary decision as to whether the reclassification is individually material, or in the aggregate material, based on other reclassifications affecting the financial statement line and the recommended course of action. The Manager, Financial Reporting will then review the assessment with the Controller and a final determination will be made. The assessment will be shared with the Sarbanes Oxley Compliance department and the external auditors. The materiality conclusions for the reclassifications will be reflected in the Overall Error Assessment memo prepared by the Financial Reporting Department for each reporting period.

Quantitative

For purposes of overall quantitative materiality, LKE, LG&E and KU will use 7% of projected full year pretax income for the first three quarters and actual year-to-date pretax income for the fourth quarter as an outside limit for determining whether the Income Statements as a whole are materially correct and 5% of total current assets for determining whether the Balance Sheets as a whole are materially correct. The percentage threshold is supported by the SEC SAB Topic 1-M-1, which states that “the use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that – without considering all relevant circumstances – a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material. The staff has no objection to such a ‘rule of thumb’ as an initial step in assessing materiality. But quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations.” The thresholds used by LKE, LG&E and KU were developed after obtaining benchmark ranges provided to PPL by Deloitte Consulting during a Sarbanes-Oxley Program Improvement Project

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(Note: Text in italics indicates key SOX control 80.08.08)

consulting engagement conducted during 2014. The thresholds used by LKE, LG&E and KU are within or below the ranges of the Deloitte benchmarks.

LKE, LG&E and KU have only public debt. LKE's equity is 100% owned by PPL Corporation and LG&E's and KU's equity is 100% owned by LKE. For LG&E and KU, and therefore for LKE, much of the debt is secured by mortgages. Using a 7% threshold rather than the 5% example used by the SEC recognizes the lower risk of investing in the debt of LKE, LG&E and KU for the debt investors – the primary external users of the LKE, LG&E and KU financial statements.

LKE, LG&E and KU will assess all income statement errors which meet or exceed certain quantitative thresholds. These thresholds are determined by each Registrant quarterly as 0.35% of the following:

- 1st Quarter – Projected full year pretax income from the current year budget
- 2nd Quarter – Projected full year pretax income from the 1st quarter's reforecast
- 3rd Quarter – Projected full year pretax income from the 2nd quarter's reforecast
- 4th Quarter – Actual full year pretax income

The 0.35% threshold is 5% of the 7% baseline materiality level and is evaluated for reasonableness quarterly and therefore subject to change when appropriate. The calculation of the thresholds for each quarter is contained in the waived adjustment file for that quarter.

The above threshold is also used for review of spreadsheets received from third parties and manual accrual certifications.

LKE, LG&E and KU will assess all balance sheet reclassifications, which meet or exceed 0.25% (5% of 5%) of pretax income as a proxy for current assets and current liabilities at each reporting date. The balance sheet threshold is set at this level to ensure errors are properly evaluated for their impact on operating cash flows in the statement of cash flow. The calculation of the thresholds for each quarter is contained in the waived adjustment file for that quarter.

LKE, LG&E and KU will also apply the following quantitative thresholds, based on the 7% of pre-tax income, when assessing the following:

- Income statement analysis in the MD&A – 60% of 7% or 4.2% of actual pre-tax income for each quarter or year-to-date in the 10-Q and for total year in the 10-K. Disclosures meeting this criteria in earlier quarters may be carried forward to all subsequent quarters in a year, based on qualitative factors.
- Material internal control weakness – 100% of 7%, or 7% of pre-tax income. The thresholds are calculated on a quarterly basis, using projected full year pretax income

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(Note: Text in italics indicates key SOX control 80.08.08)

budget for the first quarter, projected full year pretax income from the 2nd and 3rd quarter's reforecast for the second and the third quarter, and actual full year pretax income for the fourth quarter.

- Significant internal control deficiency – 50% of 7%, or 3.5% of pre-tax income. The thresholds are calculated on a quarterly basis, using projected full year pretax income budget for the first quarter, projected full year pretax income from the 2nd and 3rd quarter's reforecast for the second and the third quarter, and actual full year pretax income for the fourth quarter. (This threshold is also used by SOX department for information processing system and interface scoping).
- Tolerable Misstatement threshold (i.e., scoping accounts and processes and of Key SOX controls) – 20% of 7%, or 1.4% of pre-tax income. The thresholds are calculated on a quarterly basis; using the projected full year pretax income budget for the first quarter, projected full year pretax income from the 2nd and 3rd quarter's reforecast for the second and the third quarter, and actual full year pretax income for the fourth quarter. (This threshold is also used for GFOC's approval of impairments).
- High risk or complex manual journal entries – 25% of 7%, or 1.75% of pre-tax income. The thresholds are calculated once on an annual basis (in the first quarter of each year) using the projected full-year pretax book income from the current year budget.

  (**Note:** The thresholds for a significant internal control deficiency and a material internal control weakness are used to determine when assessments regarding the significance of a control deficiency are initiated. However, qualitative assessment of items (see discussion below) may indicate that the items are not significant or material, even when the quantitative threshold is met.)

LKE, LG&E and KU will also apply the following quantitative thresholds, based on the 5% of total current assets, when assessing the following:

- Balance sheet disclosure assessment – 100% of 5% or 5% of total current assets at the end of each quarter. Disclosures meeting this criterion in earlier quarters may be carried forward to all subsequent quarters in a year, based on qualitative factors.

The calculation of the above mentioned thresholds for each quarter is contained in the waived adjustment file for that quarter.

These quantitative measures will be considered along with the overall level of risk of the item being considered. The Company considered the following factors when determining the range of materiality:

- existence of a stable business environment;
- the Company's business is viable and not under financial duress;

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(Note: Text in italics indicates key SOX control 80.08.08)

- management of the Company is competent and capable;
- entity level controls are in place and working; and
- historical track record of few minor adjustments proposed by auditors on an annual basis.

The SEC Staff Accounting Bulletin: Topic 1 (Financial Statements), Item N (Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements) (SAB Topic 1-N) also provides guidance regarding the determination of materiality. The two techniques that are most commonly used to accumulate and quantify misstatements are the "rollover" and "iron curtain" approaches. The rollover approach quantifies a misstatement based on the amount of the error originating in the current year income statement. This approach ignores the effects of correcting the portion of the current year balance sheet misstatement that originated in prior years (i.e., it ignores the "carryover effects" of prior year misstatements. The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement's year(s) of origination. Companies should quantify the impact of correcting all misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. All errors should be quantified and evaluated using both the rollover and the iron curtain methods.

Qualitative

Although an account or group of transactions is below the quantitative materiality scope, materiality must also be evaluated on a qualitative basis. In addition to quantitative computations, qualitative considerations must be factored in when determining whether an item is material to the financial statements. Qualitative measures for determining the risk of material misstatement in individual accounts include the following from the company's Balance Sheet Accounts Reconciliation Policy and internal control risk assessment:

- susceptibility of the account or transactions to loss due to errors or fraud, including past errors in the account;
- risk level of account involved (see Balance Sheet Reconciliation Policy and Procedures);
- volume of activity, complexity, and homogeneity of the individual transactions processed through the account (i.e., based on estimates);
- nature of the account (e.g., suspense accounts generally warrant greater attention);
- level of management judgment used in the account;
- existence of related party transactions in the account;
- changes from the prior period in account characteristics (e.g., new complexities or subjectivity or new types of transactions); and
- sensitivity of the account in affecting the reporting entity's (LKE, LG&E or KU) compliance with legal or regulatory requirements, loan covenants, or other contractual requirements.

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(Note: Text in italics indicates key SOX control 80.08.08)

The above measures are listed on the 'Account Segment Change Request Form'. When new accounts are created they are required to be ranked on a low, medium, high scale for the above seven criteria and an eighth segment asks if the account should be given a qualitative risk ranking of 3 (high) regardless of the responses to the seven preceding questions.

SAB Topic 1-M-1 also lists the following qualitative measures:

- Whether it arises from a precisely measurable item/calculation or an estimate;
- Whether it masks a change in earnings or other trends;
- Whether it hides a failure to meet analysts' or others' consensus expectations;
- Whether it changes a loss into income or vice versa;
- Whether it affects compliance with regulatory requirements;
- Whether it affects compliance with loan covenants or other contractual requirements;
- Whether it has the effect of increasing management's bonuses or other compensation; and
- Whether it involves concealment of an unlawful or fraudulent transaction.

Key areas of disclosure that should be considered when evaluating material transactions include:

1. Contingencies
    a. Legal proceedings
    b. Guarantees
    c. Regulatory matters
    d. Lease arrangements
2. Risks (financial and other)
    a. Financial risks (e.g. credit rating downgrades, counterparty credit, financial covenants)
    b. Environmental regulations
    c. Risk management activities
    d. Energy trading activities
3. Known trends, demands, commitments, events or uncertainties. Use the "reasonably likely" standard (i.e. what is reasonably likely to come to fruition?)
    a. Decrease in demand
    b. Market price changes
    c. Government regulation
    d. Rating agency scrutiny
    e. Contraction/expansion of operations
4. Off-balance sheet arrangements
    a. Consider effect of terminating the arrangement or including the effect of the arrangement on the balance sheet

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(Note: Text in italics indicates key SOX control 80.08.08)

5. Related party transactions
    a. Consider transactions involving parties that have a relationship with the company, including officers and directors and their family (also ex-officers and directors)
6. Lag periods
    a. Prior to issuing periodic reports, consideration should be given to specific transactions or events of subsidiaries whose financial statements are prepared as of a date preceding the date of the parent's consolidated financial statements (within an acceptable lag period). These specific transactions or events could be either lag period transactions or subsequent events.
    b. Financial Standards Board (FASB) Accounting Standards Codification (ASC) 810, Consolidations, (ASC 810) and Regulation S-X, 3A-02(b)(1) (Article 3A – Consolidated and Combined Financial Statements, Topic 02 – Consolidated Financial Statements of the Registrant and Its Subsidiaries) indicate that it is acceptable to consolidate a subsidiary on a lag that is not more than about three months different from the fiscal period of the parent. Recognition should be given by disclosure or otherwise of intervening events which materially affect the parent's financial position or results of operations.
    c. Specific transactions or events that occur after the lag period are considered subsequent events. See the Subsequent Events Accounting Policy and Procedures for additional information.
7. Financial Statements
8. Other
    a. Credit arrangements/financing activities
    b. Acquisitions/divestitures
    c. Critical accounting policies
    d. Material contracts

Detailed Procedures Performed:

1. All adjustments, no matter the dollar amount, must be booked to the general ledgers prior to closing the books each month. Adjustments may only be "waived as immaterial" if they are not timely identified during the closing process and are immaterial based on determinants in this policy or are determined by Management to be a valid deferred adjustment (i.e., amounts <$50,000 not yet processed for payment in Accounts Payable [See Accounting Policy and Procedures 751 – AP – Manual Accrual]).

2. *All adjustments not booked during the quarter, including reconciling errors appearing in balance sheet account reconciliations, and out of period adjustments booked during the quarter greater than or equal to the error thresholds as outlined in quarterly waived adjustments file, must be placed on the waived adjustment list. This file, including the thresholds, is maintained for the quarter in a file labeled "Waived Adjustments X Qtr Year"*

(Note: Text in italics indicates key SOX control 80.08.08)

(i.e., Waived Adjustments 1st Qtr 2012) on the acctshare on 'fs2' shared drive by the person identifying the adjustment and reviewed for accuracy by the respective accounting manager.

3. Adjustments not meeting the threshold to be included on the Waived Adjustments file must still be reviewed to determine if they resulted from a deficiency in internal controls (SOX deficiency). As a general rule, errors that are identified relating to previously issued financial statements are considered to result from a SOX deficiency since existing internal controls did not identify the error prior to the financial statements being issued. All adjustments will be reviewed by the SOX Compliance Department (SOC) to determine if they resulted from a SOX deficiency. In certain instances, adjustments related to previously issued financial statements may not have resulted directly from a failure of a control and do not materially impact the previously issued financial statements, in these instances the SOC review may result in the determination that the adjustments were not a result of a SOX deficiency. Issues reviewed by the SOC and deemed not to be deficiencies are considered "Observations". Some examples are:
   - Adjustments identified by Management (not Audit Services, External Auditors or external parties such as a vendor)
   - Adjustments not resulting directly from a control failure (e.g. failure to accrue an invoice, inadequate spreadsheet controls)
   - Adjustments resulting from estimates which do not have material (as defined in this policy) implications on future financial statements

   The SOC has defined procedures and process flow for reviewing potential deficiencies which can be found on the SOC SharePoint site.

4. Adjustments waived as immaterial must be booked as soon as practical but no later than the close of the next quarter. Waived adjustments that are elected to not be booked must be approved by the CFO and controller.

5. *All adjustments (that meet the lowest threshold as outlined in that quarter's waived adjustments file must be documented in a memo (known as an "Error Assessment Memo", see Appendix A[1]) should be addressed to the Controller and copied to the relevant Director(s) and the reporting workpapers. Communications of the draft and final error assessment memo should be performed by the author of the error assessment memo. To avoid confusion, error assessment memos are required for any error exceeding the lowest threshold calculated for the quarter (i.e. if LG&E's threshold is the lowest of the three*

[1] Appendix A is a template for the Error Assessment Memo and contains additional SOX assessment documentation required if the error identified is greater than the lowest threshold outlined in the quarterly waived adjustments file. In addition to Appendix A, Appendix B provides guidance for reporting SOX issues in the error assessment memo.

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(Note: Text in italics indicates key SOX control 80.08.08)

registrants' thresholds any adjustment waived as immaterial that exceeds LG&E's threshold must be documented in an error assessment memo, including amounts related to each registrant).

An electronic copy of the memo must be filed on the \\lgeenergy.int\shares\Group3: acctrestricted drive for the respective quarter. The memo must state the following at a minimum, if applicable:

- *Overview of the error*
- *How the error was identified*
- *Controls impacted and corrective action to ensure the misstatement does not reoccur*
- *A materiality assessment including:*
  - *A quantitative assessment addressing the periods impacted*
  - *the amount of adjustment reported on respective financial statements by financial statement line item*
  - *A qualitative assessment based upon SEC guidelines*
  - *A conclusion regarding materiality*
- *SOX assessment*
- *Disclosure requirements*

In order to ensure timely reporting of internal control exceptions, Error Assessment Memos must be completed prior to the end of the quarter in which the error was identified. In the instance of errors identified for the current reporting period, Error Assessment Memos should be completed within two weeks of the identification of the error but no later than five business days prior to the issuance of the financial statements.

The SOX Compliance department uses the information contained in Error Assessment Memo to evaluate the impact of the error on the Company's system of internal controls. Care should be taken to include relevant information in the Error Assessment Memo. The SOX Compliance department should review the Error Assessment prior to finalization.

All final error assessment memos are saved in the appropriate quarter's directory on the shared \\lgeenergy.int\shares\Group3: acctrestricted\Error Assessment Memos\ drive after approved by the Director, Accounting and Regulatory Reporting and the Controller.

Files containing the Error Assessment Memos can only be saved to the \\lgeenergy.int\shares\Group3: acctrestricted\Error Assessment Memos\ drive/directory by the Director, Accounting and Regulatory Reporting and the Controller or their designees to ensure only approved memos are presented. All other access to the directory is set as "read-only".

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(Note: Text in italics indicates key SOX control 80.08.08)

6. When a significant financial or non-financial item is identified and affects an entity's financial statements, the Controller will make a preliminary determination as to whether the item may require adjustment to or disclosure in the financial statements. If adjustment and/or disclosure are deemed necessary, the Manager, Financial Reporting or a designee in Financial Reporting and the appropriate Controller's group department will draft the appropriate change and/or prepare the required disclosure. Concurrence will be obtained from the Controller and the result will be communicated back to the appropriate business line.

7. *The Controller or the Controller's designee will assess all waived adjustments individually and collectively in relation to the relevant company(ies) and relevant line items of the affected company's(ies') financial statements to determine that waived adjustments individually and collectively are immaterial. The determination that adjustments individually and collectively are immaterial must consider qualitative items in addition to quantitative measures. See Quantitative and Qualitative under General Requirements.*

8. Should it be determined that items previously determined to be immaterial are determined to be material, either quantitatively or qualitatively, after the general ledgers have been closed for the period, the general ledgers will be reopened to adjust for the items, and the financial statements will be adjusted accordingly.

9. Adjustments deemed to be immaterial are identified after balances for the reporting period(s) are submitted to PPL for the reporting period and will be communicated to the appropriate personnel within PPL by the Controller's designee through the following:

   - Waived adjustment list
   - Individual Error Assessment Memos
   - Overall Assessment of Errors to the Financial Statements

10. Adjustments waived as immaterial will be reported to the GFOC during its quarterly meeting.

Reports Generated and Recipients:

- Individual Error Assessment Memos will be generated using the format in Appendix A when required by this policy and provided to the Controller
- Overall Assessment of Errors to the Financial Statements - a summary of waived adjustments and reclassifications will be prepared for and approved by the Controller quarterly

Additional Controls or Responsibility Provided by Other Procedures:

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(Note: Text in italics indicates key SOX control 80.08.08)

- All balance sheet accounts will be reconciled based on their assigned risk but at least quarterly in accordance with the Balance Sheet Account Reconciliation policy and procedures

Regulatory Requirements:

None

Reference:

- FASB Statement of Financial Accounting Concepts No. 2, Qualitative Characteristics of Accounting Information
- SEC Staff Accounting Bulletin: Topic 1 (Financial Statements), Item M (Materiality), Subtopic 1 (Assessing Materiality) (SAB Topic 1-M-1)
- SAB Topic 1-M-1, Materiality
- SAB Topic 1-N, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements
- APB Opinion No. 20, Accounting Changes
- ASC 250-10-05, Accounting Changes and Error Corrections
- 250 – Balance Sheet Account Reconciliation Policy and Procedures
- 251 – Journal Entries Policy
- 751 – AP – Manual Accrual Policy and Procedures

Corresponding PPL Policy No. and Name:

304 - Materiality

Key Contact:

Manager, Financial Reporting

Administrative Responsibility:

Controller

Date Created: 10/31/05
Dates Revised: 11/03/05
07/18/06

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(Note: Text in italics indicates key SOX control 80.08.08)

11/11/06
02/29/08
08/27/09
03/21/11
07/05/11
08/03/11
10/03/11
6/22/12
10/19/12
4/2/13
10/7/13
6/30/14
5/26/15
1/16/2016
4/1/16
11/13/2017

Note: The file naming convention to be used for this memo is "Topic from "Re" line below MM-DD-YYYY"

MEMORANDUM

Date: Insert Date here & in 2^{nd} page header

To: Controller

From: Insert name of memo preparer &/or relevant manager

Re: Insert topic here & in 2^{nd} page header

cc: Insert name of relevant Director or Officer and the following recipients
Director, Audit Services
Manager, Sarbanes-Oxley Compliance
Manager, Financial Reporting
Ernst & Young/Deloitte
Director, Shared Accounting Services, PPL
Controller, PPL
(Draft & final distribution of the memo is the responsibility of the manager responsible preparing the memo. No distribution should occur before memo has been reviewed and approved by the Controller.)

Overview of Error [1]

Narrative containing a general description and cause of the error/change, including high-level background of the process where the error/change occurred and when the error was detected or the change made (i.e., month and year). This section should include description, root cause, and issue implication from *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos.*

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[1] LKE, LG&E and KU will assess all income statement and balance sheet errors which meet or exceed certain quantitative thresholds. These thresholds are determined by each Registrant quarterly as 0.35% of pretax income and are updated in the quarterly waived adjustments file.

How Error Was Identified

Narrative containing a general description of how and when the error was identified (i.e., "In analysis of the June activity an error was identified in the way …" or "While reconciling the XXX account for the month of April it was determined that ….")

Controls Impacted

Narrative indicating the controls impacted (i.e., "The error was attributable to failure of controls surrounding key spreadsheets …") including the control activity number(s) and compensating control numbers, if any. If a control detected the error, it should be noted in this section. See *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos*.

Action Plan

Narrative indicating the plan to mitigate future risk of the error occurring (including the individual(s) responsible for the action plan), evidence requirements and affirmation that Sarbanes-Oxley (SOX) documentation has been updated for the change(s) in process.

See *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos*.

Date to Implement: _______________

Materiality Assessment

Periods Impacted *(including quarter correction booked)*

Year/Quarter	Q1	Q2	Q3	Q4
2017				
2016				
2015				
Pre-2015				

Quantitative Assessment -- Adjustment to Amounts Reported on Financial Statements (000's)

(from Error Correcting Entries file ***or other format, if appropriate****)*
(LKE consolidated entries do not need to be provided if only LG&E and KU are impacted)
(include federal and state income tax impact)

Adjust dates in this table		9ME 09/30/14		3ME 09/30/14	
Fin Statement Line Item	Company	Debit	Credit	Debit	Credit

($ in thousands)

	LG&E				
Copy entry(ies) into this space	LG&E				

	LG&E				
	LG&E				

	KU				
Copy entry(ies) into this space	KU				
	KU				
	KU				

	Other				
Copy entry(ies) into this space	Other				
	Other				
	Other				

See the waived adjustment file for the percentage impact on each financial statement line item. (Alternatively, insert columns U to Z (as applicable) from the waived adjustments file.) (**Note:** If the error is 5% or greater of any line item, insert the columns U to Z (as applicable) and columns AK to AP (as applicable) from the waived adjustments file and discuss justification for the error being considered quantitatively immaterial. If the error is 5% or greater of any financials statement subtotal line, also discuss the relative % error to the forecasted full year financial statement balances.)

Qualitative Assessment

In Topic 1 - M, “Materiality” the SEC provides examples of qualitative factors that could cause an otherwise small quantitative error to be material to an investor. The following is an assessment of each of these factors relative to the error described in this memo.

- Whether it arises from a precisely measurable item/calculation or an estimate.

  Insert comments addressing factor

- Whether it masks a change in earnings or other trends.

  Insert comments addressing factor

- Whether it hides a failure to meet analysts’ or others’ consensus expectations.

  Insert comments addressing factor

- Whether it changes a loss into income or vice versa.

  Insert comments addressing factor

- Whether it affects compliance with regulatory requirements.

Insert comments addressing factor

- Whether it affects compliance with loan covenants or other contractual requirements.

  Insert comments addressing factor

- Whether it has the effect of increasing management's bonuses or other compensation.

  Insert comments addressing factor

- Whether it involves concealment of an unlawful or fraudulent transaction.

  Insert comments addressing factor

Materiality Assessment Conclusion

Management has concluded, based on both the quantitative and qualitative assessments above, this error is not material to the financial statements. Because the error is not significant to the financial statements, no adjustment to the current or previous financial statements is necessary and no disclosure of the error is required. (Adjust the language in this paragraph based on the quantitative materiality of the error.)

This error will be noted during the next LG&E and KU Energy Governance and Financial Oversight Committee meeting.

See also Financial Reporting's overall assessment of all errors for an assessment of this and all other errors identified as affecting the financial statements to for this period.

SOX Assessment

PCAOB Audit Standard (AS) 5, Appendix A, paragraph 3 defines a deficiency in internal control over financial reporting as follows:

"A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
- *A deficiency in <u>design</u> exists when (a) a control necessary to meet the control objective is missing or (b) and existing control is not properly designed to that, even if the control operates as designed, the control objective would not be met.*
- *A deficiency in <u>operation</u> exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively."*

In evaluating the deficiency, management considered PCAOB AS 5 paragraphs 63 through 69, under *Evaluating Identified Deficiencies*:

"63. The severity of a deficiency depends on -

- *Whether there is a reasonable possibility that the company's controls will fail to prevent or detect a misstatement of an account balance or disclosure; and*
- *The magnitude of the potential misstatement resulting from the deficiency or deficiencies.*

64. The severity of a deficiency does not depend on whether a misstatement actually has occurred but rather on whether there is a reasonable possibility that the company's controls will fail to prevent or detect a misstatement.

65. Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following -

- *The nature of the financial statement accounts, disclosures, and assertions involved;*
- *The susceptibility of the related asset or liability to loss or fraud;*
- *The subjectivity, complexity, or extent of judgment required to determine the amount involved;*
- *The interaction or relationship of the control with other controls, including whether they are interdependent or redundant;*
- *The interaction of the deficiencies; and*
- *The possible future consequences of the deficiency.*

66. Factors that affect the magnitude of the misstatement that might result from a deficiency or deficiencies in controls include, but are not limited to, the following -

- *The financial statement amounts or total of transactions exposed to the deficiency; and*
- *The volume of activity in the account balance or class of transactions exposed to the deficiency that has occurred in the current period or that is expected in future periods.*

67. In evaluating the magnitude of the potential misstatement, the maximum amount that an account balance or total of transactions can be overstated is generally the recorded amount, while understatements could be larger. Also, in many cases, the probability of a small misstatement will be greater than the probability of a large misstatement

68. The auditor should evaluate the effect of compensating controls when determining whether a control deficiency or combination of deficiencies is a material weakness. To have a mitigating effect, the compensating control should operate at a level of precision that would prevent or detect a misstatement that could be material.

69. Indicators of material weaknesses in internal control over financial reporting include -

- *Identification of fraud, whether or not material, on the part of senior management;*
- *Restatement of previously issued financial statements to reflect the correction of a material misstatement;*
- *Identification by the auditor of a material misstatement of financial statements in the current period in circumstances that indicate that the misstatement would not have been detected by the company's internal control over financial reporting; and*
- *Ineffective oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee."*

SOX Assessment Conclusion

Management has concluded that the deficiency in internal control over financial reporting does not rise to the level of a material weakness due to the following: (provide support for this conclusion based on paragraphs 68-69 above). See *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos*.

Management has concluded that the deficiency in internal control over financial reporting does not rise to the level of a significant deficiency due to the following: (provide support for this conclusion based on paragraphs 63-67 above). See *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos*. (**Note:** This paragraph should be deleted if the error is a material weakness.)

Management has concluded, based on the guidance in PCAOB AS 5, this error is a deficiency in the design/operation (pick one) of internal controls over financial reporting (provide support for this conclusion based on Appendix A, paragraph 3 above). See *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos*. This error is not the result of a material error or significant deficiency as described above, but is a deficiency in internal controls over financial reporting. (**Note:** This paragraph should be deleted if the error is a material weakness or a significant deficiency.)

This error will be noted during the next LG&E and KU Energy Governance and Financial Oversight Committee meeting.

Required Disclosures

This error is not material to the interim or year-end financial statements and does not involve a material weakness, accordingly no disclosure is required. (Note: Delete this sentence if not accurate.)

Disclosure of out of period adjustment (Note: Delete this section, if not necessary.)

If the error is determined to be material to the financial statements add discussion of how the financial statements will be corrected and how the correction of the error will be disclosed. See *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos*.

This section should also provide the narrative for disclosure in the Form 10-K or Form 10-Q, the disclosure should be presented either in the affected note, for example if the error is a tax out of period adjustment, the disclosure will be included in the Income Tax footnote, if there is no specific footnote it will be included in Note 1 Summary of Significant Accounting Policies – General for the Form 10-K or Note 1, Interim Financial Statements for the Form 10-Q.

Disclosure of internal control deficiency (Note: Delete this section, if not necessary.)

(If the error is determined to be a material weakness add discussion of how this will be disclosed in the financial statements. See *Appendix B - Guidance for reporting Sarbanes-Oxley Issues in Error Assessment Memos*. Also provide a discussion on the necessary steps taken to ensure timely disclosure through the filing of a Form 8-K in accordance with the policy, see *355- SEC Reporting requirements*. No disclosure in the Form 10-K or Form 10-Q is required if the error is classified as a deficiency or significant deficiency.)

<u>This section should provide the narrative for disclosure in the Form 10-K or Form 10-Q, the disclosure should be presented in Part III, Item 9A in the Form 10-K and in Item 4 of the Form 10-Q.</u>

Appendix B

Guidance for Preparing an Error Assessment Memo

This information is required to document the control exception and will be used to populate the LKE Audit Services (AS) issues database.

The Sarbanes-Oxley Compliance Department (SOC) is available to assist in the various evaluations within this process and to review Error Assessment Memo (EAM) drafts at critical points throughout their development.

When a financial statement error is documented in an EAM, an evaluation of the Sarbanes-Oxley (SOX) control documentation must be performed to determine if an existing control failed. This evaluation must be included in the EAM. If it is determined that the error does not relate to an existing SOX control, evaluate the error to determine if a control should be developed to prevent future errors. When a new control is needed, coordinate with the SOC to document and implement the new control.

Once a determination is made that a control exception exists, the individual responsible for the issue should use the following guidelines to assist in preparation of the EAM. After review of the EAM by the SOC, the SOC will complete the SOX Issue Template to be forwarded to all of the recipients of the EAM for review. Upon completion of the review, the information contained in the template will be input into the AS issues database.

Definitions for required information in EAMs

Overview of Error

Description: Provide a detailed description of the issue. Use language that individuals from outside of the immediate business area can understand.

Root Cause: Describe the root cause of the issue. For example, human error, lack of training, lack of monitoring, staff attrition.

Understanding the root cause of an issue involves identifying the contributing factors (key conditions, actions or inaction) that contributed to the occurrence of the issue. It is important to understand the root cause in order to develop the appropriate corrective action(s) so that the issue does not re-occur. To identify the root cause, it helps to ask probing questions such as those listed in the example below.

Example:

An issue occurred when an accountant was instructed to change the way a certain journal entry was handled. However, the entry was not changed. Asking the following probing questions can help get to the root cause.

- What is the reason for the presence of the problem? The accountant did not change the entry.
- What is the source or origin of the problem? The accountant was busy and forgot to make the change. The person who reviewed the entry was not aware or forgot that it was supposed to be changed.

Appendix B

Guidance for Preparing an Error Assessment Memo

- What is the basic reason that, if eliminated, would prevent recurrence? The accountant should have alerted the manager that this change was forthcoming and/or a checklist item should have been created to ensure that this change was incorporated into the monthly/quarterly process.
- Was a control in place or is one needed to mitigate the risk of recurrence? The journal entry review control was in place, but it should be enhanced to include a checklist for the reviewer that would track expected changes in standard journal entries.

We can see from this example, that change management and communication were primary causes for the issue and the remediation plan should focus on those areas.

Issue Implication: Is there a potential for additional misstatements resulting from the control failure? If so, explain. The SOC will use the information included in the **Materiality Assessment** section.

Controls Impacted

Compensating Control Number(s): Identify existing documented controls (by control activity number(s) and name(s)), which either detected or prevented the error in financial reporting that is related to the issue.

Action Plan:

Description: Describe Management's plan to address the issue and who is responsible for ensuring the action occurs. Action plans should be specific, actionable, and provide evidence of implementation.

Evidence Requirements: Provide a description of the evidence that will be provided to support implementation of the **Action Plan**.

Date to Implement:

Provide the date Management has committed to implement the action plan. Once communicated to senior management, this date can only be changed with approval from the CEO at least two weeks before the original **Date to Implement**.

Materiality Assessment:

Section of the EAM to identify the company, financial statement line item, and dollar impact of the error.

Appendix B

Guidance for Preparing an Error Assessment Memo

SOX Assessment

In the event that a significant/key SOX control is found to have failed, determine the level of deficiency:

Deficiency - A deficiency in internal control over financial reporting (ICFR) exists when the design or operation of a control does not allow Management, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis[1].

- Control design relates to the set-up of the control. Control design is documented in SOX narratives by describing the control that is performed. For example, "Bank reconciliations are performed monthly."
- Control operation relates to how the control is executed. The control design should describe how the control should be operated. For example, "Bank reconciliations are prepared in Excel by an Accounting Analyst."

All deficiencies are communicated to the Governance and Financial Oversight Committee (GFOC) and PPL's Audit Committee.

Significant Deficiency - A significant deficiency is a deficiency, or a combination of deficiencies, in ICFR that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of a company's financial reporting. Significant deficiencies are reported in the Company's Form 10-Q and Form 10-K and communicated to GFOC and PPL's Audit Committee.

The Company is not required to disclose a significant deficiency in the Form 10-Q and Form 10-K. However, if management identifies a significant deficiency that, when combined with other significant deficiencies, is determined to be a material weakness, management must disclose the material weakness and, to the extent material to an understanding of the disclosure, the nature of the significant deficiencies. In addition, if a material change is made to either disclosure controls and procedures or to internal control over financial reporting in response to a significant deficiency, the Company is required to disclose the change and should consider whether it is necessary to discuss further the nature of the significant deficiency in order to render the disclosure not misleading.

Material Weakness - A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. Material weaknesses are reported in the Company's Form 10-Q and 10-K and communicated to the GFOC and PPL's Audit Committee. Management should consider filing a Form 8-K if the material weakness results in non-reliance on previously issued statements or a related audit report that result in an error. See *Ongoing Disclosure*

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[1] Timely basis will vary based on the design of the control. For example, the timely basis of a control designed to function on a monthly basis would not be the same for a control designed to function on a daily basis.

of Material Information (Form 8-K) policy for information on what is to be included in a Form 8-K filing and deadline dates.

<u>Disclosures</u>

Disclosure if the error results in recording a material out of period adjustment

Per FASB ASC 250-10-45 Accounting Changes and Error Corrections – Presentation, Materiality Determination for Correction of an Error, paragraph 45-27 – "In determining materiality for the purpose of reporting the correction of an error, amounts shall be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings. Changes that are material with respect to an interim period but not material with respect to the estimated income for the full fiscal year or to the trend of earnings shall be separately disclosed in the interim period."

Therefore, the disclosure should include:

- the fact that an out of period adjustment was made,
- the period in which the adjustment was recorded in the general ledger,
- the financial statement caption affected and the amount before and after tax, and
- if there is a material impact to the previously reported financial statements and the affect on the full year financial statements for the current period reported.

Material Weakness Disclosure:

<u>The disclosure for a material weakness in Form 10-K Item 9A and Form 10-Q Item 4 should include:</u>

- <u>the nature of the material weakness,</u>
- <u>the period in which the adjustment was recorded in the general ledger,</u>
- <u>its effect on financial reporting and the control environment, and the financial statement caption affected and the amount before and after tax, and</u>
- <u>management's current plans, if any, for remediating the weakness.</u>

Per E&Y's 2011 SEC annual reports- Form 10-K guidance book:

"The SEC staff has stated that it does not believe that an Item 4.02 Form 8-K is required for every revision to a registrant's previously issued financial statements that is the result of an error. However, the SEC staff has indicated that it would be "surprised" if amounts in the primary financial statements (e.g., balance sheet, income statement, cash flow statement) were changed due to an error, but an Item 4.02 Form 8-K was not filed.

A notable exception to the SEC staff's expectation involves SAB Topic 1-N. Under SAB Topic 1-N, correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. Such correction may be made the next time a registrant files the prior year financial statements. The SEC staff has stated that, in cases where a pending restatement is immaterial, an Item 4.02 Form 8-K would not be required. However, the SEC staff cautioned that, if the error being corrected materially affected a prior quarter of the current

Appendix B

Guidance for Preparing an Error Assessment Memo

fiscal year, the SEC staff would expect the registrant to file an Item 4.02 Form 8-K with respect to those interim financial statements.

While not addressed in the SEC rules, we believe that a material weakness in internal control that was identified and corrected during the fiscal year would not preclude management from concluding that internal control over financial reporting was effective as of the end of the fiscal year. In those circumstances, management's internal control report" would not be required to disclose the existence and correction of a material weakness earlier in the company's fiscal year. However, under Item 308(c) of Regulation S-K (discussed below), a change during a fiscal year necessary to correct a material weakness in internal control would need to be disclosed in the periodic SEC report covering the respective fiscal quarter."

355 - SEC Reporting Requirements

Policy: All required U.S. Securities and Exchange Commission (SEC) filings are to be completed for LG&E and KU Energy LLC (LKE), Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (collectively the Company).

Procedure: The United States government through laws and rules requires companies with publicly traded securities to report information to the SEC. All SEC forms that are required to be filed by the Company are to be prepared and filed when due following the controls, policies and guidelines of the Company. Quarterly reports on Form 10-Q and annual reports on Form 10-K will be included in PPL Corporation's (PPL) Forms 10-Q and 10-K, consistent with other PPL registrants.

Scope: All forms filed by the Company with the SEC.

Objective of Procedure: To ensure all forms for LKE, LG&E and KU that are required to be filed with the SEC are accurate.

General Requirements:

Procedures:

Any questions on SEC Reporting or potential disclosures should be directed to Financial Reporting. Requirements for the preparation and review of 10-Q/10-K workpapers include, among others:

- The financial statements, including footnotes, and management discussion and analysis (MD&A) and other items or supplementary information reported in the Forms 10-Q or 10-K

355 - SEC Reporting Requirements

(i.e., audit fees, long-term debt schedule, parent only financial statements, fixed charge ratio calculations, etc.) will be cross-referenced where applicable, to supporting workpapers.

- Support for all amounts presented in the financial statements, footnotes, MD&A and other items or supplementary information will be contained in the workpapers.
- Workpapers will be provided to Financial Reporting containing the sign-off of the preparer and the reviewer to document appropriate review of analyses for accuracy, including calculations in spreadsheets. The workpapers will be maintained by Financial Reporting.
- The following items will be documented in the workpapers through checklist/timeline sign-off by the performer and the reviewer:
  - verify the reasonableness of the results,
  - compare disclosures among registrants for consistency,
  - compare disclosures for each registrant for internal consistency,
  - apply other verifications for accuracy, reasonableness and consistency specific to the area of contribution.

Additional procedures and controls are set forth in accounting policy and procedure *359 - Financial Statement Disclosures and Filing Requirements*.

Reports Generated and Recipients:

All SEC Forms are filed electronically with the SEC along with the filing of the respective PPL forms. The revolving credit facility banks and bond trustees will access copies of the reports on the SEC's internet site. Copies are maintained by the LKE Controller group.

Electronic copies of the 10-K/10-Q reports for LKE, LG&E and KU are sent to the Treasurer's department to be filed with the MSRB (Municipal Securities Rulemaking Board) and to provide courtesy copies to rating agencies. Electronic copies are also maintained on \\lgeenergy.int\shares\group1\financial_reporting shared drive, Financial and Operational Documents SharePoint site at http://home/og/fin/finrpt/SitePages/Home.aspx and the PPL internet site (pplweb.com).

Hard copies of the 10-K/10-Q reports for LKE, LG&E and KU are provided to Accounting Managers, CFO Directors and Officers, the Legal department, the Treasurer's department, the Rates department and other interested parties based on distribution lists maintained by Financial Reporting and the Legal department, or upon request

Additional Controls or Responsibility Provided by Other Procedures:

355 - SEC Reporting Requirements

- Adherence to accounting policy and procedure *962 - Compliance with GAAP and Regulations.*
- Controls over financial statement disclosures as set forth in accounting policy and procedure *359 - Financial Statement Disclosures and Filing Requirements*.
- Internal Controls over financial reporting documented for all internal control cycles

Regulatory Requirements:

The Securities Exchange Act of 1934 (Exchange Act) primarily addresses securities trading and the disclosures that a public company must make to ensure that investors are continually informed of a company's financial condition and prospects. Companies that report under the Exchange Act are required to file if the company engages in interstate commerce, the securities are held of record by 500 or more security holders, and the company had more than $10 million in total assets at its latest year end. Any company whose securities are registered under Section 12 of the Exchange Act must file annual and other reports that the SEC prescribes. Accordingly, LKE and subsidiaries, LG&E and KU must file with the Securities and Exchange Commission due to their public debt securities.

Rule 13a-1 of the Exchange Act requires the filing of an annual report on the appropriate form. Rule 13a-13 of the Exchange Act requires the filing of a quarterly report for each of the first three quarters of a fiscal year. Rule 13a-11 or Rule 15d-11 of the Exchange Act requires the filing of a "current report" on Form 8-K unless the information was previously reported. Form 8-K should also be used for reports of nonpublic information required to be disclosed by Regulation FD of the Exchange Act.

Forms required to be filed under the Exchange Act applicable to LKE, LG&E and KU registrants include the following:

- Form 10-K – For the annual report, large accelerated filers are required to file within 60 days after year-end, and must comply with internal control over financial reporting disclosure requirements (including obtaining an auditor's opinion regarding the effectiveness of internal controls over financial reporting). Non-accelerated filers are required to file their annual reports within 90 days after the end of the year. Effective with the passing of the Dodd-Frank Act (signed into law in July 2010), non-accelerated filers are no longer required to obtain an auditor's opinion regarding the effectiveness of internal controls over financial reporting. (Note: Although PPL is the only large accelerated filer, the Form 10-K reports for all PPL registrants are filed within the 60-day period, since the notes to the financial statements are prepared on a combined basis.)
- Form 10-Q – For the quarterly report, large accelerated filers are required to file within 40 days after the quarter end. Non-accelerated filers are required to file within 45 days.

355 - SEC Reporting Requirements

(Similar to the Form 10-K, all PPL registrants file within the Form 10-Q deadline for large accelerated filers.)

- Form 8-K - For the reporting of certain events, to be filed within four business days of the occurrence of the reportable event unless otherwise specified. See LKE corporate policy *Ongoing Disclosure of Material Information (Form 8-K)*, for additional information.
- Form 12b-25 – To be filed when a report is not filed by its due date and which, if certain conditions are met, provides additional time in which to file.

Reference:

- Securities Act of 1933
- Securities Act of 1934
- SEC Regulation S-X (governs the form and content of the financial statements)
- SEC Regulation S-K (governs the form and content of disclosures outside the financial statements)
- SEC Requirements, rules, regulations and interpretive guidance
- Accounting policy and procedure *962 - Compliance with GAAP and Regulations*
- Accounting policy and procedure *359 - Financial Statement Disclosures and Filing Requirements*

Corresponding PPL Policy No. and Name:

305 - SEC Reporting

Key Contact:

Manager, Financial Reporting - coordinate all external financial reporting for LKE, LG&E and KU and coordinate the holding company's reporting within PPL's quarterly and annual financial statements on Form 10-Q/10-K.

Administrative Responsibility:

Controller

Date Created: 3/18/11
Date Revised: 6/30/11, 9/4/12, 4/20/15

356 - Subsequent Events Accounting Policy and Procedures

Policy: LG&E and KU Energy LLC ("LKE" or the "Company") and its subsidiaries will recognize in their respective financial statements any subsequent event if the event provides additional evidence about conditions that existed at the balance sheet date. Subsequent events that provide evidence of a condition that did not exist at the balance sheet date should not be recognized in the financial statements.

Procedure: Between the balance sheet date and the date the Company's financial statements are issued or available to be issued, reviewers of the financial statements are to consider whether an amount reported or information disclosed needs to be adjusted or updated for the occurrence of a subsequent event.

Scope: All financial statements issued by LKE and/or its subsidiaries.

Objective of Procedure: To establish a policy and procedure for identifying and reporting subsequent events that may impact LKE reporting companies' financial statements. These financial statements may be prepared for and filed with the Securities and Exchange Commission ("SEC") or the Federal Energy Regulation Commission ("FERC").

General Requirements:

Definition

Subsequent events, as defined in Accounting Standards Codification ("ASC") 855, Subsequent Events, ASC 855-10-20, are:

Events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events:

A. The first type (Type I) consists of events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements (that is, recognized subsequent events). Example: When a previously identified loss contingency is increased after a quarter's end but before financial statements are released.

B. The second type (Type II) consists of events that provide evidence about conditions that did not exist at the date of the balance sheet but arose subsequent to that date (that is, non-recognized subsequent events). Example: When an entirely new event occurs after the quarter's end but before financial statements are released, resulting in a loss contingency or probable loss contingency.

356 - Subsequent Events Accounting Policy and Procedures

Recognition

As indicated in ASC 855-10-25-1, subsequent events should be recognized in the financial statements if the events provide additional evidence about conditions that existed at the balance sheet date (Type I), including adjustments to estimates made at the balance sheet date.

As indicated in ASC 855-10-25-2, public entities should evaluate subsequent events through the date the financial statements are issued.

As indicated in ASC 855-10-25-3, subsequent events that provide evidence of a condition that did not exist at the balance sheet date (Type II) should not be recognized in the financial statements, but may be disclosed.

As indicated in ASC 855-10-25-4, if financial statements are reissued, Type II subsequent events should not be recognized in the financial statements; however, disclosure may be necessary to keep the financial statements from being misleading.

Disclosure

As stated in ASC 855-10-50-1, "[a]n entity shall disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued." As indicated in ASC 855-10-50-4, this date should be disclosed in originally issued financial statements as well as reissued financial statements.

As stated in ASC 855-10-50-2, "some non-recognized subsequent events may be of such nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity shall disclose the following:

A. The nature of the event and

B. An estimate of its financial effect or a statement that such an estimate cannot be made."

If a non-recognized subsequent event is significant, disclosure of proforma financial data should be considered. See ASC 855-10-50-3 for additional information.

ASC 855-10-55-1 through 55-2 provide examples of both recognized and non-recognized subsequent events.

356 - Subsequent Events Accounting Policy and Procedures

Detailed Procedures Performed:

1. Management and the business units must establish a reporting system or structure that ensures the ongoing, prompt and accurate identification and reporting of all events, circumstances or occurrences, including subsequent events, that may be material to LKE and its reporting companies and therefore, may require disclosure in various financial statements. The reporting system or structure and its importance must be clearly communicated to employees within each area of responsibility. Employees must understand that their reporting obligation under this reporting system or structure is an ongoing obligation and that they should report to their supervisors all matters that might be deemed to be material.

2. When reviewing drafts of quarterly and annual financial statements, reviewers are to consider whether an amount reported or information disclosed needs to be adjusted or updated for the occurrence of a subsequent event. If an event has occurred, the Controller, the Manager, Financial Reporting and the Legal department need to be contacted.

3. During internal LKE financial statement review meetings, other Controller group staff meetings, the Governance and Financial Oversight Committee meeting, meetings with external auditors and PPL's Materiality and Disclosure Committee meeting that occur between quarter-end and year-end balance sheet dates and the filing date of the financial statements, discuss whether any subsequent events have occurred and whether the events should be disclosed in the financial statements. If an event has occurred, Financial Reporting and/or the Legal department will act accordingly.

4. Once notified, Financial Reporting, the Controller, and/or the Legal department, with input from other departments, will determine the type of subsequent event. If a recognized subsequent event, the applicable Controller's group department will record the necessary adjustment. If a non-recognized subsequent event, Financial Reporting and/or the Legal department will prepare the appropriate disclosure for the financial statements. Financial Reporting and/or the Legal department will contact PPL's Office of General Counsel to communicate the matter.

5. If an event has occurred or been identified after LKE's Governance and Financial Oversight Committee meeting or PPL's Materiality and Disclosure Committee meeting has taken place, Financial Reporting, the Controller, and/or the Legal department or Office of General Counsel will determine whether the event should be communicated to the Committees' members.

356 - Subsequent Events Accounting Policy and Procedures

6. Financial Reporting and the Legal department will continue to monitor developments in their areas of responsibility to identify the occurrence of subsequent events.

Reports Generated and Recipients:

Subsequent event footnote, which is included in the Company's financial statements.

Additional Controls or Responsibility Provided by Other Procedures:

Materiality is assessed at the reporting company level throughout the organization as of the date financial statements are externally produced, per the Company's Materiality Policy. The assessment is made separately for each registrant at quarter-end and year-end.

Regulatory Requirements:

Disclosure of subsequent events is required for FERC Form 1 and Form 3 reporting.

Reference:

FASB Accounting Standards Codification 855, Subsequent Events

Corresponding PPL Policy No. and Name:

306 – Subsequent Events Policy

Key Contact:
Manager, Financial Reporting

Administrative Responsibility:
Controller

Date Created: 12/10/10
Dates Revised: 3/31/11, 8/5/11

357 - Assets/Liabilities Classification

(Note: Text in italics indicates a key SOX control.)

Policy: To properly record assets and liabilities on the balance sheet as current or long-term.

Procedure: The detailed procedure provides specifics for identifying assets and liabilities as current or long-term based on accounting guidance and the nature of the underlying transactions.

Scope: The policy and procedure applies to LG&E and KU Energy LLC ("LKE") and its subsidiaries.

Objective of Procedure: To ensure accurate presentation of assets and liabilities on the balance sheet.

General Requirements:

Detailed Procedures Performed:

Per the Master Glossary of the Accounting Standards Codification ("ASC"), current assets are cash or other assets that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. LKE's operating cycle is 12 months. Per ASC 210-10-45 - Balance Sheet – Overall – Other Presentation Matters, liabilities are classified as current if their liquidation is reasonably expected to require the use of existing resources properly classified as current assets or to create other current obligations. Obligations that are due on demand or that are callable at any time by the lender are classified as current regardless of the intent of the enterprise or lender.

Current Assets:

For LKE, current assets typically include resources such as:

- Cash, cash equivalents, restricted cash and restricted cash equivalents[i]
- Short-term investments including certain marketable securities and short-term deposits that could be used in current operations are reflected in other within current assets[i]
- Accounts receivable, less a reserve for uncollectible accounts
- Unbilled revenue
- Receivables from officers, employees, affiliates and others, if collectible in the ordinary course of business within a year
- Inventories of fuel, materials and operating supplies
- Prepaid expenses such as insurance, rents, taxes, current paid advertising service not yet received applicable to the next 12 months
- Certain deferred income tax assets

357 - Assets/Liabilities Classification

(Note: Text in italics indicates a key SOX control.)

- Assets held for sale
- Price risk management assets expected to be realized within 12 months
- Portion of intangibles related to emission allowances and renewable energy credits expected to be consumed or sold within 12 months
- Regulatory assets related to under-recovery of regulatory mechanisms (FAC, ECR, GSC and DSM)

If a current asset has been specifically designated for use of repayment or liquidation of a long-term liability, it should be classified as a noncurrent asset.

Certain resources warrant classification as noncurrent assets, including:

- Cash and claims to cash which are restricted to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets or are segregated for the liquidation of long-term debt
- Investments in securities or advances which have been made for the purposes of control, affiliation, or other continuing business advantage[i]
- Receivables arising from unusual transactions which are not expected to be collected in 12 months
- Cash surrender value of life insurance policies
- Land and other natural resources
- Depreciable assets
- Financing costs associated with long-term debt (financing costs, commissions, reacquired debt (in regulated operations only), even if a portion will be amortized in the subsequent 12 months)
- Long-term prepayments which are chargeable to the operations over several years, or deferred charges such as prepayments under a long-term lease
- Regulatory assets not related to under-recovery of regulatory mechanisms (see above)

Current Liabilities:

For LKE, current liabilities typically include obligations such as:

- Trade accounts payable for obligations to be repaid within the normal operating cycle of the business
- Short-term debt is generally classified as a current liability when the transfer of resources is required during the normal operating cycle of the business. There are certain exceptions [ii]
- Long-term debt portion payable within 12 months[iii]
- Debt and other obligations due on demand (many customer and collateral deposits are considered current because they are due on demand)

- Accruals of expenses such as wages, commissions, rentals and royalties
- Income and other taxes payable (including taxes withheld payable) within 12 months
- Interest payable within 12 months
- Dividends declared and payable within 12 months
- Liabilities related to assets held for sale
- Price risk management liabilities expected to be realized within 12 months
- Current portion of ARO liability if timing of settlement is reasonably assured
- Advances and deposits
- Regulatory liabilities related to over-recovery of regulatory mechanisms (FAC, ECR, GSC and DSM)

FERC and U.S. GAAP reporting requirements may differ. Oracle balance sheet accounts are established consistent with the FERC Uniform System of Accounts. Each Oracle balance sheet account must be identified to the appropriate line item for both utility financial reports and U.S. GAAP financial statements by indicating the appropriate line item on the GLAFF Change Request Form. Within the GLAFF Change Request Form, inquiries will be made about prior period balances for reclassification discussions, see 354 – Materiality Policy for further information.

Each department is responsible for reviewing the account balances under its responsibility before the end of Day 4 during monthly accounting close to ensure that an asset account with a credit (negative) balance and/or a liability or equity account with a debit (positive) balance are properly reported. An EIS query has been developed to facilitate this analysis; the query name is GL_Trial Balance review. The report returns all accounts with a non-net zero balances for the period for all companies and populates a "Check" column within the query with "YES" if certain criteria detailed above are met.

<u>Reports Generated and Recipients:</u>

EIS query - GL_Trial Balance review

<u>Additional Controls or Responsibility Provided by Other Procedures:</u>

354 – Materiality Policy
550 – Chart of Accounts and GLAFF Updates policy
GLAFF Change Request Form – Account

<u>Regulatory Requirements:</u>

357 - Assets/Liabilities Classification

(Note: Text in italics indicates a key SOX control.)

N/A

Reference:

FASB ASC Topic 210-10-45 - Balance Sheet – Overall – Other Presentation Matters
FASB ASC Master Glossary
FASB ASC Topic 470-10-45 - Debt-Overall-Other Presentation Matters

Corresponding PPL Policy No. and Name:

307 – Current Asset/Liability Classifications

Key Contact:

Accounting Managers

Administrative Responsibility:

Director, Accounting and Regulatory Reporting
Controller

Date Created: 3/31/11
Date Revised: 8/9/11, 3/21/13, 3/21/16

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[i] Generally, only investments with original maturities of three months or less qualify as cash equivalents. Original maturity means the original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased with three months to maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months (although it would be classified as a current asset when its remaining maturity is twelve months or less).

[ii] FASB ASC 470-10-45-14 (Debt-Overall-Other Presentation Matters) indicates that a short-term obligation shall be excluded from current liabilities if the entity intends to refinance the obligation on a long-term basis and the intent to refinance the short-term obligation on a long-term basis is supported by an ability to consummate the refinancing demonstrated in either of the following ways:

A. Post-balance-sheet-date issuance of a long-term obligation or equity securities. After the date of an entity's balance sheet but before that balance sheet is issued or is available to be issued a long-term obligation or equity securities have been issued for the purpose of refinancing the short-term obligation on a long-term basis. If equity securities have been issued, the short-term obligation, although excluded from current liabilities, shall not be included in owners' equity.

357 - Assets/Liabilities Classification

(Note: Text in italics indicates a key SOX control.)

B. Financing agreement. Before the balance sheet is issued or is available to be issued, the entity has entered into a financing agreement that clearly permits the entity to refinance the short-term obligation on a long-term basis on terms that are readily determinable, and all of the following conditions are met:
   a. The agreement does not expire within one year (or operating cycle) from the date of the entity's balance sheet and during that period the agreement is not cancelable by the lender or the prospective lender or investor (and obligations incurred under the agreement are not callable during that period) except for violation of a provision with which compliance is objectively determinable or measurable.
   b. No violation of any provision in the financing agreement exists at the balance sheet date and no available information indicates that a violation has occurred thereafter but before the balance sheet is issued or is available to be issued, or, if one exists at the balance sheet date or has occurred thereafter, a waiver has been obtained.
   c. The lender or the prospective lender or investor with which the entity has entered into the financing agreement is expected to be financially capable of honoring the agreement.

[iii] Current portion of long-term debt should also include long-term obligations that would be callable by a creditor if LKE was in violation of the debt agreement at the balance sheet date for which the violation would make the obligation callable.

358 - Waived Adjustments Policy and Procedures

Policy:

Waived adjustments will be tracked and analyzed in support of the Materiality Policy.

Procedure:

All waived adjustments impacting a quarter will be tracked and analyzed for overall materiality on the quarterly and annual financial statements impacted by the adjustments.

Scope:

All amounts not accurately reflected in the financial statements in accordance with the materiality policy.

Objective of Procedure:

To ensure that the waived adjustments files for each quarterly and annual period accurately reflect entries for the period in order to accurately analyze their impact on the related financial statements.

General Requirements:

Detailed Procedures Performed:

- All waived adjustments greater than or equal to the threshold included in the Materiality Policy must be put in the Error Correcting Entries file. The file is located at 'acctshare on fs2' in the 'Waived Adjustments' directory and in subdirectories by year and quarter.

- Entries in the Error Correcting Entries file should reflect the adjustment needed to the current quarter and year-to-date balances in the financial statements to make them correct.

- The Error Correcting Entries file is set up in thousands. An entry for $250,000 should appear as $250.

- When placing an entry into the Error Correcting Entries file, place a description of the entry on the "Description" tab. The description must briefly describe the cause of the error and include reference to an error assessment memo, if the error met the criteria for the memo, see 354 - Materiality Policy for the criteria.

358 - Waived Adjustments Policy and Procedures

- All entries that affect the period must be included. If an error occurred in a prior quarter or prior year and was corrected in the current quarter and/or year, it must be reflected in the current quarter's file since it created an error in the current quarter's balances.

- Entries must reflect the adjustment to correct the current period's financial statements.
  - If an income statement adjustment was identified in a prior period and corrected in the current period, the current period will be over- or under-stated and an adjustment to reverse the correction booked should appear in the current quarter's Error Correcting Entries file.
  - If a balance sheet adjustment was identified in a prior period and corrected in the current period, the current period should not be impacted.

- Entries having an income statement impact must also include the tax effect by the accounts impacted by the tax effect.

- Managers are responsible for reviewing the entries put into the files by their staffs.

Reports Generated and Recipients:

An Error Correcting Entries file by year and by quarter. The file is located at 'acctshare on fs2' in the 'Waived Adjustments' directory and in subdirectories by year and quarter.

Additional Controls or Responsibility Provided by Other Procedures:

This policy and procedures document supports controls provided by the Materiality Policy.

Regulatory Requirements:

None.

Reference:

354 - Materiality Policy

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

358 - Waived Adjustments Policy and Procedures

Manager, Financial Reporting

Administrative Responsibility:

Controller

Date Created: 3/31/08
Dates Revised: 10/08/09, 3/31/11, 8/5/11, 9/4/12

359 - Financial Statement Disclosures and Filing Requirements

(Note: Text in italics indicates a key SOX control.)

Policy: Disclosures made in financial statement filings (the Reports) by LG&E and KU Energy LLC (LKE), Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (collectively, the Company) are complete and accurate, and all required filings are filed within the mandated due date, including extensions.

Procedure: Various regulators such as the Financial Accounting Standards Board (FASB) and U.S. Securities and Exchange Commission (SEC), etc. require certain disclosures to be included in the U.S. Generally Accepted Accounting Principles (U.S. GAAP) Reports issued by the Company. These disclosures are reviewed by management to ensure they are complete and accurate, and the Reports are filed in accordance with the appropriate governing regulations.

Scope: All U.S. GAAP Reports filed by the Company with the SEC. The Federal Energy Regulatory Commission (FERC), the Kentucky Public Service Commission (KPSC), the Virginia State Corporation Commission (VSCC), and other regulatory or special purpose financial statement filings (see the current quarter's checklist at acctpolicies on fs1/old checklists and working checklist) are excluded from the scope of this policy.

Objective of Procedure: Financial statement disclosures are required to clarify and provide additional information related to what is presented in the financial statements contained within the Reports. The objective of this policy is to ensure all disclosures are complete and accurate, and the proper information regarding disclosure requirements is made available to, and considered by, the preparers and subject matter experts for the disclosures.

General Requirements:

Procedures

Filing Requirements

The Reports are issued annually and quarterly are prepared in compliance with U.S. GAAP and SEC requirements and include, as applicable,

- Income Statements,
- Statements of Comprehensive Income,
- Statements of Cash Flows,
- Balance Sheets,
- Statements of Member's/Common Equity,
- Footnotes,
- Management's Discussion and Analysis (MD&A) and,
- Other information requested by management or required by various regulations.

359 - Financial Statement Disclosures and Filing Requirements

(Note: Text in italics indicates a key SOX control.)

Data contained in the Reports originates primarily from the Oracle financial system, the Hyperion Financial Management system or Workiva Wdesk and is entered directly into the applicable financial statements and supporting sections of the Reports. The footnotes further clarify and provide additional information related to what is presented in the financial statements. Disclosures included in the footnotes and MD&A are required by the regulatory bodies or are included at the Company management's discretion to ensure the users of the Reports receive a complete and accurate picture of the Company's financial position and results of operations.

The Financial Reporting department (Financial Reporting) is responsible for issuing annual and quarterly U.S. GAAP basis SEC financial statements for LKE, LG&E and KU that are included in PPL's annual and quarterly Reports (i.e., Form 10-K and 10-Q). Financial Reporting prepares a schedule designating the anticipated timetable for various steps in drafting and reviewing the relevant disclosure document and coordinates this timeline with PPL's timeline to ensure PPL's reporting requirements are met relative to LKE. The timeline helps ensure important disclosure issues are raised and analyzed in sufficient time for effective handling under the various disclosure rules. The timeline also assists in ensuring relevant bodies, such as the Governance and Financial Oversight Committee (GFOC) and outside advisors, such as legal counsel and external auditors, are involved in a timely fashion in disclosure issues.

New Accounting Guidance

Each quarter, Financial Reporting completes an assessment of new accounting guidance issued by the FASB and the SEC. The assessment reviews the new guidance issued and determines the effect of the accounting and the disclosure requirements on the Company. A rationale and overall conclusion is documented for any new guidance that affects the Company.

Financial Reporting follows up with each relevant group quarterly to ensure there are no new regulations or requirements that need to be addressed in the Reports. Communications with the groups as documented in accounting policy and procedure 962 - Compliance with GAAP and Regulations are maintained with the supporting documentation for the Reports.

Disclosure Responsibilities Matrix

A disclosure responsibilities matrix is maintained by Financial Reporting for the preparation of the Reports and outlines by report section the Financial Reporting personnel responsible for preparation, subject matter expert(s), and management personnel responsible for reviewing and signing off on the disclosures. The subject matter expert(s) may be the same as the Financial Reporting personnel responsible for preparation, an individual from another accounting department, or a non-financial person with the requisite knowledge. Financial Reporting personnel perform technical research, coordinate review comments, update the disclosures, and resolve issues identified in coordination with the subject matter expert(s) and reviewers of the Reports. Financial Reporting is also responsible for maintaining and completing the most current disclosure checklists, which provide detail guidance of information required to be in the Reports based on the FASB and SEC guidelines.

On a quarterly basis, Financial Reporting updates the disclosure responsibilities matrix and timeline and distributes them to all individuals listed on the disclosure responsibilities matrix to ensure roles and responsibilities are clearly communicated with the subject matter experts and management personnel responsible for reviewing and signing off on the disclosures. Financial Reporting personnel individually distribute rolled-forward disclosures from the last issued Reports and preliminarily completed disclosure checklists to the subject matter experts in order to start obtaining information needed for the disclosures in the current Reports.

All parties identified on the disclosure responsibilities matrix are responsible for reviewing disclosure inputs and content to ensure accuracy and completeness of the disclosed information. Any issues identified are resolved through discussions with the subject matter expert(s), Accounting departments and/or legal counsel. *Supporting documentation for the disclosures is prepared by the subject matter expert(s) or Financial Reporting personnel. The manager of the key subject matter expert(s) for each report section is required to sign off on the disclosure responsibilities matrix next to the applicable report section when the disclosures are complete and the supporting workpapers have been placed in the support binders. This sign off also indicates that the manager has reviewed the applicable disclosure checklist section(s) and is in agreement with the responses provided. Financial Reporting maintains the signed workpapers and disclosure checklists in support binders.*

Accounting Issues or Changes

See accounting policies and procedures 251 – Journal Entries Policy and 354 – Materiality Policy for information regarding the handling of adjustments after consolidation is complete, including information regarding the thresholds for waived adjustments.

Any issues in need of clarification as identified by functional management, internal auditors or legal counsel are communicated to and investigated by the respective departments responsible for the report section, in coordination with the Financial Reporting personnel responsible for relevant activities/functions to ensure completeness and accuracy of the information. Issues are identified during the reviews of the drafts of the Reports. All issues are resolved before the filing of the Reports.

Disclosures

The departments responsible for various sections of the Reports coordinate the evaluation of material disclosures among the legal counsel, subject matter experts and subsidiaries to ensure that all material items are considered in determining matters to be disclosed. Communications regarding these issues are retained with the supporting documentation for the Reports.

359 - Financial Statement Disclosures and Filing Requirements

(Note: Text in italics indicates a key SOX control.)

Quantitative and qualitative thresholds for materiality are documented in accounting policy and procedure 354 -Materiality Policy.

Financial statement and footnotes criteria are applied in these discussions. The materiality thresholds for disclosure in the footnotes are described in accounting policy and procedure 354 – Materiality Policy. Special items, if any, are noted in the MD&A, and include items such as:

- discontinued operations,
- gains and losses on sales of assets not in the ordinary course of business,
- impairment charges, and
- other charges or credits that are, in management's view, not reflective of the Company's ongoing operations.

Supporting Workpapers

All source documents are stored in binders and maintained by Financial Reporting to ensure a complete record of the support for the Reports. Supporting documents for all disclosures are reconciled by the preparer to the general ledger, as applicable, and reviewed by the preparer's manager or his/her assigned delegate, to ensure accuracy and completeness. Sign-off on the supporting workpapers is required of the preparer and the manager. Cross-references are made among the statements, footnotes, and other sections of the Reports, as appropriate, by Financial Reporting to ensure consistency throughout the Reports.

Electronic evidence which is used to calculate, develop or support the amounts in the SEC financial statements, including footnotes, MD&A, and other information included in the filings must be provided to document the following:

- Verification of query parameters for reports run from an IT system to document time periods, accounts, business unit, etc. used as parameters;
- Tie out to an independent source, when available and appropriate;
- Tie out to a general ledger balance, when available and appropriate; and/or
- Changes made to source data downloaded from an IT system.

When multiple queries are exported to a spreadsheet, each query, in its original form, must be included on a tab in the spreadsheet and a lead sheet must be used to perform relevant calculations from those tabs.

Electronic evidence is defined as reports, queries, spreadsheets, e-mails or other data generated by an IT application, reporting database or End User Computing Tool (EUCT) that is used in the performance of internal controls over financial reporting that are in the scope of the company's Sarbanes-Oxley assessment. EUCTs are applications that usually reside on an end user's desktop, and therefore are not traditionally subject to rigorous application and general computer controls. Microsoft Excel spreadsheets and Access databases are examples of common EUCTs.

See also PPL's guidance regarding Electronic Evidence Requirements and Electronic Evidence Process Flow chart on the SOX SharePoint page at:
https://teams.sp.lgeenergy.int/sites/ICS/Shared%20Documents/Electronic%20Evidence%20Process%20Flow.docx
https://teams.sp.lgeenergy.int/sites/ICS/Shared%20Documents/Electronic%20Evidence%20Requirements.docx

See also LKE's accounting policy and procedures 950 - Spreadsheets Policy.

Audit Services may re-perform the tie out of the Reports at the request of Deloitte, Company or Accounting management or PPL.

Other Items Related to Identifying Potential Disclosures

The Manager, Financial Reporting receives quarterly risk reports from the Treasurer's department and compares the information therein to the Reports to ensure that all identified risks, as appropriate, are considered for inclusion prior to the filing of the Reports, documentation of the review is maintained in the supporting work papers. In addition, the Senior Corporate Attorney handling securities matters reviews the Reports for completeness and accuracy. Any items in question are discussed with management to determine the proper treatment/disclosure.

Financial Reporting personnel review the disclosure checklists to ensure consideration has been given to required disclosures to determine their applicability. All disclosures are checked off during the preparation of the Reports by Financial Reporting in coordination with the subject matter expert(s). Any issues or missing items are discussed with Accounting management, and legal counsel, if appropriate, for appropriate resolution.

The Financial Reporting department on a quarterly basis reviews the monthly highlights and a listing of nonstandard journal entries. This review is to ensure that any potential significant and unusual entries are considered for disclosure.

Certifications

Various personnel complete quarterly backup certification memos to the signers of the Reports and to the remaining members of the GFOC (the signers of the Reports are also members of the GFOC). The purpose of the memos is to certify that the Reports have been reviewed and fairly present the Company's financial condition and results of operations to the best of the certifier's knowledge. A memo received from the Director, Audit Services is to certify concurrence with Management's conclusion that there are no actual or potential significant deficiencies or material weaknesses in the Company's internal controls over financial reporting. See Appendix 1 for

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(Note: Text in italics indicates a key SOX control.)

back-up certifiers. The Treasurer, the Vice President State Regulation and Rates and all Directors reporting to the Treasurer, Vice President State Regulation and Rates, Controller and directly to the Chief Financial Officer (CFO) also certify that they have reviewed the management representation letters to the external auditors related to the Reports indicating that based on their knowledge of the business and adequate inquiry within their areas of responsibility, they believe it is appropriate to execute the representation letter. The Controller signs the management's representation letters to the external auditor, along with the CEO (Chief Executive Officer) and the CFO.

GFOC Review

The most recent Reports are sent to the GFOC before the quarterly GFOC meeting. The GFOC meets prior to finalizing and issuance of the Reports. At the GFOC meeting, legal counsel presents an evaluation of internal controls over financial reporting based on reviews of various matters by the Controller; Director, Accounting and Regulatory Reporting; Director, Audit Services; and legal counsel. This review is based on the matters documented in the Evaluation of Internal Controls over Financial Reporting memo. Discussion of any significant issues concerning disclosures or internal controls occurs until all GFOC members and attendees are comfortable with their resolution. If any changes to the Reports are made after the GFOC meeting the Controller and the Manager, Financial Reporting, will coordinate review of the changes with the appropriate functional personnel and provide significant changes to the GFOC members.

Distribution of the Reports and Timing of Filings

The final versions of the Reports are sent in electronic format to the Treasurer's department to be filed with the Municipal Securities Rulemaking Board (for LG&E and KU only) and to provide courtesy copies to rating agencies. Electronic copies are also maintained on the, \\lgeenergy.int\shares\group1\financial_reporting shared drive, Financial and Operational Documents SharePoint site at http://home/og/fin/finrpt/SitePages/Home.aspx and the PPL internet site (http://www.pplweb.com/investors/).

Hard copies of the Reports for the Company are provided to Accounting Managers, CFO Directors and Officers, the Legal department, the Treasurer's department, the Rates department and other interested parties based on distribution lists maintained by Financial Reporting and the Legal department, or upon request.

Reports Generated and Recipients:

- Disclosure responsibilities matrix that outlines by report section the Financial Reporting personnel responsible for preparation, subject matter expert(s), and management personnel responsible for reviewing and signing off on the disclosures.

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(Note: Text in italics indicates a key SOX control.)

  - Proof of review by the CFO and CEO is maintained by Financial Reporting and the Legal department in the form of the signature pages included in the Reports and certifications, including backup certifications.
  - Proof of review by the GFOC is maintained by the Legal department in the form of the certifications and the GFOC meeting minutes.
  - Disclosure Checklist provided to the external auditor
- Timeline schedule designating the anticipated timetable for various steps in drafting and reviewing the relevant disclosure document.
- Disclosure responsibilities matrix documenting the subject matter expert and Financial Reporting contact for each section of the Reports.

Additional Controls or Responsibility Provided by Other Procedures:

- Adherence to U.S. GAAP and regulations as set forth in accounting policy and procedure 962 - Compliance with GAAP and Regulations.
- Internal Controls over financial reporting documented for all internal control cycles.
- SEC reporting as set forth in accounting policy and procedure 355 - SEC Reporting Requirements.

Regulatory/Contractual Requirements:

- The annual Reports are required by Orders of the Kentucky Public Service Commission and the Virginia State Corporation Commission.
- Annual Reports are required due to debt covenants with the Company's lenders.
- LKE quarterly and annual Reports are required due to commitments made to Big Rivers until 2021(12 years after the WKE Unwind guarantee dated July 16, 2009), or longer if a claim under the guarantee is outstanding.
- LKE quarterly and annual Reports are required due to commitments made to Big Rivers through 2023 (termination of the Indemnity Agreement related to Henderson Municipal Power & Light excess energy).
- LKE quarterly and annual Reports are required in support of LG&E Energy Marketing's credit with MISO.

Reference:

Accounting policy and procedure 962 - Compliance with GAAP and Regulations

Accounting policy and procedure 354 - Materiality Policy

Accounting policy and procedure 355 - SEC Reporting Requirements

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(Note: Text in italics indicates a key SOX control.)

Accounting policy and procedure 251 – Journal Entries Policy

Accounting policy and procedures 950 - Spreadsheets Policy

Electronic Evidence Requirements and Electronic Evidence Process Flow chart (see SOX SharePoint site)

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(Note: Text in italics indicates a key SOX control.)

Corresponding PPL Policy No. and Name:

None

Key Contact:

Manager, Financial Reporting

Administrative Responsibility:

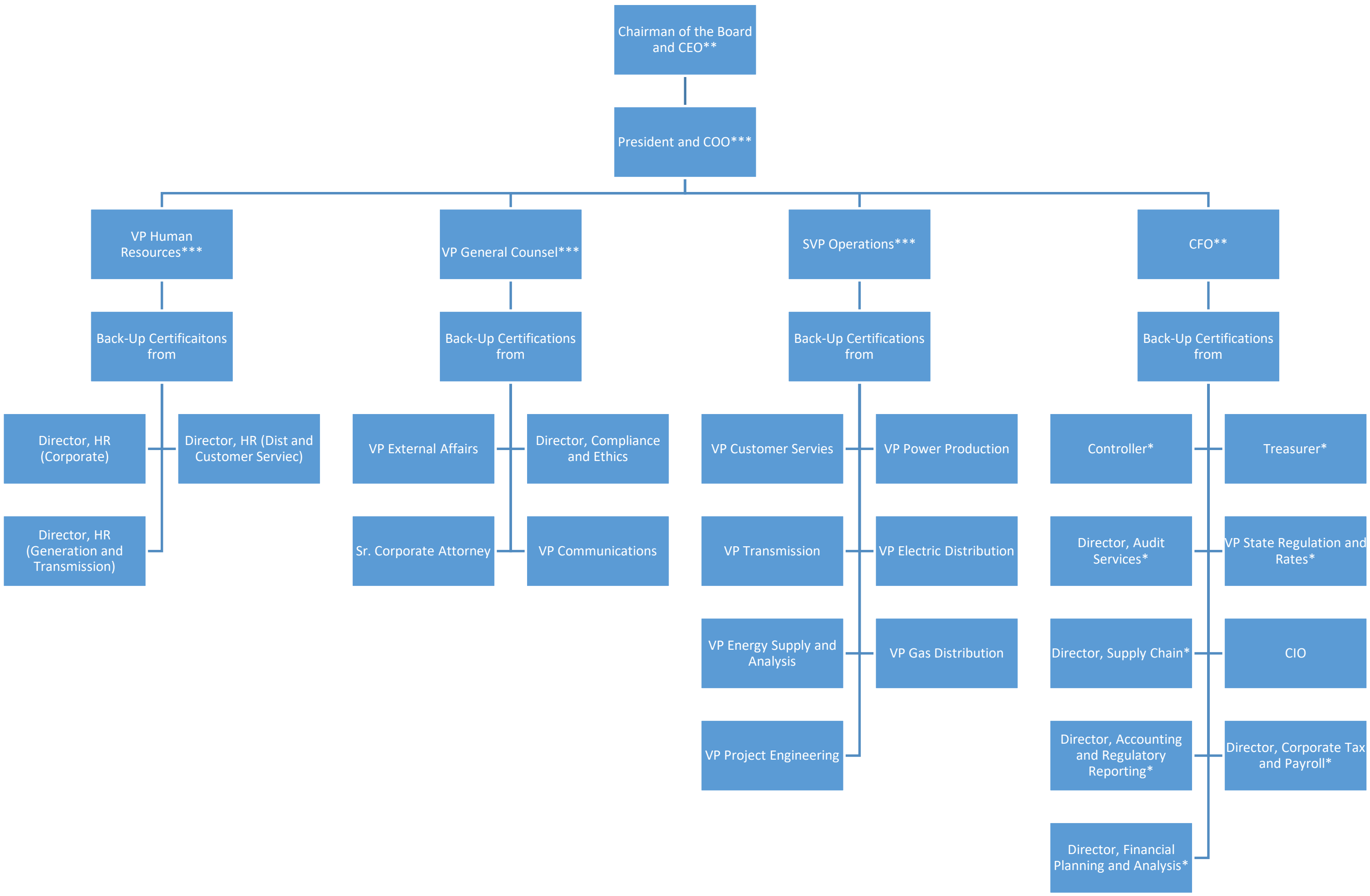
Controller

Date Created: 1/3/08

Date Revised: 7/20/10, 3/18/11, 7/05/11, 8/3/11, 6/20/12, 12/18/13, 4/20/2015, 7/1/2015, 4/1/16, 8/19/2016

Appendix

11/13/2017



*These certifications are maintained in a file by the Controller and in the support binders held by Financial Reporting. All other back-up certifications are maintained by the Legal department.

** The Chief Executive Officer and the Chief Financial Officer are members of the GFOC and their certifications are in the 10-Q and 10-K.

*** Members of the GFOC that provide back-up certifications to the CEO and CFO.

450 – Derivatives and Hedging

(Note: Text in italics indicates a key SOX control.)

Policy:

FASB's Accounting Standards Codification Topic 815 (ASC 815), Derivatives and Hedging establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that all derivatives that have not qualified for scope exceptions to be recognized on the balance sheet at fair value. If certain conditions are met, a derivative may be specifically designated as a cash flow hedge, fair value hedge, or net investment hedge.

LG&E and KU Energy LLC's (LKE) regulated entities Louisville and Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (collectively the Company) apply the provisions of ASC 980, "Regulated Operations," which provide for the creation of regulatory assets and liabilities when regulators allow for costs to be recovered in a period other than when the costs would be charged to expense by an unregulated entity. Derivative activity that has not been designated as Normal Purchases or Normal Sale (NPNS) is reflected in current earnings (that is, hedge accounting is not elected); the income statement impact is then reversed with the creation of a regulatory asset or liability when it is probable that these costs are recoverable. When a regulated entity cannot assert that it is probable that the costs are recoverable (for example, when the entity uses forward starting swaps to hedge the cash flows from an anticipated debt issuance that have not been approved by a regulator), it will receive hedge accounting treatment, provided that all requirements for hedge accounting are met. When management determines that it is probable that the gains/losses from the hedge will be reflected in rates, regulatory accounting treatment will be elected and the gains/losses will be reclassified from OCI to a regulatory asset or liability, to recognize that the economic impact belongs to the ratepayer, not the shareowner.

The Company's policy is to designate all contracts for commodity purchases for fuel and other products that are derivatives and that have physical delivery points where there is customer need or for company operations as normal purchases. The Company believes that these commodity contracts are derivatives; however, the contracts fall under the exception guidelines and are considered normal purchases, exempt from fair value mark to market accounting. Management noted that the commitment contracts for commodity purchases are executed in the ordinary course of business. The Company's intention is to take physical delivery of the materials purchased and to utilize them in the daily transactions of normal production or transportation to its customers. Management noted that certain contracts have provisions to be able to net settle (forward contracts). While certain provisions exist, management has no intention to net settle as these purchases are used in operations or delivery to customers. As such, the contracts qualify for the normal purchase, normal sale exemption in accordance with Company policy as well as outlined in ASC 815 and accordingly are exempt from fair value mark to market accounting. No trading commodity swaps are transacted at this time, as documented in Note 18 in the Authority Limits Matrix, which states: "*No contracts or transactions for any of the commodities listed* *under Power Supply, Fuel and By-Products or Gas Supply may be entered into utilizing financial instruments including, but not limited to, forwards, futures, and/or swaps. As such,,* commodity hedge accounting treatment will not be discussed in this policy.

Procedure:

Derivatives not qualifying for scope exceptions are recognized on the balance sheet at fair value.

Scope:

Derivative instruments represent rights or obligations meeting the definition of assets or liabilities and should be reported in the financial statements. Per ASC 815-10-15-83, a derivative instrument is a financial instrument or other contract with all three of the following characteristics:

1. It has (1) one or more **underlyings** and (2) one or more **notional amounts**[1] or payment provisions, or both. Those terms determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required. An **underlying** is a specified interest rate, security price, commodity price, foreign exchange rate, index of rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract). A **notional amount** is a number of currency units, shares, megawatts, pounds, or other units specified in a derivative instrument.

2. It requires **no initial net investment** or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

3. Its **terms require or permit net settlement.** A contract meets the net settlement criteria if its settlement provisions meet one of the following criteria:

   a. Neither party is required to deliver an asset that is associated with the underlying and that has a principal amount, stated amount, face value, number of shares, or other denomination that is equal to the notional amount (or the notional amount plus a premium or minus a discount). For example, most interest rate swaps do not require that either party deliver interest-bearing assets with a principal amount equal to the notional amount of the contract.[2]

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[1] Sometimes, other names are used. For example, the notional amount is called a face amount in some contracts.
[2] ASC 815-10-55-9 through 55-18 state that a non-performance penalty provision that requires the defaulting party to compensate the non-defaulting party for any loss incurred but does not allow the defaulting party to receive the effect of favorable price changes (an asymmetrical default provision) does not give a commodity forward contract the characteristic described as net settlement. In contrast, a contract that permits only one party to elect net settlement of

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b. One of the parties is required to deliver an asset of the type described above in paragraph (a), but there is a market mechanism that facilitates net settlement; for example, an exchange that offers a ready opportunity to sell the contract or to enter into an offsetting contract.

c. One of the parties is required to deliver an asset of the type described in paragraph (a), but that asset is readily convertible to cash[3] or is itself a derivative instrument. An example is a forward contract requiring delivery of an exchange-traded equity security. Although the number of shares to be delivered is the same as the notional amount of the contract and the price of the shares is the underlying, an exchange-traded security is readily convertible to cash. Another example is a swaption – an option to require delivery of a swap contract, which is a derivative.

Although a contract may meet the definition of a derivative, it may be exempt from fair value accounting if the contract is considered a NPNS. For those transactions qualifying for the normal exception, LKE records the transactions at the time of delivery (accrual accounting). Guidelines for determining if a contract qualifies for the NPNS exception can be found in the “Qualifying for the Normal Purchases and Normal Sales Exception for Energy Transactions” section.

Additionally, the following contracts are generally not subject to derivative accounting requirements if specified criteria are met:

- Normal purchases and sales (election must be documented)
- Regular-way security trades
- Certain insurance contracts
- Certain financial guarantee contracts
- Certain contracts not traded on an exchange, such as a climactic, geological variable, or other physical variable
- Derivative instruments that impede sales accounting
- Investments in life insurance
- Certain investment contracts
- Certain loan commitments
- Certain interest-only and principle-only strips
- Certain contracts involving an entity’s own equity

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the contract (by default or otherwise), and thus participate in either favorable changes only or both favorable and unfavorable price changes in the underlying, meets the derivative characteristic described as net settlement.

[3] FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, states that assets that are readily convertible to cash "have (i) interchangeable (fungible) units and (ii) quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price" (paragraph 83(a)). For contracts that involve multiple deliveries of the asset, the phrase “in an active market that can rapidly absorb the quantity held by the entity” should be applied separately to the expected quantity in each delivery.

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- Lease arrangements
- Residual value guarantees
- Registration payment arrangements
- Contracts issued or held by an entity that are both (1) indexed to its own stock and (2) classified in stockholders' equity
- Contracts issued by an entity in connection with stock-based compensation
- Contracts issued by an entity as contingent consideration from a business combination
- Forward contracts that require settlement by an entity delivering cash in exchange for the acquisition of a fixed number of its equity shares

Based on LKE's assessment, certain commodity contracts do not meet the definition of a derivative because there is no net settlement, as defined in paragraph (c) above. While many physical commodity contracts meet the definition of a derivative because the commodities are considered "readily convertible to cash," the determination of "readily convertible to cash" requires judgment. Markets continually evolve, which can increase or decrease a market's liquidity and/or the number of products available. At this time, LKE does not consider contracts requiring physical delivery of coal, renewable energy credits not traded on an exchange, or limestone to be derivatives, because LKE does not believe that the contracts meet the net settlement criteria, including "readily convertible to cash". If or when LKE believes markets have evolved to the point where the contracts are considered "readily convertible to cash," LKE would apply ASC 815-10-25-3, which states if a contract not meeting the definition of a derivative instrument at acquisition by the entity meets the definition of a derivative instrument after acquisition, the contract shall be recognized immediately as either an asset or liability with the offsetting entry recorded in earnings. The Company would elect normal accounting for these commodity contracts should they become derivatives in the future. This election will preclude the need to mark these contracts to fair value in the future as long as they continue to qualify for that exception.

Embedded Derivatives

An embedded derivative is defined as implicit or explicit terms within a contract that do not in their entirety meet the definition of a derivative and affect, in a manner similar to a derivative, some or all of the cash flows or the value of other exchanges required by the contract. In certain circumstances embedded derivatives are required to be bifurcated and accounted for separately, in the same manner as free-standing derivatives. Bifurcation is required when all of the following criteria are met:

- The economic characteristics and risks of the embedded derivative are not "clearly and closely related" to the economic characteristics and risks of the host contract.
- The contract that embodies both the embedded derivative and the host contract is not re-measured at fair value under GAAP with changes in fair value reported in current earnings.

- A separate, free-standing instrument with the same terms as the embedded derivative would be a derivative.

FASB has indicated that debt, equity, and lease contracts are the most likely contracts to contain embedded derivatives, but they may exist in any contract. Characteristics of potential embedded derivatives are:

- Renewal, extension, cancellation, and prepayment options in debt
- Contracts that can be settled through multiple means (e.g., gross physical shares, net physical shares, or cash)
- Contracts denominated in or referenced to a foreign currency that is not characteristic of either party to the transaction
- Commodity contracts with floor and ceiling prices, which constitute an embedded put and/or call option (collar)
- Investments in convertible, exchangeable, or indexed debt
- If…then provisions, such as:
    - A contract that requires additional payments if a particular index, such as an interest rate, equity or foreign currency index, moves above a predetermined floor or cap
    - A contract for which the cash flows can fluctuate based on the occurrence or nonoccurrence of a specified event, such as a change in control
    - A contract for which cash flows can fluctuate based on a sliding scales or index.

Paragraph 815-15-25-4 states if an entity identifies an embedded derivative that must be bifurcated in a financial instrument not re-measured at fair value under GAAP, the entity may irrevocably elect to record the entire host contract at fair value. LKE assesses this option on a facts and circumstances basis.

FASB issued ASU 2014-16 Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or Equity. GAAP requires that entities issuing or investing in hybrid financial instruments separate embedded derivative features from the host contract and account for the feature as a derivative. This guidance applies to hybrid financial instruments that are issued in the form of a share and must be evaluated to determine if those shares are more akin to debt or equity. Currently, LKE does not issue or invest in these types of financial instruments as described in FASB ASU 2014-16.

Objective of Procedure:

The objective of this policy is to outline the accounting methodology followed by LKE to comply with accounting and reporting requirements for derivatives and hedging activities.

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(Note: Text in italics indicates a key SOX control.)

General Requirements:

Detailed Procedures Performed:

LKE does not currently elect hedge accounting, but rather utilize regulatory treatment for financial derivatives where regulatory precedence exists. If regulatory treatment was revoked at any time in the future, LKE would need to implement hedge accounting and would need to demonstrate the hedges were effective to use hedge accounting. Furthermore, as a matter of due diligence, PPL Corporation (PPL) or LKE (depending on the type of swap) performs hedge effectiveness testing to ensure a swap was prudently executed.

ASC 815, Derivatives and Hedging, provides for three types of hedges, which are described briefly below:

1. **Fair value hedge** (ASC 815-25): A hedge of the exposure to changes in the fair value of a recognized asset or liability, or of an unrecognized firm commitment, that are attributable to a particular risk;
2. **Cash flow hedge** (ASC 815-30): A hedge of the exposure to variability in the cash flows of a recognized asset or liability or of a forecasted transaction, that is attributable to a particular risk;
3. **Net investment hedge** (ASC 815-35): A hedge of the exposure to foreign currency risk of a net investment in a foreign operation.

If the derivative instrument qualifies as a hedging instrument, the gains or losses are recognized in earnings and offset by recognition of the effective portion of the hedge as an asset or liability on the balance sheet (for fair value hedges); are recognized in equity as part of accumulated other comprehensive income (AOCI) (for cash flow hedges) to the extent the hedge is effective and later reclassified into earnings when the hedged item impacts earnings.

Designating a contract as a cash flow hedge, fair value hedge, or normal contract is an accounting election. As previously stated, LKE does not currently elect hedge accounting, even though the contract may be eligible for hedge accounting. LKE has derivatives accounted for under regulatory accounting that include interest rate swaps which are cash flow hedges (intercompany with PPL) and economic hedges. Economic hedges are transactions serving to mitigate cash flow or fair value risks that are not designated as hedging transactions for financial reporting purposes.

Derivative Identification/Contract Review

Due to their complexity, all energy (and energy-related), interest rate, and foreign exchange contracts must be reviewed by accounting personnel to determine the applicability of derivative

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(Note: Text in italics indicates a key SOX control.)

accounting guidance. As part of Policy 451 - Contractual Review, all contracts within scope are reviewed by appropriate personnel to ensure they are properly evaluated to identify the potential presence of a derivative, an embedded derivative, lease, guarantee or variable interest entity (VIE). Contracts within scope are reviewed at contract execution or following any significant amendment to the contract. The following additional policies are followed for reviewing contracts:

- 454 - Leases
- 1058 - Variable Interest Entities
- 1057 - Guarantees

Designated business line contacts are required to contact designated FAA personnel to discuss and review contract terms to determine whether the contract, or any of its components, must be accounted for under derivative accounting guidance. With input from the business line contacts, FAA formally documents its review as documented in the Policy 451- Contractual Review.

The Derivative Documentation Flowchart located in Appendix 1 provides general guidance for classifying transactions under derivative accounting standards. Any questions concerning the identification and designation of a contract should be directed to the FAA Department.

The derivatives section of the contract review template is attached as Appendix 2.

Hedge Documentation Requirements

The criteria for hedge accounting are very specific. Derivatives utilized as hedges must substantially offset the risk associated with the underlying contract or forecasted transaction being hedged and must be specifically designated and documented as a hedge. While ASC 815-20 does not provide specific guidance, prior FAS 80 practice and informal FASB staff statements provide that a hedge must be 80% - 125% effective to qualify for hedge accounting.

When a contract is designated as a hedge, **formal documentation must be completed concurrently,** explaining why the derivative is a hedge and its association with the hedged transaction. Hedge documentation must include, at a minimum, the following criteria:

1. An identification of the hedging instrument, the hedged item, and nature of the risk that is being hedged.

2. A description of how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk will be assessed, both prospectively and retrospectively.

3. A specification of the entity's intent for undertaking the hedge.

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(Note: Text in italics indicates a key SOX control.)

4. Evidence that, at the hedge's inception and on an ongoing basis, it is expected the hedging relationship will be effective in achieving offsetting changes in the fair value or cash flows that are attributable to the hedged risk.

5. Formal approvals of non-system-generated hedge documentation by the applicable business line and the responsible accounting group.

Initial designation of interest rate swaps is to be made by Corporate Finance at the time the swap is executed and simultaneously entered into Wallstreet Suite Systems (WSS).

Qualifying for Cash Flow Hedge – Accounting Treatment

In a cash flow hedge, a derivative instrument is marked to its fair value with gains or losses reflected in Accumulated Other Comprehensive Income (AOCI). The gain or loss on the derivative instrument is reclassified from AOCI into earnings in the same period as the loss or gain is recognized on the hedged cash flow. Any ineffectiveness (discussed later) associated with the cash flow hedge will be recorded immediately in current earnings.

From time to time, LKE enters into intercompany forward-starting interest rate swaps with PPL that hedge the interest payments on new debt expected to be issued. These swaps are classified as cash flow hedges. All of these swaps have terms identical to forward-starting swaps entered into by PPL with third parties. The swap information is entered into WSS and at the end of each month the Corporate Finance Analyst generates the accounting entries required to book the Mark to Market (MTM) values of each outstanding intercompany forward-starting swap. Gains and losses on these swaps are probable of recovery through regulated rates; as such, the monthly change in MTM value is reclassified from AOCI to regulatory assets/liabilities and upon termination, the net settlements of the swaps are recognized in Interest Expense over the life of the newly issued debt. Hedge effectiveness testing is performed by the PPL Corporate Finance organization at inception at least quarterly. See **Hedge Documentation Requirements** section above for formal documentation requirements.

A forecasted transaction is eligible for designation as the hedged item in a cash flow hedge if all the following additional criteria are met:

a. The forecasted transaction is specifically identified as a single transaction or a group of individual transactions. If the hedged transaction is a group of individual transactions, those individual transactions must share the same risk exposure for which they are designated as being hedged.

b. The occurrence of the forecasted transaction is probable. The Company relies on the business plan and subsequent forecasts that document, among other things, its expected financing needs, as well as plan updates provided by senior management.

c. The forecasted transaction is a transaction with a party external to the reporting entity and presents an exposure to variations in cash flows for the hedged risk that could affect reported earnings.

d. The forecasted transaction is not the acquisition of an asset or incurrence of a liability that will subsequently be re-measured with changes in fair value attributable to the hedged risk reported currently in earnings. If the forecasted transaction relates to a recognized asset or liability, the asset or liability is not re-measured with changes in fair value attributable to the hedged risk reported currently in earnings.

e. If the variable cash flows of the forecasted transaction relate to a debt security that is classified as held-to-maturity, the risk being hedged is the risk of changes in its cash flows attributable to default or changes in the obligor's creditworthiness. For those variable cash flows, the risk being hedged cannot be the risk of changes in its cash flows attributable to changes in market interest rates.

f. The forecasted transaction does not involve a business combination and is not a transaction (such as a forecasted purchase, sale, or dividend) involving (1) a parent company's interests in consolidated subsidiaries, (2) a minority interest in a consolidated subsidiary, (3) an equity-method investment, or (4) an entity's own equity instruments.

g. If the hedged transaction is the forecasted purchase or sale of a **non-financial** asset, the designated risk being hedged is (1) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates or (2) the risk of changes in the cash flows relating to all changes in the purchase price or sales price of the asset (reflecting its actual location if a physical asset), not the risk of changes in the cash flows relating to the purchase or sale of a similar asset in a different location or of a major ingredient.

h. If the hedged transaction is the forecasted purchase or sale of a **financial** asset or liability or the variable cash inflow or outflow of an existing financial asset or liability, the designated risk being hedged is (1) the risk of changes in the cash flows of the entire asset or liability, such as those relating to all changes in the purchase price or sales price (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency), (2) the risk of changes in its cash flows attributable to changes in market interest rates, (3) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates , or (4) the risk of changes in its cash

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(Note: Text in italics indicates a key SOX control.)

flows attributable to default or changes in the obligor's creditworthiness. Two or more of the above risks may be designated simultaneously as being hedged.

Economic Hedges:

LKE has entered into interest rate swaps that economically hedge interest rate payments on variable rate debt. The Corporate Finance Analyst generates the accounting entries required to book the Mark to Market (MTM) values of each outstanding interest rate swap. Because realized gains and losses from these swaps are recoverable through regulated rates, any subsequent changes in fair value of these derivatives are included in regulatory assets or liabilities until they are realized as interest expense. Realized gains and losses are recognized in Interest Expense when the hedged transaction occurs.

Qualifying for Fair Value Hedge Accounting

A fair value hedge represents the hedge of an exposure to changes in the fair value of an asset, liability, or an unrecognized firm commitment that is attributable to a particular risk. In a fair value hedge, a derivative instrument is marked to its fair value currently through earnings, as it is an offsetting change to fair value of the hedged item. A hedge that is 100% effective would offset perfectly; otherwise, the ineffectiveness will impact earnings. See **Hedge Documentation Requirements** for formal documentation requirements.

Designated derivative instruments qualify for fair value hedge accounting if all of the following criteria are met:

a. At inception of the hedge, there is formal documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge.

b. Both at inception of the hedge and on an ongoing basis (at least quarterly), the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value attributable to the hedge risk during the period that the hedge is designated.

c. If a written option is designated as hedging a recognized asset or liability, the combination of the hedged item and the written option provides at least as much potential for gains as a result of a favorable change in the fair value of the combined instruments as exposure to losses from an unfavorable change in their combined fair value.

LKE uses fair value hedges in certain circumstances when LKE hedges the fair value of its floating-rate debt by effectively converting it to fixed-rate obligations through the use of a float-to-fixed swap.

Tax Hedging Documentation Rules

(Note: Text in italics indicates a key SOX control.)

In addition to applying the proper designations for derivatives and energy contracts for accounting purposes, separate determinations must be made for tax purposes. The Tax department will review certain transactions for appropriate designations. Usually, the Company's federal income tax issues related to its use of derivatives and energy contracts concern whether the gain or loss arising from such contracts will be treated as capital or ordinary. Generally, ordinary gain or loss treatment is preferable because the Internal Revenue Code limits the deductibility of capital losses. For LKE, taxable gains and losses are recorded when a hedge terminates and LKE pays cash or receives cash. Gains and losses due to changing market conditions that are recorded to the regulatory asset or liability are not a taxable transaction and no determination is needed.

Hedge Effectiveness Testing

Derivative accounting may increase volatility in earnings to the extent hedges do not perfectly offset the underlying risk and do not receive regulatory accounting treatment. Earnings volatility is also increased by the requirement that hedge accounting treatment is permitted only for those hedges that are deemed to be effective (commonly defined as being between 80% and 125%) and only the effective portion of the hedge is recorded in AOCI, with the ineffective portion being recorded in earnings.

Ineffectiveness results when the change in the hedging instrument's fair value or cash flows are not completely offset by the change in the hedged item's fair value or cash flows. For a cash flow hedge, the effective portion of the gain or loss is reported in AOCI and the ineffective portion (that exceeds the change in the hedged item's fair value) is reported quarterly in earnings. For fair value hedges, changes in the fair value of the derivative and the hedged items are reflected in earnings. Ineffectiveness is recorded to the same line items as the hedged transactions.

Initial Hedge Effectiveness Assessment (Prospective Assessment)

The initial hedge effectiveness assessment is a prospective assessment made prior to initiating a hedge relationship. This analysis shall be able to justify the expectation that the hedge will be highly effective over the period being hedged (the hedged period) in achieving offsetting changes in the cash flows or fair value of the hedged item.

The methods of assessing prospective hedge effectiveness include regression analysis or another statistical analysis approach (such as historical simulation or Monte Carlo simulation). The FASB decided not to include examples of specific effectiveness assessment tests to preserve entities' flexibility. The Company typically elects to use regression for the initial prospective assessment of hedge effectiveness, but any method may be chosen, as long as it is stated in the hedge documentation. To conclude that the hedging relationship is expected to be highly effective using a regression analysis, at least 30 data points should be used in the analysis. The R^2 (which can vary between 0 and 1) should be equal to or greater than 0.8, the slope should be between a 0.8 and 1.25, and the "t" and "F" statistics

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(Note: Text in italics indicates a key SOX control.)

should be evaluated at a 95 percent confidence level in accordance with guidance provided by the SEC staff.

R^2 measures the ability of the independent variable to explain the variation in the dependent variable. The higher the value is, the higher the indication that the independent variable can explain variation in the dependent variable. The slope represents an estimate of the sensitivity to changes in the independent price to changes in the dependent price.

The "t" and "F" statistics are used to indicate correlation or a linear relationship between independent and dependent variables. A high "t" statistic generally indicates that correlation or a linear relationship exists between the independent and dependent variables. To achieve a 95% confidence level, the significance of "F" should be less than 5%. If the significance of "F" is less than 5% there is less than 5% probability that no linear relationship is present. The initial assessment need not be performed for each and every hedge but only when a new hedge strategy is proposed. However, the data used in the regression shall be updated at least on a quarterly basis (as new hedges are entered into). In addition, the initial assessment of effectiveness for a particular hedge strategy shall be evaluated if the ongoing assessment for a particular relationship, as discussed below, repeatedly indicates an ineffective hedge.

Hedges must pass volumetric tests that are used to assess that the forecasted transaction is probable of occurring.

Special situations: Short-cut method/Critical terms match
Shortcut: An assumption of no ineffectiveness is especially important in a hedging relationship involving an interest-bearing financial instrument and an interest rate swap, because it significantly simplifies the computations necessary to make the accounting entries (referred to as the shortcut method). An entity may assume no ineffectiveness in a hedging relationship of interest rate risk involving a recognized interest-bearing asset or liability and an interest rate swap. ASC 815-20-25-104 through 25-106 detail the criteria that must be met to apply the shortcut method. It is common for the fair value hedges of the Company's debt instruments to qualify for the short-cut method.

Critical terms match: ASC 815-20-35-9 through 35-13 allow for a simplified approach to assessing and measuring ineffectiveness of cash flow hedges if, at inception, the critical terms of the hedging instrument and the hedged forecasted transaction are the same. If so, the entity can conclude that changes in cash flows attributable to the risk being hedged are expected to be completely offset by the hedging derivative. Therefore, subsequent assessments can be performed by verifying and documenting whether the critical terms of the hedging instrument and the forecasted transaction have changed during the period in review. Because the assessment of hedge effectiveness in a cash flow hedge involves assessing the likelihood of the counterparty's compliance with the contractual terms of the derivative instrument designated as the hedging instrument, the entity must also assess whether there have been adverse developments regarding the risk of counterparty default.

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If there are no changes in the critical terms and it is still probable that the counterparty will not default, the entity may conclude there is no ineffectiveness to be recorded. In that case, the change in fair value of the derivative instrument can be viewed as a proxy for the present value of the change in cash flows attributable to the risk being hedged. However, the entity must measure the amount of ineffectiveness that must be recorded currently in earnings if any of the following conditions exist:

- The critical terms of the hedging instrument or the hedged forecasted transaction have changed.
- There have been adverse developments regarding the risk of counterparty default.

In addition, the entity must also assess whether the hedging relationship is expected to continue to be highly effective.

The Company will document that critical terms match for interest rate swaps that match expected debt issuances.

- Quarterly, the PPL Corporate Finance department on behalf of LKE for intercompany interest rate swaps, formally documents its assertion that the use of critical terms match as the assessment of hedge effectiveness continues to be appropriate. If terms have changed, the PPL Corporate Finance department will perform hedge effectiveness testing for the changed transactions. This generally occurs when the issuance date and/or benchmark interest rate for the forecasted debt changes.
- All blanket hedge documentation notes the need for the Corporate Finance organization to notify the appropriate accounting group if there has been a significant adverse development in any counterparty's creditworthiness. This is implicitly corroborated through the magnitude of the credit valuation adjustment.

On-Going Hedge Effectiveness Testing (Prospective and Retrospective Assessments)

The PPL Corporate Finance organization performs dollar offset, regression and volumetric testing for cash flow hedge and fair value hedge positions. The specific testing requirements for each hedging relationship are detailed in the respective hedge documentation.

Interest rate and foreign currency hedges generally qualify for the "short-cut method" or the "critical terms match method," which are discussed in Special Situations: Shortcut method/Critical terms match. When the Company can no longer use critical terms match (generally because Corporate Finance changes its expectation of the date it will issue debt and/or the benchmark interest rate to be hedged) as its hedge effectiveness assessment, the Company

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assesses hedge effectiveness via the hypothetical-derivative method, discussed in ASC 815-30-35-25 through 35-30.

Measuring hedge ineffectiveness: The only appropriate method for calculating the amount of ineffectiveness that is recorded in earnings is the dollar offset method. This method compares the amount of the dollar change in fair value or cash flows of the derivative with the amount of the dollar change in fair value or cash flows of the hedged item over the assessment period. In those cases where the Company uses the dollar offset method for its retrospective assessment and regression analysis for its prospective assessment, ASC 815-20-55-68 through 55-69 is followed to compute the amount of quarterly ineffectiveness. A hedge transaction that fails the dollar offset test but passes the regression test will lose hedge accounting for the quarter being assessed, but will not be de-designated as a hedge since the prospective assessment passes. In this instance, the entire change in fair value of the derivative for the quarter being assessed will be recorded in earnings, as well as any ineffectiveness computed as of the last time the dollar offset test passed.

Special Situation: Counterparty Credit Risk
ASC 815-20-35-14 through 35-18 require entities to assess the possibility of whether a counterparty will default by failing to make any contractually required payments to the entity. The assessment should include the effect of any related collateralization or financial guarantees. Although a change in a counterparty's creditworthiness would not necessarily indicate the counterparty would default, such a change must warrant further evaluation. If the likelihood that the counterparty will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective. In contrast, a change in the creditworthiness of a counterparty in a fair value hedge would have an immediate impact because the change in the creditworthiness would affect the change in the derivative's fair value, which would immediately affect both the assessment of whether the relationship qualifies for hedge accounting and the amount of ineffectiveness to be recognized. The Credit and Contract Administration Department (Credit) monitors the credit worthiness of derivative counterparties. Should the credit worthiness of a counterparty be down-graded, Credit would be responsible for informing Corporate Finance. Due to regulatory accounting treatment applied to derivatives, Corporate Finance would adjust the credit value reserve accordingly when calculating the monthly mark-to-market valuation. Additionally, any call for collateral outlined in the derivative documentation would be executed.

However, under fair value accounting guidance, nonperformance risk (including the counterparty's credit risk and the entity's own credit risk) may be calculated on a counterparty portfolio level (unit of valuation), if the contracts are subject to master netting arrangements (e.g., ISDA, EEI, NAESB). Conversely, derivative accounting rules are applied at transaction level (unit of account). The difference between the unit of valuation and the unit of account had raised questions regarding (1) whether credit risk must be considered in assessments of hedge effectiveness and, if so, whether a qualitative approach

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is permitted and (2) how and whether allocations from the counterparty portfolio to the individual derivatives should be performed.

The accounting guidance provides an explicit accommodation for credit risk in cash flow hedging relationships, and for calculations performed under methodologies most commonly used, credit risk does not impact the dollar amount of ineffectiveness recognized in earnings or the assessments of effectiveness. The three methodologies used for assessing effectiveness under a cash flow hedge, which are discussed in ASC 815-30-35-10 through 35-32, are:

- Method 1: Change in variable cash flows (credit risk is not assessed)
- Method 2: Hypothetical derivative (credit risk is qualitatively assessed)
- Method 3: Change in fair value (would result in ineffectiveness from credit risk)

For fair value hedging relationships (excluding those accounted for under the short-cut method), the fair value of the derivative must include an adjustment for credit risk, whereas the assessment of the hedged item for hedges of the benchmark interest rate (the Company's most common strategy when using fair value hedges) is not impacted by credit risk. In April 2008, the SEC provided guidance that a qualitative analysis may be performed for non-shortcut fair value hedges in which the entity determines that changes in fair value attributable to credit risk would not affect whether the hedge is considered highly effective. Therefore, the Company is permitted to exclude the credit valuation adjustment calculated on a counterparty portfolio from the quarterly quantitative assessments, provided that the Company documents qualitatively that credit risk would not cause the hedging relationship to fail.

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(Note: Text in italics indicates a key SOX control.)

Derivative Classifications

Qualifying for the Normal Purchase and Normal Sales (NPNS) Exception for Energy Transactions

Contracts providing for the purchase or sale of nonfinancial instruments in quantities expected to be used or sold by the entity over a reasonable period in the normal course of business are not subject to derivative accounting requirements. Transactions qualifying for the NPNS exception receive accrual accounting treatment at the time of delivery. [See Appendix 1.]

The following guidance should be considered in determining whether a specific type of contract qualifies for the NPNS exception (from ASC 815-10-15-22 through 15-51).

(1) Forward contracts (non-option-based contracts). Forward contracts are eligible to qualify for the NPNS exception if it is probable at inception and throughout the term of the individual contract that the contract will not settle net and will result in physical delivery. Therefore, forward contracts containing net settlement provisions under the contract terms[4] or through a market mechanism will rarely qualify for the NPNS exception.

(2) Freestanding option contracts. Option contracts that would require delivery of the related asset at an established price under the contract only if exercised are not eligible to qualify for the normal purchases and normal sales exception, except as indicated in (4) below.

(3) Forward contracts that contain optionality features. Forward contracts containing optionality features that do not modify the quantity of the asset to be delivered under the contract are eligible to qualify for the NPNS exception. Except for power purchase or sales agreements addressed in (4), below, if an option component permits modification of the quantity of the assets to be delivered, the contract is not eligible for the NPNS exception, unless the option component permits the holder only to purchase or sell additional quantities at the market price at the date of delivery. For forward contracts containing optionality features to qualify for the NPNS exception, the criteria discussed in (1) must be met.

(4) Power purchase or sales agreements. Notwithstanding the criteria in (1) and (3), a power purchase or sales agreement (whether a forward contract, option contract, or a combination of both) that is a capacity contract also qualifies for the NPNS exception if it meets the criteria below.

[4] Neither party is required to deliver an asset that is associated with the underlying and that has a principal amount, stated amount, face value, number of shares, or other denomination that is equal to the notional amount (or the notional amount plus a premium or minus a discount). For example, most interest rate swaps do not require that either party deliver interest-bearing assets with a principal amount equal to the notional amount of the contract.

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Criteria applicable for both parties to the contract:

1. The terms of the contract require physical delivery of electricity. That is, the contract does not permit net settlement provisions, as described in ASC 815-10-15-100 through 15-109 under the contract terms or through a market mechanism settlement. For an option contract, physical delivery is required if the option contract is exercised.

2. The power purchase or sales agreement (whether a forward contract, an option contract, or a combination of both) is a capacity contract. Differentiating between an option contract that is a capacity contract and a traditional option contract (that is, a financial option on electricity) is a matter of judgment that depends on the facts and circumstances. For power purchase or sale agreements that contain option features, the characteristics of an option contract that is a capacity contract and a traditional option contract, which are set forth in Paragraph 815-10-55-31 [see Appendix 1], should be considered in that evaluation; however, other characteristics not listed may also be relevant to that evaluation.

Criteria applicable for the seller of electricity

3. The electricity that would be deliverable under the contract involves quantities that are expected to be sold by the reporting entity in the normal course of business.

Criteria applicable to the buyer of electricity:

4. The electricity that would be deliverable under the contract involves quantities that are expected to be used or sold by the reporting entity in the normal course of business.

5. The buyer of the electricity under the power purchase or sales agreement is an entity engaged in selling electricity to retail or wholesale customers that is statutorily or otherwise contractually obligated to maintain sufficient capacity to meet electricity needs of its customer base.

6. The contracts are entered into to meet the buyer's obligation to maintain a sufficient capacity, including a reasonable reserve margin established by or based upon a regulatory commission, local standards, regional reliability councils, or regional transmission organizations.

Additionally, certain contracts meeting the definition of a derivative in their entirety and may otherwise qualify for the NPNS exception have a price adjustment feature the underlying of which is based on the fair value of an asset that is different from the asset to be delivered in the contract. In other cases, the underlying of the price adjustment feature is based on an index or other variable not related to the asset to be delivered under the contract. ASC 815-10-15-30 through 15-34

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provide guidance about when the price adjustment for an underlying would not be considered clearly and closely related to the asset being delivered, which would preclude the NPNS exception:

- The underlying is extraneous (that is, irrelevant and not pertinent) to both the changes in the cost and the changes in the fair value of the asset being sold or purchased, including being extraneous to an ingredient or direct factor in the customary or specific production of that asset.
- If the underlying is not extraneous as discussed in (1) above, the magnitude and direction of the impact of the price adjustment is not consistent with the relevancy of the underlying. That is, the magnitude of the price adjustment based on the underlying is significantly disproportionate to the impact of the underlying on the fair value or cost of the asset being purchased or sold (or of an ingredient or direct factor, as appropriate).
- The underlying is a currency exchange rate involving a foreign currency that meets none of the criteria in Paragraph 815-15-15-10(b) for that reporting entity

LKE policies to comply with this guidance follow:

- Forward physical contracts (non-option-based contracts) subject to unplanned netting (that is, subject to possibly being booked out) are **not** eligible to qualify for the NPNS exception unless delivery is highly probable. If not eligible for NPNS, these transactions may be eligible for cash flow hedge accounting. (See "Qualifying for Cash Flow Hedge Accounting.")
- Forward option contracts requiring delivery of the related asset at an established price under the contract only if exercised are **not** eligible to qualify for the NPNS exception, unless they meet the definition of a capacity contract. (For example, plant-specific tolling arrangements may qualify for the normal exception.) Again, if not eligible for NPNS, these transactions may be eligible for cash flow hedge accounting.
- Forward contracts containing optionality features that do not modify the quantity of the asset to be delivered are eligible for the normal purchases and normal sales exception. If an option component permits modification of the quantity of the assets to be delivered (as in the case of a requirements contract), the contract is **not** eligible for the normal purchase and normal sales exception, unless it is probable that the contract will result in physical delivery, and if the option component permits the holder only to purchase additional quantities at the market price at the date of delivery.
- Power purchase or sales agreements (whether a forward contract, option contract, or a combination of both) that are classified as capacity contracts (see definition above) may qualify for the normal purchases and normal sales exception if it meets certain criteria.

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- Contracts that contain more than one underlying are evaluated to ensure that all underlyings are relevant to the contract or are immaterial to the overall contract. An example of an immaterial underlying could be the escalation of variable operation and maintenance costs at CPI when the primary underlying is the price of gas in a financial tolling arrangement.

The following transactions for LKE fall under the NPNS exclusion:

- Ohio Valley Electric Cooperative (OVEC) Surplus [CTS transaction ids #96002766 (LG&E), 98029245 (KU)]. These transactions represent our ownership interests in OVEC generation via our electric bilateral capacity purchase agreements. The amount of generation we receive on these contracts is based on the ownership percentages of LG&E and KU (5.63% and 2.5% respectively) and the availability of the OVEC units. These are physical purchases of electricity used to serve native load requirements in the ordinary course of business and therefore fall under the NPNS exemption.

- Trimble County Allotment to IMEA and IMPA based on ownership percentage of approximately 12.5%, respectively. These CTS "transactions" simply track the ownership percentage allotment of generated power to IMEA and IMPA from the Trimble County facility. These "transactions" are scheduling mechanisms and not real transactions.

Other transactions in CTS are excluded from MTM treatment due to the following:

1. Certain transactions are excluded:
   - Sales to ultimate customers (physical transactions) because these transactions are considered normal sales
   - Transactions to track capacity agreements for reserve margin purchases
   - Physical transactions to supply municipal customers
   - Transactions that have no notional amount (no minimum quantity)

2. Internal transactions between LKE are excluded since they are physical delivery transactions and therefore are NPNS.

3. Transmission transactions do not meet the definition of a derivative because of limited and illiquid markets which fail the net settlement provision.

Transaction Accounting

While the Company elects regulatory accounting treatment, if such treatment was no longer elected or allowed, the Company would utilize hedge accounting treatment.

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Hedge accounting treatment is discussed below.

Cash flow hedges are marked to fair value with the effective portion reflected in AOCI, and the ineffective portion (if any) reflected currently in earnings. For interest rate derivatives, the ineffective portion would be included in the income statement line item “Interest Expense”.

Amounts in AOCI are reclassified into earnings in the same period as the hedged forecasted transaction impacts earnings and on the same line item as the hedged item.

Cash flow hedge accounting is discontinued prospectively if any one of the following occurs:

- Any criteria qualifying the transaction as a cash flow hedge is no longer met.
- The derivative expires or is sold, terminated, or exercised.
- The designation of the cash flow hedge is voluntarily removed.

For discontinued hedges, the net gain or loss shall remain in AOCI and be reclassified into earnings as specified above, unless it is probable the forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter. If it is probable the forecasted transaction will not occur, all amounts will be reclassified into earnings at the time the hedge is discontinued. A pattern of determining hedged forecasted transactions probably will not occur would call into question both an entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions.

De-designated Cash Flow Hedges

The Company may enter into an offsetting position to “lock in” a margin on another forward position that was originally designated as a cash flow hedge. If a cash flow hedge is discontinued because it is probable the original forecasted transaction will not occur, the net derivative gain or loss in AOCI shall immediately be reclassified into earnings. The Company has interpreted this guidance to mean it must be 80% probable the forecasted transaction will NOT occur. Therefore, the forecasted transaction only needs to be 20% probable at the time of de-designation for the balances to remain in AOCI at the time of de-designation.

The Corporate Finance organization would perform a dollar offset test on the original transaction as of the date of de-designation. Based on the calculation, the effective portion of the original transaction would be deferred in AOCI. The amount in AOCI would be reclassified to earnings as the deal goes to delivery. The ineffective portion of the transaction would be immediately reclassified to earnings.

Deferred taxes

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At any given time, AOCI reflects unrealized gains and losses from active or de-designated cash flow hedges and realized gains and losses from settled or de-designated cash flow hedges. Under FASB's ASC 740, "Income Taxes," AOCI must be recorded net of taxes.

Fair Value Hedge Accounting

The gain or loss on the hedging instrument (the fair value hedge) that results from recording the derivative at fair value is recognized currently in earnings on the Statement of Income. The gain or loss on the hedged item is recorded as an adjustment to the carrying amount of the hedged item and recognized currently in earnings on the Statement of Income. For interest rate swaps, the line items that would be impacted on the Statement of Income are "Interest Expense". The realized cash settlements will be recognized in "Interest Expense" over the life of the hedged item.

Economic Activity
When describing ongoing earnings in press releases and analysts calls, the Company excludes the unrealized gains and losses ("Carve-out") related to economic hedging transactions which either do not qualify or were not designated as accounting hedges, or receive regulatory accounting treatment.

Realized vs. Unrealized Accounting & Reporting
As economic transactions are realized on the income statement, they should be recognized on the same major income statement line item as the unrealized activity related to those transactions.

Valuation Issues

Definition of Fair Value

Fair value, as defined in ASC 820-10-20, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Within this definition are fair value measurement concepts including: a) exit price (an entry or settlement price does not necessarily equate to fair value), b) highest and best use, c) principal or most advantageous market and d) non-performance risk (e.g., credit risk) for an entity's assets as well as its own liabilities.

Fair Value Hierarchy

Each derivative (and other instruments recognized at fair value on the balance sheet) must be classified within one of three levels in the fair value hierarchy for disclosures purposes. The measurement of fair value gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Quoted prices for similar assets or liabilities in active markets or for identical or similar assets or liabilities that are not active are considered Level 2. The level in the fair value hierarchy is to be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability. A contract is classified as Level 3 if at least 10% of its value was derived from Level 3 inputs or if a negative input (e.g., credit valuation adjustment) reduces the gross value of the contract by 10% or more.

Inputs may be observable or unobservable:

- Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity.
- Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs.

Valuation – General

All derivative instruments not designated and qualifying for the NPNS exception shall be recorded on the balance sheet at their fair value at each reporting period. All transactions shall be valued using appropriate valuation techniques and inputs.

Valuation techniques consistent with the market approach, income approach, and/or cost approach shall be used to measure fair value. Key aspects of those approaches are:

- **Market approach**: The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- **Income approach:** The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts.
- **Cost approach:** The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost). This valuation technique is not appropriate for the valuation of derivatives.

If no active trading market exists for a derivative or a derivative's duration, fair value must be calculated using internally developed valuation techniques or models. Key components used in these valuation techniques include price curves, creditworthiness, volatility, correlation, and tenor. There may be observable market data for certain components and unobservable data for other components, the combination of which measures the fair value of the derivative. These relationships shall be routinely re-evaluated based on available market data, and changes in price relationships shall be reflected in price curves prospectively.

Valuation – Interest Rates Contracts

The fair value of interest rate contracts is calculated by evaluating the mark-to-market value, adjusted for other factors, such as credit risk, liquidity risk, and modeling risk.

Mark-to-Market Value: The intercompany forward-starting swaps described under the Cash Flow Hedging section above are held in WSS and valued based on rates downloaded directly from Bloomberg, where the MTM is calculated. The valuations can be considered the settlement value, excluding transaction costs.

For certain types of instruments, WSS does not calculate the MTM value adequately so a spreadsheet process is used for the valuation. On a monthly basis, a Corporate Finance Analyst who is not responsible for trading receives mark-to-market valuations from counterparties for each transaction to ensure they are reasonable. To ensure reasonableness, these monthly valuations are validated each month by an internal spreadsheet prepared by a Corporate Finance Analyst. The Corporate Finance Analyst checks the valuations received from the counterparties against this spreadsheet. If the valuation provided by the counterparty is not reasonably comparable with the internal models, the Corporate Finance Analyst resolves the differences with the counterparty. Once any errors are corrected and valuations agree, a second Corporate Finance Analyst reviews the spreadsheet for accuracy and initials the report indicating agreement. The internal models are not sophisticated enough to value the derivatives exactly and will only provide a rough approximation of the mark-to-market position.

Credit valuation adjustments: Valuing the credit risk in a derivative contract is particularly complex for three main reasons:

- It is unknown whether the contract will be in an asset position or liability position at the time of default (which requires entities to consider both the counterparty's and its own creditworthiness at each valuation date).
- It is unknown what the value of the contract will be at the time of default.
- Entities rarely sell/transfer contracts but enter into offsetting positions instead – at prices that do not incorporate credit risk. Credit risk is managed through credit limits and collateral.

Additional complexities include:

- Credit risk theory states that credit valuation adjustments should be based on both the current exposure (current settlement value) and potential exposure, which is a function of potential price movements over time and the resulting, probability-weighted fair values.

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The potential exposure is calculated by (a) applying implied volatilities to the current term structure of market prices, (b) determining the fair values of the derivative based on the dispersion of those prices after volatility is applied, and (c) probability weighting and discounting those potential future values. Added together, the current exposure and potential future exposure make up the total expected exposure.

- Credit valuation must include the effects of master netting arrangements and collateral (or other credit enhancements).

Fortunately, the impact of credit risk on the fair value of derivatives is generally small relative to liabilities like debt, because the principal (notional) amount is not at risk and credit enhancements often exist. As such, LKE has taken a more pragmatic approach to valuing credit risk. LKE's policy is to apply a counterparty's probability of default (from the Credit/Contract Administration department, which gets it from S&P's system) to the net asset position (offset by liabilities and collateral) for each counterparty and to apply LKE's probability of default to a net liability position (offset by assets and collateral) for each counterparty. For those net positions that include non-derivative or NPNS deals, collateral is applied first to derivatives on the balance sheet and then to the non-derivative and NPNS deals.

This practice will be assessed periodically to determine if observable market information is available to calculate its credit valuation adjustments, rather than relying on probabilities of default, which are based on historical default rates. Because LKE uses probabilities of default, the credit valuation adjustments are considered Level 3 and are considered in the overall evaluation of whether a contract should be classified as Level 2 or Level 3.

<u>Domestic interest rate</u>:
For interest rate derivatives, LKE uses a 40% recovery rate (consistent with market practice) to acknowledge it is improbable a loss given default would equal 100% of the fair value.

Some derivatives extend well beyond the probabilities of default available; as such, the Company has used simple extrapolation to extend the default curves to approach 100%, if necessary.

This practice will be assessed quarterly to assess the reasonableness of the results and to determine if observable market information is available to calculate its credit valuation adjustments, rather than relying on probabilities of default, which are based on historical default rates.

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Reports Generated and Recipients:

Monthly:

- SwapsMMYY – prepared by LKE Corporate Finance calculating monthly settlement to be paid for LG&E interest rate swaps with banks
- JPMSwap CollateralMMYY – prepared by LKE Corporate Finance reporting economic swap collateral requirements for month-end.
- Bond Rate Sheets and DisbReq – YY – prepared by LKE Corporate Finance calculating monthly interest expense on variable rate bonds used for effectiveness testing of economic swaps
- FAS133 Calculations MMYY – prepared by LKE Corporate Finance to review reasonableness of MTM values provided by counterparties and to calculate monthly adjusting entries for each economic swap
- Interest Rate Swaps – schedule prepared by LKE Corporate Finance to calculate effectiveness of economic swaps with banks
- MTM report for interest rate derivative cash flow hedges – run from WSS at month-end to calculate MTM values of intercompany swaps with PPL
- Long-term Debt (LTD-4) – prepared by LKE Corporate Finance to provide summary of all outstanding swaps at month-end

Quarterly:

- Credit Value Adjustment – provided by PPL Corporate Finance to LKE Corporate Finance to record the credit value adjustment against the MTM value of the intercompany swaps with PPL
- Collateral Requirement Triggers Swaps – prepared by LKE Corporate Finance to report additional collateral requirements if credit rating changes
- Swap Sensitivity to Interest Rate Summary – prepared by LKE Corporate Finance to report change in market value of swaps due to effect of 10% adverse movement in rates (PPL Corporate Finance provides Bloomberg data that is used in preparing schedule)

Additional Controls or Responsibility Provided by Other Procedures:

451 - Contractual Review policy

Regulatory Requirements:

Guidance for accounting for derivative activities referenced in the Code of Federal Regulations (CFR) Title 18 Federal Energy Regulatory Commission (FERC) Uniform System of Accounts

Reference:

ASC-815, Derivatives and Hedging

Corresponding PPL Policy No. and Name:

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400 - Accounting Policy for Derivatives and Hedging

Key Contact:

Manager, Financial Accounting and Analysis
Manager, Corporate Finance

Administrative Responsibility:

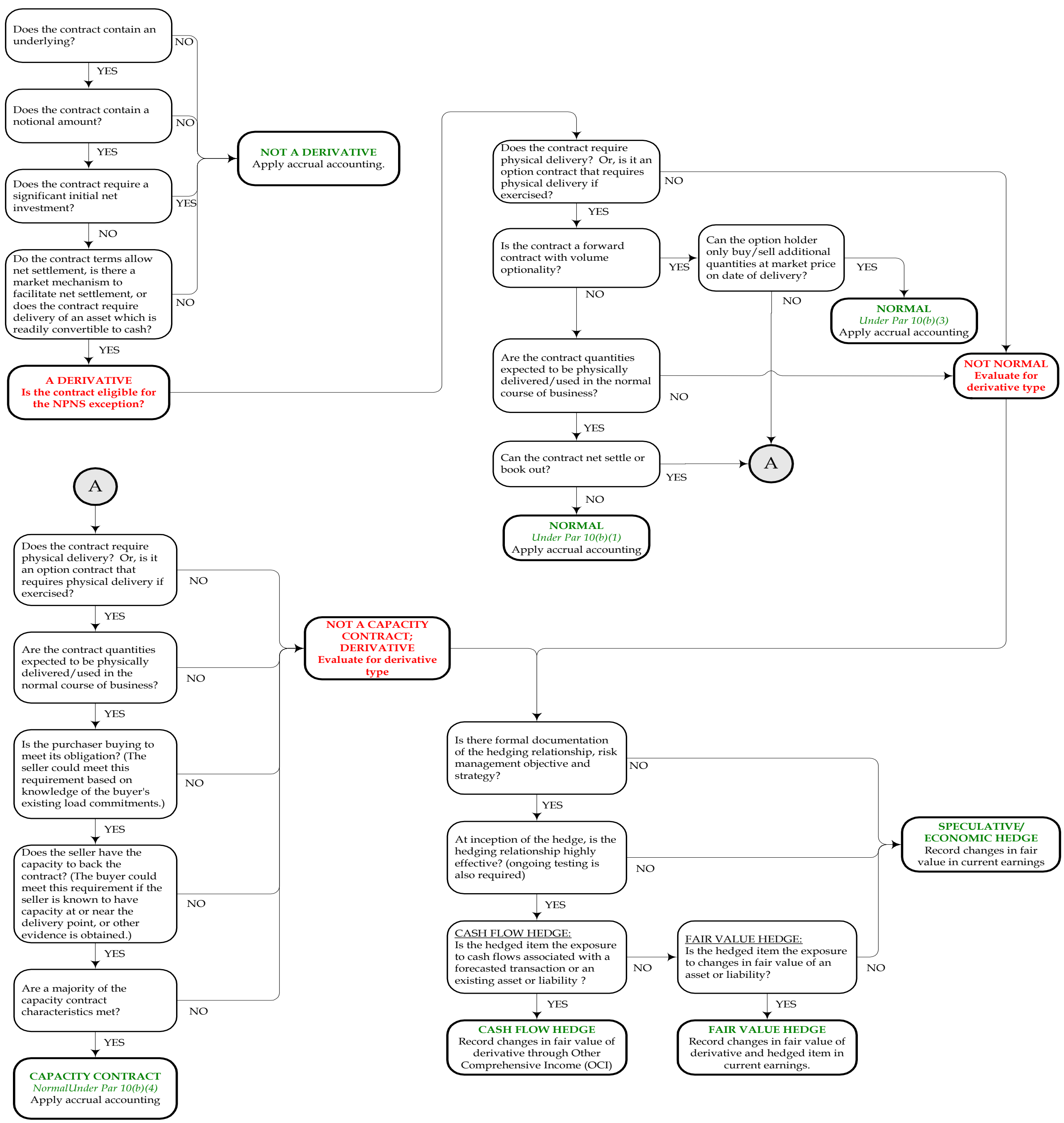
Director, Accounting and Regulatory Reporting
Treasurer

Date Created: 3/31/11
Dates Revised: 9/21/11, 11/1/12, 3/20/15, 4/1/16, 3/27/2017

450 – Derivatives and Hedging

(Note: Text in italics indicates a key SOX control.)

Appendix 1: Derivative Evaluation Flowchart



(Note: Text in italics indicates a key SOX control.)

APPENDIX 2 - Derivative

ASC 815 - Derivative Evaluation Worksheet
Counterparty Name

Background			
Counterparty:		PPL Company:	
Date of contract initiation:		Purchase or Sale:	
Date of contract end:		Product/Service:	
Duration:			

Additional Comments (Overview)

Summary of Conclusions:

Is the contract a derivative?	0	(automatically populated)
Does the contract qualify for NPNS?	0	(automatically populated)
Do price adjustment features exist and therefore NPNS cannot be taken?	0	(automatically populated)

APPENDIX 2 - Derivative

Does the contract contain an embedded derivative? 0 (automatically populated)

(Answer the below questions using the drop-down menu in the shaded boxes)

In order to correctly answer the questions in this template, the referenced guidance must be read to completely understand what each question is asking.

Step 1: Is the contract a derivative? (automatically populated) 0

Is the Contract a Derivative? (All Criteria Must Be Met)		
Underlying ASC 815-10-15-88 through 15-91		
Notional Amount ASC 815-10-15-92		
Little or no initial net investment ASC 815-10-15-94 through 15-98		
Net settlement, Market mechanism or readily convertible to cash ASC 815-10-15-99 through 15-139		
Derivative Conclusion:		

If yes, continue to Step 2. If no, continue to Step 4 (Embedded Derivatives).

Step 2: Does the contract qualify for the normal purchase normal sale exception? (automatically populated) 0

Is the Contract Eligible for the Normal Purchase Normal Sale Exception? (One Criterion Must be Met)

(Note: Text in italics indicates a key SOX control.)

APPENDIX 2 - Derivative

NPNS must meet the four criteria as listed in ASC 815-10-15-25: (1) Normal Terms (ASC 815-10-15-27 through 15-29) (2) Clearly and Closely Related (ASC 815-10-15-30 through 15-34) (3) Probably Physical Settlement (ASC 815-10-15-35 through 15-36) (4) Documentation (ASC 815-10-15-37 through 15-39)		If yes, complete the rest of this section. If no, move to Step 4.
Forward (Non-Option-Based) Contracts must meet the criteria for NPNS eligibility as outlined in ASC 815-10-15-41		
Freestanding Option Contracts must meet the criteria for NPNS eligibility as outlined in ASC 815-10-15-40		
Forward Contracts that Contain Optionality Features must meet the eligibility criteria as outlined in ASC 815-10-15-42 through 15-44		

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(Note: Text in italics indicates a key SOX control.)

APPENDIX 2 - Derivative

Capacity contract must meet the criteria outlined in 815-10-15-45 (Include checklist.)		If yes, must complete the ASC 815-10-15-45 checklist.
Conclusion: Normal?		

If the contract qualifies for NPNS, continue to Step 3. If it does not qualify, continue to Step 4 (Embedded Derivatives).

Step 3: Does a contract that qualifies for the normal purchase normal sales exception have price adjustment features and therefore the NPNS exception cannot be taken?
If yes or no, continue to Step 4.

Price Adjustment Features in Contracts that Qualify for the Normal Purchase Normal Sales Exception ASC 815-10-15-30 through 15-34
ASC 815-10-15-30: Contracts that have a price based on an underlying that is not clearly and closely related to the asset being sold or purchased (such as a price in a contract for the sale of a grain commodity based in part on changes in the Standard and Poor's index) or that are denominated in a foreign currency that meets none of the criteria in paragraph 815-15-15-10(b) shall not be considered normal purchases and normal sales.

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(Note: Text in italics indicates a key SOX control.)

APPENDIX 2 - Derivative

ASC 815-10-15-31: The phrase not clearly and closely related in the preceding paragraph with respect to the normal purchases and normal sales scope exception is used to convey a different meaning than in paragraphs 815-15-25-1(a) and 815-15-25-16 through 25-51 with respect to the relationship between an embedded derivative and the host contract in which it is embedded. The guidance in this discussion of normal purchases and normal sales does not affect the use of the phrase not clearly and closely related in paragraphs other than the preceding paragraph. For purposes of determining whether a contract qualifies for the normal purchases and normal sales scope exception, the application of the phrase not clearly and closely related to the asset being sold or purchased shall involve an analysis of both qualitative and quantitative considerations. The analysis is specific to the contract being considered for the normal purchases and normal sales scope exception and may include identification of the components of the asset being sold or purchased.

ASC 815-10-15-32: The underlying in a price adjustment incorporated into a contract that otherwise satisfies the requirements for the normal purchases and normal sales scope exception shall be considered to be not clearly and closely related to the asset being sold or purchased in any of the following circumstances:

Does the contract qualify for the normal purchase normal sale exception? If "No" stop here.	
Does the contract contain price adjustment features? If "No" stop here.	
a. The underlying is extraneous (that is, irrelevant and not pertinent) to both the changes in the cost and the changes in the fair value of the asset being sold or purchased, including being extraneous to an ingredient or direct factor in the customary or specific production of that asset.	
b. If the underlying is not extraneous as discussed in (a), the magnitude and direction of the impact of the price adjustment are not consistent with the relevancy of the underlying. That is, the magnitude of the price adjustment based on the underlying is significantly disproportionate to the impact of the underlying on the fair value or cost of the asset being purchased or sold (or of an ingredient or direct factor, as appropriate).	
c. The underlying is a currency exchange rate involving a foreign currency that meets none of the criteria in paragraph 815-15-15-10(b) for that reporting entity.	
Conclusion: Does a contract that otherwise qualifies for the normal purchase normal sales exception that has price adjustment features meet any of the criteria above? If no, the contract can receive the normal purchase normal sale exception.	

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(Note: Text in italics indicates a key SOX control.)

APPENDIX 2 - Derivative

Step 4: Does the contract contain an embedded derivative? (automatically populated) 0

Embedded Derivative Instruments Evaluation ASC 815-15-25-1	
An embedded derivative shall be separated from the host contract and accounted for as a derivative instrument pursuant to Subtopic 815-10 if and only if all of the following criteria are met:	
Does the contract contain an embedded derivative? If "No", stop here. If "Yes", identify the features of the contract being evaluated for an embedded derivative.	
a. The economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract.	
b. The hybrid instrument is not re-measured at fair value under otherwise applicable generally accepted accounting principles (GAAP) with changes in fair value reported in earnings as they occur.	
c. A separate instrument with the same terms as the embedded derivative would, pursuant to Section 815-10-15, be a derivative instrument subject to the requirements of this Subtopic. (The initial net investment for the hybrid instrument shall not be considered to be the initial net investment for the embedded derivative.)	
Conclusion: Does a contract meet the criteria of an embedded derivative?	

Final Conclusion

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(Note: Text in italics indicates a key SOX control.)

Policy:
Contracts within the scope defined below are reviewed monthly and evaluated to determine the appropriate accounting treatment related to the terms in the contract, which may include leases, variable interest entities (VIEs), guarantees, derivatives, purchase obligations, joint and several liability, and credit contingent features within the executed contract. Additionally, contracts are evaluated to identify swaps to comply with the requirements of the Commodity Exchange Act, as modified by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Procedure:

Contracts are reviewed by Financial Accounting and Analysis (FAA) using checklists of items to consider when evaluating the transactions for accounting implications and for Dodd-Frank Act swap identification purposes.

Scope:

Applicable to LG&E and KU Energy LLC's and its subsidiaries' ("LKE" or "the Company") all contracts meeting the following thresholds are considered "in-scope":

- $1 Million total contract value over the life of the contract, or
- Term of 5 years or longer, or
- Any contract with an indeterminable amount or an indeterminable term.
- All lease agreements (no financial threshold).
- All long-term commodity transactions entered into by Power Supply (no financial threshold).

The financial thresholds and guidelines are based on a determination of contracts that may have a material impact on the financial statements.

The review of contracts is documented differently based on the financial impact of the contract as follows:

- Review of a contract greater than $5 Million or a term of 5 years or longer is required to be documented using the contract review template. (See Step 2 - Review of the Contracts, Item 2 below).
- Review of contracts that are greater than $1 Million, but less than $5 Million, is done at a higher level with the goal of complex issue identification. Completion of the contract review template is not required; however it may be used if a complex accounting issue is identified. (See Step 3 - Contract Inventory and Conclusions, Item 2 below).

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(Note: Text in italics indicates a key SOX control.)

- Review of a contract that has no estimable total value or an indeterminable term is required to be documented using the contract review template. (See Step 2 – Review of the Contracts, Item 2 below).
- If the contract value is clearly lower than $1 Million and has no reasonable possibility of approaching that amount, the contract can be excluded from the review and documented as such.

In addition to the accounting review of the contracts, all contracts are subject to the Authority Limit Matrix approval requirements and are not considered approved contracts until all the appropriate approvals are obtained. It is noted in the Authority Limit Matrix in Notes 6(e) that in compliance with accounting guidelines, all contracts greater than $1,000,000 must be submitted to Financial Accounting and Analysis.

Included in this policy are the references to the Sarbanes-Oxley Transaction 80.04 Loss Contingencies, Leases, Contracts and Guarantees Control Activities (80.04 CA 1, 2, 3, 6, 8).

Objective of Procedure:
The objective of this procedure is to establish guidance for the review and evaluation of contracts so that the proper accounting treatment may be applied, and to provide a process for ascertaining LKE's compliance with the Dodd-Frank Act.

This policy addresses controls 1, 2, 3, 6, and 8 in 80.04 Loss Contingencies, Leases, Contracts and Guarantees Control Activities.

General Requirements:

Detailed Procedures Performed:

Step 1 - Gathering the Contracts

1. Microsoft SharePoint will be utilized as a central location to gather in-scope contracts to be reviewed. FAA is one of the site owners and has access to review all site content. Each business line shall appoint one individual, the "Group Admin", who will coordinate the submission of documents to the site; however any approved individual within a business line will have access to upload or view documents. (See the Contracts Database SharePoint Site under references for the SharePoint Permission Levels document for more information).
2. FAA will notify Group Admins of monthly submission deadlines via Microsoft Outlook Calendar appointment (with copy to site Calendar) to be sent in January as a recurring monthly appointment for the year. Group Admins are responsible for meeting this

monthly submission deadline. Upon submission, Group Admins are also responsible for initiating review workflows and assigning a review task to the FAA Analyst.

3. An Oracle report is received from Supply Chain for all contracts and purchase orders entered into Oracle greater than $1M to gather monthly procurement contracts. These lists are used to ensure that FAA has received these contracts.
4. *FAA Analyst conducts a separate survey of leases on a quarterly basis, as all lease agreements are reviewed regardless of the dollar value of the agreement. The FAA Analyst sends the lease inventory spreadsheet to designated business line contacts (see Appendix B) within LKE who are responsible for lease agreements (including, but not limited to, vehicles, equipment, rail cars and real estate). [80.04 CA 6]*

Step 2 – Review of the Contracts [80.04 CA1]

1. All contracts are reviewed by the FAA Analyst and evaluated to determine that the appropriate accounting features have been identified in the contract. The evaluation is performed in accordance with the following LKE and PPL policies containing the relevant ASC technical guidance and all other applicable GAAP:
   - 450 - Derivatives and Hedging (ASC 815, Derivatives and Hedging)
   - 454 - Leases (ASC 840, Leases)
   - 1057 - Guarantees (ASC 460, Guarantees)
   - 1058 - Variable Interest Entities (ASC 810, Consolidation)
   - Dodd-Frank Wall Street Reform and Consumer Protection Act, Title VII Compliance Manual for PPL Corporation
2. If required (see Scope section), the review of the in-scope contract is documented on an Excel spreadsheet template. Changes to the template are coordinated with PPL. The completed templates are uploaded to the applicable contract document set in SharePoint. (See the Contracts Database SharePoint Site under references for the current version of the Contract Review Template document for more information).
3. FAA Analyst will perform a high-level review of $1 - $5 million contracts uploaded to the site in order to identify trends, unusual items or other accounting issues that could potentially have a material financial impact. The contract review templates are not required to be completed, but may be used as a tool to evaluate complex accounting issues identified during the review of the contract.
4. FAA's review is not limited to the items included on the template, as the template is a tool that is utilized to walk through complex accounting issues. FAA will also review the accounting features and other attributes populated by users on a contract document set for accuracy as part of the review.
5. *The contract review template may be completed by the Business Line Contact or by the FAA analyst, and must be reviewed by the Manager, Financial Accounting and Analysis*

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(FAA Manager) and Manager, Credit and Contract Administration (CCA Manager). The FAA analyst initiates a workflow task to be completed by FAA Manager and CCA Manager indicating the completion of their reviews. This occurs quarterly.[80.04 CA 1,3]

6. The CCA Manager has access to review all site content and will review all contracts for the proper identification of credit contingent features and to identify swaps based on the definition in the Dodd-Frank Act.
7. Certain contracts have standard terms and conditions in a base agreement. These contracts are executed by individual counterparty, but executed contracts cannot vary in terms and conditions from the base agreement. Therefore, the base agreements are reviewed annually or as changes are made. These contracts include the following:
   - Customer Contracts - The Company's Rates, Terms and Conditions for Furnishing Electric/Gas Service, are filed with and approved by the Kentucky Public Service Commission and the Virginia State Corporation Commission. In lieu of reviewing individual contracts, FAA will confirm quarterly with the Economic Development and Major Accounts departments (see Appendix A) that no deviations have occurred from the base agreements. The Federal Energy Regulatory Commission municipal customer's contracts are reviewed separately in the Energy Supply and Analysis Business Line and sent to FAA.
   - Gas Retail Contracts - Individual transactions are denoted on daily nomination schedules. These contracts are deemed to be derivative contracts that qualify for the normal purchase, normal sale exclusion. These transactions are entered into and managed by the Gas Management Planning and Supply department. In lieu of reviewing individual contracts, FAA will confirm quarterly with the Gas Management Planning and Supply department that no deviations have occurred from the base agreement (see Appendix A) and that all transactions entered into would be considered normal purchase normal sale transactions.
   - Gas Supply for Generation Contracts - Individual transactions are denoted on daily nomination schedules. These contracts are deemed to be derivative contracts that qualify for the normal purchase, normal sale exclusion. These transactions are entered into and managed by the Credit/Contract Administration and Regulated Trading and Dispatch departments. In lieu of reviewing individual contracts, FAA will confirm quarterly with the Credit/Contract Administration department that no deviations have occurred from the base agreement (see Appendix A) and that all transactions entered into would be considered normal purchase normal sale transactions.

The signed Confirmations are sent by the respective Business Line contacts from Economic Development and Major Accounts, Gas Supply, and Credit/Contract Administration departments

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(Note: Text in italics indicates a key SOX control.)

to the FAA Analyst before the last day of a quarter-end month and uploaded by the FAA Analyst to the Contracts Database SharePoint site. (see Appendix A) [80.04 CA 2]

Step 3 - Contract Inventory and Conclusions

1. All conclusions reached through the contract review process should be included within the appropriate document set for the contract and available to the Business Line contacts and others for review.
2. A listing of all contracts over $5 million along with completed templates and a listing of contracts between $1 and $5 Million will be sent to PPL Technical Accounting before the quarter-end closing meeting.
3. Financial Reporting and Audit Services will have access to the SharePoint Site to facilitate gathering SEC reporting, SOX, and quarterly/annual Client Assistance contract review supporting documentation.

Security:

The FAA department will perform a quarterly SharePoint access review to ensure proper access to the site and each document library. Access to the site should be approved by Manager-level or above within the lines of business and granted by Site Owners.

<u>Reports Generated and Recipients:</u>
The following reports are generated quarterly:

- Contract Inventory listing of contracts greater than $5 million from FAA is sent to PPL Technical Accounting and Financial Reporting.
- Contract Inventory listing of contracts between $1 - $5 million from FAA is sent to PPL Technical Accounting and Financial Reporting
- Confirmations received from Economic Development and Major Accounts and the Gas Management Planning and Supply departments are sent to FAA
- Lease inventory report from FAA is sent to Financial Reporting and E&Y

<u>Additional Controls or Responsibility Provided by Other Procedures:</u>
None

<u>Regulatory Requirements:</u>
None

Reference:
ASC-460, Guarantees

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(Note: Text in italics indicates a key SOX control.)

ASC-810, Consolidation of Variable Interest Entities
ASC-815, Accounting for Derivative Instruments and Hedging Activities
ASC-840, Accounting for Leases
Dodd-Frank Wall Street Reform and Consumer Protection Act, Title VII Compliance Manual for PPL Corporation

Corresponding PPL Policy No. and Name:
None

Key Contact:
Manager, Financial Accounting and Analysis
Administrative Responsibility:

Director, Accounting and Regulatory Reporting

Date Created: 4/9/07
Dates Revised: 6/30/08, 4/23/09, 8/23/10, 3/18/11, 6/29/11, 10/4/11, 6/28/12, 4/13/13, 12/17/13, 2/9/16, 2/28/17

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(Note: Text in italics indicates a key SOX control.)

APPENDIX A – Confirmations

Confirmation of Customer Contracts

Group Name : Economic Development and Major Accounts

The purpose of this confirmation is to confirm that all transactions entered into under the base contract agreements for the applicable quarter did not deviate from the base agreement.

1.) Were there any executed agreements over $1,000,000 during the quarter that deviated in terms and conditions from the base agreements?

The Company's Rates, Terms and Conditions for Furnishing Electric/Gas Service, are filed with and approved by the Kentucky Public Service Commission and the Virginia State Corporation Commission. A response of no confirms there are no deviations from the base agreements that exceeded $1,000,000.

Confirmation of Normal Purchase Normal Sales Transactions

Group Name : Gas Management Planning and Supply

The purpose of this confirmation is to confirm that all transactions entered into under the base contract agreements for the applicable quarter are in compliance with the normal purchase normal sale exception for derivatives accounting.

1.) Determine if the contract transactions meet the definition of a normal purchase normal sales.
All of the following answers must be yes in order for the contract transactions to be deemed normal purchase normal sales transactions.

a.) Did all transactions entered into have normal quantities, location for physical delivery, and timing of gas purchases and sales reasonable in relation to the business needs of LG&E?
(no transactions occurred without the probable intent of being used for LG&E gas customers)

b.) Were all price indices used to determine the fair value of the transactions not extraneous, not disproportionate in magnitude or direction, and not related to a nonfunctional currency?
Please list the indices used for the transactions. ______________

c.) Did all transactions occur in physical settlement of gas delivered? (no transactions occurred with only financial settlement and no gas delivered)

2.) Were there any executed agreements during the quarter that deviated in terms and conditions from the base agreement?

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(Note: Text in italics indicates a key SOX control.)

Confirmation of Normal Purchase Normal Sales Transactions

Group Name : Credit/Contract Administration

The purpose of this confirmation is to confirm that all transactions entered into under the base contract agreements for the applicable quarter are in compliance with the normal purchase normal sale exception for derivatives accounting.

1.) Determine if the contract transactions meet the definition of a normal purchase normal sales.
All of the following answers must be yes in order for the contract transactions to be deemed normal purchase normal sales transactions.

a.) Did all transactions entered into have normal quantities, location for physical delivery, and timing of gas purchases and sales reasonable in relation to the business needs of LG&E and KU?
(no transactions occurred without the probable intent of being used for LG&E and KU generation)

b.) Were all price indices used to determine the fair value of the transactions not extraneous, not disproportionate in magnitude or direction, and not related to a nonfunctional currency?
Please list the indices used for the transactions. ______________

c.) Did all transactions occur in physical settlement of gas delivered? (no transactions occurred with only financial settlement and no gas delivered)

2.) Were there any executed agreements during the quarter that deviated in terms and conditions from the base agreement?

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(Note: Text in italics indicates a key SOX control.)

APPENDIX – B

Lease Review Contacts

Contact Title	Lines of Business
Manager, Corporate Accounting	Accounting
Manager, Transportation	Distribution Operations
Right of Way Agent III	Distribution Operations
Manager, Administrative/Contract Services	Distribution Operations
Fleet Contract Manager	Distribution Operations
Director, Operating Services Business Process Management	Distribution Operations
Transportation Records Technician	Distribution Operations
Director, Distribution Operations	Distribution Operations
Manager, Fuels Accounting and Administration	Energy Marketing
Manager, Commercial Operations (Cane Run)	Energy Services
Contract Administrator (Mill Creek)	Energy Services
Manager, Commercial Operations (Trimble County)	Energy Services
Manager, Commercial Operations (E.W. Brown)	Energy Services
Manager, Finance & Budgeting - Power Production	Energy Services
Senior, Budget Analyst (Trimble County)	Energy Services
Senior, Budget Analyst (Ghent)	Energy Services
Manager, Maintenance - Power Generation (Green River)	Energy Services
Senior, Budget Analyst (Cane Run)	Energy Services
Administrative Coordinator (Green River)	Energy Services
Senior, Budget Analyst	Energy Services
Manager, Commerical Operations (Ghent)	Energy Services
Senior, Budget Analyst (E. W. Brown)	Energy Services
Senior, Corporate Attorney	Legal
Corporate Affairs Coordinator	Legal
Telecommunications Shop Supervisor	Network Infrastructure

452 - Goodwill

(Note: Text in italics indicates a key SOX control)

Policy: Goodwill of LG&E and KU Energy LLC (”LKE”) and its subsidiaries is recorded in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 350, Intangibles – Goodwill and Other, and ASC 820, Fair Value Measurements and Disclosures.

Procedure: The excess cost of the acquired entity over the net fair value of assets acquired and liabilities assumed is recorded as goodwill. Goodwill is tested for impairment annually or on a more frequent interim basis if relevant conditions dictate.

Scope: Goodwill recorded on LKE and its subsidiaries.

Objective of Procedure: The objective of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 350, Intangibles – Goodwill and Other, is to address how intangible assets that are acquired individually or with a group of other assets (excluding those acquired in a business combination) should be accounted for in financial statements upon their acquisition and thereafter. The purpose of testing goodwill is to determine if an impairment of the asset according to ASC 350 has occurred and if it must be recognized in the financial statements. Below are definitions of values used for testing goodwill:

- Impairment of goodwill is the condition that exists when the carrying value of the goodwill exceeds its implied fair value.
- Carrying value of goodwill is defined as the value of the asset as it appears on the balance sheet.
- Implied fair value of goodwill is defined as the excess of the fair value of reporting unit over the amounts assigned to its assets and liabilities.

Fair Value – As stated in ASC 820, Fair Value Measurements and Disclosures, “fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” ASC 820 requires documentation of fair value measurement concepts including: a) exit price (entry, transaction or settlement price does not necessarily equate to fair value), b) highest and best use, c) principal or most advantageous market and d) non-performance risk (e.g. credit risk) for an entity’s own liabilities. In addition, ASC 820 expands the fair value disclosure requirements of other accounting pronouncements. When measuring fair value, these concepts as well as the disclosures should be considered and documented.

452 - Goodwill

(Note: Text in italics indicates a key SOX control)

General Requirements:

ASC 350 is generally an acknowledgement by the FASB that goodwill often is not a wasting asset and that such assets, accordingly, should not be subject to amortization. Replacing amortization in this context is the application of impairment testing which generally involves:

- Definition of the reporting units;
- Allocation of goodwill to the various reporting units;
- Determination of the fair value of each reporting unit;
- Comparison of the fair value of each reporting unit with the carrying value of the reporting unit;
- Adjustment of goodwill in the event of impairment (carrying value of the reporting unit exceeds its fair value).

Testing for impairment of goodwill is conducted at least annually on the reporting unit level. The impairment test may be performed any time during the fiscal year provided the test is performed at the same time every year. LKE and its affiliates have determined that the annual impairment testing for reporting units will occur in the fourth quarter of each year based on the current long-term planning data. (For example, the goodwill impairment for 2011 would occur in October of 2011 using long-term planning data from the 2012 Plan.)

Reporting unit – definition
Goodwill impairment test must be performed on the reporting unit level. According to ASC 250 – *Segment Reporting*, a reporting unit is an operating segment or one level below an operating segment (referred to as a component). An operating segment is defined as a component of an enterprise that engages in business activities from which it may earn revenues and incur expenses whose operating results are regularly reviewed by the chief operating decision-maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

A component of an operating segment is a reporting unit if the following criteria are fulfilled:

- The component constitutes a business for which discrete financial information is available;
- The components have different economic characteristics and;
- Segment management regularly reviews the results of that component.

Currently, LKE has three reporting units – LKE and subsidiaries, Louisville Gas and Electric Company (LG&E) and Kentucky Utilities (KU).

452 - Goodwill

(Note: Text in italics indicates a key SOX control)

All goodwill acquired in a business combination shall be assigned to one or more reporting units as of the acquisition date. Goodwill shall be assigned to reporting units of the acquiring entity.

In connection with PPL's acquisition of LKE on November 1, 2010, the carrying value of LKE's goodwill as of October 31, 2010, was eliminated. New goodwill was recorded on November 1, 2010 on LG&E and KU as the reporting units of LKE. The allocation of the goodwill was based on the net asset value of each company. The goodwill represents value paid for the rate regulated business located in a defined service area, which provides for investment, future earnings and cash flow growth. LG&E's and KU's franchise values are being attributed to the going concern value of the business and thus, were recorded as goodwill rather than a separately identifiable intangible asset. None of the goodwill recognized is deductible for income tax purposes or included in customer rates.

When a portion of a reporting unit that constitutes a business is to be disposed of when the reporting structure is reorganized the amount of goodwill shall be allocated based on the relative fair values of the portion of the business to be disposed of and the portion of the reporting unit to be retained. However, if the business to be disposed of was never integrated into the reporting unit after its acquisition, (thus the benefits of the acquired goodwill were never realized by the rest of the reporting unit) the current carrying amount of that acquired goodwill shall be included in the carrying amount of the business to be disposed of. When only a portion of goodwill is allocated to the business to be disposed of, the goodwill remaining in the portion of the reporting unit retained shall be tested for impairment.

Qualitative Assessment (Step 0 Analysis)

In 2011, the FASB issued Accounting Standard Update (ASU) 2011-08 which amends the guidance in ASC 350-20 on testing goodwill for impairment. Under the revised guidance, beginning with fiscal years beginning after December 15, 2011, entities testing goodwill for impairment have the option of performing a qualitative assessment before calculating the fair value of the reporting unit (i.e., step 1 of the goodwill impairment test). In the qualitative assessment, entities would determine whether it is more likely than not (i.e., a likelihood of more than 50 percent) that the fair value of the reporting unit is less than the carrying amount. If so, they would proceed to step 1 of the goodwill impairment analysis in ASC 320-20. However, if not, further testing of goodwill for impairment would not be required to be performed. Because the qualitative assessment is optional, entities may bypass it for any reporting unit in any period and begin their impairment analysis with the quantitative calculation in step 1. Entities may resume performing the qualitative assessment in any subsequent period.

452 - Goodwill

(Note: Text in italics indicates a key SOX control)

The ASU did not change how goodwill is calculated or assigned to reporting units, nor does it revise the requirement to test goodwill annually for impairment. In addition, the ASU does not amend the requirement to test goodwill for impairment between annual tests if events or circumstances warrant.

All goodwill recognized by a public or nonpublic subsidiary (subsidiary goodwill) in its separate financial statements that are prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") shall be accounted for in accordance with ASC 350. Subsidiary goodwill shall be tested for impairment at the subsidiary level using the subsidiary's reporting units. If goodwill of a subsidiary is impaired, a push-up of the impairment to the consolidated level does not necessarily take place. If a goodwill impairment loss is recognized at the subsidiary level, an assessment is made as to whether or not the fair value of the reporting unit needs to be adjusted on a higher consolidated level by performing an interim impairment test in the reporting units in which the subsidiary resides. Should a reduction in the fair value of the reporting unit be considered unnecessary, an impairment loss is not recorded in the consolidated statement of income.

If goodwill and another asset (e.g., under ASC 360 – Impairment of Long-Lived Assets) of a reporting unit are tested for impairment at the same time, the other asset shall be tested for impairment before goodwill.

Detailed Procedures Performed for Goodwill Impairment Test:

Step 0 Analysis
If the optional qualitative assessment is performed, ASC 350-20-35-3C provides the following examples (not all-inclusive) of events and circumstance that may be considered in the qualitative assessment:

a. Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets

b. Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development

c. Cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows

(Note: Text in italics indicates a key SOX control)

d. Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods

e. Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation

f. Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit

g. If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).

Entities should also consider:

- The "extent to which each of the adverse events and circumstances identified could affect the comparison of a reporting unit's fair value with its carrying amount. An entity should place more weight on the events and circumstances that most affect a reporting unit's fair value or the carrying amount of its net assets."
- Any "positive and mitigating events and circumstances that may affect" the analysis. However, positive and mitigating evidence should not be viewed as a rebuttable presumption that an entity does not need to perform the quantitative calculation under step 1.
- The difference between the current-period carrying amount and the fair value of a reporting unit calculated in a recent prior period.
- The factors in their totality. No one factor is meant to be a determinative event that triggers a quantitative calculation.

If the qualitative analysis is performed it must be documented thoroughly including any underlying analysis to support the assertion of whether the fair value of the reporting unit is not more likely than not less than its carrying amount.

Indicators for a possible decrease in value

Goodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Per ASC 350-20-35-30, examples of such events or circumstances include:

- A significant adverse change in legal factors or in the business climate;
- An adverse action or assessment by a regulator;
- Unanticipated competition;
- A loss of key personnel;
- A more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of:
- The testing for recoverability under ASC 360 – Property, Plant and Equipment of a significant asset group within a reporting unit;
- Recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

Quantitative Testing

Identification of a possible decrease in value (Step 1)
The first step in the quantitative portion of testing goodwill to identify potential impairments is to compare each reporting unit's fair value with its carrying amount including goodwill. If a reporting unit's carrying amount exceeds its fair value, this indicates that its goodwill may be impaired and second-step testing is required.

To test for impairment, the fair value of a reporting unit is determined by means of a valuation model that is derived from the business plan presented to the Board of Directors. PPL has determined that it will centrally coordinate and perform all goodwill impairment testing beginning in 2011. LKE will retain responsibility for ensuring the overall accuracy and reasonableness of the calculations performed by PPL including conformity with GAAP.
A detailed determination of the fair value of a reporting unit may be carried forward from one year to the next if all of the following criteria have been met:

- The assets and liabilities that make up the reporting unit have not changed significantly since the most recent fair value determination;
- The most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin;
- Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote.

Determining the decrease in value (Step 2)

452 - Goodwill

(Note: Text in italics indicates a key SOX control)

The second step of the quantitative portion of the goodwill impairment test, used to measure the amount of impairment loss, is to compare the implied fair value of the reporting unit's goodwill with the carrying amount of its goodwill. The implied fair value of goodwill is computed by allocating the reporting unit's fair value to all of its assets and liabilities in a manner that is similar to a purchase price allocation in a business combination in accordance with ASC 805 – Business Combinations. The remainder after this allocation is the implied fair value of the reporting unit's goodwill. If the fair value of goodwill is less than its carrying value, the difference is recorded as an impairment loss.

Recognition of subsequent reversal of a previously recognized goodwill impairment loss is prohibited once the measurement of that loss is completed under ASC 350.

Disclosure requirements

According to ASC 350 for each goodwill impairment loss recognized, the following information shall be disclosed in the notes to the financial statements that include the period in which the impairment loss is recognized:

- A description of the facts and circumstances leading to the impairment;
- The amount of the impairment loss and the method of determining the fair value of the associated reporting unit;
- If a recognized impairment loss is estimated that has not yet been finalized, that fact and the reasons therefore and, in the subsequent periods, the nature and amount of any significant adjustments made to the initial estimate of the impairment loss.

Goodwill disclosure requirements pursuant to ASC 350 include, but are not necessarily limited to the following:

- The total carrying amount at the end of each financial reporting period;
- The change in the carrying amount of goodwill during the period, including the aggregate amount of goodwill acquired, the amount of impairment losses recognized, and the amount of goodwill included in the gain or loss on disposal of a reporting unit (or portion thereof).

Relevant personnel will determine, by use of Impairment Questionnaires and Checklists, the applicability of reporting requirements pursuant to ASC 350 on at least an annual basis (or more frequently based on the occurrence of relevant events) as previously described. (See Asset Impairment Accounting Policy and Procedures.)

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(Note: Text in italics indicates a key SOX control)

The PPL Controller and PPL Senior Director of Financial Planning is responsible for determining whether the optional qualitative analysis will be performed, coordinating the performance of any required impairment tests with PPL's and LKE's Financial Planning departments and/or external consultants, reviewing the results with the external auditor and communicating the results to LKE. LKE's Financial Accounting and Analysis department, will record any entries required if impairment exists.

452 - Goodwill

(Note: Text in italics indicates a key SOX control)

Reports Generated and Recipients:

Annual impairment test completed by PPL.

Additional Controls or Responsibility Provided by Other Procedures:

654 - Asset Impairment

Regulatory Requirements:

Federal Energy Regulatory Commission ("FERC") Accounting Guidelines

Reference:

- ASC 820 - Fair Value Measurements and Disclosures
- ASC 350 - Intangibles – Goodwill and Other
- ASC 250 - Segment Reporting
- ASC 360 - Impairment of Long-Lived Assets
- ASC 360 - Property, Plant and Equipment
- ASC 805 - Business Combinations
- February 13, 2011 - Segment Reporting technical research memo
- April 25, 2011 - Segment Reporting LKE technical research memo
- July 30, 2011 - Addendum I to April 25, 2011 Segment Reporting LKE technical research memo

Key Contact:

Manager, Financial Accounting and Analysis

Corresponding PPL Policy No. and Name:

- 1002 – Accounting and Reporting Requirements for Goodwill
- 402 – Asset Impairments

Administrative Responsibility:

Director, Accounting & Regulatory Reporting
Controller

Date Created: 6/30/05

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(Note: Text in italics indicates a key SOX control)

Dates Revised: 7/27/10, 3/31/11, 9/8/11, 3/7/12, 3/3/16

454 - Leases

(Note: Text in italics indicates a key SOX control.)

Policy:
LG&E and KU Energy LLC ("LKE" or "the Company") will account for and disclose leases as required by U.S. GAAP.

Procedure:
Review the applicable contracts within scope and consult with Supply Chain and Legal department to report all leases for LKE.

Scope:
All leases entered into by the Company and its subsidiaries.

Objective of Procedure:
Ensure all contracts for leases are appropriately reviewed and reported.

General Requirements:

I. Definitions

Bargain purchase option - A provision allowing the lessee, at his option, to purchase the leased property for a price which is sufficiently lower than the expected fair value of the property at the date the option becomes exercisable that exercise of the option appears, at the inception of the lease, to be reasonably assured.

Bargain renewal option - A provision allowing the company, as lessee, the option, to renew the lease for a rental sufficiently lower than the expected fair rental of the same or equivalent property at the date the option becomes exercisable. At the inception of the lease, the projected economic benefit of this "bargain" rental renewal is such that the ultimate exercise of the option is reasonably assured.

Capital lease - A lease which because of the terms of the agreement, requires that the leased asset and corresponding obligation be recorded on the balance sheet of the entity (lessee) which benefits from the use of the asset.

Contingent Rental - The increases or decreases in lease payments that result from changes occurring subsequent to the inception of the lease in the factors (other than the passage of time) on which lease payments are based. The portion of a lease payment which increases or decreases depending on changes in factors such as the prime rate or the consumer price index, or the future use of the leased property, such as machine hours of use or sales volume during the lease term. Since these changes are not known at the inception of the lease, contingent rentals are excluded from minimum lease payments. Lease payments which depend on a rate or index are included in minimum lease payments based on the index or rate in effect at the inception of the lease; any increases or decreases in lease payments that result from subsequent changes in the index or rate are contingent rentals. Escalation of lease payments in accordance with the terms of the lease agreement due to increase in construction, acquisition cost or other measure of cost prior to or during the construction period are not considered to be contingent rentals; therefore these payments are included in minimum lease payments.

Estimated economic life of leased property - The estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease without limitation by the lease term.

Estimated residual value of leased property - The estimated fair value of the leased property at the end of the lease term.

Executory costs - Those costs such as insurance, maintenance and taxes incurred for leased property, which depending on the lease arrangement, may be paid by the lessor or lessee. Amounts paid by a lessee in consideration for a guarantee of the residual value from an unrelated third party are also executory costs.

Fair value of Leased Property - The price for which the property could be sold in an arm's-length transaction between unrelated parties

Inception of the lease - The date of the lease agreement or commitment, if earlier. For purposes of this definition, a commitment must be in writing, signed by authorized parties in interest to the transaction, and must specifically set forth the principal provisions of the transaction. Preliminary agreement or commitments, wherein any of the principal provisions are yet to be negotiated, do not fall within this definition and, accordingly, the lease is deemed to have not commenced.

Incremental Borrowing Rate - the rate that, at the inception of the lease, the lessee would have incurred to borrow over a similar term the funds necessary to purchase the leased asset. If the lessee is a subsidiary, the rate used by the subsidiary should reflect the incremental borrowing rate of the parent, unless the subsidiary is able to obtain financing on a stand-alone basis without the parent or other related entities guaranteeing the debt.

Interest rate implicit in the lease - the discount rate that, when applied to:

1. the minimum lease payments excluding that portion of the payments representing executory costs to be paid by the lessor, and
2. the unguaranteed residual value accruing to the benefit of the lessor
   causes the aggregate present value at the beginning of the lease term to be equal to the fair value of the leased property at the inception of the lease, minus any investment tax credit retained by the lessor.

Initial Direct Costs - Only those costs incurred by the lessor that are (a) costs to originate a lease incurred in transactions with independent third parties that result directly from and are essential to acquire that lease and would not have been incurred had the leasing transactions not occurred and (b) certain costs directly related to specified activities performed by the lessor for that lease. Those activities are: evaluating the prospective lessee's financial condition, evaluating and recording guarantees, collateral, and other security arrangements; negotiating lease terms; preparing and processing lease documents and closing the transaction.

Lease - an agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time.

Lease term - The sum of the following:

1) The fixed, noncancelable term of the lease,
   A lease which is cancelable for any of the following reasons is considered to be noncancelable for purposes of this definition
   (a) only upon the occurrence of some remote contingency,
   (b) only with the permission of the lessor,
   (c) only if the lessee enters into a new lease with the same lessor, or
   (d) only if the lessee incurs a penalty in such amount that continuation of the lease appears, at inception, reasonably assured.
2) Any periods covered by bargain renewal options
3) Any periods which penalties are imposed for failure to renew the lease and the amount of the penalty reasonably ensures renewal (see below for definition of penalty)
4) Any periods covered by ordinary renewal options during which a guarantee by the lessee of the lessor's debt related to the leased property is expected to be in effect or a loan from the lessee to the lessor related to the leased property is expected to be outstanding
5) Any periods covered by ordinary renewal options preceding the date as of which a bargain purchase option is exercisable, and
6) Any periods, representing renewals or extensions of the lease at the lessor's option

(Note: Text in italics indicates a key SOX control.)

However, in no case shall the lease term be assumed to extend beyond the date a bargain purchase option becomes exercisable.

Minimum lease payments -
From the standpoint of the lessee: The payments that the lessee is obligated to make or can be required to make in connection with the leased property.
Minimum lease payments include the following:
1. The minimum rental payments called for by the lease over the lease term.
2. Any payments or guarantees that the lessee must make or can be required to make concerning the leased property at the end of the lease term including:
   a) Any amount to purchase the property
   b) Any amount to cover a deficiency from a specified guaranteed residual value
   c) Any amount for failure to renew or extend the lease at the expiration of the lease term

When a lease contains a bargain purchase option, only the minimum rental payments over the lease term and the payment called for by the bargain purchase option are included in the minimum lease payments.

The following are excluded when computing minimum lease payments:
1. A guarantee by the lessee of the lessor's debt
2. The lessee's obligation (apart from rental payments) to pay executory costs in connection with the leased property
3. Contingent rentals

From the standpoint of the lessor:
Minimum lease payments include the following:
1. Lessee minimum lease payment as defined above plus,
2. Any guarantee of the residual value or of rental payments beyond the lease term by a third party unrelated to either the lessee or the lessor, provided the third party is financially capable of discharging the obligation that may arise from the guarantee.

Non-cancelable Lease - A lease that is cancelable (a) only upon the occurrence of remote contingency (b) only with the permission of the lessor, (c) only if the lessee enters into a new lease with the same lessor, or (d) only if the lessee incurs a penalty in such amount that continuation of the lease appears, at inception, reasonably assured.

Operating lease - A lease which, due to its terms, does not qualify as a capital lease and therefore is recorded as periodic rental expense.

Penalty - Any requirement that is imposed or can be imposed on the lessee by the lease agreement or by factors outside the lease agreement to disburse cash, incur or assume a liability, perform services, surrender or transfer an asset or rights to an asset or otherwise forego an economic benefit, or suffer an economic detriment. Factors to consider when determining if an economic detriment may be incurred include, but are not limited to, the uniqueness of purpose or location of the property, the availability of a comparable replacement property, the relative importance or significance of the property to the continuation of the lessee's line of business or service to its customers, the existence of leasehold improvements or other assets whose value would be impaired by the lessee vacating or discontinuing use of the leased property, adverse tax consequences, and the ability or willingness of the lessee to bear the cost associated with relocation or replacement of the leased property at market rental rates or to tolerate other parties using the leased property.

Sale-Leaseback - a transaction that occurs when a company sells property and immediately leases it back from the purchaser.

Sublease - The leased property is re-leased by the original lessee to a third party, and the lease agreement between the two original parties remains in effect.

Unguaranteed residual value - The estimated residual value of the leased property exclusive of any portion guaranteed by the lessee or by a third party unrelated to the lessor.

II. Accounting Practice

1. Background

The accounting principles for leases are primarily promulgated by Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 840 (Leases). However, there is additional significant authoritative guidance that addresses implementation questions. Please see References - Related Publications for a listing of some of the more significant guidance.

2. Accounting

Through the contract review process (See 451 – Contractual Review policy), LKE identifies arrangements to be evaluated for potential lease treatment in accordance with the procedures outlined below. The evaluation of whether an arrangement contains a lease should be based on the substance of the arrangement. The Lease Evaluation Worksheet which is part of the contract review process should be utilized to document an initial assessment or a reassessment of an arrangement. (See 451 – Contract Review policy) (The decision matrix included in Appendix A provides additional guidance, if needed, in determining whether an arrangement qualifies as lease.)

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(Note: Text in italics indicates a key SOX control.)

Examples of arrangements that may qualify as leases include take-or-pay contracts/commitments, service arrangements involving the use of specific items of PP&E, information technology outsourcing arrangements, emission treatment contracts, throughput arrangements, power supply arrangements and energy-related contracts and transportation service contracts.

Following the initial assessment of a contractual arrangement at its inception, an arrangement would be reassessed only if:
(1) a substantive formal or informal modification or change is made to the contractual arrangement,
(2) there has been a substantial physical change to the specified PP&E, or
(3) there is a change in the determination as to whether fulfillment of the contractual arrangement is dependent on the specified PP&E.

The reassessment of the arrangement is based on the facts and circumstances as of the date of the reassessment, including the remaining term of the arrangement.

A renewal or extension of an arrangement that does not include modification of any of the terms in the original arrangement prior to the end of the original arrangement will be evaluated only with respect to the renewal or extension period. The accounting for the remaining term of the original arrangement will continue without modification.

If the original accounting for an arrangement gave effect to the assumed exercise of a renewal option, then the exercise of the option, absent any modification, would not trigger a reassessment of the arrangement. The exercise of a renewal option in all other circumstances would trigger a reassessment

If upon reassessment, an arrangement or a portion of an arrangement becomes a lease or ceases to be a lease, the applicable guidance is outlined below:

- Supply arrangement becomes an operating lease for the Purchaser/Lessee - see ASC 840-20-25-9
- Supply arrangement becomes an operating lease for the Seller/Lessor - see ASC 840-20-25-22
- Supply arrangement becomes a capital lease for Purchaser/Lessee - see ASC 840-30-30-5
- Supply arrangement becomes a sales-type lease for the Seller/Lessor - see ASC 840-30-25-4
- Operating lease becomes a supply arrangement for the Purchaser/Lessee - see ASC 840-20-40-2
- Operating lease becomes a supply arrangement for the Seller/Lessor - see ASC 840-20-40-6

- Capital lease becomes a supply arrangement for the Purchaser/Lessee - see ASC 840-30-40-2
- Direct-financing, sales-type or leveraged lease becomes a supply arrangement for the Seller/Lessor - see ASC 840-30-40-6

Disclosure Requirements

If the arrangement is determined to be a lease, the lease disclosures as outlined in sections of ASC 840-50 must be provided.

Lessee Accounting:
Lease Classification

When LKE is the lessee, it classifies the lease as capital or operating depending on its assessment of the lease criteria at the inception of the lease term.

- Capital Lease - A lease is capital if it meets one or more of the following criteria
  - The lease transfers ownership of the property to the lessee by the end of the lease term
  - The lease contains a bargain purchase option
  - The lease term is equal to 75% or more of the estimated economic life of the leased property. However, if the beginning of lease term falls within the last 25% of the total estimated economic life of the leased property, including earlier years of use, this criterion will not be used for purposes of classifying the lease
  - At the inception of the lease, the present value of the minimum lease payments excluding executory costs equals or exceeds 90 percent of the fair value of the leased property less any investment tax credit, or other investment tax incentive retained and expected to be realized by the lessor. This criterion is not used for purposes of classifying the lease if the beginning of lease term falls within the last 25% of the total estimated economic life of the lease property.

    LKE will compute the present value of the minimum lease payments using the incremental borrowing rate, unless it is practicable to learn the implicit rate computed by the lessor and the implicit rate is less than the incremental borrowing rate. If both these conditions are met, LKE will use the implicit rate.

If the lease does not meet any of these four criteria, it is an operating lease.

NOTE: The lease classification determined for financial accounting purposes is not necessarily the same classification to be used for income tax purposes. For the appropriate tax treatment, consult the Tax department.

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(Note: Text in italics indicates a key SOX control.)

Accounting for capital and operating leases

1. Recording capital lease transactions

   A capital lease is recorded as an asset and an obligation in an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term, excluding executory costs to be paid by the lessor. However, if the amount determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the asset and obligation will be the fair value.

2. Amortization of capital leases
   - If the lease terms provide for transfer of ownership of the property to the lessee by the end of the lease term or contains a bargain purchase option, the asset will be amortized in a manner consistent with normal depreciation policy for owned assets
   - Otherwise, the asset will be amortized over the lease term to the estimated residual value at the end of the lease term

3. Recording of capital lease payments
   The interest portion of each lease payment will be identified and expensed so as to produce a constant periodic rate of interest on the remaining obligation throughout the life of the lease. The remaining portion of the lease payment reduces the amount of the lease obligation.

4. Recording operating lease
   Rental on an operating lease is charged to expense straight-line over the lease term as it accrues.

Lessor Accounting:
Lease Classification

When LKE is the lessor, it classifies the lease as sales-type, direct financing, leveraged or operating depending on its assessment of the lease criteria at the inception of lease term.

If the lease at inception meets any one of the four criteria under Lessee Accounting**,** Lease Classification—Capital Lease and it meets both of the following criteria, it shall be classified as a sales-type lease, a direct financing lease, or a leveraged lease.

- Collectability of the minimum lease payments is reasonably predictable, and
- No important uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor under the lease.

(Note: Text in italics indicates a key SOX control.)

- Sales-type –Sales type leases give rise to manufacturer's or dealer's profit or loss to the lessor (i.e. fair value of the leased property at the inception of the lease is greater or less than its cost or carrying amount, if different) and normally result when a company uses leasing as a means of marketing its products. A lease involving real estate shall be classified as a sales-type lease only if it transfers ownership of the property to the lessee by the end of the lease term.

  LKE has determined that the detailed definition of Integral Equipment in ASC-Topic 360 is intended to be within the context of ASC-Topic 840 and ASC-Topic 360-20 (Property, Plant and Equipment-Real Estate Sales), related to those subsections which specifically address real estate or real estate including equipment. Accordingly, the concept of integral equipment as defined in the previously discussed lease accounting literature does not apply to projects that do not involve the sale or lease of real estate and accordingly, real estate lease accounting rules do not apply to these projects

- Direct Financing—Direct financing leases do not give rise to manufacturer's or dealer's profit or loss to the lessor and result from financing the acquisition of property by a lessee.
- Leveraged –Leveraged leases are direct financing leases meeting certain other specified criteria:
  - Lease involves 3 parties-lessee, a long-term creditor and lessor
  - Financing provided by long-term creditor is nonrecourse and the amount of financing is sufficient to provide the lessor with substantial "leverage" in the transaction
  - The lessor's net investment declines during the early years once the investment has been completed and rises during the later years of the lease before its final elimination.

Leases not classified as sales-type, direct financing or leveraged leases will be classified as operating leases.

NOTE: As LKE for the most part is not in the business of financing equipment for lessees, most leases will either qualify as a sales-type lease or an operating lease. For Direct Financing and Leveraged Lease accounting guidance, see applicable accounting literature or contact Financial Reporting.

Accounting for Sales-type leases

- The minimum lease payments, net of any executory costs plus the unguaranteed residual value will be recorded as the gross investment in the lease. The present value of the minimum lease payments will be computed using the interest rate implicit in the lease.

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(Note: Text in italics indicates a key SOX control.)

- The difference between the gross investment in the lease and the sum of the present value of two components of the gross investment (i.e. minimum lease payments and unguaranteed residual) will be recorded as unearned income.
- The sales price will be equal to the present value of the minimum lease payments receivable.
- The cost of sales will be equal to the cost or carrying amount of the leased asset plus initial direct costs minus the present value of the unguaranteed residual value.
- The discount rate to be used in determining the present values shall be the interest rate implicit in the lease.
- The unearned income will be amortized to income over the lease terms so as to produce a constant periodic rate of return on the net investment in the lease.

  NOTE: A lease involving real estate, property improvements or integral equipment may not be classified as a sales-type lease unless the lease agreement provides for the transfer of title to the lessee at or shortly after the end of the lease term.

Accounting for Operating leases:

- The leased property will be included with property, plant and equipment in the balance sheet. The property will be depreciated using the lessor's normal depreciation policy.
- Rent will be included as income over the lease term as it becomes receivable according to the provisions of the lease. If rentals vary from a straight-line basis the income will be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit from the leased property is diminished, in which case that basis shall be used.
- Initial direct costs will be deferred and allocated over the lease term in proportion to the recognition of rental income. Initial direct costs may be charged to expense as incurred if the effect is not materially different.
- If, at the inception of the lease the fair value of the property in an operating lease involving real estate that would have been classified as a sales-type lease except that it did not transfer ownership to the lessee by the end of the lease term is less than its cost or carrying amount, if different, then a loss equal to that difference will be recognized at the inception of the lease.

Review of Residual Values

For leases in which LKE qualifies as lessor, a review of the estimated residual basis must be performed on a lease-by-lease basis at least annually and, if the review results in a lower estimate than had been previously established and the decline is judged to be other than temporary, then the effect must be given to the lower estimate.

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(Note: Text in italics indicates a key SOX control.)

LKE has adopted the approach that upon an other-than-temporary reduction in residual value, a revised implicit rate using the revised lower estimate is calculated. The amortization to date of unearned income would be recalculated using the revised implicit rate, and the net investment would be adjusted to reflect the recalculated earned to date.

Other Leasing Issues

<u>Leases Involving Real Estate:</u>

Land and Buildings

If the lease transfers ownership of the property or contains a bargain purchase option, LKE, as lessee, will capitalize the land and the building separately. For this purpose the present value of the minimum lease payments after deducting executory costs will be allocated between the two elements in proportion to their fair values at the inception of the lease. The building will be amortized in a manner consistent with normal depreciation policy for owned assets.

If the lease meets neither the transfer of ownership or bargain purchase criteria and the fair value of the land is less than 25 percent of the total fair value of the leased property at the inception of the lease then the land and building will be considered a single unit. If either the economic life or the present value of future minimum lease payments criterion is met, LKE shall capitalize the land and building as a single unit and amortize it to its expected value over the lease term.

If the lease meets neither the transfer of ownership or the bargain purchase criterion and the fair value of the land is greater than or equal to 25 percent of the total fair value of the leased property at the inception of the lease, the land and the building will be considered separately in evaluating whether it qualifies as a capital lease under the remaining two criteria. If the building element meets either of the last 2 criteria and therefore qualifies as a capital lease, the period of amortization will be the lease term. The land element will be accounted for separately as an operating lease. If the building element does not meet either of the last 2 capital lease criteria then both the building element and the land element will be accounted for as an operating lease.

Leases Involving Only Part of Building

When the leased property is part of a larger whole, its cost and fair value may not be objectively determinable for example, when an office or floor of a building is leased. If the fair value of the leased property is objectively determinable, the lease should be classified and accounted for in accordance with Section IV above entitled Leases Involving Real Estate. If the fair value of the leased property is not objectively determinable, the lessee should classify the lease solely on criterion 3 (lease term equal to or in excess of 75% of the estimated economic life of the leased property). If that criterion is met, the leased property will be capitalized as a unit and amortized over the lease term. For the lessor, if either the cost or the fair value of the property is not objectively determinable, the lessor shall account for the lease as an operating lease.

Leases Involving Equipment as well as Real Estate

If a lease involving real estate also includes equipment, the portion of the minimum lease payments applicable to the equipment element of the lease shall be estimated by whatever means appropriate in the circumstances. The equipment shall be considered separately for purpose of applying the lease criteria and determining capital or operating lease classification.

Lessee Involvement in Asset Construction

When intending to be the lessee, LKE's involvement during the construction period may raise questions about whether it is acting as an agent for the owner-lessor or is in substance the owner of the asset during the construction period. LKE's involvement may include:

- Being obligated to begin making lease payments regardless of whether the project is complete
- Guaranteeing the construction debt or providing construction financing either directly or indirectly
- Being primarily or secondarily obligated on construction contracts
- Serving as an agent for the construction, financing or ultimate sale of the assets for the owner-lessor
- Acting as a developer or being the general contractor
- Being obligated to purchase the asset if the construction is not successfully completed by an agreed-upon date and,
- Being obligated to fund cost overruns

If LKE is considered the owner of the asset during the construction period, then effectively a sale and leaseback of the asset occurs when construction of the asset is complete and the lease term begins.

If the documents governing the construction project could require, under any circumstances, that the lessee pay 90 percent or more of the total project costs (excluding land acquisition costs) as of any point in time during the construction period, then the lessee/agent should be deemed to have substantially all of the construction period risks and should be considered to be the owner of the real estate project during the construction period.

Accounting for Rental Costs Incurred during a Construction Period

Rental costs associated with ground or building operating leases that are incurred during a construction period shall be recognized as rental expense.

(Note: Text in italics indicates a key SOX control.)

Related Party Leases

Leases between related parties normally use the same criteria as similar leases between unrelated parties.

Subleases and Similar Transactions

For all sublease transactions, both the original lessee and the original lessor will continue to account for the original lease as before. If LKE is the original lessee and the original lease was accounted for as an operating lease, the sublease must be accounted for as an operating lease. Sublease payments received may not be netted against lease obligations paid unless the transaction qualifies for right of offset.

If original lease is replaced with a new lease agreement, LKE as lessor shall account for the original lease as a terminated lease and the new lease as a separate transaction.

If LKE, as the original lessee, is relieved of the primary obligation under the original lease, the termination of the original lease agreement shall be accounted for as follows:

a. If the original lease was a capital lease of property (other than real estate including integral equipment), the asset and obligation representing the original lease shall be removed from the accounts, a gain or loss shall be recognized for the difference.

   If LKE is secondarily liable, a guarantee obligation shall be recognized in accordance with ASC-Topic 860 (Transfers and Servicing). As a guarantor, a guarantee obligation will be recognized in the same manner as would a guarantor that had never been primarily liable to that creditor. The guarantee obligation will be initially measured at fair value, and that amount will reduce the gain or increase the loss recognized on extinguishment.

   Any consideration paid or received upon termination shall be included in the determination of gain or loss to be recognized.

b. If the original lease was a capital lease of real estate (including integral equipment), the determination as to whether the asset held under the capital lease and the related obligation may be removed from the balance sheet shall be made in accordance with the requirements of ASC-Topic 360-20. If the criteria for recognition of a sale in ASC-Topic 360-20 are met, the asset and obligation representing the original lease will be removed from the accounts and any consideration paid or received upon termination and any guarantee obligation will be recognized in accordance with the requirements above for property other than real estate. If the transaction results in a gain, that gain may be recognized if the criteria in ASC-Topic 360-20 for recognition of profit by the full accrual method are met. Otherwise, the gain shall be recognized in accordance with one of the other profit recognition methods discussed in ASC-Topic 360-20. Any loss on the transaction shall be recognized immediately.

c. If the original lease was an operating lease and LKE is secondarily liable, the guarantee obligation shall be recognized in the same manner as would a guarantor that had never been primarily liable to that creditor. The guarantee obligation will be initially measured at fair value, and that amount will reduce the gain or increase the loss recognized on extinguishment.

Operating Leases with Scheduled Rent Increases

Operating leases with scheduled rent increases, including “rent holidays” will be recognized on a straight-line basis over the lease term (including any “rent holiday” period) unless another systematic and rational allocation basis is more representative of the time pattern in which the leased property is physically employed.

Landlord/Tenant Incentives

In regards to an operating lease, landlord incentives will be recorded as deferred rent and amortized as reductions to lease expense over the lease term.

Sale-Leaseback Transactions

When accounting for a sale-leaseback transaction, the seller-lessee records the sale, removes all property and related liabilities from its balance sheet, and recognizes the gain or loss from the sale in accordance with ASC-Topic 840 and ASC-Topic 360. Generally when a sale-leaseback occurs, the profit or loss on the sale is deferred and is amortized in proportion to the leased asset, if a capital lease, or in proportion to the related gross rental charged to expense over the lease term, if an operating lease.

3. Disclosure requirements

Lessee:

1. All Leases:
   A general description of the lessee’s leasing arrangements, including but not limited to the following:
   - ✓ The basis of which contingent rental payments are determined
   - ✓ The existence and terms of renewal or purchase options and escalation clauses
   - ✓ Restrictions imposed by lease arrangements, such as those concerning dividends, additional debt and further leasing.
2. Capital Leases:
   - ✓ Assets recorded under capital leases and the accumulated amortization thereon shall be separately identified in the lessee’s balance sheet or in footnotes thereto as of the date of each balance sheet presented. Also, the related obligations shall also be separately identified in the balance sheet as of the date of each balance sheet presented and should be subject to the same considerations as other obligations in classifying them with current or noncurrent liabilities. The

amortization charge to income for each period an income statement is presented should be separately disclosed in the financial statements or footnotes, unless it is included in depreciation expense and the fact that it is included is disclosed.

- ✓ The gross amount of assets recorded under capital leases as of the date of each balance sheet presented by major classes according to nature or function.
- ✓ Future minimum lease payments as of the latest balance sheet date presented, in the aggregate and for each of the five succeeding fiscal years, with separate deductions from the total for the amount representing executory cost and imputed interest.
- ✓ The total of minimum sublease rentals to be received in the future under noncancelable subleases as of the date of the latest balance sheet presented.
- ✓ Total contingent rental actually incurred for each period for which an income statement is presented.

3. All Operating Leases:
   - ✓ Rental expense for each period for which an income statement is presented, with separate amounts for minimum rentals, contingent rentals, and sublease rentals. Rental payments under leases with terms of a month or less that were not renewed need not be included.
4. Operating Leases having an initial or remaining noncancelable lease term in excess of one year:
   - ✓ Future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years.
   - ✓ The total of minimum rentals to be received in future under noncancelable subleases as of the date of the latest balance sheet presented
5. Related Parties

   The nature and extent of any leasing transactions with related parties must be disclosed.

Lessor

When leasing, exclusive of leverage leasing, is a significant part of revenue, net income, or assets certain information is required to be disclosed. Lessor disclosures generally would be unnecessary whenever revenue, net income, and assets related to leasing represent less than 10% of consolidated amounts. Since it would appear that the above requirements would not be met for LKE or any other reporting entity currently, the required disclosures have not been enumerated in this policy. Required disclosures can be found in ASC 840, ASC 310 (Receivables) and ASC 410 (Asset Retirement and Environmental Obligations) for assets under operating lease that include an ARO.

Sale-Leaseback Disclosures

- The financial statements of a seller-lessee shall include a description of the terms of the sale-leaseback transaction, including future commitments, obligations, provisions, or circumstances that require or result in the seller-lessee's continuing involvement.
- The financial statements of a seller-lessee that has accounted for a sale-leaseback transaction by the deposit method or as a financing according to the provisions of ASC 840 also shall disclose:
  - The obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding fiscal years
  - The total of minimum sublease rentals, if any, to be received in the future under noncancelable subleases in the aggregate and for each of the five succeeding fiscal years.

III. Procedures

- Financial Accounting and Reporting (FAA) will identify Business Line areas/departments within their organizations that may enter into contracts/arrangements that may qualify as a lease.
- Business Line Contacts must establish a process to obtain from their organizations information about new arrangements/contracts or amendments and modifications to existing arrangements/contracts in a timely manner. The process should be coordinated with FAA and the Legal Department. Contact individual(s) must be designated for each Business Line. See LKE's 451 - Contractual Review policy for the list of Business Line Contacts. The lease contract reviewers are the designated Accounting Analyst in FAA, designated Supply Chain Manager, and Manager of Corporate Fuels and By-Products.
- Upon identification of arrangement as a lease determine appropriate lease classification depending on whether LKE is lessee or lessor in leasing transaction. Analysis performed in connection with determination must be documented and reviewed by designated Lease Reviewer and his (or her) manager/director.
- Upon determination of the appropriate lease classification, FAA must apply the appropriate accounting.
- In connection with modification of original arrangement or renewal/extensions respective accounting organization must evaluate impact on current classification and accounting.
- For leases in which LKE qualifies as the lessor, a review of the estimated residual value must be performed on a lease-by-lease basis at least annually.

(Note: Text in italics indicates a key SOX control.)

- At least quarterly but preferably on a monthly basis, all Lease Evaluation Worksheet results will be summarized by each Lease Reviewer as part of the contract review process.
- The Lease Evaluation Worksheet and supporting documentation, including arrangements and conclusions, will be reviewed and approved by the Manager, Financial Accounting and Analysis or designee.
- Upon approval, the summary of the conclusions reached in the contract review process will be sent to LKE Financial Reporting and PPL Technical Accounting. FAA will notify LKE Financial Reporting and PPL Technical Accounting of new leases as they become aware of them.
- PPL Financial Reporting/Technical Accounting may request copies of significant or unusual agreements for additional review or disclosure.
- FAA will submit significant or unusual arrangements to the Controller (or designee) for his (or her) review and approval.
- Each Lease Reviewer will maintain supporting documentation in accordance with record retention policies**.** FAA will maintain supporting documentation in accordance with record retention policies.

IV. Responsibility

A. The Controller is responsible for implementing and maintaining procedures to ensure that the practices set forth in this policy are followed.
B. The Legal Department and Business Line Contacts are responsible for providing timely notification to FAA of new arrangements or changes to existing arrangements.
C. FAA is responsible for performing necessary lease analysis in accordance with the policy to determine appropriate classification and accounting. Documentation of lease analysis and conclusions reached thereon will be in writing.
D. FAA will be responsible for ensuring that the appropriate accounting/disclosure requirements are implemented based on those conclusions/decisions in a timely manner.
E. Lease Reviewers within respective business areas must review and approve conclusions reached in a timely manner. Review and approval must be evidenced in writing.
F. FAA must notify Financial Reporting of outcome of analysis, conclusions/decisions reached in a timely manner so that required disclosures can made in financial statements.
G. FAA must ensure that a review of the residual values is performed and documented, as required above, at least on an annual basis.

454 - Leases

(Note: Text in italics indicates a key SOX control.)

Reports Generated and Recipients:

- Inventory listing of contracts within scope of contract review that include review for Leases provided by FAA
- Contract review templates provided by Lease Reviewers
- List of existing contracts from the Legal Department

Additional Controls or Responsibility Provided by Other Procedures:
451 - Contractual Review policy

Regulatory Requirements:

None

References - Related Publications

Accounting Pronouncements

- ASC 840 (Leases)
- ASC 360 (Property, Plant and Equipment)
- ASC 860 (Transfers and Servicing)
- ASC 310 (Receivables)
- ASC 410 (Asset Retirement and Environmental Obligations)

Other

- PPL Research and Special Projects White Paper, R&SP 04-20, “Sundance Sale-Leaseback Accounting”
- “Accounting for Leases—Interpretations of FASB Statement No. 13”, Author-Arthur Andersen
- “Financial Reporting Series—Lease Accounting”; Author-Ernst & Young

Corresponding PPL Policy No. and Name:

- 403 Determining Whether an Agreement Contains a Lease
- 404 Accounting and Reporting Requirements for Leases

454 - Leases

(Note: Text in italics indicates a key SOX control.)

Key Contact:

Manager, Financial Accounting and Analysis

Administrative Responsibility:

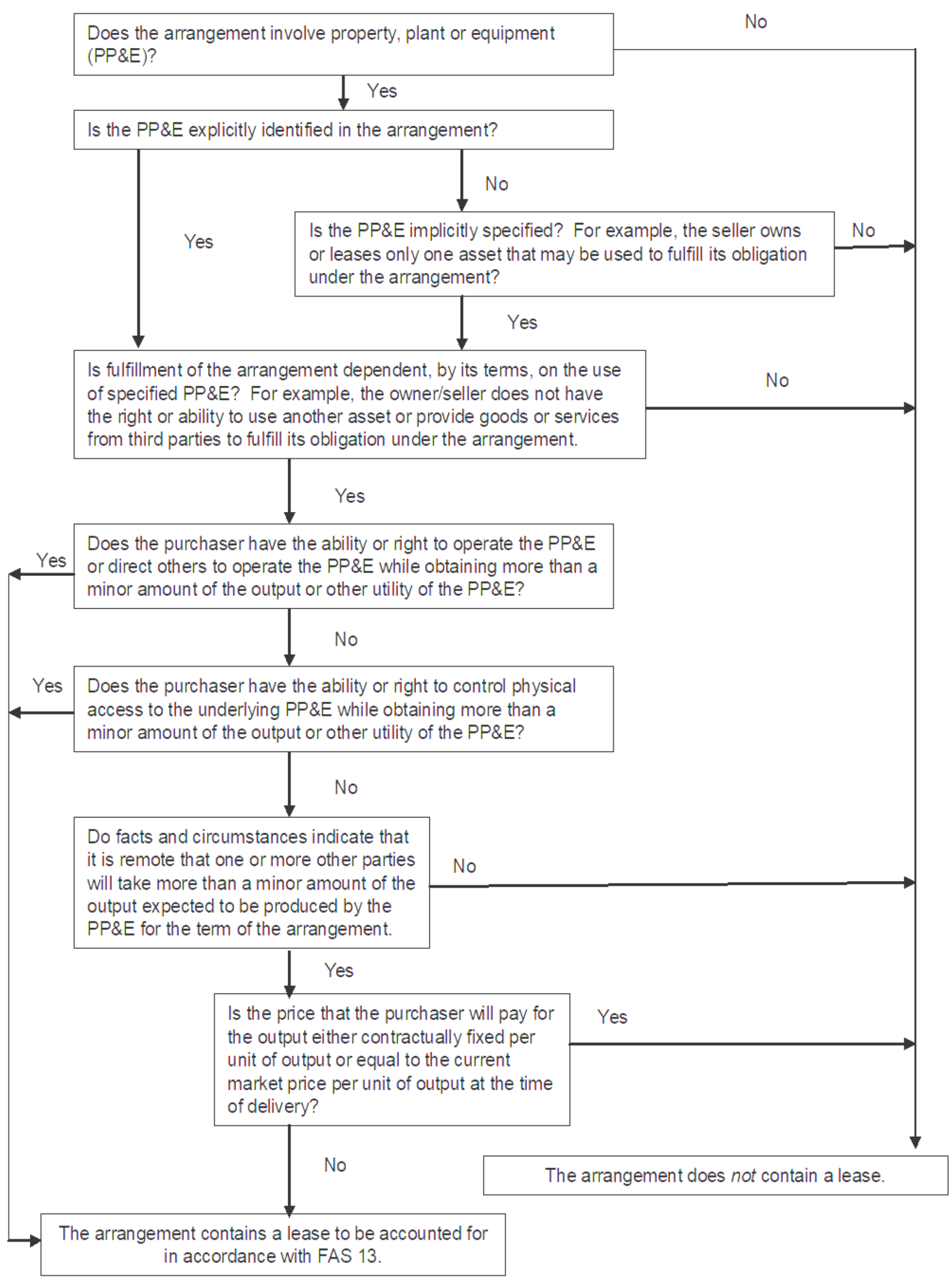
Director, Accounting and Regulatory Reporting
Controller

Date Created: 3/31/11
Dates Revised: 9/19/11, 4/1/16

454 - Leases

(Note: Text in italics indicates a key SOX control.)

Appendix A – Flowchart Illustration of the EITF 01-8 Model to Determine Whether an Arrangement Contains a Lease
(Intended only to be used as a supplement, not in lieu of, to the guidance in EITF 01-8)



454 - Leases

(Note: Text in italics indicates a key SOX control.)

(Note: The above illustration was taken from an external document and therefore is read-only and cannot be updated. All pre-codification references should be updated to ASC 840, “Leases.”

Notes to Appendix A:

A) ASC 840, “Leases” applies to contracts that convey the right to use land, a depreciable asset or both. Therefore, intangible assets, inventory, etc. are outside the scope of ASC 840.

In order for an arrangement to contain a lease of Property, Plant & Equipment (“PP&E”), the PP&E must be identified either explicitly or implicitly. Although specific PP&E may be identified explicitly in the contract, the arrangement would not contain a lease if the legal owner of the PP&E has both the right and the ability to fulfill the arrangement with the buyer using other PP&E not specified in the arrangement. Operational, legal, and financial restrictions should be considered in evaluating whether the PP&E is identified either explicitly or implicitly. PP&E has been implicitly specified if, for example the seller owns or leases only one asset with which to fulfill the obligation and it is not economically feasible or practicable for the owner/seller to perform its obligation through the use of alternative PP&E.

A warranty provision allowing or requiring the seller to substitute other PP&E in the event the specified PP&E becomes defective would not, by itself, preclude the arrangement from being considered a lease. Likewise, a provision that contractually permits or requires the seller to substitute other PP&E on or after a specified date does not preclude the arrangement from being considered to contain a lease prior to the substitution date.

B) If the seller has the right to fulfill its obligation under the arrangement using other assets but it is not economically feasible or practicable for the seller to do so, PP&E would be implicitly specified because the right to use other assets to fulfill the obligation would be considered non-substantive. For example, suppose an enterprise contracts to provide data-processing outsourcing services to a customer. If the seller can fulfill its obligation under the arrangement with the purchaser by using only a particular piece of computer equipment (i.e., PP&E), the computer equipment would be considered to be specified implicitly. If the seller has a contractual right to use other PP&E, the use of the other PP&E would not be considered feasible and, therefore, disregarded if the pricing of the arrangement with the purchaser precludes the use of other PP&E for the entire term of the arrangement. The pricing would be considered to preclude use of other PP&E if it would be cost-prohibitive for the seller to use other PP&E for the entire term of the arrangement. Further, it would not be considered feasible to use other PP&E if the other PP&E is not expected to have sufficient capacity to service the purchaser.

C) The purchaser’s ability to operate the PP&E may be evidenced by (but is not limited to) the purchaser’s ability to hire, fire, or replace the property’s operator or the purchaser’s ability to specify significant operating policies and procedures in the arrangement with the owner/seller having no ability to change such policies and procedures.

A requirement to follow "prudent operating practices" (or other similar requirements) generally does not convey the right to control the underlying PP&E. Similarly, a contractual requirement designed to enable the purchaser to monitor or ensure the seller's compliance with performance, safety, pollution control, or other general standards generally do not establish control over the underlying PP&E.

PPL believes that 10 percent or more of the output to be produced by the PP&E over the term of the contractual arrangement is considered "more than a minor amount of the output." An arrangement in which a purchaser receives substantially all of the output from dedicated PP&E may be considered to contain a lease.

D) Complex pricing arrangements should be discussed with FAA.

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

Policy: Contingencies must be recognized if they are probable and can be reasonably estimated. Disclosure is required for certain events which could give rise to a loss, but do not meet the conditions for accrual.

Procedure: Contingencies required to be recognized must be recorded in a timely manner and required disclosure information must be submitted to Financial Reporting in accordance with its SEC reporting timeline. Detailed procedures are outlined below.

Scope: All contingencies, with the exception of tax contingencies and guarantees (See 1057 – Guarantees Policy). Examples include:

- collectability of non-customer receivables (see 953 – Reserve for Bad Debts Policy for customer receivables),
- product warranties or defects,
- damage by fire, explosion or other hazards,
- expropriation of assets,
- pending or threatened litigation,
- actual or possible claims or assessments, and
- environmental obligations.

Objective of Procedure: The purpose of this policy is to appropriately account for and disclose contingencies according to Accounting Standards Codification (ASC) 450, Contingencies and ASC 410-30, Asset Retirement and Environmental Obligations: Environmental Obligations.

Definitions:

Contingency – an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.

Probable – the future event or events are likely to occur.

Reasonably Possible – the chance of the future event or events occurring is more than remote but less than likely.

Reasonably Estimable – range of amounts can be established.

Remote – the chance of the future event or events occurring is slight.

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

General Requirements:

Recognition and Measurement

Loss Contingencies:

Individual loss contingencies must be accrued as a charge to income if the loss is probable (75% or greater probability), can be reasonably estimated, and the estimate is $100,000 or more. Loss contingencies that are probable and estimable, but individually below $100,000 must be accrued if in aggregate they exceed $100,000.

Where there is a probable loss (75% or more) with a range of possible values as the outcome, the most likely point in the range should be included in the loss accrual. If a judgment cannot be made as to the most likely outcome within the range, the lower end of the range should be included in the loss accrual. If an offer of settlement has been made by the Company for a matter, the probability of loss is assumed to be 100% and the amount of the offer is the minimum amount accrued.

For certain events which could give rise to a loss, but do not meet the conditions for accrual, disclosure is required when it is reasonably possible (but not probable) that a loss has been incurred (see the Disclosures section for further detail). Furthermore, if the loss is probable (75% or more), but the amount of the loss cannot be reasonably estimated, disclosure is required.

General or unspecified business risks (sometime referred to as “reserves for general contingencies”) do not meet the conditions for accrual and therefore no accrual and no disclosure for such risks is required.

The accrual or disclosure of remote contingencies is not required, except for guarantees within the scope of ASC-460, Guarantees. If a remote contingency related to a guarantee would result in a material loss, judgment must be exercised regarding disclosure (see 1057 – Guarantees Policy).

Gain Contingencies:

Gain contingencies which represent the recovery of previous losses (costs) incurred will be recognized as a receivable and a credit to the account initially charged for the respective loss contingency when the amount is greater than $100,000 and formal written confirmation of the reimbursable amounts or information regarding the timing of such reimbursements from the respective insurer (minimum of $100,000 threshold) is received from the Legal Department. Gain contingencies which represent a gain in excess of loss amounts, or incremental income, are not recorded until their realization is 100% probable (i.e., when payment is received). Gain contingencies may not be recognized until all contingencies related to the matter are resolved.

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

Costs of attorneys' and other experts' fees, associated with defending the Company's position related to a contingency, should be accrued as incurred.

If information becomes available after the books are closed, but prior to the issuance of the financial statements, indicating it is probable an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount is material in conformity with 354 – Materiality Policy, the financial statements will be adjusted.

Disclosure

A. Amounts accrued

Footnote disclosure of the nature and amount of the accrual may be necessary for the financial statements to present fairly, in all material respects, relevant information.

B. Amounts not accrued

If a loss contingency has not been recorded because one or both of the conditions for accrual are not met, ASC 450 requires footnote disclosure when there is at least a reasonable possibility that a loss has been incurred.

Financial Accounting and Analysis (FAA) works with the Financial Reporting department to ensure any required disclosures are appropriately included in the financial statements and notes thereto.

If exposure to loss exceeds the amount accrued, disclosure is required when there is a reasonable possibility that an additional loss could be incurred. The disclosure must indicate the nature of the contingency and provide an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.

No disclosures are required for contingencies qualifying as remote except for guarantees within the scope of ASC 460 (see 1057 - Guarantees Policy).

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

Detailed Procedures Performed for Contingencies:

A. Loss Contingency Accruals

The Legal Department prepares the quarterly Material Loss Contingency Assessment chart which lists potential losses with a probability of 75% or greater that the Company will incur a loss of over $100,000. A quarterly meeting is held with the designated Legal and Accounting personnel, including the Manager, Financial Accounting & Analysis, to evaluate the need for accruals related to these potential losses. Additionally, after the quarterly Loss Contingency meeting has taken place, the LKE designated Legal and Accounting personnel participate with designated PPL personnel in conference calls to discuss any loss contingencies.

Separately, the Legal Department also prepares a quarterly Immaterial Loss Contingencies -- Summary memo, as requested by the FAA department, for estimable, in-scope matters not individually meeting the >75% and >$100,000 thresholds described above. The memo identifies potential aggregate accruals for individual estimable loss contingencies of less than $100,000. This memo includes the items that are handled by in-house counsel and external counsel. Additionally, the Manager, FAA or designated Accounting Analyst also receive the applicable monthly Auto and General Liability Open/Reserved Claims report provided by Underwriters Safety and Claims Inc. (USC), the Company's outside third party claims administrator. The Legal Department chart and memo are intended to exclude relevant privileged information of the cases in order to maintain attorney-client privilege. FAA verifies that the amounts included in the chart, memo and report are properly accrued as of quarter-end.

In determining the estimate of loss or obligation required above, there may be a wide range of possible losses due to various interpretations or on-going developments regarding the facts, the legal issues involved, commercial or negotiating aspects applicable to the parties, etc. Where there is a probable loss with a range of possible values as the outcome, the most likely point in the range is included in the loss accrual. If a judgment cannot be made as to the most likely outcome within the range, the lower end of the range is included in the loss accrual. If an offer of settlement has been made by the Company for a matter, the probability of loss is assumed to be 100% and the amount of the offer is the minimum amount accrued.

For the amounts reported, the Legal department must designate the legal liability as current if the liability is more than likely to be paid within the following 12 months, or non-current, if longer than 12 months from the quarter being reviewed. If there are multiple risks or sub-components, the Legal department must report the portion of the liability that is current and the portion of the liability that is non-current for each Company. Any non-current liabilities may need to be discounted by the FAA department. To determine if a liability should be discounted, refer to the 960 – Discounting Policy.

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

The Company has certain varying insurance deductibles. For any covered amounts (claims, settlements, attorneys' fees, etc.) that are paid in excess of the deductible, a receivable may need to be set up for reimbursement of this excess amount from the insurer. A receivable is not set up unless a formal written confirmation for reimbursement is received from the Legal Department that a claim has been approved by the insurer.

Previously recorded contingencies must be reviewed at least quarterly.

Quarterly, required disclosure information, as outlined above, must be submitted to the Financial Reporting department in accordance with its reporting timeline.

B. Environmental Contingencies

The requirements and criteria for recording liabilities as stated in ASC 450 also apply to environmental obligations. There are a few clarifications within ASC 410-30 – Asset Retirement and Environmental Obligations: Environmental Obligations related to the recognition criteria and the disclosure requirements specific to environmental contingencies (see 652 – Capital – Asset Retirement Obligations Policy).

1. Financial Disclosure

The SEC regulations and FASB accounting standards require disclosure of:

- any material estimated capital expenditures for environmental control facilities;
- any administrative or judicial proceeding arising out of environmental laws, if the results of such a proceeding are material;
- any potential environmental loss contingency for which the Company cannot determine that a material effect on future financial condition or results of operations is not reasonably likely to occur;
- an environmental loss contingency accrued by a charge to income when it has been determined it is probable that a liability has been incurred and the amount of the loss is reasonably estimable.

2. Milestone Events

The time line for recording an environmental liability begins when contamination is released into the environment and ends when clean-up is completed. This process can span several decades. Additionally, surveillance and monitoring of sites declared as "clean" may continue in perpetuity. A liability should be recorded on the Company's books as soon as it is determined that environmental damage has occurred and costs can be reasonably estimated. This usually is at the Discovery stage.

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

Contamination Release:

Generally, hazardous waste is disposed of in a timely manner and charged to current operations. Unfortunately, past disposal practices, which were legal at the time, have caused contamination that regulatory agencies now require to be cleaned up.

Discovery:

Operating managers and Environmental Management personnel continually monitor the Company's environmental requirements in concert with the Kentucky Department of Environmental Protection (DEP), the United States Environmental Protection Agency (EPA) and local environmental control agencies. When waste disposal methods used by the Company differ from changing regulatory requirements, and revised disposal methods or remediation costs can be **reasonably estimated**, the associated liability is recorded. Also, when any environmental monitoring or testing identifies the need for remediation and the costs can be reasonably estimated, this additional liability is recorded.

Notification By Regulatory Authorities:

Official notification of an environmental liability by the Kentucky DEP or EPA normally follows the Company's reporting a possible environmental exposure to these agencies. Exceptions include unknown liabilities associated with property purchased from others or Superfund sites where the Company has been identified as a Potentially Responsible Party (PRP) through contracted services.

Consent Decree:

Regulatory agencies typically require PRPs to sign consent decrees to undertake studies to determine appropriate clean-up methods and associated costs. Often times cost estimates for clean-up are not available at this stage.

Investigation:

The first step in understanding the liabilities associated with a contaminated site is to investigate the nature and extent of the contamination, then evaluate remedial alternatives. Under Superfund, this is called the Remedial Investigation and Feasibility Study (RI/FS). The investigation is often conducted under a consent decree with the Kentucky DEP or EPA.

Settlement:

Following the investigation, the Company may decide to undertake the remedy itself, enter an allocation agreement with other potentially responsible parties sharing the costs, or cash-out of the process entirely.

Clean-up:

Site clean-up may be performed by the Company, Kentucky DEP, EPA and/or other parties. These activities may occur over several years, followed by continuing surveillance and monitoring.

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

3. Estimated Costs

   ASC 410-30-25,"Recognition", requires that environmental losses be recorded at estimated cost. If the Company can only estimate a range of environmental costs and no amount within the range is a better estimate, the minimum amount in the range should be accrued.

   In practice, several remediation methods, with variable costs, may be available (e.g. capping, bio-remediation, waste removal or on-site incineration). For example, assume that each clean-up option - capping to on-site incineration - are progressively more expensive and therefore establish a range of potential costs. If bio-remediation is likely to be selected by the regulator, that cost should be accrued. If there is no precedent as to which remediation method will be selected, the cost of capping should be accrued (i.e., the minimum estimated cost).

   Accruable costs **included** in the estimate generally include:
   - Regulatory agency costs for clean-up and oversight
   - Outside contractor fees for remediation
   - Ongoing surveillance and monitoring
   - Internal payroll costs for those employees who devote a significant amount of time directly to a remediation effort

   Costs **excluded** from environmental costs accruals are:
   - Operating costs of waste reduction program
   - Capital projects to reduce emissions or generation of hazardous waste

   Liabilities for environmental losses should be recorded gross on the balance sheet. Possible insurance recoveries or recovery through rates should not be netted against the liability.

4. Capital Projects

   Environmental clean-up costs incurred as part of a capital project that have been determined to be expense must be charged to a Project Number and applicable Task.

   Capitalization of environmental clean-up costs may be considered under the following conditions:
   1. Costs incurred extend the life, increase capacity or improve safety or efficiency of Company property.
   2. Expenditures mitigate or prevent environmental contamination that has not occurred to date, but may occur from future operations. Additionally, such improvements add to the value of the property (e.g., installation of air pollution controls).

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

3. Costs incurred in preparation for sale of property held for sale, assuming such costs will be recovered in the sales price.

C. Workers' Compensation Accruals

The detailed procedures regarding the recognition of contingencies related to workers' compensation claims vary from those described above, however the general accounting standards related to loss contingencies and uncertainties also apply to workers' compensation losses.

As workers' compensation expenses are tied to labor costs, the Company accrues for estimated workers' compensation claims through the burden process that allocates labor costs to appropriate departments and entities. The Company has outsourced the claims processing to USC. (See 750 – Oracle Burdening Policy)

On a monthly basis, USC provides a "Loss Experience Report" to the Risk Management department by the third workday that details claims made and claims paid. A designated Risk Management Analyst incorporates information from this report into an internally developed workers' compensation loss model, which estimates the Company's liability for current and future claims. On a quarterly basis, adjustments to estimates can be made, if needed, via journal entry.

The Manager, Risk Management reviews the Loss Experience Report and the loss model, as evidenced by reconciliation sign-off. The liability is properly classified as current or non-current on the balance sheet.

The Legal Department also reviews the Loss Experience Report to determine coordination with the Material Loss Contingency Assessment chart. The Loss Experience Report matters are not reportable on the Immaterial Loss Contingency -- Summary memo.

Reports Generated and Recipients:

- The Auto and General Liability Open/Reserved Claims report is provided monthly by USC to the Legal Department, FAA and others
- The Workers' Compensation Loss Experience Report is provided monthly by USC to the Risk Management department, which provides the report to FAA
- Immaterial Loss Contingencies -- Summary memo from Legal Department provided to FAA and others
- Material Loss Contingency Assessment chart from Legal Department provided to FAA and others

Additional Controls or Responsibility Provided by Other Procedures:

- 250 – Balance Sheet Account Reconciliation Policy
- 354 – Materiality Policy

455 - Contingencies

(Note: Text in italics indicates a key SOX control.)

- 750 – Oracle Burdening Policy
- 1057 – Guarantees Policy

Regulatory Requirements:
N/A

Reference:
- ASC 210 - 20, Balance Sheet – Offsetting
- ASC 275, Risks and Uncertainties
- ASC 410, Asset Retirement and Environmental Obligations
- ASC 450, Contingencies
- ASC 460, Guarantees
- EITF Issue 01-10, Accounting for the Impact of the Terrorist Attacks of September 11, 2001
- SEC Regulation S-K, Items 101, 103 and 303.
- SEC SAB No. 92, "Accounting and Disclosures Relating to Loss Contingencies"

Corresponding PPL Policy No. and Name:
405 – Accounting and Disclosure Requirements for Contingencies
406 – Accounting and Disclosure Requirements of Environmental Costs

Key Contact:
Manager, Financial Accounting and Analysis

Administrative Responsibility:
Controller
Director, Accounting and Regulatory Reporting

Date created: 5/23/2011
Dates revised*:* 8/18/2011
1/26/2012
2/21/2012
4/01/2012
6/30/2013
4/1/16

456 – Pension and Postretirement Plans

(Note: Text in italics indicates a key SOX control.)

Policy: Accounting and disclosures for pension and other postretirement plans will be in conformity with FASB ASC 715, Compensation – Retirement Benefits.

Procedure: Plan assets and obligations must be measured at a specific and consistently applied point in time. LKE uses a December 31 measurement date for its pension and other postretirement benefit plans. Under ASC 715, the funded position (the fair value of the plan assets less the project benefit obligation, or PBO) of each pension plan at the plan sponsor's fiscal year-end is required to be reported as an asset (for overfunded plans) or a liability (for underfunded plans). Fiscal year-end reporting information and disclosures are prepared before detailed participant data and full valuation results are available. Therefore, the funded position at December 31 (the measurement date) is derived from a roll forward of the January 1 (census date) valuation results, adjusted for the year-end discount rate, changes in other key assumptions and asset values, as well as significant changes in plan provisions and participant population.

Using valuations provided by its actuaries, LKE and its subsidiaries will record/adjust liabilities and assets associated with its pension and other postretirement plans at least annually and whenever changes to the plans or significant events occur resulting in a material change in valuation. Monthly costs associated with these plans will be recorded consistent with the allocation of labor (as well as capital and O&M expense) to the various subsidiary entities. Costs will be recorded on a regulatory basis with the difference between the regulatory and financial reporting basis due to purchase accounting adjustments recorded to LKC.

Scope: LKE employees benefit from both funded and unfunded retirement benefit plans. Its defined benefit pension plans cover employees hired by December 31, 2005. Employees hired after this date participate in the Retirement Income Account ("RIA"), a defined contribution plan. The postretirement plan includes health care benefits that are contributory, with participants' contributions adjusted annually. This policy applies to all of LKE's qualified and non-qualified defined benefit pension and other postretirement plans, including plans that provide health and life insurance and other welfare benefits to retirees.

Objective of Procedure: The accounting for pensions, ASC 715-10-30 and other postretirement benefits, ASC 715-10-60 are premised on the delayed recognition of actual results versus expected or estimated results. This concept recognizes and allows for the smoothing of short-term volatility in the capital markets in which plans are invested and from which assumptions are used to measure results. However, certain events such as settlements, curtailments and termination benefits could require immediate recognition of a liability and offsetting cost.

The basis for the determination of pension and other postretirement benefit obligations and cost are the plan provisions coupled with economic assumptions and demographic and mortality

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(Note: Text in italics indicates a key SOX control.)

assumptions applied to actual employees and retirees. An obligation for each employee and retiree is calculated and projected to an assumed date of death using Society of Actuaries mortality tables, as adjusted following consultation with the actuaries, then discounted to present values.

The discounted pension and other postretirement benefit obligations are netted with plan assets to determine the amount of liability, or prepayment if assets exceed discounted obligations, to be recorded on the Company's balance sheet.

General Requirements:

Defined Benefit Plans:
LKE's qualified pension plans meet specific IRS guidelines and are required to be funded in a trust, which is legally separated from corporate assets for the sole purpose of providing for present and future pension obligations. The Company's policy is to make contributions equal to the greater of the minimum required contributions, as calculated under the Pension Protection Act of 2006 ("PPA") excluding the impact of the Moving Ahead for Progress in the 21st Century Act or the amount of the ASC 715 pension expense. Additionally, contributions will be made to maintain a minimum 80% PPA funded status in order to avoid financial penalties levied by the PBGC.

SERPs:
Non-qualified pension plans, most commonly referred to as Supplemental Executive Retirement Plans (SERP's), are plans that provide for additional pension benefits to highly compensated employees above IRS limits for qualified plans. Non-qualified pension plans are not required to segregate assets for benefit payments into a separate trust. LKE provides benefits under non-qualified plans, which are paid from corporate assets, as it does not currently maintain separate trusts for these plans. Note that for the purposes of this document, the Officer SERP, the Restoration Plan and the Hale SERP are all collectively referred to by the term SERP.

Post-Retirement Plan:
LKE is not required to make contributions to its other postretirement benefit plan but has historically funded this plan in amounts equal to the postretirement benefit costs recognized. Participants shall be required to contribute to the Plan such amounts at such times and in such manner as the Company shall determine from time to time in order to pay for all or part of the cost of coverage for the participant or the participant's dependents. Participants shall not be entitled to any refunds or rebates under the Plan.

Contributions to the Plan by the Company or participants shall, as directed by the Company, be deposited in the Trust, or be paid to a claims administrator or insurer. All contributions by

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(Note: Text in italics indicates a key SOX control.)

participants payable to the Company will be used by the Company within ninety (90) days of their receipt to pay the premiums on insurance contracts, and any payments to a claims administrator or insurer by the Company will be treated as being made first from contributions by participants.

All benefits to which participants are entitled under the Plan are to be paid solely from the Trust as provided in the Trust agreement, and only to the extent thereof, except to the extent coverage under the Plan is provided through the purchase of group medical insurance contracts from one or more claims administrators or insurers. Premiums for such contracts may be paid, in whole or in part, as determined by the Company, by any or all of (i) the Company, (ii) participants or (iii) the Trust, as provided in the Trust agreement.

Contributions by retired executives of the Company are not allowed to be deposited into the Trust and are, instead, deposited into the general assets of the Company. All contributions by retired executives are used by the Company within ninety (90) days of their receipt to pay the premiums or insurance contracts under the same policies as all other retirees. Their contributions are treated no differently than those listed above. All benefits to which the retired executives are entitled under the Plan are paid out of the general assets of the Company. Their benefits are the same as the other retirees and as such are paid out according to the same terms as listed above.

Definitions:

"Accumulated postretirement benefit obligation" – The measure of benefit obligations under a postretirement benefit plan, such as a retiree health care plan.

"Curtailment" – An event that either significantly reduces active participants' years of future service under the plan or eliminates future accrual of defined benefits for a significant number of active plan participants. Examples of transactions that could constitute a curtailment include plant closings, sales of a division, restructuring, a freeze of benefits, suspension of a plan, or a plan amendment eliminating benefits for future retirees. When a curtailment occurs, the company measures the effect of the curtailment. Curtailment gain/loss is intended to reflect the change in the benefit obligation and recognize unamortized prior service cost associated with years of service no longer expected to be rendered. Future service may be counted toward vesting of benefits accumulated based on past service.

"Discount rate" – The interest rate used to adjust for the time value of money.

"Expected long-term rate of return on plan assets" – An assumption as to the rate of return on plan assets stated as a percentage reflecting the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation.

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(Note: Text in italics indicates a key SOX control.)

"Expected return on plan assets" – A dollar amount calculated as a basis for determining the extent of delayed recognition of the effects of changes in the fair value of assets. The expected return on plan assets is determined based on the expected long-term rate of return on plan assets and the market-related value of plan assets.

"Fair value" – As stated in FASB Accounting Standards Codification (ASC) 820-10-20, Fair Value Measurements and Disclosures, "fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." ASC 820 introduces and requires documentation of new fair value measurement concepts including: a) exit price (entry, transaction or settlement price does not necessarily equate to fair value), b) highest and best use, c) principal or most advantageous market and d) non-performance risk (e.g. credit risk) for an entity's own liabilities. In addition, ASC 820 expands the fair value disclosure requirements of other accounting pronouncements. When measuring fair value, these new concepts as well as the disclosures should be considered and documented.

"Gain or loss" – A change in the value of either the projected benefit obligation or the plan assets resulting from experience different from that assumed or from a change in an actuarial assumption.

"Health care cost trend rates" – An assumption about the annual rate(s) of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in the composition of the plan population by age and dependency status, for each year from the measurement date until the end of the period in which benefits are expected to be paid. The health care cost trend rates implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of the plan participants. Differing types of services, such as hospital care and dental care, may have different trend rates.

"Market-related value of plan assets" – A balance used to calculate the expected return on plan assets. Market-related value can be either fair market value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years. LKE applies the expected rate of return to all assets and then smoothes all asset gains/losses that differ from that expected rate of return.

"Measurement date" – The date as of which plan assets and obligations are measured.

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(Note: Text in italics indicates a key SOX control.)

"Plan assets" – The assets of the plans are legally separated from LKE and invested in external trusts for the exclusive purpose of providing for present and future benefit payments under the plans for which they are invested.

"Prior service cost" – The cost of retroactive benefits granted in a plan amendment.

"Projected benefit obligation (PBO)" – The actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using assumptions as to future compensation levels if the pension benefit formula is based on those future compensation levels (pay-related, final-pay, final-average-pay, or career-average-pay plans).

"Rate of compensation increase" – Management's projection of employees' annual pay increases, which are used to project employees' pension benefits at retirement. This rate is based on a review of historical salary increases including annual merit increases and increases due to promotions.

"Settlement" – An irrevocable action that relieves the employer (or the plan) of primary responsibility for a pension benefit obligation and eliminates significant risks related to the obligation and the assets used to effect the settlement. Examples of transactions that could constitute a settlement include (a) making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits and (b) purchasing nonparticipating annuity contracts to cover vested benefits. ASC 715-30-35-82 states that a recognition in earnings of gains or losses from settlements is required if the cost of all settlements (including lump sum payments) during a year is greater than the sum of the service cost and interest cost components of net periodic pension cost for the pension plan for the year.

"Termination Benefits" - An employer may provide benefits to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual termination benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs. An employer that offers special termination benefits to employees shall recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. Termination benefits may take various forms including lump-sum payments, periodic future payments, or both. They may be paid directly from an employer's assets, an existing pension plan, a new employee benefit plan, or a combination of those means. The cost of termination benefits recognized as a liability and a loss shall include the amount of

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(Note: Text in italics indicates a key SOX control.)

any lump-sum payments and the present value of any expected future payments. A situation involving termination benefits may also involve a curtailment.

Detailed Procedures Performed:

The following referenced guidance provides the broad considerations applied to all LKE's plans. However, ASC 715-30 provides that "If estimates, averages, or computational shortcuts can reduce the cost of applying this Subtopic, their use is appropriate, provided the results are reasonably expected not to be materially different from the results of a detailed application." Thus, the application of the following is evaluated on a plan by plan basis with consideration to the materiality of each plan.

Measurement date / Remeasurements:

ASC 715-30-35-62 through 68 provides the following guidance in regard to the measurement date. The measurements of plan assets and benefit obligations required by this Statement shall be as of the date of the employer's fiscal year-end statement of financial position unless (a) the plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent's, as permitted by ASC 810-10-45-12 or (b) the plan is sponsored by an investee that is accounted for using the equity method of accounting under ASC 323-10-35-6 using financial statements of the investee for a fiscal period that is different from the investor's, as permitted by that Subtopic. In those cases, the employer shall measure the subsidiary's plan assets and benefit obligations as of the date used to consolidate the subsidiary's statement of financial position and shall measure the investee's plan assets and benefit obligations as of the date of the investee's financial statements used to apply the equity method. Requiring that the pension measurements be as of a particular date is not intended to require that all procedures be performed after that date.

Interim Remeasurement

PwC's ARM section 4270, "Pension Costs", paragraph .431 indicates that judgment is required to determine what constitutes a significant portion of expected future service and a significant number of employees in regard to settlements and curtailments. Paragraph .431 goes on to indicate that, absent other consideration a 10% or greater reduction would be considered significant, a reduction of less than 5% would not be significant and a reduction between 5 and 10% should be evaluated based upon the facts and circumstances. This same guidance and quantitative assessment should be applied to all events to determine if they are significant and require remeasurement.

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To determine what constitutes a significant event that would require remeasurement, LKE will review internal and external events that could impact its plans, including plan amendments, changes in law, settlements, curtailments, termination benefits etc. Such events will be initially evaluated by LKE's Human Resources department in consultation with the independent actuarial firms retained by LKE. Any changes that could be significant to an individual plan are communicated to the appropriate accounting groups. Plan changes that have the potential of changing the benefit obligation and/or expected years of future service by 5% or less according to preliminary actuarial calculations are not considered significant events. Plan changes that have the potential of resulting in changes of between 5% and 10% are evaluated in greater detail by LKE's accounting groups in consultation with LKE's independent actuarial firms. A file memo or white paper will be prepared to formalize LKE's decision as to whether events impacting its plans are considered significant events that require remeasurement. Plan changes that result in changes of 10% or greater will be considered significant events that require remeasurement.

Semi-Annual Remeasurement

During January, the actuary provides year-end disclosures prepared in accordance with FASB ASC 715-20-50 and ASC 715-60-50. These reports measure benefit obligations as of the Company's fiscal year end date of December 31, 20xx and are based on the census data from January 1st of that year. The actuary projects forward the benefit obligations to December 31 where applicable, adjusting for benefit payments, expected growth in benefit obligations, changes in key assumptions, anticipated demographic experience and plan provisions. LKE will review these valuation reports and determine if the assets or liabilities for each individual plan should be adjusted.

During the first half of the year, the independent actuary delivers the final current year pension expense. At this time, the actuary also provides an updated funded status of the plan liabilities. The difference between the reported funded status and the funded status recorded at December 31 is due to the rollforward of data used to generate the annual year-end disclosures and complete data collection and reconciliation used to produce the final plan valuations as of the census date. The review of any resulting differences will encompass both quantitative and qualitative considerations to determine the significance of the differences and if they should be recorded. Significant differences will be assessed under ASC 250-10-20, Change in Accounting Estimate.

Ideally, pension obligations should be based on a census of participants as of the measurement date. However, assembling and verifying participant data is time consuming and using participant data as of the measurement date would mean that the actuarial calculations could not be performed until after that date. Companies that use a roll-forward approach are exposed to a particular risk of error-namely, that significant changes in the employee group would not be reflected in the plan liabilities in the proper accounting period.

According to the EY Accounting Manual, section P1.1.11.5.1, the roll-forward approach is acceptable and "a company may be able to satisfy itself that the use of beginning-of-the-year participant data "aged" one extra year to calculate year-end measurements would obtain results that are reasonably not expected to be materially different from the results that would have been obtained using end of the year participant data". Therefore, when LKE receives the updated estimate of pension liabilities in the 2nd quarter of each year, it will review the reasons for all changes and account for the change in the liability as a change in estimate as part of its normal pension process. The Company will not consider the change an error, unless an actual error in the calculations is identified during its review of the updated liability.

Asset Values:

Plan assets are measured at fair value at each measurement date, which are then offset against the pension and other postretirement benefit obligations to determine the funded status to be recorded on the balance sheet.

Plans are allowed to smooth the volatility of asset fluctuations by using a calculated or "market related value" approach to determine the value of assets to be used to measure pension costs and determine funding requirements. LKE uses a five year smoothing for the determination of its market-related value of assets. Under this approach, asset gains or losses are recognized in the asset base over a five year period.

ASC 715-30-55-101 through 107 provides guidance/illustrations in the use of a market related value approach.

Assumption Setting:

Management makes key decisions regarding the primary assumptions used in the calculations of obligations and assets which include the discount rate, expected rate of return on assets, expected mortality, salary increase rate and health care cost trend rate. Plan assumptions are evaluated by financial and human resources management and the independent actuary. These assumptions are approved on an annual basis, barring any events requiring an interim measurement. The basis for determining the primary assumptions are as follows:

Discount rate: Discount rates are based on the results of the Towers Watson BOND:Link model. BOND:Link matches the plans' expected cash flows to coupons and expected maturity values of individually selected bonds. Individual bonds are theoretically purchased to settle the plans' expected future benefit payments (bonds that match the timing of the plans' expected cash flows). This model reflects approximation of the process of settlement of obligations as required by the FASB.

Expected rate of return on plan assets: LKE's Treasury department, in conjunction with the PPL Employee Benefit & Pension Board (EBPB), monitors and reports on the returns achieved by LKE's pension and other postretirement benefit plans and provides guidance for expectations of future performance. Consideration is given to the percentage of assets invested in equities, bonds, real estate and cash in weighting the Return on Plan Assets. Consideration is also given as to whether the assets are actively managed.

To determine the expected return on plan assets, plan sponsors project the long-term rates of return on plan assets using a best-estimate of expected returns, volatilities and correlations for each asset class. Each plan's specific current and expected asset allocations are also considered in developing a reasonable return assumption.

The expected return on plan assets is determined based on a market-related value of plan assets, which is calculated by rolling forward the prior year market-related value with contributions, disbursements and long-term expected return on investments. One-fifth of the difference between the actual value and the expected value is added (or subtracted if negative) to the expected value to determine the new market-related value.

Health care cost trend rate: LKE's Director, Human Resources – Corporate, or delegate, reviews the health care cost trend rates for each plan with LKE's independent actuary. This review is conducted with regard to plan provisions, experience and macro-economic expectations.

Lump-sum option election rate: Percentage of employees assumed to take the lump-sum option available to them. This rate is set based on industry experience until actual experience can be established.

Mortality: The mortality assumption is composed of two parts. The first is the base table which reflects the initial mortality rates at the time the mortality study is published. The second is the projection scale which projects how mortality rates will change in the future. LKE's actuaries perform a demographic experience study every three years to determine the appropriateness of the current demographic assumptions for the plans. LKE management compares the results of its plans based on the experience study to the Society of Actuaries (SOA) tables and selects adjustment factors which will align the SOA tables to the plan experience.

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(Note: Text in italics indicates a key SOX control.)

Retirement rate: This rate represents the number of people expected to retire in a year as a percentage of the number of employees eligible for retirement at that age. LKE management reviews the results of its plans per the experience study and updates the retirement rate table to reflect experience.

Salary increase rate: LKE's Director, Human Resources – Corporate, or delegate, provides guidance regarding recent and expected future salary increases. The independent actuary provides a report showing LKE's historical trend.

Amortization of Gains and Losses:

Net periodic pension costs include the aggregate recognition of:

1. the costs associated with providing benefits (service cost and interest cost);
2. an offset to those costs related to the expected return on the assets held in trust; and
3. amortizations of deferred items (including the transition amount from the adoption of ASC 715, if applicable, prior service cost resulting from plan amendments, and the difference between assumed and actual demographic and asset performance results).

ASC 715-30-35-24 requires, at a minimum, the amortization of unrecognized net gain or loss in excess of 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets over the average remaining service period of active employees expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.

ASC 715-30-35-25, states "Any systematic method of amortizing gains or losses may be used in lieu of the minimum specified in the previous paragraph provided that all of the following conditions are met: (a) the minimum is used in any period in which the minimum amortization is greater (reduces the net balance included in accumulated other comprehensive income by more), (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses."

LKE uses a double corridor approach to amortizing unrecognized actuarial gains and losses for its defined benefit pension plans. In addition to the minimum amortization required by ASC 715-30-35-24, a second corridor is utilized for the net unrecognized gains or losses in excess of 30% of the plan's projected benefit obligation. The net unrecognized gains or losses outside the second corridor are amortized on a straight-line method over a period equal to one-half of the average future service period of the plan participants. This method provides more current recognition of gains and losses, thereby lessening the accumulation of unrecognized gains and losses.

LKE uses a single corridor method for recognition of gains and losses for its post retirement plan. Under the single corridor method, actuarial gains and losses in excess of 10% of the greater of the plan's projected benefit obligation or the market-related value of plan assets are amortized on a straight-line basis over the expected average remaining service period of active plan participants.

On November 26, 2014, LG&E and KU filed requests with the Kentucky Public Service Commission ("KPSC") to increase their electric and gas (LG&E only) rates (Case No. 2014-00371 for KU and Case No. 2014-00372 for LG&E). The parties in the cases reached a unanimous settlement agreement. One of the stipulations of the settlement agreement included the KPSC approving regulatory asset treatment for the difference between (1) the Utilities' pension expense booked according to its accounting policy in accordance with GAAP, i.e. double corridor approach, and (2) pension expense with actuarial gains and losses exceeding the 10% corridor amortized over 15 years. This will result in new Regulatory Assets on the financial statements of LG&E and KU. See 1055 Regulatory Asset and Liability Policy and its related Appendix A for further details of the accounting for the Regulatory Assets. This settlement applies to LG&E, the portion of KU regulated by the KPSC, and to the allocation of costs from LKS to LG&E and KU regulated by the KPSC. For FERC and VA ratemaking purposes, qualified pension actuarial gains and losses will continue to be amortized in accordance with the double corridor method discussed above. LKE's accounting policy continues to remain the use of the accelerated amortization methodology for pension gains and losses per ASC 715 except where ASC 980 Regulated Operations provides for recording amortization based on the 15 year methodology agreed upon in the settlement with the KPSC.

Responsibilities:

Treasury (Allentown) – Manages and/or coordinates all trust and investment manager relationships, ultimately responsible for all plan investments.

Treasury (Louisville) - Coordinates all plan funding decisions with senior management.

Human Resources – Communicates plan provisions and any changes to plan provisions to the plan actuary and pension accounting. Provides annual employee census data, input on the health care cost trend and the rate of compensation increase assumptions to the plan actuary.

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(Note: Text in italics indicates a key SOX control.)

Risk Management – Responsible for recommending and coordinating the year-end assumptions to be used for plan measurement with senior management and the actuary. Responsible for all general ledger journal entries and account analysis associated with all LKE pension and postretirement plan activity. Coordinates and/or prepares quarterly and annual 10Q/10K disclosures as required by ASC 715-20-50 in consultation with PPL Services Benefits Accounting group. Provides and coordinates information and accounting assessment related to plan changes with PPL's Benefit Accounting group for potential remeasurement and/or settlement / curtailment accounting.

Reports Generated and Recipients:

- Annual financial statement disclosures under regulatory and financial reporting scenarios prepared by actuary and distributed to various Treasury, Risk Management and Accounting personnel
- Annual actuarial valuation reports to various Treasury, Risk Management and Accounting personnel

Additional Controls or Responsibility Provided by Other Procedures:

None

Regulatory Requirements:

Employee Retirement Income Security Act of 1974 (ERISA)
Pension Protection Act of 2006
Internal Revenue Code Section 401(k)
Patient Protection and Affordable Care Act of 2010

Reference:

- ASC 715 Compensation Retirement Benefits
- ASC 820 Fair Value Measurements and Disclosures
- ASC 980 Regulated Operations

Corresponding PPL Policy No. and Name:

401 – Defined Benefit Pension and Other Postretirement Plans

Key Contact:

456 – Pension and Postretirement Plans

(Note: Text in italics indicates a key SOX control.)

Manager, Risk Management

Administrative Responsibility:

Manager, Risk Management
Treasurer
Controller

Date Created: 3/28/11
Dates Revised: 9/22/11, 5/13/15, 6/26/15, 10/6/15, 12/9/15, 3/3/16

550 – Chart of Accounts and GLAFF Updates

(Note: Text in italics indicates a key SOX control.)

Policy: Requests for any changes to the General Ledger ("GL") chart of accounts requires approval from various accounting managers and others in the finance organization.

Procedure: See "Detailed Procedures Performed" section.

Scope: Applies to the creation and update of all chargeable (non-parent) accounting segment values for each segment of the General Ledger Accounting Flexfield ("GLAFF") in Oracle for all companies. Excluded are additions and changes to the Oracle Project Accounting version of location segment values, as these are non-chargeable in the General Ledger.

Objective of Procedure: To maintain a formalized and controlled mechanism for adding new segments, disabling segments, and updating existing segments of the GLAFF.

General Requirements:

Detailed Procedures Performed:

The procedures to update the GL chart of accounts are as follows:

1. The "GLAFF Change Request Form" may be found on the Intranet in the Controller Group section.

2. The person requesting changes to any segment of the GLAFF completes the appropriate workbook version of the "GLAFF Change Request Form". The form contains drop down lists and instructions to minimize errors when completing the form.

3. The "GLAFF Change Request Form" is then forwarded to the initiator's direct supervisor for approval. The supervisor emails approved form to the email address "GLAFF.Changes@lge-ku.com" (GLAFF Changes mailbox). The email is also received automatically by the "GLAFF.Changes-Audit@lge-ku.com" email address, which is accessible by Auditing Services only.

4. *The Sr. Accounting Systems Support Analyst or designee forwards the completed form in an email with approval buttons to accounting and finance employees responsible for internal or external financial reporting. These employees review/correct/approve the submitted form. Approvals and rejections are communicated to the Sr. Accounting Systems Support Analyst or designee via the GLAFF Changes mailbox. The Company / Intercompany, Product, Account, Expenditure Type, and (GL) Location segment value changes must be approved by the entire list of approvers. Changes to the Organization / Exp Organization segment values must only be approved by the Sr. Financial Analyst*

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from Finance & Budgeting – Corporate. (See cycle/transaction 80.02 Control Activity 2 in the Sarbanes-OxleyCompliance documentation.)

5. If rejections are received, the Sr. Accounting Systems Support Analyst or designee communicates these to the initiator, who must make the requested changes to the form and have his or her director supervisor resubmit it to the GLAFF Changes mailbox for redistribution to the accounting and finance employees responsible for approving changes. As approvals are received they are added to the "Pending Approval" email folder.

6. After all approvals are received, the Sr. Accounting Systems Support Analyst or designee makes the requested changes in Oracle.

7. *The Senior Accounting Systems Support Analyst or designee forwards the GLAFF Change Request Form from the GLAFF Changes mailbox to the manager/delegate of the requesting department seeking positive confirmation of agreement with the changes made by use of the segment values listing on the chart of accounts Intranet web page. The other accounting managers, those responsible for updating the Oracle Financial Statement Generator reports with new segments and other individuals who have expressed a need to be informed about this information are copied on the request. The email is moved to the "Pending Confirmation" folder. (See cycle/transaction 80.02 Control Activity 2 in the Sarbanes-OxleyCompliance documentation.) After confirmation is received, the email is moved to the "Completed" folder. After the monthly cutoff for changes affecting HFM (last work day of the month minus four days) has passed, the Senior Accounting Systems Support Analyst runs a report from HFM to verify that these changes have been correctly made in HFM. This report is maintained for audit evidence. (See cycle/transaction 80.02 Control Activity 7 in the Sarbanes-OxleyCompliance documentation.)*

8. *Before the books are closed for each quarter-end, the Senior Accounting Systems Support Analyst or designee requests positive confirmation from the manager/delegate of the requesting department that any open items may still remain open. (See cycle/transaction 80.02 Control Activity 2 in the Sarbanes-OxleyCompliance documentation.)*

9. *The Senior Accounting Systems Support Analyst or designee will follow up to make sure a response is received for each request, whether completed or open, before the books are closed for each quarter-end. (See cycle/transaction 80.02 Control Activity 2 in the Sarbanes-OxleyCompliance documentation.)*

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(Note: Text in italics indicates a key SOX control.)

Note: In certain instances, it is necessary to make temporary changes to segments of the GLAFF that do not flow through the formal process outlined above in order to allow processing to continue in a timely manner. These changes are made at the discretion of the Senior Accounting Systems Support Analyst or designee. Included are such items as temporarily reopening a GLAFF segment to allow a Purchase Order line to be backed out, a mass allocation to be processed, an LKE allocation to be processed, or a journal entry to be uploaded to an account that ordinarily requires a project and task. These instances are documented in email form or in the case of LKE allocations, on a spreadsheet.

Reports Generated and Recipients:

- GLAFF Change Request Form for changes to the Company/Intercompany, Account, Expenditure Type, and Location (GL version only) segments – The Sr. Accounting Systems Support Analyst or designee, the managers of the Corporate Accounting, Regulatory Accounting & Reporting, Financial Reporting, and Financial Planning departments and other designated accounting and finance personnel.
- GLAFF Change Request Form for changes to the Organization/Expenditure Organization segment – the Sr. Accounting Systems Support Analyst or designee and the Sr. Financial Analyst from Finance & Budgeting – Corporate. Approval or rejection of requested GLAFF changes – The Sr. Accounting Systems Support Analyst or designee.
- Notification of GLAFF changes - The list of approvers, all accounting managers and various other accounting and finance personnel.
- Confirmation of GLAFF changes by the manager of the requesting department – the Accounting Systems Support Analyst or designee.
- Report from HFM showing SEC, Ongoing, and FERC hierarchy structures as of report run date.

Additional Controls or Responsibility Provided by Other Procedures:

N/A

Regulatory Requirements:

N/A

Reference:

N/A

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(Note: Text in italics indicates a key SOX control.)

Corresponding PPL Policy No. and Name:

505 – HFM Metadata Changes

Key Contact:

Manager, Corporate Accounting

Administrative Responsibility:

Controller
Director, Accounting and Regulatory Reporting

Date Created: 1/10/05
Dates Revised: 3/15/11, 8/10/11, 5/17/12, 5/31/13, 2/27/15, 3/30/16

551 – Oracle System Interface Balancing

(Note: Text in italics indicates a key SOX control.)

Policy: Oracle system interfaces which impact financial and management reporting are monitored regularly, and transactions causing processing errors are corrected on a timely basis.

Procedure: Each interface is reviewed at the same frequency that the interface processes are run in Oracle using available reporting tools, such as EiS and concurrent request output reports. Transactions that cannot be successfully interfaced are identified and corrected by the Corporate Accounting Department or by contacting the transaction initiator or other appropriate Accounting Department. All corrections to transactions should be made in the source system whenever possible.

Scope: All Oracle interfaces that impact financial and management reporting, including interfaces between the Oracle G/L and Projects modules, interfaces from external systems to Oracle, and interfaces from Oracle to data warehouses.

Objective of Procedure: Sufficient controls are in place to ensure that complete and accurate transactions are transferred via Oracle system interfaces.

General Requirements:

Detailed Procedures Performed:

Customized/Semi-Customized Interfaces:

Labor – On a nightly basis, the labor file is imported from VOLTS into the Oracle Projects interface table by a scheduled custom process. The VOLTS process sends an email alert containing the file control totals to the Sr. Accounting Systems Support Analyst who balances to an EiS report before and after the data is interfaced to G/L and who corrects any errors.

Burdens – The custom burden interface from Oracle Projects to G/L is run by the Sr. Accounting Systems Support Analyst during the close cycle and on a daily basis after the 11th work day. Two EiS reports are run by the Sr. Accounting Systems Support Analyst to compare the control totals from Oracle Projects and Oracle G/L. Differences other than rounding are investigated by the Sr. Accounting Systems Support Analyst.

Vehicle Costs – The vehicle cost allocation process is a custom program that allocates transportation costs accumulated in the Fleetfocus system for the current G/L period by labor in departments that own vehicles. The Sr. Accounting Systems Support Analyst runs an EiS report to compare control totals of the costs to be allocated in Oracle Projects to control totals of the unposted G/L batch and corrects any discrepancies.

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CCS – The batches from the Customer Care System (CCS) are automatically imported and posted into Oracle G/L without any manual intervention. Control totals are run by the Sr. Accounting Systems Support Analyst after the fact to make sure that the totals in G/L match the totals per the CCS email alert. If the totals do not match or if the files did not make it to Oracle G/L during the nightly process, members of the CCS team and Revenue Accounting are contacted to provide a resolution.

Aligne (formerly Fuelworx) – This interface has two components:

I. Aligne to A/P: Aligne produces invoices related to shipments at plants. The Fuels Accounting Analysts work with the suppliers to make sure they are in agreement about the details of the invoices. The invoices are then approved for payment in Aligne. On a daily basis, Aligne produces a file of invoices that is interfaced to the A/P module for automatic import and processing. No fuels invoices are entered manually. This interface to A/P produces a control report that shows what has been approved in Aligne. Copies are given to the Director of Corporate Fuels & By-Products and the Chief Financial Officer for review in accordance with the statement of trading and the Authority Limits Matrix.

II. Aligne to G/L: Data extracted from Aligne is put into a spreadsheet and checked monthly by the Fuels Accounting Analysts to ensure that the correct amounts are reflected in the interface file prior to importing the file into Oracle. If an error is detected in the data, it can be corrected by the Manager, Fuels Accounting prior to the archive of the file and its import into Oracle. Errors that may occur during the journal import into Oracle are detected by standard import controls and custom controls applied by a database trigger on the G/L interface table. Any errors in GLAFFs and/or project-task combinations are referred to the Manager, Fuels Accounting for research who then provides any changes that must be made to the file to the Sr. Accounting Systems Support Analyst who makes the changes. Upon successful import into Oracle G/L, the Sr. Accounting Systems Support Analyst ensures that the file debits and credits match as a final check prior to posting to the G/L. The posted G/L batch is then interfaced to the Oracle Projects system, and various personnel who have expressed a need to know are notified that this portion of the monthly close process has been completed.

Oracle G/L to Oracle Projects – A custom process is scheduled to run each night to interface project-related items posted to the G/L to Oracle Projects. Included in this interface are project-related accounting journal entries imported into G/L through the Automatic Data Interface. This process is also run by request to interface items to Projects such as the A/P accrual entries on the second work day. The Sr. Accounting Systems Support Analyst runs a series of maintenance queries several times a day during the close cycle that will detect if any errors occurred that prevented transactions from being successfully interfaced from G/L. Any error conditions

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preventing the data from being interfaced are corrected by the Sr. Accounting Systems Support Analyst, and the process is re-run.

PowerPlan – The PowerPlan interface consists of three main components: Interface from Oracle to PowerPlan to populate the Cost Repository (CR) with detail information from Oracle G/L balances and journal lines items; depreciation and other related transactions; and tax-related transactions from PowerTax:

I. PowerPlan Charge Repository – A system job runs daily to verify the CR balances to the Oracle G/L. If it does not balance, an alert is sent to a Property Accounting Analyst, who investigates the differences and makes appropriate corrections to G/L, CR or both.

II. PowerPlan transactions to Oracle G/L – A Property Accounting Analyst ensures that the depreciation and other transactions interfaced from PowerPlan to G/L are correct and that any errors are identified. Monthly unitization and retirement control sheets are verified against PowerPlan reports. Balance sheet account reconciliations are used by Property Accounting Analysts to ensure account balances in PowerPlan agree to account balances in Oracle G/L. Coding errors on journal entries from PowerPlan are detected during the validation process in PowerPlan before importing into Oracle G/L.

III. PowerTax - Data (i.e. pretax and other tax items) pulled from Oracle into PowerTax are checked on a monthly basis by a Tax Analyst to ensure that the right amounts are reflected in the PowerTax system. Debits and credits from tax journal entries interfaced into Oracle from PowerTax are verified by a monthly account reconciliation process that checks the tax amounts booked in Oracle vs. PowerTax. If interface errors occur they are corrected by the Tax department.

File from Oracle to HFM – This file is the process by which LG&E and KU Energy LLC (LKE)'s unconsolidated data is provided to PPL for consolidation in HFM with its other entities. Various reports are produced from the HFM system to be used in consolidated financial reporting.

WallStreet Suites – WallStreet Suites is a treasury management system that allows for a single repository for debt, derivative, and banking transactions along with an accounting sub-ledger for these transactions. The monthly activity is interfaced each month during the close cycle to Oracle GL posting and interface to Oracle Projects. The sub-ledger detail is maintained and reviewed and reconciled by Corporate Finance.

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Standard Interfaces from Other Oracle Modules:

Accounts Receivable (A/R) - Each month, before the Accounts Receivable accounting period is closed, the Senior Accounting Analyst in the Financial Accounting & Analysis department reviews the journal entries report for any unposted items to ensure they are coded to the proper General Ledger Accounting Flex Fields. The incomplete invoices report is also run to ensure there are no transactions in process that need to be completed. Corrections are made, as needed. Additionally, an Accounting Analyst in the Financial Accounting & Analysis department runs an EiS report against the A/R customer transaction distributions table to ensure there are no errors. All errors must be corrected and all outstanding transactions must be processed before the A/R period can be closed.

Accounts Payable/Purchasing – Transactions process automatically from the A/P module to G/L nightly and reviewed by the Accounting Associates on the following business day. Inventory receipts and payments generate accrual journal entries from the Purchasing module to the G/L automatically and these are checked the following month as part of the account reconciliation process.

Inventory – A Materials Services & Logistics (MSL) Analyst ensures that any pending inventory transactions are resolved before the inventory period can be closed in Oracle for each location. After closing the inventory period, the G/L is automatically updated and inventory balances are confirmed with an Accounting Analyst in Regulatory Accounting & Reporting. Any discrepancies are reconciled, with any adjustments needed to G/L or Inventory requested by the Manager, MSL.

Oracle Patch Regression Testing

All of the above interfaces undergo regression testing by functional users and IT Shared Services Applications departments when new Oracle application or security patches are applied.

Reports Generated and Recipients:

Oracle Processing Status Reports for each interface job are reviewed by the owner of each process, and for Oracle G/L and Projects processes, the Sr. Accounting Systems Support Analyst or designee.

The results of the Oracle G/L and Projects EiS reports are also reviewed by the Sr. Accounting Systems Support Analyst or designee.

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Additional Controls or Responsibility Provided by Other Procedures:

The monthly balance sheet reconciliation process is used to assist in detecting any interface problems that may cause out-of-balance conditions between the Oracle subledgers and the General Ledger.

Regulatory Requirements:

N/A

Reference:

250 – Balance Sheet Account Reconciliation policy

Corresponding PPL Policy No. and Name:

504 – G/L (BMI) Interface

Key Contact:

Manager, Corporate Accounting

Administrative Responsibility:

Controller

Date Created: 12/31/04
Dates Revised: 10/23/07; 10/19/09; 3/31/11; 9/20/11; 6/17/13; 9/16/13; 4/22/14; 6/24/14; 7/14/15; 8/27/15; 3/15/16; 6/8/16

552 – Reporting Governance

(Note: Text in italics indicates a key SOX control.)

Policy: EiS Reporting Tool (EiS) provides real time reporting from the Oracle E-Business Suite (Oracle). EiS reports are utilized for many business reporting needs and must comply with this governance for using the tool and for IT report development.

Procedure: EiS Report users (users) will contact their respective EiS Reporting Administrator for any EiS reporting need that is not met within the system and follow the IT governance for report development.

Scope: Applies to all users who have access to EiS.

Objective of Procedure: EiS governance establishes how business specific reports will be effectively and efficiently generated and maintained.

General Requirements:

Detailed Procedures Performed:

EiS Reporting Administrators and Developers:

For the purposes of establishing and maintaining consistent reporting governance, functional EiS Reporting Administrators will be identified within the respective Business areas. The role of the Reporting Administrator will be as follows:

- Serve as the Business specific contact person for EiS reporting issues
- Ensure that the tenets of the governance process are maintained within that Business area
- Work with the other Administrators to share best practices in order to improve the overall use and capability of the reporting tool
- Serve as the point of contact with the vendor to resolve outstanding system problems

The EiS Reporting Administrators are:

- John Ising – Finance (Accounting, Tax, Budget Analysts and others)
- Sherry Townsend – Supply Chain
- Deborah Dowd – Commercial Operations
- Janiene Boatman – Supply Chain

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EiS Reporting Developer functional positions will be established to support the Reporting Administrators. The Reporting Developers will be responsible for:

- Supporting the development of technical reports that cannot be performed by the Reporting Administrators
- Serving as the point-of-contact with the vendor to resolve technical system issues

The EiS Reporting Developers are:

- Tom Bush
- Toni Sheets
- Brenda Fogerty
- Victoria Crick
- Jenny Skaggs

Modules and Categories:

EiS uses Modules and Categories to provide an organizational listing of the report inventory. Modules are aligned with the Oracle Modules and Categories represent how the reports should be categorized based on the purpose of the report.

When users copy a report they must keep the same module, but can choose a category that is appropriate for the purpose of the report. The Reporting Administrator will monitor the use of modules and categories used for copying a report. If the user has any questions about modules and categories the Reporting Administrator will provide assistance.

See Modules and Categories listing in EiS.

LKE Reports:

LKE reports were developed based on known and anticipated reporting needs.

LKE reports consist of standard reporting needs that are most commonly used for recurring data requirements and reports that are more complex in nature that can contain specific views, complex calculation formulas and conditions that meet a specific reporting requirement.

See LKE Report list in EiS of all available LKE reports.

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Financial Statement Generator (FSG) Reports:

FSG reports were developed using Oracle in the General Ledger (GL) module and the output can be run using Oracle or EiS. The maintenance of updating the row sets and the column sets must be done within the GL module. A report in EiS is available to run (LKE FSG Line Item Definitions) that will report any updates made to the row set definitions and the user that made those updates. The FSG reports are primarily used by the Accounting and Tax departments since the reports strictly retrieve GL account balance data for dollars and stats. These reports are updated by the respective departments that use those reports. The reports are automatically shared after being developed with the users that have access to the Oracle GL module and EiS. There is generally no IT development needed since the user can define all report criteria through the GL module. When a new FSG is created the Finance Reporting Administrator should be contacted to review and approve the final report. Evidence of the review and approval will be maintained by the Finance Reporting Administrator.

See the FSG report listing in EiS of all available FSG reports.

Creating Reports:

EiS Report Users (users) will have the ability to create new reports by using an existing report and copying that report to make modifications to meet unique or specific business reporting needs. Examples of modifications to copied reports are column selection, column order, parameters, conditions/filters, sort, format, calculations, and adding pivot tables.

New reports will not be created “from scratch” by a user due to the technical experience needed for selecting the proper object views which involves having the understanding of the Oracle database tables. If an existing report does not meet the need of the user, the appropriate Reporting Administrator needs to be consulted.

Report development performed by the Reporting Administrator, Developer, or Analyst must occur in a development environment and not production. Once reports have been developed, it is necessary to move reports from the development environment to the test environment before moving them to production. The move to the test environment is required to test the scripts that are created by the EiS export process. The EiS export process is a manual process that creates scripts which can be run against the target environments (test and production). Moving the reports into the test environment will uncover any issues with the scripts, reports, joins (link between two tables in a relational database), parameters, or conditions. Finally, testing of the EiS scripts and EiS reports created by those scripts is required for the change controls necessary to move EiS reports into the production environment.

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Saving Reports:

Users have the ability to save copied reports. EiS will automatically assign a copied report to the user as the report owner. There must be a valid business purpose for copying a report to be saved for an individual user. A valid business purpose would represent a reporting need to provide a specific data request from Oracle for the business that cannot be met by reports already available in EiS.

The EiS Reporting Administrator will monitor semi-annually all new EiS reports created to confirm each report is needed on an ongoing basis. The monitoring of new reports is to ensure the EiS report inventory stays at a manageable level.

Standardized Naming Convention of Reports:

Custom Reports created by users will begin with "LKE", a space, (no underscore, no dash), and name of the report. The name must reflect the purpose of the report. The report name must not contain a user's name, employee ID, or employee's initials.

An example base report name is provided below:

- LKE Project Expenditures

If a user decided to copy this report for a specific business purpose that the existing base report did not meet, the user could rename the report below as:

- LKE Project Expenditures for Storm Restoration

Examples of unacceptable names for a report would be:

- KT LKE Project Expenditures
- Copy of LKE Project Expenditures
- E10896 LKE Project Expenditures
- LKE Project Expenditures for Larry

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Departmental initials will be allowed in report names when used after "LKE" for example:

- LKE RAR Fuel Accounts

RAR is the departmental abbreviation for Regulatory Accounting and Reporting

For any reports that do not follow the standardized naming convention, the Reporting Administrator will be contacting that user to correct the name of the report.

Sharing Reports:

When reports are copied by a user to create their own report, the report will only be shared with that user. The copied report is considered a "private" report. If a user needs the report to be shared it must be shared with a responsibility. Reports will only be shared with a responsibility e.g. Mult Reporting and not single users.

For a report to be shared with a responsibility e.g. Mult_Reporting, the report must be reviewed by the Reporting Administrator. The reports shared with Mult_Reporting are considered "public" reports. The Reporting Administrator must approve sharing a report to ensure the report would meet the needs of multiple users, not be a duplicate of another public report, and ensure the data is accurate. These reports may require additional maintenance due to GLAFF changes or other Oracle updates. The Reporting Administrator will be responsible for sharing approved reports with a reporting responsibility.

New private and public EiS reports will be monitored semi-annually by the Reporting Administrator to ensure the reports are needed on an ongoing basis.

Deleting Reports:

Users will have the ability to delete reports where they are the report owner. If the report has been shared with a responsibility, the user must contact the Reporting Administrator to confirm the report can be deleted. If the report has not been shared, the user can delete the report if no longer needed.

Report Development (creating reports from scratch using new objects or SQL code):

For any new reports that are created by a Reporting Developer or Reporting Administrator that involves using new objects (views) or new SQL code, the report must first be created in the EiS development environment and tested by the Reporting Administrator and/or report user to ensure the data is accurate and meets the needs of the user. Once this report is tested and signed off by the user, the report will be migrated to the test environment before moving to the EiS production instance. The IT EiS Technical Support Analyst will migrate the report from the development environment to the test environment and then production environment, once the report is sufficiently tested. The Reporting Administrator will coordinate the developing, testing, and migrating of the report to production with the user.

Reporting Issues:

When users encounter reporting issues, the first step to resolve the issue is to contact your Reporting Administrator (as listed above for your respective business area). If the Reporting Administrator cannot resolve the reporting issue, the issue will be logged with EiS Support and once the EiS ticket number is received will log the issue with the IT service desk referencing that ticket number to make them aware of the issue and if their assistance will be needed. The Reporting Administrator will coordinate between working with EiS Support and IT (if necessary) to resolve any technical related issues associated with the reporting issue. The Reporting Administrator will continually update the user throughout the issue resolution process. All reporting issues until resolved are tracked in the issue tracking system by EiS and IT.

Monitoring Reports:

As stated previously, the Reporting Administrators will be responsible for monitoring the EiS and FSG report inventories for their respective business areas. Evidence of the EiS report review must be performed twice a year. The report listing must include the name of the report (that must meet the EiS standardized naming convention), the date the report was last run, report owner, module and category. The FSG review will be performed once a year.

Reports Generated and Recipients:

Once a year, a listing of all EiS reports and FSGs are sent to all departments for review. The second EiS report review is only sent to the EiS administrators.

Additional Controls or Responsibility Provided by Other Procedures:

N/A

Regulatory Requirements:

N/A

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Reference:

N/A

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Director, Accounting and Regulatory Reporting

Administrative Responsibility:

Controller

Date Created: 3/31/2014
Dates Revised: 1/31/2015; 3/15/2016; 9/13/16; 3/31/17

650 - Capital - Additions and Retirements Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: Capital assets will be recorded based on the acquisition or construction of property, plant and equipment ("PP&E") with useful lives greater than one year, and assets will be removed based on retirements and disposals of PP&E to ensure the accounting records are accurate.

Procedure: The procedures for adding and removing capital assets are described in the detailed instructions below.

Scope: All asset additions and retirements of LG&E and KU Energy LLC ("LKE" or the "Company") and its subsidiaries.

Objective of Procedure: Ensure that all capital assets and retirements are properly added or removed from the accounting records.

General Requirements:

Detailed Procedures Performed:

Various costs are considered appropriate to be accounted for as capital. The following are some generic definitions of these costs:

Capitalizable Costs - costs that are directly identifiable with specific PP&E. This includes incremental costs related to the acquisition, construction or improvement of capital assets. These costs singly or in combination with other assets will provide a future economic benefit that will contribute directly or indirectly to future net cash inflows.

Direct Costs - costs which can be identified and directly attributed to a specific capital project for the acquisition or construction of PP&E. These costs can be readily identified and are itemized by name and amount. Examples are direct labor, direct material, and direct equipment costs.

Direct Labor Cost - labor cost which can be identified and directly attributed to a specific capital project for the acquisition or construction of PP&E. The cost components are basic wage/salary rate, shift premiums, fringe benefits and overtime premiums.

Direct Material Cost - material cost which can be identified and directly attributed to a specific capital project for the acquisition or construction of PP&E. These costs include inventory loading cost, freight, transportation, and applicable taxes associated with the material.

Probable – the future event or events are likely to occur. A capital project for the acquisition or construction of PP&E is probable when: 1) proper management approval as specified by the

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(Note: Text in italics indicates a key SOX control.)

authority limits matrix is obtained in writing, 2) financial resources are available to fund the project, and 3) any regulatory requirements can likely be met.

Indirect/Overhead Costs - costs which generally are not directly attributable to a specific capital project for the acquisition or construction of PP&E.

Capital projects generally follow a timeline and progress through the following stages of acquiring or constructing an asset:

- Preliminary Stage - the period during which the acquisition or construction of specific PP&E is being evaluated. Feasibility studies often occur during this stage. At this stage the project is not yet approved by Management and all costs are expensed as incurred. The only capitalizable costs are payments to obtain an option to purchase PP&E.

- Preacquisition Stage - the acquisition or construction of specific PP&E is deemed probable at this time, so appropriate costs can be capitalized. Only those costs that are directly identifiable to the asset are capitalized. Activities often include zoning, surveying, and engineering studies.

Directly identifiable costs include:

- incremental direct costs incurred in transactions with a third party often include an element of the third party's administrative overhead. That element is considered to be an incremental direct cost and should be capitalized.
- labor and burden costs related to time spent on specified activities performed by the entity during this stage.
- depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during this stage.
- inventory (including spare parts) used directly in the construction or installation of PP&E.
- payment to obtain an option to acquire PP&E.

NOTE: Costs that are capitalized during the preliminary and preacquisition stages will be added to the basis of the asset acquired or constructed. If the likelihood no longer exists that the asset will be acquired or constructed, capitalized costs should be reduced to the lower of cost or fair value less cost to sell.

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(Note: Text in italics indicates a key SOX control.)

- Acquisition or Construction Stage - the acquisition or construction activities occur that are necessary to get the PP&E ready for its intended use. This is the stage when the business entity acquires ownership of the assets or rights to the assets. It continues until the asset is acquired or until completion of all major construction and installation activities. If the asset is constructed in phases, it can be divided into multiple projects as long as the phases can be operated independently from the projects that are incomplete. Capitalized interest, if applicable, begins during this stage (see AFUDC Policy and Procedures). Costs directly identifiable related to the asset during this stage can be capitalized. Examples are listed below:

    - labor and burden costs related to time spent on specified activities performed by the entity during this stage.
    - depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during this stage.
    - inventory (including spare parts) used directly in the construction or installation of PP&E.
    - payment to obtain an option to acquire PP&E.
    - incremental direct costs incurred in transactions with a third party often include an element of the third party's administrative overhead. That element is considered to be an incremental direct cost and should be capitalized.
    - for real estate, costs incurred for property taxes, insurance and ground rentals are capitalizable during the time that activities are necessary to get the asset ready for its intended use are in progress. The cost of demolition that occurs with the acquisition of real estate is capitalized during a reasonable period of time thereafter.

- In-Service Stage - PP&E is substantially complete and ready for its intended use. Capitalized interest, if any, ceases (see AFUDC Policy and Procedures) and depreciation commences at this stage. Costs that are incurred during this stage can be as follows:

    - repair and maintenance - expensed as incurred.
    - replacement of existing components of PP&E - capitalized under the guidelines of the FERC Uniform System of accounts.
    - additional components to PP&E- follow the capitalization criteria set forth in the first three stages within this policy.

  NOTE: Major maintenance activities may include costs related to replacements of PP&E and should be capitalized (when incurred and not accrued) according to the FERC Uniform System of Accounts. Additions to PP&E should follow the capitalization criteria

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set forth in first three stages within this policy. All other maintenance costs should be expensed as incurred.

Refer to Appendix A – Summary of Accounting, for more details on accounting for specific types of costs.

LKE and its subsidiaries have historically applied the standards of the Federal Energy Regulatory Commission ("FERC") and other regulators in their accounting practices when making capital versus expense determinations. It has been LKE's practice is to capitalize the following:

- Direct costs related to asset construction – costs directly charged such as labor, purchased material, contractors and inventory.

- Burden Cost Component – cost that can NOT be directly charged. Examples of burdens include pensions, insurance, payroll taxes and other labor related costs.

- A portion of indirect overheads directly attributable to capital activities –including Administrative and General Expense-Transferred ("A&G") and Engineering, Warehouse and Transportation Overheads. A&G is an allocation from Operation and Maintenance to Capital which allocates labor and expenses of employees that support the capital process but do not work directly on a particular capital project. These costs can be capitalized per the Code of Federal Regulations and have been deemed recoverable in rates by the various regulating entities.

According to the Capital and Investment Review Policy guidelines, projects with a total cost of $5,000 or less will be expensed, and any Authorization for Investment Proposal ("AIP") that is received for $5,000 or less is returned to the Project Manager with an explanation. All other capital expenditures are subject to mandatory capitalization. All fixed assets are recorded at cost as mandated by the FERC. When the requestor completes preparation of the AIP for capital expenditures in PowerPlan, appropriate authority must be achieved based on the Authority Limits Matrix. The preparer sends the *electronic AIP for approval via PowerPlan (SOX Cycle 40.01, CA#1).* At the point the AIP is received by Property Accounting for approval, the Accounting Analyst reviews the AIP for appropriate budget funding, approvals, and whether the described expenditure is indeed a capital expenditure. If the AIP passes review, the Accounting Analyst approves the project in PowerPlan. Should the AIP not pass review, the Accounting Analyst has the option to request additional information or reject the AIP. If the AIP is rejected the approval process starts all over.

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To ensure timely capitalization and retirement of projects, a report, referred to as the *90-Day Report (SOX Cycle 40.01, CA#3)*, is generated on a quarterly basis identifying capital and cost of removal projects which are in "open" status but having no activity for 90 days or more. This report is sent to every line of business Budget Coordinator with a request to update the project with either in-service or completion dates or verify that the project is still active. If the project is complete, the Property Accounting Department will capitalize it or process a retirement in a timely matter.

Monthly, a report called the "Job Log" is generated (SOX Cycle 40.01, CA#4) identifying all capital projects, which are in "completed" or "closed" status with no activity for 90 days or more. The purpose of this report is to identify projects eligible for capitalization/retirement. The report is saved on the Property Accounting Department shared drive (propacct on 'fs2':\ POWER PLANT CLASSIFICATION\Job Logs\Current Year Job Logs\Current Month Year\ Job Log).

During the accounting period, Accounting Analysts select projects from the Job Log for capitalization/retirement. The Accounting Analyst uses the *Work Order Analysis Checklist (SOX Cycle 40.01, CA#6)* posted on the Property Accounting Department's shared drive (propacct on 'fs2':\POWER PLANT CLASSIFICATION\Work Order Analysis Checklist) to aid in the capitalization and retirement process. This checklist ensures that fixed asset records are processed consistently by all Accounting Analysts or Associates, reducing the risk of misstatement of fixed assets in the financial statements. The capitalization process includes the following:

- Review Authorization for Investment Proposal ("AIP").
- Reconcile capital and cost of removal expenditure charges to the AIP to ensure that all expenditures have been properly authorized. If the variance compared to the original AIP is 10% or $100,000 over; (whichever is less, subject to a minimum of $25,000), a revised AIP must be completed as soon as possible.
- Review all project charges to ensure that all charges should be properly capitalized or classified as cost of removal.
- Reconcile units of property listed on the AIP to what has been charged to the project.

Transaction processing is accomplished in PowerPlan with a combination of manual and automated processes as documented in the PowerPlan User Guides maintained in PowerPlan. The Accounting Analyst or Associate creates manual as-builts in PowerPlan for all non-mass property. Mass property such as utility poles, crossarms etc., is unitized through an automated as-built process. In both processes, costs charged to capital projects are distributed automatically by the system based on units of property established by the Accounting Analyst or Associate in the case of manual as-builts, and those established from inventory transactions in the case of automated as-builts. The Accounting Analyst or Associate again verifies the segmentation is correct and assigns the asset to a segmented plant account pursuant to FERC regulations.

The retirement process includes the following:

- Review AIP and the associated retirement/salvage information to determine if a retirement is listed or should be listed based on a description of the project (i.e., if a project addition is to replace an asset a retirement should be listed). The Accounting Analyst or Associate will question the responsible Budget Analyst if retirements are not listed where it appears they should be.
- Review all project removal charges in the Cost Repository Report – Actual Cost ("RWIP").

Manual retirements are those related to a one time retirement event. Assets are selected for retirement through the "CPR Retire" function. Costs charged to retirement projects are distributed automatically by the system based on units of property, established by the Accounting Analyst or Associate in the case of manual as-builts and those established from inventory transactions in the case of automated as-builts.

Blanket retirements are those related to ongoing projects which are processed periodically. These retirements are created automatically in PowerPlan based on actual charges that occur on the project.

In order to insure that potential large dollar retirements are properly recorded in the financial records, it may be necessary to record a "preliminary retirement." A preliminary retirement is defined as an "estimated asset cost retired at the time the replacement asset is put into service." A preliminary retirement is entered into PowerPlan when an asset has been placed into service but is not yet eligible for final unitization due to timing issues, etc. The following guidelines are used to determine whether a preliminary retirement is necessary:

- The project is in In-Service Status /or Completed Status – but not yet unitized; and
- The new asset replacement cost must be equal to or greater than $500,000

Preliminary retirements will be identified for projects which meet the above guidelines. Preliminary retirements where the total estimated asset costs by project to be retired are equal to or less than $100,000 will not be recorded as the resulting reduction in depreciation expense is considered to be immaterial. Preliminary retirements will be processed during the 'mid' month (February, May, August and November) of each quarter. Once a project is unitized, all related retirements, including those less than or equal to $100,000 are recorded in the system.

In order to minimize record keeping requirements, equipment in certain General Plant accounts are amortized (office furniture and equipment, stores equipment, tools, shop equipment, garage equipment and laboratory equipment). These assets are retired when the assets become fully depreciated based on their in-service date and depreciable lives. For equipment in these accounts, AIP reporting for retirements is not necessary.

For both additions and retirements, PowerPlan validation rules prevent the Accounting Analyst or Associate from choosing invalid units of property, plant accounts and business segment combinations in order to prevent incorrect data from being entered. An error message is generated in the event of an invalid combination and the Analyst must correct the error before proceeding. In addition, mandatory input fields are required including in service dates, tax districts, locations, units of property, etc. PowerPlan does not allow the posting of assets with incomplete data fields.

After the Accounting Analyst or Associate creates the assets in PowerPlan, and before the transaction is posted, the work is reviewed (SOX Cycle 40.01, CA#5) as a final check to ensure additions and retirements are compliant with the various accounting rules (FERC, Company guidelines, etc.) by another Accounting Analyst. After the review and approval process is completed, relevant data including project number, amount added or retired, cost of removal, salvage amount, and the Accounting Analyst's or Associate's initials are entered into the PowerPlan Classification Spreadsheet maintained on the Property Accounting shared drive (propacct on 'fs2':\POWER PLANT CLASSIFICATION\Current Year Class\ASBUILTS-INPUT-MONTH YEAR). The spreadsheet calculates a control total of all additions, retirements, removal and salvage costs entered by Accounting Analysts or Associates during the month. The as-built folder is then passed to an Accounting Analyst responsible for the monthly system closing process for posting.

The Accounting Analyst responsible for the closing process begins the process by sending an email to all Property Accounting personnel toward the end of the accounting period informing them of the last day to unitize assets for the current period. The Accounting Analyst then runs the PowerPlan processes to post all acquisitions for assets and retirements. To verify the accuracy and completeness of the data, monthly the Accounting Analyst reconciles all addition and retirement postings in the general ledger to control totals in the PowerPlan Classification Spreadsheet (I:\POWER PLANT CLASSIFICATION\Current Year Class\ASBUILTS-INPUT-MONTH YEAR). Discrepancies are investigated and cleared as discovered. Once all totals are reconciled, the Accounting Analyst runs the depreciation calculations. PowerPlan automatically generates entries for gains and losses on non-mass property which are then checked for correctness by the Accounting Analyst. The monthly reconciliation and closing process is then completed. Procedures are documented in the "Property Accounting Monthly Closing Procedures". These procedures are maintained by the Accounting Analyst to ensure accurate monthly financial closing. The Accounting Analyst maintains all supporting documentation in binders stored in the Property Accounting Department. During the closing process, the Accounting Analyst uses a *closing checklist (SOX Cycle 40.01, CA#7)* saved on the Property

650 - Capital - Additions and Retirements Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Accounting Shared Drive (propacct on ‘fs2’:\Closing\Closing Reports\PP Closing Checklist) to ensure that all steps are completed.

Reports Generated and Recipients:

- 90-Day Report sent to the Budget Coordinators
- Job Log report accessible to Property Accounting on the fs2:\\propacct shared drive
- Plant Additions and Retirement Report – PowerPlant Classification Spreadsheet accessible to Property Accounting on the fs2:\\propacct shared drive
- Cost Repository Report – Actual Cost (RWIP) accessible to Property Accounting in PowerPlan

Additional Controls or Responsibility Provided by Other Procedures:

- General ledger debits and credits for Account 101 Plant in Service should tie to the additions and retirements.
- Budget Coordinators, Financial Planning personnel and Accounting Analysts review AIPs to confirm assets are to be capitalized.

Regulatory Requirements:

- FERC Accounting Guidelines

Reference:

- Code of Federal Regulations 18 Part 101 Electric Plant Instructions
- Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 360 – Property, Plant and Equipment
- FASB ASC Topic 720 – Other Expenses
- FASB ASC Topic 970 – Real Estate
- FASB ASC Topic 980 – Regulated Operations

Corresponding PPL Policy No. and Name:

- 602 – Accounting Guidelines for Capitalizing Costs for the Acquisition or Construction of Property, Plant and Equipment
- 612 – Accounting for Capital Office Furniture, Tool, and Equipment
- 616 – Accounting for Leaseholds and Improvements

650 - Capital - Additions and Retirements Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Key Contact:
Manager, Property Accounting

Administrative Responsibility:
Director, Accounting and Regulatory Reporting

Date Created: 11/24/04
Dates Revised: 10/1/08; 6/15/10; 12/01/10; 3/31/11; 10/07/11; 3/02/16; 06/15/16; 06/06/17; 11/03/17, 9/7/18

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(Note: Text in italics indicates a key SOX control.)

Appendix A- Summary of Accounting

Type of Work	Capital	Expense	Deferred Charges	Comments
Preliminary Stage (pre-probable)				
Internal/external costs of developers working to facilitate project negotiation and start up		X		
Internal/external legal fees to draft letters of intent and purchase agreements		X		
Travel expenses of internal/external developers and other company personnel to conduct negotiations with other parties and review project		X		
Salaries/consultant fees to review or develop models of projected cash flows/operations		X		
Payment to obtain an option to acquire PP&E	X			
Preacquisition Stage (Project is deemed probable) & Construction Stage				
Payment to acquire a site permit and license when directly identifiable to the property	X			**A**
Internal/external legal fees for Operational/Commercial contracts	X			**B**
Internal/external legal fees for litigation proceedings related to PP&E	X			**B**
Internal/external legal fees for condemnations proceedings, including court and counsel costs for land and land rights	X			
Internal/external legal fees for environmental activities directly related to PP&E	X			**C**
Internal/external fees for incorporation related to a regulated entity	X			
Salaries of developers, legal counsel and other Company personnel working to facilitate obtaining a	X			**D**

650 - Capital - Additions and Retirements Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Type of Work	Capital	Expense	Deferred Charges	Comments
site permit and license when directly identifiable to the activity				
Internal salaries to negotiate and secure specific project financing		X		
Payment to obtain an option to acquire PP&E	X			
External fees to negotiate and secure project financing			X	
Incremental direct costs with independent third parties for specific PP&E	X			
External consulting fees such as architectural and engineering studies	X			
Real estate legal and title fees	X			
Real estate surveying fees, appraisal, negotiation fees, site preparation, and damage payments (e.g. crops)	X			**E**
Directly related employee salary and benefit costs	X			
Environmental compliance and due diligence in areas directly related to PP&E	X			**F**
Building demolition costs	X			**G**
Internal direct costs of constructing the asset, including labor	X			
Depreciation and incremental costs of directly related equipment	X			
Internal costs to develop software at site (subject to Policy 655 – Hardware and Software Capitalization Policy)	X			
Costs of materials to build the plant, including acquisition of inventory and contract labor	X			
Costs reduced for liquidating damages	X			**H**
Inventory (including spare parts) used directly in acquisition or construction of PP&E	X			

650 - Capital - Additions and Retirements Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Type of Work	Capital	Expense	Deferred Charges	Comments
Incremental costs associated with field office maintained during construction	X			
Costs to identify and hire operating and administrative personnel on-site		X		
Internal/external costs to conduct training, including training on internally developed or acquired software		X		
Interest expense incurred on debt incurred to finance acquisition (subject to limitations)	X			
Property taxes and insurance (subject to Policy 656 – Capitalized Property Taxes Policy)	X			**I**
Post Construction/Pre-operation				
Costs to test plant	X			**J**
Synchronization of plant to grid	X			**K**
O&M contractor costs		X		
Administrative costs such as rent, utilities, etc.		X		

Comments:

A. Capitalize only if all conditions are met: costs are directly identifiable to the specific property, costs would be capitalized if the property were acquired, and acquisition of the property is probable.
B. Capitalize only if directly identifiable to a capital project.
C. Examples of activities include licensing, air and water permitting, site acquisitions, and all other studies required by regulatory and environmental agencies as a pre-condition to permit issuance.
D. Limited to time spent on a specific permit/license. Not time exploring several possible sites; costs should not be significant.
E. Costs include professional fees of engineers, attorneys, appraisers, and financial advisors, etc.
F. Areas include hazardous material and waste management, pollution prevention, environmental permitting & impact analysis, and regulated licensing/renewals
G. Capitalize if the demolition is probable upon purchase and occurs within approximately one year after and classify as land.

650 - Capital - Additions and Retirements Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

H. Liquidating damages an entity receives because a third party did not deliver or complete construction by a contractual specified date.
I. Costs incurred for property taxes associated with real estate and insurance shall be capitalized as property cost only during periods in which activities necessary to get the property ready for its intended use are in progress.
J. Credit test power revenues against capital cost. Need to distinguish true testing from startup activities. Startup losses should be expensed.
K. Extensive connection delays or rework expenses must be expensed. Need to distinguish from startup activities. Startup losses should be expensed.

NOTE: Examples above are <u>not</u> an exhaustive list of all expenditures that may be capitalized. Contact Property Accounting with any questions.

651 – Capital - Allowance for Funds Used During Construction ("AFUDC") Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: AFUDC is a calculated allowance for Kentucky Utilities Company ("KU") representing the opportunity cost of having funds tied up in major construction projects.

Procedure: The procedures for calculating AFUDC are described below.

Scope: AFUDC is calculated for KU projects only. By order of the Federal Energy Regulatory Commission ("FERC"), KU calculates and applies AFUDC to generation[1] assets used to serve the municipal utilities in KU's territory. Because the Company earns a return on Construction Work in Progress ("CWIP") in Kentucky and Virginia, AFUDC does not apply to those jurisdictions.

A project must be a generation project and meet two criteria to be eligible for AFUDC accrual:
1. Estimated investment costs must be greater than $100,000. Note: This limit is based on the gross investment amount, regardless of the amount of cash contribution to be received by a project.
2. Actual construction time must be at least three consecutive months in duration. Construction time is measured in actual labor construction time and should not include engineering/design time. (Construction time may be measured by contract or Company labor, or outside services if those labor dollars represent actual construction).

The forgoing criteria process regarding investment dollars and construction duration has been the past practice of KU for many years and has been accepted by the FERC as an appropriate methodology.

Objective of Procedure: To calculate the AFUDC capitalized.

General Requirements:

Annually:
In January, the estimated AFUDC rate is calculated using previous year-end financial information and forecasted CWIP and borrowings. All financial information used must be on a regulatory basis, no purchase accounting amounts are included. Per Docket No. FA11-7-000, Audit of PNM Resources, Inc. and Public Service Company of New Mexico, the common equity

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[1]Generation: Effective July 1, 2014, AFUDC is calculated on 100% of eligible generation assets. Previously, only 50% of non-environmental projects were eligible for AFUDC from the inception of formula rates in 2009.
Transmission: KU recorded AFUDC on eligible transmission projects prior to January 1, 2015. KU discontinued recording AFUDC on transmission projects at that time as transmission assets are now considered a retail asset recoverable from Kentucky and Virginia retail customers. Revenues from parties that use the transmission system are credited to retail customers in rate cases.

651 – Capital - Allowance for Funds Used During Construction ("AFUDC") Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

balance used for the rate calculation must not include Account 219, Accumulated Other Comprehensive Income. The long term debt balance must be the actual prior year-end balance and should not be adjusted for any un-amortized expense, loss on reacquired debt, premium or discount. The FERC jurisdictional rate is provided annually to Property Accounting by a Rate Analyst from the State Regulation and Rates Department. The FERC jurisdictional rate is based on the most current KU annual jurisdictional study.

The annual rate is calculated using the formula in the table below. The rates are then updated in PowerPlant by an Accounting Analyst in the Property Accounting Department. The annual rate stays in effect until December, when adjustments to the annual rate are possible. See the "Rates Calculation Updates" section below for details. A sample calculation is shown below.

For purposes of illustration the following calculation for the annual rate used in 2015 is presented:

	As of 12/31/2014
S - Avg. Short Term Debt	212,627,833.33
s - Short Term Debt Interest Rate	0.635%
D - Long Term Debt	2,062,562,589.26
d- Long Term Debt Interest Rate	3.751%
P - Preferred Stock	0.00
p - Preferred Stock Cost Rate	0.00%
C - Common Equity	2,600,662,950.54
c - Common Equity Cost Rate	10.00%
W - Avg CWIP Balance	611,735,000.00

Ai = Gross allowance for borrowed funds used during construction rate.

$$Ai = s(S/W) + d\left(\frac{D}{D+P+C}\right)(1 - S/W)$$

Ai = 0.01303130 (Use 1.30%)

Ae = Allowance for other funds used during construction rate.

$$Ae = [1 - S/W]\left[p\left(\frac{P}{D+P+C}\right) + c\left(\frac{C}{D+P+C}\right)\right]$$

Ae = 0.03638512 (Use 3.64%)

651 – Capital - Allowance for Funds Used During Construction ("AFUDC") Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Total Rate		FERC Jurisdictional Rate:	AFUDC Rate:
Ai =	1.30%	8.355%	**0.108615%**
Ae =	3.64%	8.355%	**0.304122%**
	4.94%	8.355%	0.412737%

Rates Calculation Updates:
During the December financial close, the annual rate calculation must be compared to a rate calculation which has been updated with actual monthly CWIP and short-term debt balances for the entire year. If there is at least a 0.25% variance between the rate calculated with actuals and the annual rate calculated at the beginning of the year then adjustments must be calculated and entered into PowerPlant by an Accounting Analyst in the Property Accounting Department. This comparison between the rate calculated with actuals and annual rate must be completed in order to be in compliance with Federal Power Commission Order No. 561, Order Adopting Amendment to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies. The Order states (on page 3): "We shall require, however, that public utilities and natural gas companies monitor their actual experience and adjust to actual at year-end if a significant deviation from the estimate should occur. For this purpose we shall consider a significant deviation to exist if the gross AFUDC rate exceeds by more than one-quarter of a percentage point (25 basis points) the rate that is derived from the formula by use of actual 13 monthly balances of construction work in progress and the actual weighted average cost and balances for short-term debt outstanding during the year." See Appendix A for a copy of the Order.

An Excel file is kept on the Property Accounting department shared network drive (fs2:\\propacct) with all AFUDC eligible projects. Eligibility is determined based on the criteria listed above. These projects are identified during Authorization for Investment Proposal review by Property Accounting Analysts. On a monthly basis, each project on the list is checked to see if construction has begun, or if it has been placed into service. A listing of these projects is sent monthly to the appropriate Budget Coordinator requesting this project specific info. If construction has commenced then the Property Accounting Analyst will activate the project in PowerPlant and AFUDC will be calculated. If a project has been classified as "in-service" then the AFUDC calculation ceases.

The calculation is as follows:

AFUDC rate * (CWIP balance of prior month plus ½ of current month) = AFUDC charge

651 – Capital - Allowance for Funds Used During Construction ("AFUDC") Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

The CWIP base illustrated in the above calculation should exclude all unpaid accruals, including contract retention, tax accruals, etc.[2]

During the monthly close process, an AFUDC Calculation report is generated by PowerPlant showing the AFUDC charges for the month, and is reviewed for reasonableness by the Accounting Analyst responsible for AFUDC accounting.

Reports Generated and Recipients:

- AFUDC Calculation Report as described in the previous paragraph, used by the Property Accounting Analyst

Additional Controls or Responsibility Provided by Other Procedures:

- Monthly Closing Checklist for PowerPlant

Regulatory Requirements:

- FERC Accounting Guidelines 18 CFR, Chapter 1, Subchapter C, Part 101, Electric Plant Instructions paragraph 4 A
- Federal Power Commission Order No. 561, Order Adopting Amendment to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies, 57 Federal Power Commission 608 (1977); and Order 561-A, order Clarifying orders, 2 FERC ¶ 61,050, (1978) (See Appendix A for a copy of the Orders.)
- Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 980 - Regulated Operations (formerly Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation)
- Docket No. FA11-7-000, Audit of PNM Resources, Inc. and Public Service Company of New Mexico,

Reference:

- Detailed AFUDC rate preparation procedures are kept on the Property Accounting shared network drive: fs2:\\propacct\AFUDC\Rates Estimate\Year\AFUDC-Year Estimate

[2] Guidance on unpaid item exclusions found in audit findings for Ruby Pipeline, LLC (Docket No. FA13-12-000), Panhandle Eastern Pipe Line Co, LP (Docket No. FA12-4-000), Gulfstream Natural Gas System, LLC (Docket No. FA11-10-00) and ETC Tiger Pipeline, LLC (Docket No. FA13-9-000)

651 – Capital - Allowance for Funds Used During Construction ("AFUDC") Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Generation.xls and AFUDC\Rates Estimate\Year\AFUDC-Year Estimate Transmission xls. The PowerPlant process is also documented under the AFUDC section of the PowerPlant System Closing Process.

- File memo on acctresticted--AFUDC Calculation Updates 11-23-2015.docx

Corresponding PPL Policy No. and Name:

605 – Accounting for AFUDC

Key Contact:

Manager, Property Accounting

Administrative Responsibility:

Director, Accounting & Regulatory Reporting

Date Created: 11/30/04
Dates Revised: 7/06/09; 12/01/10; 3/31/11; 8/27/12; 5/28/2015; 11/23/2015; 3/02/16

AMENDMENTS TO UNIFORM SYSTEM OF ACCOUNTS FOR PUBLIC UTILITIES AND LICENSEES AND FOR NATURAL GAS COMPANIES (CLASSES A, B, C AND D) TO PROVIDE FOR THE DETERMINATION OF RATE FOR COMPUTING THE ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION AND REVISIONS OF CERTAIN SCHEDULE PAGES OF FPC REPORTS, DOCKET NO. RM75-27

ORDER NO. 561

FEDERAL POWER COMMISSION

57 F.P.C. 608; 1977 FPC LEXIS 1165

February 2, 1977 *

* Published in the Federal Register on February 15, 1977 (42 F.R. 9161). Order issued April 1, 1977 granting application for rehearing for purpose of further consideration, unreported. Order No. 561-A issued August 1, 1977 denying application for rehearing and clarifying prior order, 59 FPC 1340 [Editor's note: Petition for review filed on September 28, 1977 *sub nom. Jersey Central Power & Light Co., et al.* v. *F.P.C.,* in CADC No. 77-1883.] Order issued January 20, 1978 clarifying Order Nos. 561 and 561-A, 2 FERC P .

[*1]

ORDER ADOPTING AMENDMENT TO UNIFORM SYSTEM OF ACCOUNTS FOR PUBLIC UTILITIES AND LICENSEES AND FOR NATURAL GAS COMPANIES

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith, John H. Holloman III and James G. Watt.

OPINION:

On May 20, 1975, the Commission issued a notice of proposed rulemaking in Docket No. RM75-27 *(40 F.R. 23322,* May 29, 1975). This rulemaking proposed to establish a uniform formulary method for determining the maximum rates to be used in computing the Allowance for Funds Used During Construction (AFUDC) and to provide accounting and reporting requirements for AFUDC which accord with the elements entering into the determination of AFUDC rates. The stated objective of the proposed rule was to establish a method which would give recognition to the interrelationship between capital utilized for rate case purposes and the capital components of AFUDC in a manner that would permit a utility to achieve a rate of return on its total utility operations, including its construction program, at approximately the rate which would be allowed in a rate case.

Comments were invited from interested parties on or before July 7, 1975. Due to requests, this date was extended to [*2] September 5, 1975. In response to the proposed rulemaking, the Commission received comments from 79 respondents (Attachment A). In general, the reaction to the proposed rulemaking was favorable as to its overall objective, but many respondents questioned the ability of the proposal to meet such objective and made suggestions for improvement.

Many respondents objected to the weight given short-term debt in the proposed rule and suggested a number of alternatives. These respondents argued that short-term debt is not necessarily the first source of construction funds, as would be indicated by application of he proposed formula, and should be ignored or given less weight. We are not convinced, however, that we should modify the proposed formula with respect to short-term debt. It is generally impossible to specifically trace the source of funds used for various corporate purposes and it was not the purpose of our proposed rule to do so. Instead, we proposed a rule that would give a utility an opportunity to be compensated for the total cost of capital devoted to utility operations, including its construction program. In order to accomplish this, it is necessary to look to how [*3] the cost of capital is handled in a rate proceeding so that a method for determining

AFUDC can be devised that will not result in double counting of the same capital cost or will not omit important categories of capital cost. Typically, short-term debt has not been included in rate of return computations for cost of service purposes on the grounds that such debt is temporary and is used essentially for construction purposes; however, the cost of such debt represents a valid and necessary expenditure for conducting utility operations which ultimately must be recovered through rates. By adopting the approach of permitting the capitalization of short-term debt cost through AFUDC, we provide such a mechanism. It should be understood that this method is for the purpose of establishing a rate for AFUDC and not for establishing a method for allocating short-term interest cost for the purpose of a rate proceeding.

Many respondents also questioned the use of embedded cost rates for long-term debt and preferred stock in the proposed AFUDC formula and suggested incremental cost rates be used instead. For essentially the same reasons that we believe the proposed handling of short-term debt [*4] should not be modified, we are rejecting this suggestion. If incremental cost rates were utilized for these categories of capital cost in the AFUDC formula, there would be a double counting for the same costs. Embedded cost rates are normally used for rate of return purposes and such cost rates include the cost of new as well as old issues of long-term debt and preferred stock. Therefore, the composite return on rate base collected through rates provides for the proportionate recovery of new or incremental capital costs in the ratio of rate base to the size of the capital structure used for rate of return purposes. If we assume for the sake of argument that the sum of a utility's permanent capital structure plus short-term borrowing is equal to the sum of its rate base plus construction work in progress balances, it is obvious that the use of incremental cost for AFUDC purposes and embedded cost for rate of return purposes would result in double counting of the same costs. Although the above illustration somewhat oversimplifies the issue, we believe that the principle is adequately demonstrated.

The other basic component for AFUDC relates to common equity funds. Comments by [*5] respondents on this subject primarily related to how the reasonable cost rate for common equity funds should be determined. Unlike debt costs or the cost of preferred stock, which can be objectively determined by analysis of actual contractual obligations and expenditures, the cost of common equity is not ordinarily related to contractual requirements. In the proposed rule we indicated that the cost rate to be used for common equity would be the rate granted common equity in the last rate proceeding before the body having primary rate jurisdiction or, if such rate is not available, the average rate actually earned during the preceding 3 years should be used. We recognize, based on the comments received, that this approach may require some modification in situations where ratemaking bodies use other than an "original cost" rate base or where utilities are subject to multiple rate jurisdiction. However, in developing a general rule relating to AFUDC, we find any possible inequities of this nature can best be handled on an individual company basis.

Having considered the broad issues of the various components of the AFUDC, it is now necessary to focus on the many constructive and [*6] helpful comments and suggestions received relating to other facets of the proposed rulemaking.

Many comments were received regarding the desirability of segregating AFUDC into two components, borrowed funds and other funds, and the relocation of the allowance for borrowed funds to the Interest Charges Section of the income statement. The main objection to this proposed requirement was that it would have the effect of reducing interest coverages and thereby restrict the issuances of additional debt by some companies. We recognized that this may be a particularly uninviting aspect of the proposed rule for some utilities since "Other Income" will be reduced upon application of the proposed rule and such income is frequently, in whole or part, used for interest coverage tests. n1 However, we believe this change to be necessary in order to better inform readers of the financial statements of utilities as to the nature and level of the capitalized allowance for borrowed funds. Since there is little conceptual difference between capitalization of the cost of borrowed funds used for construction purposes and other costs of construction such as labor and materials, we believe that the [*7] readers of financial statements will be better informed if such construction interest is shown as an allocation of cost by a reduction in the Interest Charges Section of the income statement rather than as an income item.

n1 We also recognize that interest coverages for some utilities may be increased if in their coverage computations they use net interest charges since this amount will be reduced upon application of the proposed rule.

A number of respondents criticized the proposal to determine the current year's AFUDC rates by the use of average actual book balances and cost rates of the prior year principally because short-term debt cost rates and balances are very volatile and the use of averages for a previous year does not give a proper indication of the cost of short-term debt for prospective computations of AFUDC. We agree that this is a valid point and believe that modifications of the proposed rule in this are are necessary.

We are modifying the proposed rule to provide that the balances of long-term debt, preferred stock, and common equity for use in the formula for the current year will be the balances in such accounts at the end of the prior year; the cost rates [*8] for long-term debt and preferred stock will be the effective weighted average cost of such capital. The average short-term debt balances and relatec cost and the average construction work in progress balance will be estimated for the current year. We shall require, however, that public utilities and natural gas companies monitor their actual experience and adjust to actual at year-end if a significant deviation from he estimate should occur. For this purpose we shall consider a significant deviation to exist if the gross AFUDC rate exceeds by more than one-quarter of a percentage point (25 basis points) the rate that is derived from the formula by use of actual 13 monthly balances of construction work in progress and the actual weighted average cost and balances for short-term debt outstanding during the year.

.25 change

Many respondents requested clarification as to whether premiums, discounts and expenses related to long-term debt, and compensating balances and commitment fees related to short-term debt, were to be considered when determining the cost rate for such funds. With respect to long-term debt, the cost of such capital should be the yield to maturity determined in the same manner [*9] as set forth in § 35.13(b)(4)(iii), Statement G -- Rate of Return, of the Commission's Regulations under the Federal Power Act and § 154.63(f), Statement F(3) -- Debt Capital, of the Commission's Regulations under the Natural Gas Act which gives appropriate recognition to premiums, discounts and expenses related to long-term debt. In regard to short-term debt, several respondents have pointed out that compensating balances and commitment fees have cost implications with respect to bank loans and as support for commercial paper and urged that recognition be given for such costs. We agree that in some instances, such items could properly be considered in determining the effective cost rate for short-term debt for use in the formula. However, primarily because of measurement problems, we do not believe that specific recognition should be given in the general rule. Instead, where an individual company has a written agreement and can support the fact that compensating balances and commitment fees are necessary in order to obtain favorable short-term financing and are not considered in its rate proceedings, we will permit an adjustment to the nominal short-term interest rates to reflect [*10] this additional cost. We believe that this approach is necessary because of the diversity of rate treatment for these items; the commingling and lack of identification of bank balances kept for normal operating purposes and those used for compensating bank balance purposes; and the frequent lack of formal agreements for required levels of compensating bank balances.

Some respondents commented that the value of noninvestor sources of funds such as accumulated deferred income taxes and contributions in aid of construction should be recognized in the formula. We are not adopting this suggestion since normally the entire balances in the accumulated deferred income taxes accounts are used to reduce rate base for cost of service purposes. n2 To include such balances in determining the AFUDC rate would result in double counting of the same dollars. The same reasons apply for contributions in aid of construction, since under our Uniform System of Accounts such contributions are credited directly to construction costs.

n2 There is one category of accumulated deferred taxes which is not used to reduce rate base. Under our ratemaking practices the balances of Account 281, Accumulated deferred income taxes-Accelerated amortization, are included in the capitalization used for rate of return purposes at zero cost. The balances in these accounts, however, are relatively small and the effect on the AFUDC rate if taken into consideration would be negligible.

[*11]

A number of respondents commented that previously capitalized AFUDC should be included in the cost base to which the AFUDC rate applies since AFUDC is a cost of construction similar to labor, materials and other elements of construction. Thus, it is asserted that the compound method must be recognized if AFUDC is to properly compensate the utility for use of funds while devoted to construction. We agree that compounding of AFUDC is proper in theory and necessary as a matter of sound cost determination; however, we believe that a monthly compounding of AFUDC as suggested by some respondents may result in excessive amounts capitalized since cash outlays for interest and dividends are not normally made on a monthly basis. We shall therefore permit compounding but no more frequently than semiannually.

semi annual compounding

A number of respondents also indicated that any rules issued with respect to AFUDC should apply to Nuclear Fuel in Process of Refinement, Conversion, Enrichment and Fabrication (Account 120.1) in the same manner as Construction Work in Progress. We agree with these comments and will so provide.

Certain other constructive suggestions received from respondents have been included in [*12] the accounting instructions for the purpose of adding clarity to the accounting text.

We have also deleted that portion of the proposed plant instructions pertaining to computations of income taxes. We believe that these proposed instructions are not now necessary in view of our *Order Nos. 530 (53 FPC 2123), 530-A (55 FPC 162) and 530-B (56 FPC 739)* in Docket Nos. R-424, Accounting for Premiums, Discount and Expense of Issue, Gains and Losses on Refunding and Reaquisition of Long-Term Debt, and Interperiod Allocation of Income Taxes and R-446, Amendments to the Uniform System of Accounts for Classes A, B and C Public Utilities and Licensees and Natural Gas Companies: Deferred Income Taxes. As stated in Order No. 530-A:

The accounting for deferred income taxes prescribed in Order No. 530 was structured to accommodate utilities under the rate jurisdiction of the various state regulatory bodies that may or may not authorize deferred tax accounting for rate purposes (See General Instruction 18). If a net of tax allowance for funds rate is prescribed by a regulatory body in setting the rate levels of utilities, we consider that such treatment is consistent with the intent of Order [*13] No. 530 and it is not necessary for utilities to set aside deferred income taxes related to the interest component of the allowance for funds rate. In light of this, we do not believe that it is necessary to make provision in the Uniform System of Accounts to cover this matter.

The Commission finds:

(1) The notice and opportunity to participate in this rulemaking proceeding with respect to the matters presently before this Commission through the submission, in writing, of data, views, comments and suggestions in the manner described above, are consistent and in accordance with the procedural requirements prescribed by *5 U.S.C. 553.*

(2) The amendments to Parts 101 and 104 of the Commission's Uniform System of Accounts for Public Utilities and Licensees and to FPC Forms No. 1, No. 1-F, and No. 5 required by § 141.1, 141.2, and 141.25 in Chapter I, Title 18 of the Code of Federal Regulations, herein prescribed, are necessary and appropriate for the administration of the Federal Power Act.

(3) The amendments to Parts 201 and 204 of the Commission's Uniform System of Accounts for Natural Gas Companies, and to FPC Forms No. 2, No. 2-A, and No. 11 required by § 260.1, 260.2, [*14] and 260.3 in Chapter I, Title 18 of the Code of Federal Regulations, herein prescribed, are necessary and appropriate for the administration of the Natural Gas Act.

(4) Since the amendments prescribed herein, which were not included in the notice of the proceeding, are consistent with the prime purpose of the Proposed Rulemaking, further notice thereof is unnecessary.

(5) Good cause exists for making the amendments to the Uniform System of Accounts for Public Utilities and Licensees and Natural Gas Companies ordered herein effective on January 1, 1977, and the amendments to FPC Forms No. 1, No. 1-F, No. 2, No. 2-F, No. 5, and No. 11 ordered herein, effective for the reporting year 1977.

The Commission, acting pursuant to the provisions of the Federal Power Act, as amended, particularly Sections 3, 4, 301, 304, 308, 309, and 311 (41 Stat. 1063, 1065; 49 Stat. 838, 839, 854, 855, 858, 859; *16 U.S.C. 796,* 797, 825, 825c, 825g, 825h, 825j) and of the Natural Gas Act, as amended, particularly Sections 8, 10, and 16 (52 Stat. 825, 826, 830; *15 U.S.C. 717g,* 717i, 717o), *orders:*

(A) Effective January 1, 1977, the Commission's Uniform System of Accounts for Class A and Class [*15] B Public Utilities and Licensees in Part 101, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

(1) The General Instructions are amended by revising paragraph "I" of Instruction "17. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition."* As amended, this portion of General Instruction 17 reads:

GENERAL INSTRUCTIONS

* * *

17. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*

* * *

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 432, Allowance for Borrowed Funds Used During Construction-Credit.

* * *

(2) Subparagraph "(17) Allowance for Funds Used During Construction" of Electric Plant Instruction "3. *Components of Construction Cost.*" is amended by revising the first sentence of the paragraph and by adding two new paragraphs (a) and (b) immediately following the first paragraph. As amended, subparagraph (17) reads:

ELECTRIC PLANT INSTRUCTIONS

* * *

3. *Components of Construction Cost.*

* * *

(17) "Allowance for funds [*16] used during construction" includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed, without prior approval of the Commission, allowances computed in accordance with the formula prescribed in paragraph (a) below. No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction projects which have been abandoned.

(a) The formula and elements for the computation of the allowance for funds used during construction shall be:

$Ai = s(S / W) + d(D / D + P + C) (1 - S / W)$

$Ae = [1 - S / W] [p P / D + P + C) + c (C / D + P + C)]$

Ai = Gross allowance for borrowed funds used during construction rate

Ae = Allowance for other funds used during construction rate

S = Average short-term debt

s = Short-term debt interest rate

D = Long-term debt

d = Long-term debt interest rate

P = Preferred stock

p = Preferred stock cost rate

C = Common equity

c = Common equity cost rate

W = Average balance in construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment and fabrication.

(b) The [*17] rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in § 35.13 of the Commission's Regulations under the Federal Power Act. The cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdictions. If such cost rate is not available, the average rate actully earned during the preceding 3 years shall be used. The short-term debt balances and related cost and the average balance for construction work in progress plus nuclear fuel in process of refinerment, conversion, enrichment, and fabrication shall be estimated for the current year with appropriate adjustments as actual data becomes available.

NOTE: * * *

(3) The Chart of Income Accounts is amended by revising the title of account "419.1, Allowance for Funds Used During Construction," to read "419.1, Allowance for Other Funds Used During Construction;" by adding a new account 432, Allowance for Borrowed [*18] Funds Used During Construction-Credit, immediately following account "431, Other Interest Expense" and revising the sub-total caption "Total Interest Charges" to read "Net Interest Charges." As amended, the Chart of Income Accounts reads:

INCOME ACCOUNTS

(Chart of Accounts)

* * *

2. Other Income and Deductions

A. Other Income

* * *

419.1 Allowance for other funds used during construction.

* * *

3. Interest Charges

* * *

432 Allowance for borrowed funds used during construction-Credit. Net interest charges

* * *

(4) The text of the Income Accounts is amended by revising the title and text of account "419.1, Allowance for Funds Used During Construction," and by adding a new account 432, Allowance for Borrowed Funds Used During Construction-Credit, immediately following account "431, Other Interest Expense." As amended, these portions of the text of the Income Accounts reads:

INCOME ACCOUNTS

* * *

2. Other Income and Deductions

* * *

419.1 Allowance for other funds used during construction.

This account shall include concurrent credits for allowance for other funds used during construction, not to exceed amounts computed in accordance with the formula prescribed [*19] in Electric Plant Instruction 3(17).

* * *

3. Interest Charges

* * *

432 Allowance for borrowed funds used during construction-Credit.

This account shall include concurrent credits for allowance for borrowed funds used during construction, not to exceed amounts computed in accordance with the formula prescribed in Electric Plant Instruction 3(17).

* * *

(B) Effective January 1, 1977, the Commission's Uniform System of Accounts for Class C and Class D Public Utilities and Licensees in Part 104, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

(1) The General Instructions are amended by revising paragraph "I" of Instruction "15. *Long-term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*" As amended, this portion of General Instruction 15 reads:

GENERAL INSTRUCTIONS

* * *

15. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*

* * *

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 432, Allowance for Borrowed Funds Used During Construction-Credit. [*20]

* * *

(2) Electric Plant Instruction "2. Components of Construction Cost." is amended by revising the first paragraph and lettering it "A." and by adding two new paragraphs B. and C. immediately following the first paragraph. As amended, Instruction 2 reads:

ELECTRIC PLANT INSTRUCTIONS

* * *

2. *Components of Construction Cost.*

A. The cost of construction of property chargeable to the electric plant accounts shall include, where applicable, the cost of labor; materials and supplies; transportation; work done by others for the utility; injuries and damages incurred in construction work; privileges and permits; special machine service; allowance for funds used during construction, not to exceed without prior approval of the Commission amounts computed in accordance with the formula prescribed in paragraph B below; and such portion of general engineering, administrative salaries and expenses, insurance, taxes, and other analogous items as may be properly includible in construction costs.

B. The formula and elements for the computation of the allowance for funds used during construction shall be:

Ai = s(S / W) + d(D / D + P + C) (1 - S / W)

Ae = [1 - S / W] [p(P / D [*21] + P + C) + c(C / D + P + C)]

Ai = Gross allowance for borrowed funds used during construction rate

Ae = Allowance for other funds used during construction rate

S = Average short-term debt

s = Short-term debt interest rate

D = Long-term debt

d = Long-term debt interest rate

P = Preferred stock

p = Preferred stock cost rate

C = Common equity

c = Common equity cost rate

W = Average balance in construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment and fabrication

C. The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in § 35.13 of the Commission's Regulations under the Federal Power Act. The cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction. If such cost rate is not available, the average rate actually earned during the preceding 3 years shall be used. The short-term debt balances [*22] and related cost and the average balance for construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment, and fabrication shall be estimated for the current year with appropriate adjustments as actual data becomes available.

(3) The Chart of Income Accounts is amended by revising the title of account "419.1, Allowance for Funds Used During Construction," to read "419.1, Allowance for Other Funds Used During Construction" and by adding a new account 432, Allowance for Borrowed Funds Used During Construction -- Credit immediately following account "431, Other Interest Expense" and revising the subtotal caption "Total Interest Charges" to read "Net Interest Charges." As amended, the Chart of Income Accounts reads:

INCOME ACCOUNTS

(Chart of Accounts)

* * *

2. Other Income and Deductions

A. Other Income

* * *

419.1 Allowance for other funds used during construction.

* * *

3. Interest Charges

* * *

432 Allowance for borrowed funds used during construction - Credit.

Net interest charges

* * *

(4) The text of the Income Accounts is amended by revising the title and text of account "419.1, Allowance for Funds Used During Construction," [*23] and by adding a new acount 432, Allowance for Borrowed Funds Used During Construction -- Credit immediately following account "432, Other Interest Expense." As amended, these portions of the text of the Income Accounts reads:

INCOME ACCOUNTS

* * *

2. Other Income and Deductions

* * *

419.1 Allowance for other funds used during construction.

This account shall include concurrent credits for allowance for other funds used during construction, not to exceed amounts computed in accordance with the formula prescribed in Electric Plant Instruction 2. No allowance for funds used during construction shall be capitalized on plant which is completed and ready for service.

* * *

3. Interest Charges

432 Allowance for borrowed funds used during construction -- Credit.

This account shall include concurrent credits for allowance for borrowed funds used during construction, not to exceed amounts computed in accordance with the formula prescribed in Electric Plant Instruction 2. No allowance for funds used during construction shall be capitalized on plant which is completed and ready for service.

* * *

(C) Effective January 1, 1977, the Commission's Uniform System of Accounts for [*24] Class A and Class B Natural Gas Companies in Part 201, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

(1) The General Instructions are amended by revising paragraph "I" of Instruction "17. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*" As amended, this portion of General Instruction 17 reads:

GENERAL INSTRUCTIONS

* * *

17. *LONG-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*

* * *

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 432, Allowance for Borrowed Funds Used During Construction -- Credit.

* * *

(2) Subparagraph "(17) Allowance for Funds Used During Construction" of Gas Plant Instruction "3. *Components of Construction Cost.*" is amended by revising the present paragraph, and immediately following the present paragraph, adding two new paragraphs (a) and (b). As amended, subparagraph (17) reads:

GAS PLANT INSTRUCTIONS

* * *

3. *Components of Construction Cost.*

* * *

(17) "Allowance for funds used during [*25] construction" includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed without prior approval of the Commission allowances computed in accordance with the formula prescribed in paragraph (a) below, except when such other funds are used for exploration and development of leases acquired after October 7, 1969, no allowance on such other funds shall be included in these accounts. No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction projects which have been abandoned.

(a) The formula and elements for the computation of the allowance for funds used during construction shall be:

$Ai = s(S / W) + d(D / D + P + C) (1 - S / W)$

$Ae = [1 - S / W] [p(P / D + P + C) + c(C / D + P + C)]$

Ai = Gross allowance for borrowed funds used during construction rate

Ae = Allowance for other funds used during construction rate

S = Average short-term debt

s = Short-term debt interest rate

D = Long-term debt

d = Long-term debt interest rate

P = Preferred stock

p = Preferred stock cost rate

C = Common equity

c = Common [*26] equity cost rate

W = Average balance in construction work in progress

(b) The rates shall be determined annually. The balances for long-term debt, preferred stok and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in § 154.63 of the Commission's Regulations under the Natural Gas Act. Te cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction. If such cost rate is not available, the average rate actually earned during the proceding 3 years shall be used. He short-term debt balances and related cost and the average balance for construction work in progress shall be estimated for the current year with appropriate adjustments as actual data becomes available.

NOTE: * * *

(3) The Chart of Income Accounts is amended by revising the title of account "419.1, Allowance for Funds Used During Construction," to read "419.1, Allowance for Other Funds Used During Construction" and by adding a new account 432, Allowance for Borrowed [*27] Funds Used During Construction -- Credit, immediately following account "431, Other Interest Expense" and revising the sub-total caption "Total Interest Charges" to read "Net Interest Charges." As amended, the Chart of Income Accounts reads:

INCOME ACCOUNTS

(Chart of Accounts)

* * *

2. Other Income and Deductions

A. Other Income

* * *

419.1 Allowance for other funds used during construction.

3. Interest Charges

* * *

432 Allowance for borrowed funds used during construction -- Credit.

Net interest charges.

* * *

(4) The text of the Income Accounts is amended by revising the title and text of account "419.1, Allowance for Funds Used During Construction," and by adding a new account 432, Allowance for Borrowed Funds Used During Construction -- Credit, immediately following account "431, Other Interest Expense." As amended, these portions of the text of the Income Accounts read:

INCOME ACCOUNTS

* * *

2. Other Income and Deductions

* * *

419.1 Allowance for other funds used during construction.

This account shall include concurrent credits for allowance for other funds used during construction, not to exceed amounts computed in accordance with the formula prescribed [*28] in Gas Plant Instruction 3(17).

* * *

3. Interest Charges

* * *

432 Allowance for borrowed funds used during construction -- Credit.

This account shall include concurrent credits for allowance for borrowed funds used during construction, not to exceed amount computed in accordance with the formula prescribed in Gas Plant Instruction 3(17).

* * *

(D) Effective January 1, 1977, the Commission's Uniform System of Accounts for Class C and Class D Natural Gas Companies in Part 204, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

(1) The General Instructions are amended by revising paragraph "I" of Instruction "15. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*" As amended, this portion of General Instruction 15 reads:

GENERAL INSTRUCTIONS

* * *

15. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*

* * *

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 432, Allowance for Borrowed Funds Used During Construction -- Credit. [*29]

* * *

(2) Amend Gas Plant Instruction "2. *Components of Construction Cost.*" by revising the first paragraph and lettering it "A." and by adding two new paragraphs B. and C. immediately following the first paragraph. As amended, Instruction 2 reads:

GAS PLANT INSTRUCTIONS

* * *

2. *Components of Construction Cost.*

A. The cost of construction of property chargeable to the gas plant accounts shall include, where applicable, fees for construction certificate applications paid after grant of certificate, the cost of labor, materials and supplies, transportation, work done by others for the utility, injuries and damages incurred in construction, privileges and permits, special machine service, allowance for funds used during construction, not to exceed without prior approval of the Commission amounts computed in accordance with the formula prescribed in paragraph B below, training costs and such portion of general engineering, administrative salaries and expenses, insurance, taxes, and other analogous items as may be properly includible in construction costs. (See Operating Expense Instruction 3.) When the utility employs its own funds in exploration and development on [*30] leases acquired after October 7, 1969, no alloance for funds used during construction on such funds shall be included in these accounts.

B. The formula and elements for the computation of the allowance for funds used during construction shall be:

$Ai = s(S / W) + d(D / D + P + C) (1 - S / W)$

$Ae = [1 - S / W] [p (P / D + P + C) + c(C / D + P + C)]$

Ai = Gross allowance for borrowed funds used during construction rate

Ae = Allowance for other funds used during construction rate

S = Average short-term debt

s = Short-term debt interest rate

D = Long-term debt

d = Long-term debt interest rate

P = Preferred stock

p = Preferred stock cost rate

C = Common equity

c = Common equity cost rate

W = Average balance in construction work in progress

C. The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in § 154.63 of the Commission's Regulations under the Natural Gas Act. The cost rate for common equity shall be the rate granted common [*31] equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction. If such cost rate is not available, the average rate actually earned during the preceding 3 years shall be used. The short-term debt balances and related cost and the average balance for construction work in progress shall be estimated for the current year with appropriate adjustments as actual data becomes available.

(3) The Chart of Income Accounts is amended by revising the title of account "419.1, Allowance for Funds Used During Construction," to read "419.1, Allowance for Other Funds Used During Construction" and by adding a new account 432, Allowance for Borrowed Funds Used During Construction -- Credit, immediately following account "431, Other Interest Expense" and revising the sub-totoal caption "Total Interest Charges" to read "Net Interest Charges." As amended, the Court of Income Accounts reads:

INCOME ACCOUNTS

(Chart of Accounts)

* * *

2. Other Income and Deductions

A. Other Income

* * *

419.1 Allowance for other funds used during construction.

* *

3. Interest Charges

* * *

432 Allowance for borrowed funds used during construction -- Credit.

Net interest [*32] charges.

* * *

(4) The text of the Income Accounts is amended by revising the title and text of account "419.1, Allowance for Funds Used During Construction," and by adding a new account 432, Allowance for Borrowed Funds Used During Construction -- Credit, immediately following account "431, Other Interest Expense." As amended, these portions of the text of the Income Accounts read:

INCOME ACCOUNTS

* * *

2. Other Income and Deductions

* * *

419.1 Allowance for other funds used during construction.

This account shall include concurrent credits for allowance for other funds used during construction, not to exceed amounts computed in accordance with the formula prescribed in Gas Plant Instruction 2. No allowance for funds used during construction shall be capitalized on plant which is completed and ready for service.

* * *

3. Interest Charges

* * *

432 Allowance for borrowed funds used during construction -- Credit.

This account shall include concurrent credits for allowance for borrowed funds used during construction, not to exceed amounts computed in accordance with the formula prescribed in Gas Plant Instruction 2. No allowance for funds used during construction [*33] shall be capitalized on plant which is completed and ready for service.

* * *

(E) Effective for the reporting year 1977, certain schedule pages of FPC Form No. 1, Annual Report for Electric Utilities, Licensees and Others (Class A and Class B), prescribed by § 141.1, Chapter I, Title 18 of the Code of Federal Regulations are amended, all as set out in Attachments B n1 and C n2 hereto.

n1 Omitted in printing.

n2 Omitted in printing.

(F) Effective for the reporting year 1977, certain schedule pages of FPC Form No. 2, Annual Report for Natural Gas Companies (Class A and Class B), prescribed by § 260.1, Chapter I, Title 18 of the Code of Federal Regulations are amended, all as set out in Attachments B and D n3 hereto.

n3 Omitted in printing.

(G) Effective for the reporting year 1977, certain schedule pages of FPC Form No. 1-F, Annual Report for Public Utilities and Licensees (Class C and Class D), prescribed by § 141.2, Chapter I, Title 18 of the Code of Federal Regulations are amended, all as set out in Attachment E n4 hereto.

n4 Omitted in printing.

(H) Effective for the reporting year 1977, certain schedule pages of FPC Form No. 2-A, Annual Report for Natural [*34] Gas Companies (Class C and Class D), prescribed by § 260.2, Chapter I, Title 18 of the Code of Federal Regulations are amended, all as set out in Attachment C hereto.

(I) Effective for the reporting year 1977, certain schedule pages of FPC Form No. 5, Monthly Statement of Electric Operating Revenue and Income, prescribed by § 141.25, Chapter I, Title 18 of the Code of Federal Regulations is amended, all as set out in Attachment F n5 hereto.

n5 Omitted in printing.

(J) Effective for the reporting year 1977, certain schedule pages of FPC Form No. 11, Natural Gas Pipeline Company Monthly Statement, prescribed by § 260.3, Chapter I, Title 18 of the Code of Federal Regulations is amended, all as set out in Attachment G n6 hereto.

n6 Omitted in printing.

(K) The Secretary shall cause prompt publication of this Order to be made in the Federal Register.

ATTACHMENT A

Respondents RM75-27

Respondent

Accounting Firms

* Arthur Anderson & Co.

* Not filed within the time prescribed.

* Orrin T. Colby, Jr.

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AMENDMENTS TO UNIFORM SYSTEM OF ACCOUNTS FOR PUBLIC UTILITIES AND LICENSEES AND FOR NATURAL GAS COMPANIES (CLASSES A, B, C AND D) TO PROVIDE FOR THE DETERMINATION OF RATE FOR COMPUTING THE ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION AND REVISION OF CERTAIN SCHEDULE PAGES OF FPC REPORTS, DOCKET NO. RM75-27

ORDER NO. 561-A

FEDERAL POWER COMMISSION

59 F.P.C. 1340; 1977 FPC LEXIS 281

August 1, 1977 *

* Published in the Federal Register on August 5, 1977 (42 F.R. 39661). Order issued January 20, 1978 clarifying Order Nos. 561 and 561-A, 2 FERC P61,050.

[*1]

ORDER DENYING APPLICATIONS FOR REHEARING AND CLARIFYING PRIOR ORDER

Before Commissioners: Richard L. Dunham, Chairman; Don S. Smith and John H. Holloman III.

OPINION:

On March 4, 1977, El Paso Natural Gas Company (El Paso), Public Systems n1, three bulk power suppliers for rural electric cooperatives (Oglethorp) n2 and eight investor-owned public utilities (Private Group) n3 filed Applications for Rehearing of our Order No. 561, issued February 2, 1977, in *Docket No. RM75-27, 57 FPC 608.* On March 7, 1977, Pennsylvania Power & Light Company (PP&L) filed a separate Application for Rehearing. On April 1, 1977, an order was issued granting application for rehearing by the aforementioned petitioners for the purpose of further consideration of Order No. 561. On April 18, 1977, pursuant to Section 1.34(d) of the Commission's Rules of Practice and Procedure, the Public Service Commission of the State of New York (New York) and the Private Group filed responses to Applications for Rehearing filed by the Private Group and Public Systems, respectively.

n1 See Appendix A for members of Public Systems.

n2 Oglethorp Electric Membership Corporation, North Carolina Electric Membership Corporation and Old Dominion Electric Cooperative, Inc.

n3 Jersey Central Power & Light Company, Long Island Lighting Company, Metropolitan Edison Company, New England Power Company, Northeast Utilities Company, Pacific Power & Light Company, Pennsylvania Electric Company and Pennsylvania Power & Light Company.

[*2]

Short-Term Debt

El Paso's application stated that it fully supported the Commission's objective in the instant rulemaking proceeding of providing adequate compensation for funds devoted to construction but believed that the formulas devised by the Commission and promulgated pursuant to Order No. 561 fall short of accomplishing this objective. El Paso submits that the approach adopted by the Commission is grounded upon two erroneous assumptions, *i.e.* (i) that short-term debt is the first source of funds for construction purposes, and (ii) that short-term debt is used exclusively for construction. El Paso purposed that instead of the formula adopted by the Commission that the rate for AFUDC be expressed as follows:

$$R = d\,(D / D + P + C) + P\,(P / D + P + C) + c\,(C / D + P + C)$$

In this formula R represents the AFUDC rate and the other symbols have the same meaning as defined in Order No. 561 except that D would equal the sum of long-term and short-term debt and d would equal the weighted average interest rate for D. El Paso states that this formula is grounded upon the more realistic assumption that construction work in progress is financed by funds provided according [*3] to the *pro rata* capitalization of the company, including short-term debt, if any. In the event, however, that the Commission chooses to retain the formula set forth in Order No. 561, El Paso requests clarification in cases where short-term debt exceeds construction work in progress to ensure that negative AFUDC rates do not result.

Public Systems states that the Commission correctly concludes that short-term debt is the primary source of funds for the construction of new utility plant and the procedures for the calculation of AFUDC reflect this fact. However, Public Systems expressed concern over the statement in Order No. 561 that the AFUDC method established was not for the purposes of establishing a method for allocating short-term interest cost for the purpose of a rate proceeding. They believe that such statement may be interpreted as an invitation to include the cost of construction related short-term borrowings in the development of AFUDC and to recognize the same costs in the development of the allowed return in rate proceedings. Public Systems also objects to any possible recognition of costs associated with bank or other borrowings, such as compensating bank balances, [*4] in determining short-term debt cost. They believe that recognition of such costs should be sanctioned, if at all, only in general rate proceedings after a hearing on the record.

PP&L also disagrees with the Commission's premise in Order No. 561 that all short-term debt should be allocated to financing construction work in progress. PP&L states that there are many instances when a utility can specifically identify the utilization of short-term debt for purposes other than financing construction work in progress and in such cases, it would be erroneous to include this debt in the AFUDC computation.

As we stated in Order No. 561, it is generally impossible to specifically trace the source of funds used for various corporate purposes and it was not the purpose of the proposed rule to do so. We recognize that short-term debt is a source of funds that can be used for many corporate purposes other than construction. However, short-term debt cost is a valid cost of conducting utility operations and a mechanism for the recovery of such cost should be provided for within the regulatory framework. Recovery of capital costs is usually provided for through the rate of return allowance [*5] in a general rate proceeding. However, in a typical rate case situation, short-term debt cost does not lend itself to reasonable measurement for use in setting future rates since, as El Paso graphically illustrated in the Appendix to its application, the amount of short-term debt that a company has outstanding can fluctuate widely over short periods of time. In addition, the interest rate for short-term debt often changes at frequent intervals. On the other hand, the cost of short-term debt can be effectively measured and capitalized for subsequent recovery (through depreciation charges in rates) since under our formula the balances and rates for the forthcoming year are estimated annually, with appropriate adjustments to the amounts capitalized if the estimates used are not reasonably reflective of actual experience. Therefore, we do not believe that we should modify Order No. 561 with respect to the weight given short-term debt in the formula.

El Paso's point on possible negative AFUDC rates in situations where short-term debt exceeds construction work in progress is well taken. We believe that this matter can best be clarified by stating herein that if short-term debt balances [*6] exceed construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment and fabrication the maximum total AFUDC rate to be utilized will be the weighted average short-term debt rate. In instances where this occurs, the entire credit for AFUDC will be recorded in Account 432, Allowance for borrowed funds used during construction -- Credit.

We do not believe that Public System's concerns are well founded with regard to the inclusion of short-term debt for rate of return purposes or the potential recognition in certain instances of short-term debt costs arising from such items as compensating balances. Order No. 561 neither changes the Commission's policy with respect to treatment of short-term debt in capitalization used for rate of return purposes nor does it grant blanket approval for recognition of compensating balances and commitment fees in costing short-term debt. The burden of proof is upon the companies to justify such items before they will be permitted.

State Commission Rate Determinations

Both Public Systems and Oglethorp object to the provision in Order No. 561 that the cost rate to be used for common equity be the rate granted [*7] common equity in the last rate proceeding before the body having primary rate jurisdiction or, if such rate is not available, the average rate actually earned during the preceding three years. They believe that the return on equity rate should be based upon determinations of the Federal Power Commission, whether the FPC has primary rate jurisdiction or not. Public Systems and Oglethorp believe that the approach adopted by the Commission is an unjustified abdication of statutory responsibility. On the other hand, Private Group urges that Order No. 561 be amended to provide that, if a state ratemaking agency having primary rate jurisdiction over an electric utility has prescribed a method of determining or applying an AFUDC rate, such electric utility may use such State Commission-directed rate rather than the rate developed under the formula in Order 561.

In its response to the application for rehearing filed by Public Systems, the Private Group stated the following:

> Order No. 561 is designed to provide an orderly method for accrual of AFUDC month-by-month during the on-going operations of a public utility. For the most part, the facilities constructed by an electric utility [*8] cannot be segregated as between those which will be employed solely for retail service and those which will be employed solely for wholesale service; instead, allocation procedures for joint use facilities are required and appropriate methods of allocation have been developed and are routinely applied. Under those circumstances, the utility must have a single AFUDC rate to apply to facilities under construction which will ultimately serve both groups of customers. A reasonable recognition of, and accommodation to, the Federal-State relationship involves the use of a cost rate for common equity which is equal to that last approved by the body having primary rate jurisdiction.

We fully agree with the above response by the Private Group with respect to the cost rate for equity funds. We believe that this argument is also supportive of the Commission's adoption of a uniform method for all jurisdictional companies to follow so that a single rate is developed for each company. Additionally, since the financial statements of electric utilities and natural gas companies are used by government agencies, investors, the general public, and others for purposes other than setting rates, [*9] it is important that a uniform method be used. This is especially important in an area such as AFUDC which has such a material impact on the earnings and cost determinations of utilities. We shall therefore deny rehearing on this point.

The Relocation of AFUDC in the Interest Charges Section of the Income Statement

The Private Group and PP&L urged that Order No. 561 be revised to eliminate the provision that directs the relocation of the allowance for borrowed funds as a credit to the interest charge section of the income statement. New York in its response to application for rehearing filed by Private Group supported this position. These parties argue that the relocation required by Order No. 561 is likely to have an adverse effect on the ability to finance both debt and preferred stock securities due to coverage test requirements included in mortgage indentures and corporate charters. PP&L also questions whether the relocation of a portion of AFUDC as a reduction of interest charges will better inform readers of the financial statements as to the nature of the capitalized allowance for borrowed funds as stated in Order No. 561. They argue that such reclassification [*10] may in fact mislead readers of financial statements if such amount is considered a reduction of the actual amount of interest a company must pay.

We are unpersuaded by these arguments that we should modify Order No. 561 with respect to the location of the interest portion of AFUDC in the income statement. We purposely did not require that the amount of interest charged to the income statement be shown net of interest capitalized but instead required that the gross interest charges be shown in the income statement with a separate line item for the capitalized allowance for borrowed funds. This enables readers of financial statements to be informed as to the total interest liability incurred for the year as well as to any lesser amount of interest entering into the determination of net income for the year. We continue to believe that the readers of the financial statements will be better informed with this form of accounting disclosure than other suggested methods. Furthermore, the change in the location on the income statement for the allowance for interest capitalized does not in itself change either the nature of the item or the degree of protection afforded security holders [*11] by earnings of a utility.

Net-of-tax AFUDC Rate

Public Systems objects to the normalization of income tax benefits of construction interest through the use of a net-of-tax AFUDC rate and asks that Order No. 561 be revised to prohibit this practice.

Public Systems' arguments are misplaced. The proposed plant instructions pertaining to computation of income taxes were deleted when the Commission adopted Order No. 561 because these matters were previously spoken to in the *Commission's Order Nos. 530 (53 FPC 2123), 530-A (55 FPC 162) and 530-B (56 FPC 44)* in Docket Nos. R-424 and R-446. These orders are currently under review by the D.C. Circuit (*Public Systems, et al.* v. *F.P.C.,* CADC Nos. 76-1609, 76-1830.) **

** [Editor's note: Remanded, *Public Systems, et al. v. F.E.R.C., 606 F. 2d 973* (CADC-1979).]

Other Matters

Private Group states in their application that in order for the AFUDC rate to be fully compensatory, estimates of weighted average embedded long-term debt and preferred stock costs as they are expected to exist during the current year should be used rather than the effective weighted average cost of the long-term debt and preferred [*12] stock at the end of the prior year as required by Order No. 561.

Private Group also argues that compounding of AFUDC should be permitted monthly rather than semi-annually, since utility accounting is on an accrual basis. If, however, the Commission considers the timing of cash outlays for interest and dividend to be relevant, Private Group argues that quarterly compounding would be more appropriate than semi-annual compounding since dividends on preferred and common stock and interest on short-term debt are almost invariably paid quarterly, and these items account in the aggregate for more than half of the AFUDC accrual. The remainder of the accrual relates to long-term debt which is normally paid semi-annually.

Public Systems objects to the provisions of Order No. 561 which indicate that amounts capitalized for AFUDC for the year will not be required to be adjusted if the gross AFUDC rate actually used for the year does not exceed by more than 25 basis points the rate that would be derived from the formula by use of actual thirteen monthly balances of construction work in progress and the actual weighted average cost and balances for short-term debt outstanding during the year. [*13] Public System argues that this provision creates an incentive to "misestimate" AFUDC and pocket additional prospective but unjustified revenues. Public System assumes that this provision was intended to ease accounting burdens but submits that the governing statutes do not contemplate such windfalls in the name of administrative convenience.

Oglethorp states that Order No. 561 excludes all non-investor sources of funds from the AFUDC computation on the ground that such sources are treated as rate base deductions but argues that some non-investor funds may not be treated as rate base deductions and hence could be incorrectly also overlooked for AFUDC purposes. Oglethorp believes the Order should be modified to provide that all non-investor funds which are not deducted from rate base should be included in the AFUDC formula at zero cost.

The requirement that the AFUDC rate for the current year be based on the effective weighted average cost of the long-term debt and preferred stock at the end of the prior year and the requirement that the AFUDC be compounded no more frequently than semi-annually may, in some instances, tend to slightly understate the cost of capital used for construction. [*14] Conversely, there may be relatively minor items of consumer contributed capital which are not considered in either the ratemaking process or through AFUDC and there may well be some instances in which the estimates used exceed by up to 25 basis points the rate that would be derived from actual experience.

We conclude that Order No. 561 should not be modified with respect to these matters. When considered together the proposed modifications tend to offset each other. We believe that Order No. 561 clearly provides for a rate for AFUDC which is in the zone of reasonableness, based upon uniform standards which can be effectively implemented and administered.

In light of the above, we believe that the applications for rehearing filed by the aforementioned applicants should be denied.

The Commission finds

The application for rehearing filed on March 4, 1977, by El Paso, Public Systems, Oglethorp and Private Group and on March 7, 1977, by PP&L present no facts or principles of law which would require modification of Order No. 561.

The Commission orders:

(A) The applications for rehearing filed by El Paso, Public Systems, Oglethorp and Private Group on March 4, 1977, [*15] and PP&L on March 7, 1977, are denied.

(B) The Secretary shall cause prompt publication of the Order in the Federal Register.

APPENDIX A

PUBLIC SYSTEMS SPONSORING THE APPLICATION FOR REHEARING OF ORDER NO. 561

Anaheim, California	Bryan, Ohio
Azusa, California	Colton, California
Banning, California	Croswell, Michigan
Bowling Green, Ohio	

Electric Cities of North Carolina and its members, the following municipalities:

Virginia:

Blackstone	Iron Gate
Culpeper	Manassas
Franklin	Wakefield
Harrisonburg	

North Carolina:

Albemarle	Hobgood
Apex	Hookerton
Ayden	Huntersville
Belhaven	Kings Mountain
Benson	Kingston
Black Creek	LaGrange
Bostic	Landis
Cherryville	Laurinburg
Clayton	Lexington
Concord	Lincolnton
Cornelius	Louisburg
Dallas	Lucama
Davidson	Lumberton
Drexel	Macclesfield
Edenton	Maiden
Elizabeth City	Monroe
Enfield	Morganton
Farmville	Murphy
Fayetteville	New Dern
Forest City	Newton
Fountain	Oak City
Fremont	Pikeville
Gastonia	Pinetops
Granite Falls	Pineville
Greenville	Red Springs
Hamilton	Robersonville
Hertford	Rocky Mount
Highlands	Scotland Neck
High Point	Selma
Sharpsburg	Wake Forest
Shelby	Walztonburg
Smithfield	Washington
Southport	Waynesville

652 – Capital - Asset Retirement Obligations Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: An asset retirement obligation ("ARO") will be established when a legal obligation exists, in compliance with ARO guidance per FASB Accounting Standards Codification ("ASC") Topics 410 and 980-410 (formerly Statement of Financial Accounting Standards No. 143 ("SFAS 143"), Accounting for AROs and the subsequent FASB Interpretation No. 47 ("FIN 47")).

Procedure: Criteria for the recognition and accounting of legal retirement obligations related to tangible long lived assets are detailed below.

Scope: All legal retirement obligations of LG&E and KU Energy LLC ("LKE" or the "Company") and its subsidiaries including Louisville Gas & Electric Company ("LG&E"), Kentucky Utilities Company ("KU") and LG&E and KU Services Company ("LKS").

Objective of Procedure: Accurate identification of and provision for Asset Retirement Obligations as defined in ASC Topics 410 and 980-410 and FERC Order 631.

General Requirements:

Detailed Procedures Performed:

Definition of ARO: A legal retirement obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance or contract. A retirement encompasses the sale, abandonment or disposal in some other manner of a long lived asset. After an entity retires an asset, the asset is no longer under the control of that entity, or no longer in existence, or no longer capable of being used in the manner for which it was originally acquired. Retirement does not encompass the temporary idling of a long lived asset. (ASC 410-20-05)

Legal and Environmental Department personnel, in coordination with line of business and Property Accounting personnel, determine the need to establish an ARO based upon review of legal documents including laws, statutes, contracts, permits, certificates of need, right of way agreements and environmental regulations.

ARO Establishment and Review: A long lived tangible asset is determined to give rise to a legal retirement obligation.

The need to add an ARO is considered during the approval process for asset additions. During the AIP process, Property Accounting Analysts review the projects to determine if the need for an ARO may exist. If the project is identified as having the potential to require an ARO, the Property Accounting Analyst in charge of ARO accounting reviews the AIP and if needed, contacts the Legal and Environmental personnel who will make the final determination of the need to establish an ARO based upon review of existing legal documents including laws, statutes, contracts, permits, certificates of need, right of way agreements and environmental regulations.

Additionally, *Property Accounting distributes ARO questionnaires quarterly and conducts semi-annual ARO review meetings* (quarterly for Project Engineering), *(SOX Cycle 40.01, CA#13)* unless more frequent meetings are deemed appropriate. The questionnaires and meetings are a means to determine if any new AROs need to be established or if any changes are required to AROs previously recorded. The questionnaires provide an opportunity to inform Property Accounting of any actual or proposed revisions of or additions to laws, statutes, contracts, permits, certificates of need, right of way agreements and environmental regulations which impact AROs. The semi-annual (or more frequent) ARO meetings provide a forum to discuss all topics regarding new/existing AROs as well as provide education on the ARO accounting and calculations. Recipients of the ARO questionnaires and attendees of the semi-annual ARO meetings include Legal, Environmental, Budget Managers for each operating line of business and others, as applicable.

Any cost estimate information provided by a Company field employee used in the calculation of AROs must be reviewed for accuracy and completeness and signed off on by the field employee's management prior to it being considered for use in the ARO calculation(s). Field management will ensure any spreadsheets used in calculating the estimate comply with the Comprehensive Spreadsheet Policy. (SOX Cycle 40.01, CA#14) When an ARO revision occurs, Property Accounting personnel will review the change in ARO estimates provided by field personnel. The review includes understanding and supporting the change in cost estimates, use of contingency, timing and other changes (overhead, inflation, etc.), as applicable. To the extent possible, the mathematical accuracy of the supporting files received will be verified through recalculation. A detailed view of factors driving the ARO revisions will be reviewed with the Director, Accounting and Regulatory Reporting. (SOX Cycle 40.01, CA#18) Any 3rd party studies used as the basis for these cost estimates must also be provided to Property Accounting, after a review is completed by the line of business employee and their manager.

The cost associated with the recognition of the asset retirement obligation is capitalized as part of the related tangible asset's book cost and is depreciated over a life dictated by the settlement date of the ARO liability. The asset retirement obligation book cost is initially recorded at fair value using an expected cash flow approach which utilizes the following inputs: inflation rate; discount rate; settlement date; and current costs. The inflation rate is provided by the Treasurer and is based on the 30-Yr Treasury rate less 30-Yr Treasury Inflation-Protected Securities (TIPS). The discount rate used for each ARO is equal to the yield for a bond with LG&E or KU's credit rating and a maturity date in the same year as the year the ARO is expected to be settled. The yields are provided by a major investment bank. New rates are used when a new

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(Note: Text in italics indicates a key SOX control.)

ARO is recorded or when the liabilities must be recalculated due to a change in the estimate. The estimated settlement dates used may be obtained from the annual Business Plan, State or Federal regulations, the remaining life provided during the most recent depreciation study or other suitable sources. Current cost information is provided by the various business lines.

A mark-up rate may be used to incorporate probabilities of cost into the measurement. Additionally, a market risk premium may also be incorporated due to the uncertainty of the costs in the future.

All ARO related calculations and accounting are performed within the PowerPlan fixed asset system. Any rate, settlement date and cost information manually input into the PowerPlan system by the Accounting Analyst in charge of ARO Accounting is reviewed for accuracy by an independent Accounting Analyst. Additionally, a review of the PowerPlan calculation is performed manually by the Accounting Analyst in charge of ARO Accounting to provide assurance the system is properly performing the calculation. Journal entry information regarding AROs is transmitted to the Oracle General Ledger from PowerPlan via a system interface. The account balances between PowerPlan and the Oracle General Ledger are reconciled monthly to ensure they are in balance.

The ARO asset and an offsetting liability equal to the fair value of the ARO are also recorded by PowerPlan via the following entry:

Dr. 101XXX - Plant In Service – ARO Asset Retirement Cost
Cr. 230XXX - ARO Liability

ARO Revaluation: All lines of business will be required to include updated settlement cost estimates as deemed appropriate. Property Accounting will review the proposed updated settlement estimates with the Director-Accounting and Regulatory Reporting to determine if a revaluation is needed.

Changes in the estimated lives of assets or information gathered via the ARO questionnaires/meetings might prompt the need for the revaluation of an existing ARO or the establishment of a new ARO. If this occurs, the applicable information is gathered by the Property Accounting Analyst from the appropriate company personnel (operating units, Legal, Environmental, etc.) and the present value of the future retirement obligation is calculated in accordance with the "ARO Establishment and Review" section above.

The PowerPlan journal entry reflecting revaluations is as follows:

Dr. 101XXX - Plant In Service – ARO Asset Retirement Cost

Cr. 230XXX - ARO Liability

Depreciation: Depreciation on ARO assets is calculated on a straight line basis (consistent with all utility depreciation calculations) over a life dictated by the settlement date of the ARO liability. Pursuant to ASC 410-20, revisions to ARO assets as a result of ARO revaluations affect subsequent depreciation of the ARO asset. Such adjustments are depreciated on a prospective basis.

The PowerPlan journal entry reflecting depreciation expense for the ARO asset is:

Dr. 4031XX - Depreciation Expense
Cr. 108XXX - Accumulated Depreciation – ARO Asset Retirement Cost

Accretion: As depreciation expense allocates the cost of installing an asset over its useful life, accretion expense allocates the increase in the cost of removing an asset over its useful life. Each period the ARO liability is increased through the recognition of accretion expense. The PowerPlan journal entry reflecting accretion is as follows:

Dr. 41110X - Accretion Expense
Cr. 230XXX - ARO Liability

Regulatory Assets: Pursuant to ASC 980-410, depreciation and accretion expense related to the ARO asset and liability is offset with a regulatory asset. The PowerPlan journal entry to record the offset is:

Dr. 1823XX - Other Regulatory Assets ARO
Cr. 4031XX - Depreciation Neutrality
Cr. 41110X - Accretion Neutrality

In compliance with the 2016 ECR Plan Order, certain of the regulatory assets established via the above entry will be amortized beginning in July 2016. Specifically:

- The KPSC portion of the regulatory assets associated with the Coal Combustion Residuals Rule ("CCR Rule") related surface-impoundment closures (ash and environmental ponds) and related ground water monitoring at Mill Creek, Trimble County, Brown and Ghent will be amortized using a non-levelized 25-year amortization of actual closure costs effective July 1, 2016.

- The KPSC portion of the regulatory assets associated with the surface-impoundment closures (ash ponds) at the retired Green River, Pineville and Tyrone plants will be

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(Note: Text in italics indicates a key SOX control.)

amortized using a non-levelized 10-year amortization of actual closure costs effective July 1, 2016.

On August 9, 2017, FERC Staff approved the uncontested Settlement agreement (Docket No. ER17-234 Filing of Recovery of Asset Retirement Obligations) filed on May 30, 2017 which contained the following provisions:

- The FERC portion of the regulatory assets associated with the surface-impoundment closures (ash and environmental ponds) and related ground water monitoring at Trimble County, Brown and Ghent will be amortized using a non-levelized 25-year amortization of actual closure costs effective July 1, 2016 with amortization beginning January 1, 2017.

- The FERC portion of the regulatory assets associated with the surface-impoundment closures (ash ponds) at the retired Green River, Pineville and Tyrone plants will be amortized over 28 months effective January 1, 2017.

On May 9, 2018, the VSCC ("Virginia State Corporation Commission") issued a Final Order (Case No. PUR-2017-00106) for Kentucky Utilities Company dba Old Dominion Power Company providing for the following:

- The VSCC portion of the regulatory assets associated with the CCR Rule related surface-impoundment closures (ash and environmental ponds) and related ground water monitoring at Trimble County, Brown and Ghent will be amortized using a straight-line 23-year amortization of total estimated closure costs effective June 1, 2018.

- The VSCC portion of the regulatory assets associated with the surface-impoundment closures (ash ponds) at the retired Green River, Pineville and Tyrone plants will be amortized using a straight-line 4-year amortization of total estimated closure costs effective June 1, 2018.

The amortization is recorded via a manual Oracle journal entry and is generally as follows:

Dr. 407.3 – Regulatory Debits
    Cr. 1823XX - Other Regulatory Assets ARO

See technical memos entitled "ECR CCR ARO Accounting Changes 10-14-16.docx" and "ECR CCR Amortization 11-1-16.docx" found on the acctrestricted drive for more a detailed discussion on the amortization of the regulatory asset and the 2016 ECR Plan Order.

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(Note: Text in italics indicates a key SOX control.)

Regulatory assets established as part of the ARO accounting process for assets NOT covered under the 2016 ECR Plan Order, FERC Docket No. ER17-234 Filing of Recovery of Asset Retirement Obligations and VSCC Case No. PUR-2017-00106 (primarily ash/environmental ponds and related ground water monitoring) are not amortized and are reversed as part of the ARO settlement process described below.

Settlement: At the time of settlement, all of the appropriate ARO amounts in accounts 101XXX, 108XXX, 1823XX and 230XXX are reversed for AROs which are NOT covered by the 2016 ECR Plan Order. Closure costs incurred are applied against 108XXX - Accumulated Depreciation –Net Cost of Removal.

The following entries to record closure costs incurred for AROs covered under the 2016 ECR Plan Order are recorded:

Dr. 108899 - RWIP--ARO--ECR--Clearing[1]
Cr. 131XXX – Cash

Dr. 230XXX - ARO Liability
Cr. 108899 - RWIP--ARO--ECR—Clearing

The following entry is recorded for the retirement of the ARO Asset Retirement Cost for AROs covered under the 2016 ECR Plan Order:

Dr. 108XXX - Accumulated Depreciation – ARO Asset Retirement Cost
Cr. 101XXX - Plant In Service – ARO Asset Retirement Cost

Reports Generated and Recipients:

- ARO Quarterly Rollforward Report – provided to external auditors
- ARO account reconciliation reports:
  - PowerPlan report ARO Report Reg – 1001 (182 accounts)
  - PowerPlan report ARO Report ARO – 1100 (230 accounts)

Additional Controls or Responsibility Provided by Other Procedures:

[1] Account 108899 is a "clearing" account. Account 108899 is being used for ease of PowerPlan system processing for AIPs and other budgetary uses. 108899 will be cleared via a manual JE each month to Account 230 for proper Financial Statement presentation.

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(Note: Text in italics indicates a key SOX control.)

- N/A

Regulatory Requirements:

- FERC Accounting Guidelines
- KPSC Order Case No. 2003-00426
- 2016 ECR Compliance Plan Order – CCR Costs (KPSC Order Case Nos. 2016-00026 (KU)/2016-00027 (LG&E))
- Docket No. ER17-234 Filing of Recovery of Asset Retirement Obligations
- VSCC Order Case No. PUR-2017-00106

Reference:

- ASC Topic 410
- ASC Topic 980-410
- FERC Order 552
- FERC Order 631
- Technical memos entitled "ECR CCR ARO Accounting Changes 10-14-16.docx" and "ECR CCR Amortization 11-1-16.docx" found on the acctrestricted drive.

Corresponding PPL Policy No. and Name:

407 – Asset Retirement Obligation

Key Contact: Manager, Property Accounting

Administrative Responsibility: Director, Accounting and Regulatory Reporting

Date Created: 08/24/05
Dates Revised: 10/21/06; 12/31/09; 12/01/10; 03/31/11, 2/20/12; 9/30/13; 2/28/14; 12/17/14; 3/2/16; 11/4/16; 9/7/17; 9/7/18

653 – Capital - Depreciation of Property, Plant & Equipment Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: Fixed assets of Louisville Gas & Electric Company ("LG&E") and Kentucky Utilities Company ("KU") will be depreciated in accordance with the most recently approved depreciation study. Fixed assets of LG&E and KU Energy LLC ("LKE" or the "Company") and its other subsidiaries must be depreciated over their estimated useful lives.

Procedure: The procedures for depreciating or amortizing company assets are described in the detailed instructions below.

Scope: All assets that are subject to depreciation or amortization.

Objective of Procedure: Ensure that eligible capital assets are properly depreciated or amortized.

General Requirements:

Definitions:

Automatic End of Life Retirement Method – this accounting method is typically used for fixed asset accounts that have a large number of small dollar value items. Retirements are only recorded when a given asset vintage is fully depreciated/amortized whether or not the assets are still in service. Each group of assets is assigned a life over which the assets will provide a full benefit.

Average Service Life – The average life of a group of assets which is determined using actuarial techniques. These techniques look at historical and estimated future trends to produce a pattern of life characteristics from which the average service life can be determined.

Composite Depreciation Method – A method of grouping assets that are dissimilar in nature and may have different lives but are part of a larger asset group. The asset group is depreciated over an estimated service life for the group.

Depreciation Expense – the systematic and rational allocation of the cost of tangible PP&E to expense over the estimated useful life of the asset.

Depreciation Group – the grouping of assets to which a depreciation method and applicable rate calculation is applied. Typically a depreciation group is set at a Federal Regulatory Energy Commission ("FERC") account level.

End of Life or Remaining Life Depreciation Method – A depreciation methodology which depreciates related assets to an end of life date. The end of life method calculates a "depreciable base" amount (gross plant cost less accumulated depreciation) and depreciates this value over the remaining life of the asset. The remaining life of the "depreciable base" becomes shorter and shorter as the end of life of the asset group is reached.

Group Depreciation Method – A method of grouping assets that are similar in nature and have approximately the same average service life. Each group of assets is depreciated over a common average service life and uses a similar retirement curve to calculate depreciation expense.

Straight Line Depreciation Expense Method – Depreciation expense is recognized evenly over the estimated useful life of the asset or group of assets.

Survivor Curve, Mortality Curve (Interim Survivor Curve) – The survivor curve is a curve which shows the number of units of property that survives in service at given ages. The use of survivor curves, which reflect experienced and expected dispersion of service lives, is a systematic and rational means of estimating average service lives to be used to calculate depreciation expense. The terms survivor curve and mortality curve are sometimes used interchangeably. Interim survivor curves as used by LG&E and KU are survivor/mortality curves that are associated with another primary depreciation method such as the end of life depreciation method (defined above). The interim retirement curve becomes a secondary factor in determining depreciation expense.

Accounting:

Regulated Utility Depreciation:

LG&E's and KU's calculation of depreciation expense, including the service lives of the respective assets as well as the depreciation methodology, must be approved by the Kentucky Public Service Commission ("KPSC"). KU is also regulated by the Virginia State Corporation Commission ("VSCC") and the FERC and depreciation rates are also subject to approval by these regulators. LG&E and KU will generally complete and file a depreciation study every five years with the applicable regulators. The timing of these studies may be mandated by the various regulators or it may be at the discretion of the Company. This study provides statistical information related to the life of assets which allows a retirement curve and estimated service life of the assets to be determined.

Non-Utility Depreciation:

The majority of PP&E value for the Company's non-utility assets is comprised of computer software and hardware. These assets are generally depreciated over the same lives as the related assets found on LG&E's and KU's books.

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(Note: Text in italics indicates a key SOX control.)

Detailed Procedures Performed:

Depreciation expense begins when an asset is placed in service and is ready for its intended use. Depreciation expense ceases when an asset is retired or is reclassified as held for sale. A half month convention is used to calculate depreciation expense whereby a half month's expense is taken in the month the asset is placed in service and then another half month is taken in the month the asset is retired.

When an asset which uses a group or composite depreciation method is retired during the normal course of business operations, no gain or loss is recorded. The asset's corresponding depreciation reserve is reduced by the gross book value of the retirement. These retirements will ultimately affect the group's mortality/survivor curve and affect the group's depreciation expense prospectively. When all or a significant portion of an operating unit that was depreciated under the composite or group method is retired or sold, the property and related accumulated depreciation account is reduced and any gain or loss is included in income, unless otherwise required by regulators. When assets owned by non-utility entities are retired or sold, the property and related accumulated depreciation account is reduced and any gain or loss is included in income.

The Company uses the PowerPlan Asset Management System to maintain continuing property records as well as calculate depreciation expense.

Property Accounting requests that its depreciation consultant prepare a depreciation study every five years or to meet the requirements of various regulators specified above for its regulated assets. Property Accounting will request the Generation Planning and Analysis Department to provide updated end of life dates for the various generation facilities for use in the study. Once the depreciation study is complete and approved by the Company, it is filed with the various regulators by the State Regulation and Rates Department.

All changes affecting rates must be approved by the Manager, Property Accounting. *Rate changes for regulated plant are generally only made after approval from the various regulatory agencies (SOX Cycle 40.01, CA#17).* Property Accounting is responsible for documenting all changes to depreciation rates calculated in PowerPlan as well as inputting applied rates, survivor curves, and asset end of lives in the PowerPlan depreciation module.

LG&E and KU business lines are responsible for informing Property Accounting of any planned significant abnormal retirement activity. Property Accounting will evaluate this information and determine whether a change in depreciation rates is necessary.

Reports Generated and Recipients:

653 – Capital - Depreciation of Property, Plant & Equipment Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

- LG&E and KU Plant reports
- Net book value reports generated on an as needed basis from PowerPlan

Additional Controls or Responsibility Provided by Other Procedures:

- Financial Planning personnel and Property Accounting personnel review and compare monthly/annual depreciation amounts to the Medium Term Plan for reasonableness.

Regulatory Requirements:

LG&E's and KU's calculation of depreciation expense, including the service lives of the respective assets as well as the depreciation methodology, must be approved by the KPSC. KU is also regulated by the VSCC and the FERC and depreciation rates are subject to approval by these regulators. (SOX Cycle 40.01, CA#17) LG&E and KU will file a depreciation study based on an order received from a regulatory commission or when the Company deems a study to be necessary. This study provides statistical information related to the life of assets which allows a retirement curve and estimated service life of the assets to be determined. The appropriate regulators must approve the depreciation study before the applicable data from the study can be used.

Reference:

- FERC Accounting Guidelines 18 CFR, Chapter 1, Subchapter C, Part 101, Electric Plant Instructions paragraph 22, *Depreciation Accounting*.
- Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 360 – Property, Plant and Equipment

Corresponding PPL Policy No. and Name:

617 – Accounting for Depreciation of Property, Plant & Equipment

Key Contact: Manager, Property Accounting

Administrative Responsibility: Director, Accounting and Regulatory Reporting

Date Created: 3/31/2011
Dates Revised: 3/2/2016, 9/7/2018

654 – Asset Impairment

(Note: Text in italics indicates a key SOX control.)

Policy: The assets of LG&E and KU Energy LLC and its subsidiaries (LKE) must be reviewed on a regular basis (assumed to be quarterly), to determine if an asset impairment according to FASB ASC 360, Property, Plant and Equipment, and ASC 350, Intangibles – Goodwill and Other, must be recognized.

Procedure: Survey appropriate personnel to determine if any assets are impaired and make appropriate adjustments to the books. An impairment loss will be recognized only if the carrying value of a long-lived asset is not recoverable and exceeds it fair value.

Scope: All property, plant, and equipment, including CWIP. See also 452 – Goodwill policy.

Objective of Procedure:

To ensure that LKE does not represent assets on its financial statements at net book values that are significantly greater than its fair value.

General Requirements:

The review for impairment process is performed for each location or function by one of the following: the Controller, Accounting Director, Budget Analyst, Maintenance Manager, or Plant Manager, or whoever is most appropriate from the perspective of the greatest knowledge of the assets being reviewed. The information that is gathered is then forwarded to the Property Accounting department.

Detailed Procedures Performed:

Long-lived assets

For purposes of ASC 360, impairment is the condition that exists when the carrying value of a long-lived asset exceeds its fair value. An impairment loss shall be recognized only if the carrying value of a long-lived asset is not recoverable and exceeds its fair value.

FASB has indicated that quoted market prices in active markets are the best evidence of fair value. However, when market prices are unavailable, other valuation techniques may be used, including the present value technique (discounted cash flows). Also, see the discussion in the definitions regarding the adoption of ASC 820, Fair Value Measurement, and its impact on measuring and disclosing fair value.

654 – Asset Impairment

(Note: Text in italics indicates a key SOX control.)

The carrying value of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset (Step 1). That assessment is based on the carrying value of the asset at the date it is tested for recoverability, whether in use or under development. An impairment loss is measured as the amount by which the carrying value exceeds its fair value (Step 2).

The carrying amount of the asset includes capitalized asset retirement costs, if applicable. Cash flows related to an asset retirement obligation that has been recognized in the financial statements is excluded from both (a) undiscounted cash flows used to test the asset's recoverability, and (b) the discounted cash flows used to measure an asset's fair value. If the fair value of the asset is based on a quoted market price and that price considers the costs that will be incurred in retiring that asset, the quoted market price is increased by the fair value of the asset retirement obligation for purposes of measuring impairment.

If the income approach is applied to measure fair value under ASC 820, and the traditional cash flow technique is used (which utilizes the single most-likely set of cash flows, or best estimate), the discount rate should consider the variability (or riskiness) of the cash flows. If the expected cash flow technique is used (which utilizes probability-weighted cash flows to compute the expected cash flows), a risk-free rate is to be used to discount the cash flows (such as a zero coupon U.S. Treasury bond with a similar maturity) since the riskiness of the cash flows is already reflected in the probability percentages.

For purposes of recognition and measurement of an impairment loss, a long-lived asset or assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

Other Intangible Assets

If the intangible asset has a finite useful life, then it should be amortized over that useful life. For impairment testing, ASC 360, applies to intangible assets with finite lives.

If the intangible asset has an indefinite useful life, it is not amortized. Intangible assets that are not subject to amortization are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test consists of a comparison of the fair value of the intangible asset to its carrying amount. Potential contract renewals are considered in determining the future cash flows to be discounted if a marketplace participant looking to acquire the intangible asset would consider such renewals. In selecting a discount rate, refer to the guidance noted under "Long-lived assets." If the carrying amount of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

654 – Asset Impairment

(Note: Text in italics indicates a key SOX control.)

Due to the fact that virtually all of the long-lived and intangible assets are on the regulated utilities' (LG&E's and KU's) books, and the utilities earn a return on capitalization in base rates and the environmental cost recovery mechanism, unless a triggering event occurs with an indication that a regulator will not allow recovery of an asset, an impairment test is not performed.

Quarterly questionnaires

Each location/function completes a standard questionnaire on a quarterly basis by the most appropriate party as defined above. This is considered "Part A". There is also a "Part B", Business Climate, which is completed by the Controller or Accounting Director, with a representation letter from Legal to address any related legal issues. The purpose of the (Part A) questionnaire is to search for "triggering events", that is, events that have occurred that may indicate that the assets in question have a market value that is below net book value. The following are "triggering events" under ASC 360 that need to be considered in the review process:

- A significant decrease in the market value of an asset or asset group;
- A significant change in the extent or manner in which an asset is used, or a significant physical change in the asset;
- A significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator;
- An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset;
- A current period operating or cash flow loss, combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue; or
- A current expectation that more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

Either the Budget Analyst, Maintenance Manager, or Plant Manager or whoever is most appropriate will complete the questionnaire and submit it quarterly to the Manager, Property Accounting. If none of the conditions above are noted, the questionnaire will state that. If one or more of the above conditions are indicated, it will be noted on the questionnaire that is submitted to the Manager, Property Accounting. The Manager, Property Accounting or his/her designated employee for impairment reviews will validate the one or more "triggering events" that are listed, but they will first consider some other aspects of the specific situation. They must first consider whether the asset is part of a larger group of assets. If it is part of a larger asset group, even though the specific asset may "trigger" impairment consideration, as long as the asset group does not trigger impairment consideration, there would be no impairment. For clarification purposes, a unit of property at a power plant constitutes an asset, whereas the entire power plant would constitute the asset group. Impairment tests are performed at the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets or liabilities.

If the asset is not part of a larger group of assets, one of the questions to be considered is whether or not the asset is to be abandoned. For example - a coal scraper that was at one time part of the fuel handling fleet could be abandoned. This would separate it from the larger asset group. If it is to be simply abandoned, it would be considered impaired and all remaining net book value would need to be written off. If it is a utility asset that is abandoned, the impairment would go against the retirement reserve since utility depreciation rates include a cost of retirement component (which factors into the depreciation rates used for ratemaking). The exceptions are vehicles and land. Impairment losses in those situations would go to the Income Statement.

Should an asset be separated from the larger group of assets and not be abandoned, but classified as held for sale, it should be measured at the lower of its carrying amount, or its fair value less estimated selling expenses. The same approach as stated in the previous paragraph would be followed (any write-down would go to an impairment charge on the Income Statement).

When an asset is tested for impairment and there are one or more "triggering events", the next step is to compare the projected undiscounted cash flows on a pre-tax, pre-interest basis to the net book value of the asset. This will be done by a Property Accounting Analyst and reviewed by the Manager, Property Accounting. ASC 360 recommends a probability weighted estimate of future cash flows. The first comparison is done on a non-discounted basis. For illustrative purposes, consider the following example.

Asset A has a net book value of $100k.
Asset A is subject to one or more triggering events.
The discount rate is 6%.
There is a 25% probability of future cash flows being $10k per year for each of 10 years.
There is a 50% probability of future cash flows being $5k per year for each of 10 years.
There is a 25% probability of there being no future cash flows for 10 years.

The probability weighted approach on an undiscounted basis would result in the following calculation: ($10k X 10years X 25%) + ($5k X 10 years X 50%) + ($0 X 10 years X 25%) = $25k + $25k + $0k = $50k.

Because the probability weighted future undiscounted cash flows of $50k are less than the net book value of $100k, the next step must be completed. If the probability weighted future undiscounted cash flows had been greater than the net book value of the asset, there would be no further analysis required, and no impairment. In the example, the next step is to apply the probability weighted approach on a discounted basis. The same numbers used above on a discounted basis (using the 6% discount rate) would result in a net present value on a pre-tax, pre-interest basis of $36.8k.

Since the $36.8k on a discounted basis is less than the $100k net book value, the asset is considered impaired. The loss on impairment is equal to the difference between the net book value of the asset and the discounted future cash flows associated with the asset. In this example, the impairment loss is $63.2k ($100.0k - $36.8k). Had the discounted results in the example arrived at a discounted pre-tax, pre-interest number of $100k or greater, no impairment would be recognized thus ending the process. The impairment loss is recognized to the depreciation reserve for the utilities, with a corresponding reduction in the PP&E balance representing the credit side of the entry.

The Manager, Property Accounting will review and approve the impairment journal entry that is prepared by the Property Accounting Analyst. The Manager, Property Accounting will ensure that the Financial Reporting and Financial Planning departments are made aware of the impairment. The Property Accounting Analyst will make the appropriate entries in the fixed asset subsidiary ledger, and this will be confirmed through the reconciliation process.

Reports Generated and Recipients:

- Quarterly Impairment Questionnaires, completed by Budget Analysts, Maintenance Managers (Part A), and the Controller or Accounting Director (Part B), submitted to the Manager, Property Accounting.

Additional Controls or Responsibility Provided by Other Procedures:

None

Regulatory Requirements:

- FERC Accounting Guidelines

Reference:

- FASB ASC 350, Intangibles – Goodwill and Other
- FASB ASC 360, Property, Plant and Equipment

654 – Asset Impairment

(Note: Text in italics indicates a key SOX control.)

Corresponding PPL Policy No. and Name:

402 - Impairments

Key Contact: Manager, Property Accounting

Administrative Responsibility:

Controller
Director – Accounting and Regulatory Reporting

Date Created: 12/13/14
Dates Revised: 1/3/06; 1/22/07; 7/26/10; 12/29/10; 9/22/11; 3/2/16

LG&E and KU Quarterly Asset Impairment Questionnaire – Part A

Location or Line of Business: ________________________________

Completed by: ____

Approved by:____

Date Completed:____

Reports are due to Accounting by the last business day of each quarter.

Review should include all capital assets, including CWIP.

Since the date of the last questionnaire:

(A1) Has there been a significant decrease in the market value of an individual long-lived asset or asset group? If yes, please describe:
____

(A2) Has there been a significant change in the extent or manner in which an individual long-lived asset or asset group is used? If yes, please describe:
____

(A3) Has there been a significant change in the physical condition of an individual long-lived asset or asset group? If yes, please describe:
____

(A4) Has there been an accumulation of costs significantly in excess of the amount originally expected to acquire or construct an individual long-lived asset or asset group? If yes, please describe:
____

(A5) Is there a current expectation that, more likely than not, an individual long-lived asset or asset group will be sold or otherwise disposed of significantly before the end of its previously estimated useful life? If yes, please describe:

LG&E and KU Energy LLC Quarterly Asset Impairment Questionnaire – Part B

(To be completed by Accounting Director for each Reporting Area)

Legal Entities Included:____________________________________

Completed by: ____

Date Completed:____

Reports are due to Accounting by the last business day of each quarter.

Since the date of the last questionnaire:

(B1) Has there been a significant adverse change in legal factors or in the business climate, including an adverse action or assessment by a regulator, which could affect the value of an individual long-lived asset or asset group? If yes, please describe:

____

(B2) Has there been a current period operating or cash flow loss combined with a history of operating or cash flow losses or a forecast that demonstrates continuing losses associated with the use of an individual long-lived asset or asset group? If yes, please describe:

____

655 – Capital – Hardware & Software Capitalization

(Note: Text in italics indicates a key SOX control.)

Policy: To capitalize software, hardware and all related costs that have long-term benefit to LG&E and KU Energy LLC and its subsidiaries ("LKE").

Procedure: To capitalize software and hardware in accordance with the capitalization thresholds.

Scope: All software, hardware and related costs of LKE.

Objective of Procedure: To consistently apply the guidelines for capitalizing or expensing software and hardware, in compliance with the Federal Energy Regulatory Commission ("FERC"), FASB Accounting Standards Codification ("ASC") 350-40, Internal Use Software (Intangibles – Goodwill and Other), (formerly SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use) and FASB Accounting Standards Update No. 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement.

General Requirements:

Detailed Procedures Performed:

Hardware:

All purchased hardware having a useful life consistent with the depreciable life established in the most recently approved depreciation study and a cost in excess of $5,000 shall be capitalized. Hardware will be recorded in the appropriate sub-account of FERC Account 391, Office Furniture and Equipment, and will be amortized charging FERC Account 403, Depreciation Expense, and crediting FERC Account 108, Accumulated Provision for Depreciation of Utility Plant. Incidental software included in the purchase of the hardware will be capitalized as part of the hardware. Retirements will be recognized only at the end of the amortization period as allowed by the FERC.

Purchased Software:

All software purchased separately from hardware and having a useful life consistent with the depreciable life established in the most recently approved depreciation study and a cost in excess of $5,000 shall be capitalized in accordance with ASC 350-40. Software will be recorded in FERC Account 303, Miscellaneous Intangible Plant, and amortized by charging FERC Account 404, Amortization of Limited-Term Plant, and crediting FERC Account 111, Accumulated Provision for Amortization of Utility Plant. Retirements of software will be recognized according to instructions for FERC Account 303 and ASC 350-40.

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(Note: Text in italics indicates a key SOX control.)

Internally Developed Software:

All software developed internally and having a useful life consistent with the depreciable life established in the most recently approved depreciation study and a cost in excess of $50,000 shall be capitalized in accordance with the guidelines set forth in ASC 350-40 and recorded per the rules stated above for purchased software.

Note: Internally developed software generally consists mainly of labor. However, it is not limited to internal IT labor only but rather may also include external/contract labor and insignificant purchased software costs. The use of contractors or minor purchases of software on a project do not prevent the proper classification of internally developed software (i.e. the project is still subject to the $50,000 threshold for internally developed software).

Hosted Software Agreements:

In connection with the licensing of software products, hosted software agreements are arrangements in which the Company does not take possession of the software. Instead, the software application resides on the vendor's or a third party's hardware, and the Company accesses and uses the software on an as-needed basis over the internet or via a dedicated line. Fees associated with hosted arrangements will be expensed as incurred, unless the following criteria is met:

a. The Companies have the contractual right to take possession of the software at any time during the hosting period without significant penalty.
b. It is feasible for the Companies to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

The term "without significant penalty" contains two distinct concepts:

a. The ability to take delivery of the software without incurring significant costs (i.e. costs in excess of the current capitalization threshold of $5,000).
b. The ability to use the software separately without significant diminution in utility or value.

Hosting arrangements that do not meet both criteria above are service contracts and do not constitute a purchase of or convey a license to software and thus costs should be expensed. Other costs associated with the software project will either be expensed or capitalized as described below in the Accounting for Related Costs section—provided

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(Note: Text in italics indicates a key SOX control.)

that there is a commitment that long-term benefits are to be gained from the capitalized costs. Long term benefits must be evidenced by a hosted arrangement contractual agreement with a term consistent with the depreciable software life established in the most recently approved depreciation study. Projects involving hosting arrangements should be discussed in advance with Property Accounting.

Upgrades/Enhancements to Software:

Upgrades and enhancements made when software is originally purchased will be capitalized as part of the software cost in accordance with ASC 350-40. Upgrades and enhancements made after the initial purchase or development will be capitalized in accordance with ASC 350-40 if they represent modifications to the original asset to enable the software to perform tasks that it was previously incapable of performing

Accounting for related costs:

Guidance on capitalization of costs incurred for computer **hardware/software** is provided below:

1. Costs incurred during the **preliminary stages** of a hardware/software project should be expensed as incurred include the following:
    a. development of scope
    b. business needs analysis
    c. documentation of as-is business processes
    d. documenting high-level business requirements and performance/system requirements (used in the evaluation of alternatives)
    e. conceptual formulation of alternatives
    f. evaluation of alternatives
    g. determination of existence of needed technology
    h. final selection of alternatives/vendors
    i. development of cost estimates
    j. business process reengineering (not specific to the implementation of specific technology solution)

2. Costs incurred during the **application stage** to develop software should be capitalized. Capitalization of costs shall begin when a.) the preliminary project stage is completed and b.) management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project and it is probable that the project will be completed and the software will be used to

perform the function intended. Examples of authorization include the execution of a contract with a third party to develop the software, approval of expenditures related to internal development, or a commitment to obtain the software from a third party. Application stage costs include the following:

a. design activities including documentation of process changes required (to-be process documentation), detailed application requirements, analysis of system functionality and identification of required changes/customizations (gap-analysis), functional design documents, visualization or prototyping of solution, business rules, configuration requirements/rules, data requirements and reporting requirements
b. build activities including documentation of technical requirements, development, coding, software configuration, interfaces, and installation to hardware
c. testing including the development of user stories, use cases, testing scenarios and test scripts, and defect management
d. implementation activities

Costs shall include the actual cost of purchased hardware and software, consultant fees, travel expenses and payroll costs of the Information Technology Department. User (i.e., line of business) department costs may be charged to a project, but are limited to charges incurred by persons actively working on the project. Examples of employee activities include, but are not limited to design, coding and testing during the application development stage. Charges of persons serving on steering or advisory committees are excluded from capital costs.

3. Costs to develop or obtain software to access or **convert old data** using new systems should be capitalized. However, the actual cost of data conversion (purging or cleansing existing data, reconciling or balancing old data versus the data in the new system) should be expensed as incurred.

4. **License fees** can be capitalized along with the costs to purchase software.

5. All **training** costs should be expensed as incurred.

6. Meals related to Company business and incurred as part of the capitalized activities described above may be charged to the capital project. Meals related to Company business and incurred as part of the expensed activities described above must be expensed. The cost of celebrations and other expenses (food, room rentals, entertainment, outings, etc.) incurred as employee recognition for

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(Note: Text in italics indicates a key SOX control.)

participation on a capital project shall be charged to a below-the-line expense or to LG&E and KU Capital LLC as determined by Policy 1060-Regulatory Compliance.

7. In some cases, software contract fees may include **multiple-arrangements**, such as training for the software, maintenance fees for routine maintenance work to be performed by the third party, data conversion costs, reengineering costs, and rights to future upgrades and enhancements. Entities shall allocate the cost among all individual elements.

8. Capitalization shall cease no later than the point at which a computer software project is substantially complete and ready for its intended use. Substantially complete is generally defined as when all substantial testing is completed and automated systems are operational. Costs incurred to operate and maintain software shall be expensed.

9. **Maintenance** costs, including the first year of maintenance, should be expensed as incurred.

10. **Upgrades and enhancements** to existing software (modifications that result in the software being able to perform tasks that it was previously incapable of performing) should be expensed or capitalized in accordance with the rules listed above. Upgrades without additional functionality should be expensed. Costs that cannot be separated on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements should be expensed (i.e. security patches or bug fixes).

11. When a software project will not be completed, no further costs should be capitalized, and the existing balances should be considered for impairment.

Communication of Policy Changes: Any changes to this policy will be communicated by the Manager, Property Accounting to the following:

- Director, Financial Planning and Analysis
- Director, Financial Resource Management
- Director, IT Application, Planning, Execution & Support
- Director, IT Enterprise Business Services
- Director, IT Development and Support
- Director, IT Enterprise Infrastructure
- Director, IT Security & Compliance

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(Note: Text in italics indicates a key SOX control.)

- Director, IT Data Center Operations
- Manager, Asset Management-PPL

Reports Generated and Recipients:

- None

Additional Controls or Responsibility Provided by Other Procedures:

- Budget Coordinators, Financial Planning personnel and Property Accounting Analysts review Authorization for Investment Proposals to confirm that hardware, software and related costs are being properly capitalized.

Regulatory Requirements:

- FERC Accounting Guidelines

Reference:

- FASB ASC 350-40, Internal Use Software (Intangibles – Goodwill and Other) (formerly SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use)
- FASB Accounting Standards Update No. 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement
- Hardware and Software Capitalization 5-15-15.docx (File Memo)

Corresponding PPL Policy No. and Name:

615 – Accounting for Computer Software

Key Contact:
Manager, Property Accounting

Administrative Responsibility:
Director, Accounting and Regulatory Reporting

Date Created: 11/23/04
Dates Revised: 5/17/05; 12/1/10; 3/31/11; 9/22/11; 8/17/12; 5/15/15; 3/02/16; 1/27/17

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(Note: Text in italics indicates a key SOX control.)

Appendix A

Appendix A provides specific references and exact language from Financial Accounting Standards Board ASC 350-40, Internal Use Software (Intangibles – Goodwill and Other) (formerly SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use). Appendix A is included here in support of the guidance provided above in Policy 655 and for easy reference.

Preliminary Project Stage

Internal and external costs incurred during the preliminary project stage shall be expensed as they are incurred. (ASC 350-40-25-1)

Activities include (ASC 350-40-55-3):

1. Conceptual formulation of alternatives
2. Evaluation of alternatives
3. Determination of existence of needed technology
4. Final selection of alternatives.

Application Development Stage

Internal and external costs incurred to develop internal-use computer software during the application development stage shall be capitalized. (ASC 350-40-25-2)

Activities include (ASC 350-40-55-3):

1. Design of chosen path, including software configuration and software interfaces
2. Coding
3. Installation to hardware
4. Testing, including parallel processing phase.

Costs include (ASC 350-40-30-1):

a. External direct costs of materials and services consumed in developing or obtaining internal-use computer software:

   1. Fees paid to third parties for services provided to develop the software during the application development stage
   2. Costs incurred to obtain computer software from third parties
   3. Travel expenses incurred by employees in their duties directly associated with developing software.

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(Note: Text in italics indicates a key SOX control.)

b. Payroll and payroll-related costs (for example, costs of employee benefits) for employees who are directly associated with and who devote time to the internal-use computer software project, to the extent of the time spent directly on the project. Examples of employee activities include but are not limited to coding and testing during the application development stage.

Timing (ASC 350-40-25-12):

Capitalization of costs shall begin when both of the following occur:

a. Preliminary project stage is completed.

b. Management, with the relevant authority, implicitly or explicitly authorizes and commits to funding a computer software project and it is probable that the project will be completed and the software will be used to perform the function intended. Examples of authorization include the execution of a contract with a third party to develop the software, approval of expenditures related to internal development, or a commitment to obtain the software from a third party.

Capitalization shall cease no later than the point at which a computer software project is substantially complete and ready for its intended use, that is, after all substantial testing is completed. (ASC 350-40-25-14)

The process of data conversion from old to new systems may include purging or cleansing of existing data, reconciliation or balancing of the old data and the data in the new system, creation of new or additional data, and conversion of old data to the new system. Data conversion often occurs during the application development stage. (ASC 350-40-05-8)

Costs to develop or obtain software that allows for access to or conversion of old data by new systems shall also be capitalized. (ASC 350-40-25-3)

Actual data conversion costs, except as noted in paragraph 350-40-25-3, shall be expensed as incurred. (ASC 350-40-25-5)

Training costs are not internal-use software development costs and, if incurred during this stage, shall be expensed as incurred. (ASC 350-40-25-4)

Post implementation-Operation Stage

Internal and external training costs and maintenance costs during the post implementation-operation stage shall be expensed as incurred. (ASC 350-40-25-6)

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(Note: Text in italics indicates a key SOX control.)

Activities include (ASC 350-40-55-3):
1. Training
2. Application maintenance.

Impairment

When it is no longer probable that the computer software project will be completed and placed in service, no further costs shall be capitalized, and guidance in paragraphs 350-40-35-1 through 35-3 on impairment shall be applied to existing balances. (ASC 350-40-25-13) See Policy 654 – Asset Impairment for guidance on asset impairment.

Hosting Arrangements

Hosting Arrangement - In connection with the licensing of software products, an arrangement in which an end user of the software does not take possession of the software; rather, the software application resides on the vendor's or a third party's hardware, and the customer (i.e. our Company) accesses the uses of the software on an as-needed basis over the Internet or via a dedicated line. (ASC 350-40 Master Glossary)

The guidance in this Subtopic applies only to internal-use software that a customer (i.e. our Company) obtains access to in a hosting arrangement if **both** of the following criteria are met (ASC 350-40-15-4):

1. The customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty. The term without significant penalty contains two distinct concepts:
   a. The ability to take delivery of the software without incurring significant costs.
   b. The ability to use the software separately without significant diminution in utility or value.

2. It is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

Hosting arrangements that do not meet both criteria are service contracts and do not constitute a purchase of, or convey a license to, software. (ASC 350-40-15-4)

Upgrades and Enhancements

Upgrades and enhancements are defined as modifications to existing internal-use software that result in additional functionality—that is, modifications to enable the software to perform tasks that it was previously incapable of performing. Upgrades and enhancements normally require

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(Note: Text in italics indicates a key SOX control.)

new software specifications and may also require a change to all or part of the existing software specifications. (ASC 350-40-05-9)

> In order for costs of specified upgrades and enhancements to internal-use computer software to be capitalized in accordance with paragraphs 350-40-25-8 through 25-10 *(see immediately below)*, it must be probable that those expenditures will result in additional functionality. (ASC 350-40-25-7) (Note: LKE does capitalize enhancements made to software after the initial software in-service in order to fix issues immediately after the go-live date or to modify the software to make it functional for our particular needs. After post go-live issues have been addressed, work performed to correct issues and perform routine maintenance is expensed.)
>
> Internal costs incurred for upgrades and enhancements shall be expensed or capitalized in accordance with paragraphs 350-40-25-1 through 25-6 *(see preliminary project and application development stages above*). (ASC 350-40-25-8)
>
> Internal costs incurred for maintenance shall be expensed as incurred. (ASC 350-40-25-9)
>
> Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements shall expense such costs as incurred. (ASC 350-40-25-10)
>
> External costs incurred under agreements related to specified upgrades and enhancements shall be expensed or capitalized in accordance with paragraphs 350-40-25-1 through 25-6 *(see preliminary project and application development stages above*). If maintenance is combined with specified upgrades and enhancements in a single contract, the cost shall be allocated between the elements as discussed in paragraph 350-40-30-4 *(see immediately below)* and the maintenance costs shall be expensed over the contract period. However, external costs related to maintenance, unspecified upgrades and enhancements, and costs under agreements that combine the costs of maintenance and unspecified upgrades and enhancements shall be recognized in expense over the contract period on a straight-line basis unless another systematic and rational basis is more representative of the services received. (ASC 350-40-25-11)

Multiple-Element Arrangements Included in Purchase Price

Entities may purchase internal-use computer software from a third party. In some cases, the purchase price includes multiple elements, such as training for the software, maintenance fees for routine maintenance work to be performed by the third party, data conversion costs,

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(Note: Text in italics indicates a key SOX control.)

reengineering costs, and rights to future upgrades and enhancements. Entities shall allocate the cost among all individual elements. The allocation shall be based on objective evidence of fair value of the elements in the contract, not necessarily separate prices stated within the contract for each element. Those elements included in the scope of this Subtopic shall be accounted for in accordance with the provisions of this Subtopic. (ASC 350-40-30-4)

656 – Capitalized Property Taxes

(Note: Text in italics indicates a key SOX control.)

Policy: Property taxes are capitalized as part of the original construction costs.

Procedure: Monthly capitalize property taxes on amounts recorded in Construction Work in Progress ("CWIP").

Scope: All eligible CWIP projects of Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU"). This policy does not apply to other LKE subsidiaries as property taxes generally are expensed as incurred. See the technical guidance which states that utilities (LG&E and KU) are allowed to capitalize costs that otherwise might be expensed as they are able to receive recovery through rates.

Objective of Procedure: To capitalize property taxes according to Federal Energy Regulatory Commission ("FERC") guidelines and Generally Accepted Accounting Principles ("GAAP").

General Requirements:

Electric Plant Instruction number 3A (18 CFR 101) generally permits the capitalization of property taxes as evidenced by the following:

> "3. Components of Construction cost. A. For Major utilities, the cost of construction properly includible in the electric plant accounts shall include, where applicable, the direct and overhead cost as listed and defined hereunder: …. (16) Taxes includes taxes on physical property (including land) during the period of construction and other taxes properly includible in construction costs before the facilities become available for service."

PwC – Guide to Accounting for Utilities & Power Companies, Chapter 12, Plant further specifies:

> "Figure 12-5 Accounting for Development and Construction Costs, Property taxes during construction – Generally expense: Property taxes are a cost of owning the property and are not a direct incremental cost of construction, thus such amounts should be expensed as incurred. However, similar to ground lease expense, such amounts may be capitalized if the property is being constructed for sale or rental. See UP 12.2.2."
>
> However, the following exception applies to regulated entities.
>
> "12.2.1.3 Construction Phase During the construction phase, a reporting entity should capitalize direct and incremental costs of construction in accordance with its capitalization policies. In general, indirect costs should continue to be expensed during

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(Note: Text in italics indicates a key SOX control.)

> construction. …. In addition, regulated utilities may be able to include construction-related costs in rate base that would otherwise be expensed. To capitalize such costs, a regulated utility should ensure that it is probable such amounts will be included in future rate base (see UP 18.2). Figure 12-5 (included at the end of this chapter) summarizes the accounting for costs incurred during all phases of construction of a power or utility project constructed for a reporting entity's own use. The following sections discuss specific additional considerations for certain of the costs that may be incurred during construction. See UP 12.2.2 for incremental considerations for a reporting entity constructing a project for sale or rental."

Capitalization of property taxes is limited to capital projects that possess all of the following characteristics: (Note: transmission and distribution blankets are excluded, as well as annual projects (i.e. Pole Inspection and Treatment) that are kept open until early the next year to accept all final charges.)

- have a projected cost of greater than $500,000[1]
- are constructed over a period of greater than 12 months.

Historically, property taxes had been capitalized only on coal-fired generating unit projects such as Trimble County and Mill Creek. However, effective in July 2015 with the implementation of new base rates from Case Nos. 2014-00371 and 2014-00372, LG&E's and KU's accounting policy is to capitalize property taxes based on the criteria above.[2]

Detailed Procedures Performed:

Property taxes are assessed annually based on net book value included in CWIP at the end of the preceding year. For example, property taxes on CWIP for 2015 are based on CWIP balances as of December 31, 2014.

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[1]As included in the rebuttal testimony of Kent Blake in Kentucky Public Service Commission Case Nos. 2014-00371 and 2014-00372, $100,000 was initially determined to be the threshold for capitalizing property taxes. This threshold was chosen to provide consistency with the AFUDC threshold. However, a detailed analysis was performed by Operations Budgeting & Forecasting following the rate case settlement to determine whether a different threshold should be established to avoid an administrative burden with having to track and capitalize property taxes on nearly 100 projects. This review indicated that a more appropriate threshold would be $500,000 as the amount of projects would be reduced to less than 50 projects while not materially reducing the amount of property taxes to be capitalized. Additionally, the $500,000 threshold promotes consistency with the capital policy whereby projects over $500,000 are required to have an investment proposal.

[2] See the direct testimony of Lane Kollen on behalf of the Kentucky Industrial Utility Customers and the rebuttal testimony of Kent Blake, Chief Financial Officer of LG&E and KU in Case Nos. 2014-00371 and 2014-00372.

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(Note: Text in italics indicates a key SOX control.)

1. The Operations-Budgeting & Forecasting Department provides the Tax Department with the estimated spend and duration of the projects in CWIP which meet the established guidelines for capitalization of property taxes.
2. The Tax Department calculates the amount of property tax to be charged for each eligible project. This amount is spread over the remaining duration of the project to determine the monthly figure to charge each project by journal entry. When a project is placed in service, the capitalization of property tax will stop.
3. Based on the calculation in step 2 above, the Tax Department prepares a monthly journal entry to reclass the charges from the O&M account where the Tax department charges the overall property tax accrual to the applicable CWIP project.

Reports Generated and Recipients:
None

Additional Controls or Responsibility Provided by Other Procedures:
None

Regulatory Requirements:
FERC Accounting Guidelines, CFR 18

Reference:
PwC – Guide to Accounting for Utilities & Power Companies, Chapter 12, Plant

Corresponding PPL Policy No. and Name:
N/A

Key Contact:
Manager, Tax Accounting and Compliance
Manager, Property Accounting

Administrative Responsibility:
Director, Corporate Tax and Payroll
Director, Financial Resource Management

Date Created: 4/27/07
Dates Revised: 12/1/10; 9/23/11; 6/2/15; 3/02/16; 3/22/16

658 – Joint Ownership/Use Assets

(Note: Text in italics indicates a key SOX control.)

Policy: All fixed assets which benefit the customers or shareholders of multiple companies will be recorded with the appropriate ownership percentages.

Procedure: The procedures for accounting for joint use and jointly owned assets are described in the detailed instructions below.

Scope: All asset additions of LG&E and KU Energy LLC ("LKE" or the "Company") and its subsidiaries.

Objective of Procedure: Ensure that joint use and jointly owned assets are properly recorded on the appropriate LKE entities.

General Requirements:

Jointly Used Assets:

Detailed Procedures Performed:

Definition: Jointly Used Assets – Buildings and related assets such as parking lots and driveways which were originally constructed and owned by a single company (generally either LG&E or KU) but are subsequently being used by more than one company. An example of these assets is the Broadway office complex (BOC). The original BOC assets consisting of the core infrastructure of the building (roof, HVAC, exterior walls, parking lot) are owned solely by LG&E. Rent is charged to the companies benefitting from the use of the building assets by the company owning the building. The rental amount is based upon the depreciation associated with the infrastructure assets at the location.

Jointly used assets are the following locations:

Locations:
Broadway Office Complex
One Quality Street
Dix Transmission Control
LG&E Building Leasehold Improvements**
Pineville Call Center
Morganfield
Riverport

Guidelines for establishing ownership of assets located at jointly used facilities:

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(Note: Text in italics indicates a key SOX control.)

- It is the stated practice that assets **originally** constructed and owned by a single company (example: LG&E owns the BOC) and subsequently used by a related company (example: KU) shall not be sold to the related company (KU).
- Infrastructure Assets Ownership and Rent: Asset purchases made to replace or enhance the infrastructure such as roof and HVAC replacements and driveway paving will be purchased by the original owner (LG&E for BOC example). Rent will be charged to the companies benefitting from the use of the building assets by the company owning the building. The rental amount will be based upon the depreciation (life and cost of removal/salvage) associated with the infrastructure assets at the location. Infrastructure assets are typically found in "Structures and Improvements" plant accounts. Rent will be allocated to the benefitting companies based on the percentage of time employees located in the building charge to each company based on the most recent LG&E and KU Services Company Cost Allocation Manual (CAM) percentage using an indirect account and the expenditure org of the source company for both the intercompany rental income and the intercompany rental expense.
- Non-Infrastructure Assets Ownership: Non-infrastructure assets are purchased from time to time which benefit customers or shareholders of multiple companies and these assets are physically located at one of the aforementioned buildings. An example of these assets would be the office furniture/equipment and drywall/carpet replacement required for a renovation of the customer call center located at the BOC. LG&E and KU customers both benefit from these capital expenditures and each company will share in the ownership of the assets. For asset purchases such as these, the ownership percentages will be established at the time the project is initiated/approved and must be documented on the AIP. The ownership percentages will be based on the applicable CAM ratios in effect at the time the AIP is completed. The ratio used must be documented by name on the AIP. All charges made to the project must be consistent with the ownership percentage stated on the AIP.

****LG&E Building** Leasehold Improvements—in connection with tenant improvement allowance for lease term commencing July 1, 2012:

The LG&E Building is a leased facility. A new lease was entered into and commenced July 1, 2012. Under the terms of the new lease agreement the Landlord has provided LKE with a tenant improvement allowance of approximately $7 million for leasehold improvements. A summary of the accounting treatment for the leasehold assets acquired under this tenant allowance follows:

- The leasehold improvement assets will be established on the financial records of LG&E and KU Services Company (LKS).

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- Rent will be charged by LKS to the companies benefitting from the use of the leasehold improvement assets based on the "Infrastructure Assets Ownership and Rent" guidelines established on page 2 of this policy.
- When LKE receives reimbursement for improvements under the tenant allowance agreement, a tenant incentive liability is recorded that is then amortized straight-line over the remaining lease term and allocated on the same basis as the rent expense.

Morganfield jointly used assets:

Morganfield is a facility which was constructed in 2011 predominantly to meet the needs of KU. The facility houses a storeroom, walk-in customer business office, Meter Reading/Field Service office space and office space/staging area for Distribution Operations personnel. Additionally, the facility contains a customer service call center which serves customers of both LG&E and KU.

Guidelines for establishing ownership of assets located at Morganfield:

- Since the Morganfield facility was constructed primarily for KU purposes, the building infrastructure and land are owned solely by KU. Asset purchases made to replace or enhance the infrastructure will be purchased by KU.
- Rent will be charged to LG&E for the benefit of the use of the building assets for the call center. The rent will be based on the "Infrastructure Assets Ownership and Rent" guidelines established on page 2 of this policy.
- Ownership percentages for non-infrastructure assets purchased for the call center will be established at the time the project is initiated/approved and must be documented on the AIP. The ownership percentages will be based on the applicable CAM ratios in effect at the time the AIP is completed. The ratio used must be documented by name on the AIP. All charges made to the project must be consistent with this ownership percentage stated on the AIP.

Riverport jointly used assets:

Riverport (7301 Distribution Drive) is a 200,000 square foot facility located in Louisville which was purchased in 2012. The purchase was precipitated by the need to relocate the Central Maintenance Shop from Mill Creek Generating Station due to extensive Environmental Air Compliance work at Mill Creek. This facility, purchased mainly due to the required relocation of LG&E owned property, was partially funded by LG&E's Environmental Cost Recovery Mechanism (ECR) and is located in LG&E's service territory. For these reasons, the building and land are owned solely by LG&E. The property is classified as a generation asset.

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Guidelines for establishing ownership of assets located at Riverport:

- Since the Riverport facility was purchased primarily for LG&E purposes, the building infrastructure and land are owned solely by LG&E. Asset purchases made to replace or enhance the infrastructure will be purchased by LG&E.
- Rent will be charged to KU for the benefit of the use of the building assets. As of the date of this policy, Riverport is used mostly for warehouse space with the Central Maintenance Shop occupying a smaller portion of the building. As such, very few employees are physically located at the building. Therefore, it was determined that the rent would be more reasonably based on the square footage of departments occupying Riverport rather than on the "Infrastructure Assets and Rent" guidelines established on page 2 of this policy which is based on how the time of employees located in the building is charged to the benefitting companies.
- Ownership percentages for non-infrastructure assets purchased for the site will be established at the time the project is initiated/approved and must be documented on the AIP. The ownership percentages will be based on the applicable CAM ratios in effect at the time the AIP is completed. The ratio used must be documented by name on the AIP.

Brown CT Pipeline jointly used assets:

The pipeline assets and associated land was originally built to serve Brown CT 9, which was placed in service prior to the LG&E and KU merger in 1998. The pipeline assets are solely owned by KU. Brown CT 8, 9, 10 and 11 (solely owned by KU) and BR CT 5, 6 and 7 (jointly owned by LG&E and KU) were subsequently constructed and are also served by the pipeline. KU will charge LG&E rent based upon the depreciation (life and cost of removal/salvage) associated with the infrastructure assets at the location. The rent allocation will be based on the CT nameplate rating of the CTs served by the pipeline.

Jointly Owned Assets:

Detailed Procedures Performed:

Definition: Jointly Owned Assets – Assets whose total cost is split between the companies benefitting from the use of the assets based on stated ownership percentages. For the majority of these assets, ownership percentages are established prior to construction.

Generation jointly owned assets:

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(Note: Text in italics indicates a key SOX control.)

	Ownership:	
Locations:	**LG&E %**	**KU %**
Brown 5	53	47
Brown 6	38	62
Brown 7	38	62
Brown Jointly Owned CT 5, 6 & 7	20	80
Paddy's Run 13	53	47
Trimble County CT 5 & 6	29	71
Trimble County CT Pipeline	29	71
Trimble County CT 7, 8, 9 & 10	37	63
Trimble County Jointly Owned CT 5, 6, 7, 8, 9, 10	34	66
Trimble County 2	19	81
Trimble County Jointly Owned (TC1 and TC2)	52	48
Cane Run 7 Combined Cycle GT (CR7)	22	78
Brown Solar	39	61

Guidelines for establishing ownership percentages:

- Generation ownership percentages are typically determined by the Integrated Resource Plan (IRP).
- For generation assets which are common to more than one generating asset (examples: coal conveyors, roads), ownership percentages are typically determined by a combination of the IRP ownership percentage and the nameplate rating of the applicable units.
- The land footprint under each jointly owned unit will be jointly owned by each company according to the established ownership percentages. The land footprint is generally defined as the perimeter of the jointly owned plant site (may extend to fence lines and include lay down areas) and not confined to a piece of equipment or building foundation. The footprint will be defined by the applicable subject matter experts (such as Generation Services or Project Engineering).
    - Land sales may need to be made from one company to another if the new jointly owned units are being constructed on land originally solely owned by one of the companies. The sale is required in order to be compliant with the Power Supply System Agreement whereby the utilities must be tenants in common. If the plant site was originally solely owned by one company then the land surrounding the footprint of the jointly owned plant will continue to be solely owned by the original company. Any additional land purchases made as a result of jointly owned asset construction will also be jointly owned (example: buffer land purchased for CR 7 construction.)

- If the land for the plant site is a new purchase (at a location not previously solely owned by one of the companies), the entire plant site will be jointly owned by each company according to the established ownership percentages.

Exception: For generation jointly owned projects whose cost is estimated at $25,000 or less, the assets will not be split based on the ownership percentages. Rather, 100% of the assets will be recorded on the financial records of the company with the largest ownership percentage. Projects smaller than $25,000 are a very small amount when compared to the overall total cost of generation assets and do not justify the processing time required for all parties involved.

Transmission assets constructed in conjunction with generation projects constructed 2003 or later:

Summary:

- Transmission assets will not be jointly owned between LG&E and KU.
- The cost of certain transmission assets may be allocated to generating units being constructed. The transmission assets will be classified as transmission, but will be recorded at $0 cost.

See below for detailed discussion and definitions.

Definitions:

Generator owner – The owner of the generating unit being constructed. LG&E and KU are generator owners. The generator owner could be solely LG&E or KU or the generating unit could be jointly owned by LG&E and KU as in the case of Cane Run 7 Combined Cycle CT (CR 7) and Trimble County Unit 2 (TC 2).

Transmission owner – The owner of transmission assets such as substation equipment, the substation control house and transmission lines connected to a generating unit. LG&E and KU are transmission owners.

Generator Interconnection – The connection between a generating station (example: CR 7) and the related transmission assets.

In 2003, FERC Order No. 2003 was issued that required a major overhaul of the FERC Approved Pro-Forma Open Access Transmission Tariff (OATT), specifically the Generator Interconnection Agreement (GIA). Order No. 2003 more specifically distinguished which transmission assets, determined necessary for a Generator Interconnection (GI), would be paid for by the generator owner vs. the transmission owner. Order No. 2003 also determined who (the generator owner vs. the transmission owner) would ultimately own, operate, and maintain those assets after installation. Functional classification among FERC plant accounts for new

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(Note: Text in italics indicates a key SOX control.)

transmission facilities constructed in connection with a generating facility after 2003 is in accordance with Order No 2003.

A different GIA exists for each GI installed post the 2003 Order and each pre-2003 generator required to make a GI request thru the OATT for changes to the interconnection or its capability. Each GIA may contain different terms and as a result FERC functional asset classification and asset ownership between LG&E and KU may not be consistent among transmission assets.

The GIA identifies three groups of assets for functional classification. The groups and their functional groupings are identified below.

Generator Interconnect Facilities - Requirements of the GIA specify that the following assets will be classified as generation assets and recorded in the appropriate generation plant accounts.

Generator Assets - All assets on the Generator side of the Point of Interconnection (POI)

- Generation Step Up Transformer (GSU)
- Generator Sync Breakers
- Lines
- Insulators
- Structures
- Foundations
- Right of way
- Land

Assets in this category are owned jointly in accordance with the established ownership percentages for CR 7 and TC 2.

Transmission Interconnection Facilities – Requirements of the GIA specify that assets from the POI to the “Transmission Owner’s” (TO) network facilities are transmission assets. In accordance with the GIA, the following types of assets will be classified as transmission assets and recorded in the transmission plant accounts.

Transmission Interconnection Assets - from the POI to the TO’s network facilities

- 3Phase take off structures (structures, insulators, foundations, and associated equipment)
- Generator breakers
- Generator breaker switches
- Structures, insulators, foundations, and other associated equipment for the above three items

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(Note: Text in italics indicates a key SOX control.)

- Controls for the switches and breaker
- Breaker panel in control house
- Wiring for breaker panel to and in the control house

For example, since CR 7 and TC 2 are located in LG&E's service territory and the current transmission assets are owned by LG&E, it is determined that LG&E is the transmission owner. For CR 7, these transmission assets will be recorded at $0 as the CR 7 generation owners/projects (LG&E-22%~KU-78%) will fund these assets as a contribution in aid of construction. The contribution dollars will be accounted for on the CR 7 generation projects as a spread cost and will be allocated over the generating assets being constructed. As the "transmission owner" LG&E will be the sole owner of these transmission assets (which are valued at $0). Subsequent improvements made to these assets will be 100% funded by LG&E as the transmission owner and the costs will be added to the transmission accounts and not spread over generation assets. Note: Recording these transmission assets for CR 7 initially at $0 is a departure from previous practice as well as the Code of Federal Regulations 18 Part 101 Electric Plant Instructions. However, Troutman Sanders LLP (on behalf of LG&E/KU) held a conversation with FERC which resulted in FERC's agreement that it is permissible to record these assets as spread costs over the generation assets being constructed and be treated as $0 transmission assets as described in the preceding paragraph. The TC 2 GIA agreement did not specify that any of these assets would be funded by the generation owner, therefore, all TC 2 transmission assets are recorded at full cost.

<u>Network Facilities</u> - Requirements of the GIA specify that assets after the point of interconnection, such as transmission substation equipment, the substation control house and transmission lines, are transmission assets. Assets deemed to be network transmission assets for CR 7 and TC 2 will be owned by the TO, LG&E, at 100% of the cost to construct. The cost to build and decommission network facilities upgrades will be paid for by the TO. A description of assets that could be in this grouping follows:

i. Substation –
  - Tie breakers, line breakers, transformers and other substation assets.
  - Control house (only the generator breaker control panel will NOT be a network upgrade-per interconnection facility paragraph above).
  - Wiring to and from all breakers, associated equipment, and control house (minus that specific to the generator breaker and control panel-per interconnection facility paragraph above).
  - Land on which the substation is built will be wholly owned by the TO, LG&E.

ii. Lines
  - Transmission line assets between the Companies are determined based on the territory in which they lay. However, if a line spans across LG&E and KU territories,

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(Note: Text in italics indicates a key SOX control.)

the interconnection point between LG&E and KU will be determined by LG&E/KU Transmission department. This interconnection point will determine the ownership and asset allocation.

iii. Other network upgrades (as identified in GIA OATT Studies)

Brown Solar distribution assets**:**

The E.W. Brown Solar plant is a 10MW solar powered GI, which began operation in June 2016. Brown Solar is jointly owned (KU-61%~LG&E-39%). Brown Solar contains both generation assets and distribution assets as determined by the Vice President-Power Production and Vice President-Electric Distribution. Per the OATT, the distribution assets shall be treated as interconnect assets and accounted for similar to the transmission interconnect assets at CR 7. (See immediately preceding section for discussion on CR 7 interconnect assets.) The distribution assets consist of a transformer, switchgear, poles, conductor and other assets associated with distribution operations. Since Brown Solar is located in KU's service territory and the current distribution assets are owned by KU, it is determined that KU is the distribution owner. These distribution assets will be recorded at $0 as the Brown Solar generation owners/projects (KU-61%~LG&E-39%) will fund these assets as a contribution in aid of construction. The contribution dollars will be accounted for on the Brown Solar generation projects as a spread cost and will be allocated over the generating assets being constructed. As the "distribution owner" KU will be the sole owner of these distribution assets (which are valued at $0). Subsequent improvements made to these assets will be 100% funded by KU as the distribution owner and the costs will be added to the distribution accounts and not spread over generation assets.

Simpsonville jointly owned assets:

Two separate facilities are located at the jointly owned Simpsonville, Kentucky site:

1. A combined Transmission Control/Information Technology (IT) Data Center
2. A Distribution Control Center (DCC)

Simpsonville's **Transmission Control/IT Data Center** assets will be split on a functional basis based on square footage occupied by each function as follows:

Location:	Transmission %	IT %
Simpsonville-Trans Con/IT Data Center	52	48

Ownership of infrastructure assets (example: roof, HVAC, driveway) at Simpsonville's Transmission Control/IT Data Center will first be split functionally per the ownership percentages above. Ownership of the functional assets will then be further split between LG&E,

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(Note: Text in italics indicates a key SOX control.)

KU and LG&E & KU Capital LLC (LKC) based on the following ownership percentages, which were established at the time of original construction based on the CAM:

		Ownership:	
Location:	LG&E %	KU %	LKC%
Simpsonville-Transmission Control	30%	70%	
Simpsonville-IT	52%	47%	1%

Ownership percentages for asset purchases made for non-infrastructure assets will be established at the time the project is initiated/approved and must be documented on the AIP. The ownership percentages will be based on the applicable CAM ratios in effect at the time the AIP is completed. The ratio used must be documented by name on the AIP. All charges made to the project must be consistent with the ownership percentage stated on the AIP.

Exceptions:

1. **Simpsonville Infrastructure assets $10,000 or less:** For infrastructure asset projects whose cost is estimated at $10,000 or less, the assets will be classified as Transmission Control assets and owned by KU (as the majority owner). The cost to establish amounts less than $10,000 does not justify the processing time required to split the assets functionally between Transmission Control and IT and between companies.
2. **Simpsonville Infrastructure assets between $10,001 and $50,000:** For infrastructure assets between $10,000 and $50,000, the assets will be classified as Transmission Control assets and jointly owned by KU (70%) and LG&E (30%). The cost to establish these assets does not justify the processing time required to split the assets functionally between Transmission Control and IT.

Ownership of infrastructure assets at Simpsonville's **DCC** are as follows:

Location:	LG&E %	KU %
Simpsonville-DCC	42	58

Ownership percentages for asset purchases made for DCC non-infrastructure assets will be established at the time the project is initiated/approved and must be documented on the AIP. The ownership percentages will be based on the applicable CAM ratios in effect at the time the AIP is completed. The ratio used must be documented by name on the AIP. All charges made to the project must be consistent with the ownership percentage stated on the AIP.

Exceptions:

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Simpsonville DCC Infrastructure assets $10,000 or less: For infrastructure asset projects whose cost is estimated at $10,000 or less, the assets will be owned by KU (as the majority owner) for administrative efficiencies.

Other jointly owned assets:

The Company purchases assets including software, hardware, telecommunications equipment and generation services equipment (scanners, plotters, etc.) that benefit the customers or shareholders of multiple companies. Ownership percentages for these asset purchases will be established at the time the project is initiated/approved and must be documented on the AIP. The ownership percentages will be based on the applicable CAM ratios in effect at the time the AIP is completed. The ratio used must be documented by name on the AIP. All charges made to the project must be consistent with the ownership percentage stated on the AIP.

Allocation of costs on financial records for jointly owned and jointly used assets:

Capital projects will be established on the financial records of each company with an ownership interest. Capital costs must be charged to the applicable projects based on the applicable ownership percentages. The purchase of any jointly owned and jointly used assets must be made on separate projects. Purchases for jointly owned and jointly used assets will not be allowed under blanket or other miscellaneous type projects. It is the responsibility of Budget Coordinators to monitor the actual charges to projects to ensure the appropriate ownership percentages are being maintained and to make corrections as necessary.

LG&E Building Furniture jointly owned assets: As part of the LG&E building remodeling project commencing in 2013, new furniture is being purchased. This furniture and subsequent furniture purchases made (regardless of floor) will be jointly owned in accordance with the applicable CAM ratios in effect at the time the AIP is completed. The 2013 furniture purchase is jointly owned by LG&E, KU and LKS.

General Information:

All capital charges are considered direct charges for purposes of classification on the FERC Form 60.

Effective August 1, 2013, IT and other similar assets purchased by LKS that are jointly owned by both regulated and nonregulated entities should charge LKS rather than LKC for the nonregulated portion. Depreciation expense associated with the assets capitalized on LKS will then be charged back to LKC as rent expense in entirety.

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(Note: Text in italics indicates a key SOX control.)

The “LKE capital allocation” process allows for the charging of all expenditures on jointly owned assets to a single project (“source”). Source projects will be on the Company paying the bill regardless of ownership percentages. Charges are then allocated programmatically from the “source” project to a “target” project(s) based on ownership percentages as part of the monthly financial close. The use of the LKE allocation assures that the proper CAM allocation methodology is being used. See Appendix A for illustrations of this process.

Please note that any document (requisition, purchase order, invoice, journal, etc.) for non-labor transactions (excluding expense reports) needs to be processed by and/or have an expenditure org that is owned by the same company that owns the LKE source project. The only exception are projects being charged by LG&E or KU telecommunications personnel or any other valid exception as identified by Corporate Accounting. For example, if the project was created using an LKS organization, then the document needs to be processed using a SERV responsibility and/or expenditure org. If the project is created using an LG&E organization, then the document needs to be processed using an LUTL responsibility and/or expenditure org. This is to ensure that the intercompany receivable and payables relationship is correctly identified when the LKE allocation transaction is processed.

As projects are unitized, Property Accounting will check project charges to ensure the appropriate ownership percentages are being maintained. Corrections will be required for any per company variance of $10,000 **and** where the actual ownership charges differ from the ownership allocation on the AIP by more than .99%.

Note: The ownership percentages established above will be used on a go-forward basis with the effective date of this policy.

Note: Actual ownership percentages found in PowerPlan may not be exactly as stated in this policy due to the following reasons:

1. Assets under $25,000 (for generation) and $10,000 (for non-generation) are not split between companies, but rather the entire amount is recorded on the company with the largest ownership percentage.
2. Past practice (prior to mid-2011) has been to review the project charges to ensure the ownership percentages have been materially correct. The final ownership percentages may not have been **exactly** correct, but are materially correct and will not be adjusted.

<u>Reports Generated and Recipients:</u>

- LG&E and KU Plant reports
- Net book value reports generated on an as needed basis from PowerPlan

658 – Joint Ownership/Use Assets

(Note: Text in italics indicates a key SOX control.)

Additional Controls or Responsibility Provided by Other Procedures:

- Budget Coordinators, Financial Planning personnel and Accounting Analysts review AIPs to confirm joint use and jointly owned assets will be capitalized with the correct ownership percentage on the appropriate LKE entity.

Regulatory Requirements:

All of the following entities require that no subsidization occurs between the regulated utilities or their affiliates:

- Kentucky Public Service Commission
- Virginia State Corporation Commission
- Federal Energy Regulatory Commission

Reference:

- Code of Federal Regulations 18 Part 101 Electric Plant Instructions
- Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 360 – Property, Plant and Equipment
- FASB ASC Topic 980 – Regulated Operations
- LG&E and KU Services Company Cost Allocation Manual
- Generator Interconnection White Paper dated May 12, 2014-- Transmission Policy and Tariffs Department

Corresponding PPL Policy No. and Name:

N/A

Key Contact:
Manager, Property Accounting

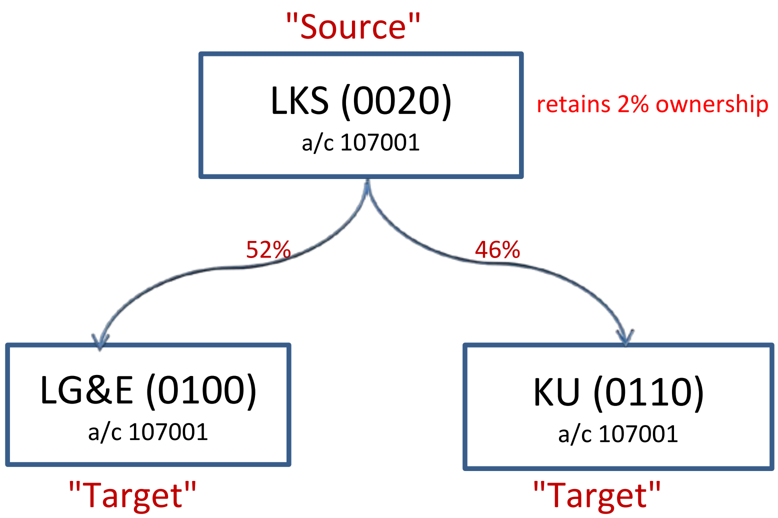
Administrative Responsibility:
Director, Accounting and Regulatory Reporting

Date Created: 3/21/12
Dates Revised: 10/21/13; 5/15/15; 3/02/16; 9/1/16; 4/4/18

Description of when this type of allocation would be used:

LKS (LG&E and KU Services Company) owns a piece of the project and SERVCO is paying the bills.

IT Projects/LG&E Building furniture:



		CO	Acct	IC			
①	Dr.	0020	107001 (CWIP)	0000	$ 100		**Original Transaction**
	Cr.	0020	232xxx/131xxx (AP Trade/Cash)	0000		$ 100	
②	Dr.	0020	184xxx (LKE Clearing)	0000	$ 98		**LKE Reversal**
	Cr.	0020	107001 (CWIP)	0000		$ 98	
③	Dr.	0100	107001 (CWIP)	0020	$ 52		**LG&E Target**
④	Dr.	0110	107001 (CWIP)	0020	$ 46		**KU Target**
	Cr.	0020	184xxx (LKE Clearing)	0000		$ 98	

Intercompany created when target transactions transferred to GL (note these would be in 2 batches)

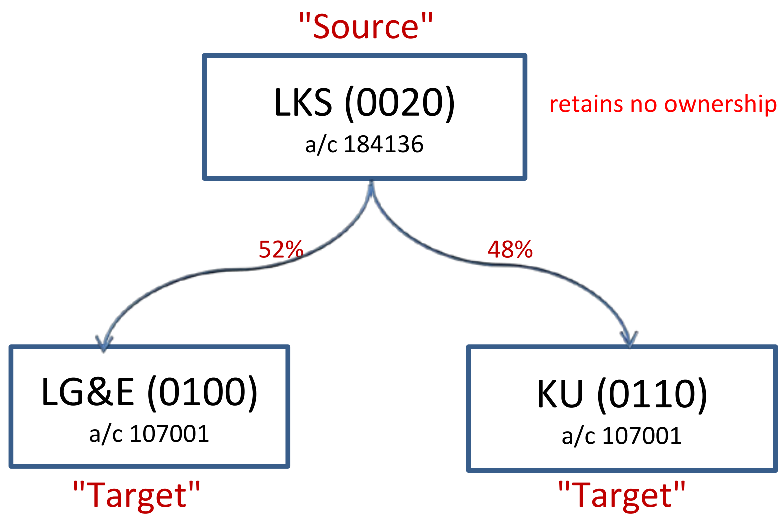
⑤	Dr.	0020	146100 (Intercompany)	0100	$ 52		**Batch 1**
	Cr.	0100	146100 (Intercompany)	0020		$ 52	
⑥	Dr.	0020	146100 (Intercompany)	0110	$ 46		**Batch 2**
	Cr.	0110	146100 (Intercompany)	0020		$ 46	

Reason for using 184xxx account: Every transaction has to have 2 accounts associated with the entry. The "charge" account and the "clearing" account. The use of the 184xxx allows us to use it as the "charge" when we reverse the original transaction (the clearing account for the reversal is the account charged in the original transaction) and it is used as the "clearing" account on the target expenditure (the "charge" for the Target expenditure is the account used on the target task). The net effect is zero. There should never be balance at month end for the 184xxx account.

Description of when this type of allocation would be used:

LKS (LG&E and KU Services Company) pays the bills; assets are owned by LG&E, KU and possibly LKC (Simpsonville IT only).
LKS has no asset ownership.

IT Projects/LG&E Building furniture:



		CO	Acct	IC			
①	Dr.	0020	184136 (CWIP Clearing)	0000	$ 100		**Original Transaction**
	Cr.	0020	232xxx/131xxx (AP Trade/Cash)	0000		$ 100	
②	Dr.	0020	184xxx (LKE Clearing)	0000	$ 100		**LKE Reversal**
	Cr.	0020	184136 (CWIP Clearing)	0000		$ 100	
③	Dr.	0100	107001 (CWIP)	0020	$ 52		**LG&E Target**
④	Dr.	0110	107001 (CWIP)	0020	$ 48		**KU Target**
	Cr.	0020	184xxx (LKE Clearing)	0000		$ 100	

Intercompany created when target transactions transferred to GL (note these would be in 2 batches)

⑤	Dr.	0020	146100 (Intercompany)	0100	$ 52		**Batch 1**
	Cr.	0100	146100 (Intercompany)	0020		$ 52	
⑥	Dr.	0020	146100 (Intercompany)	0110	$ 48		**Batch 2**
	Cr.	0110	146100 (Intercompany)	0020		$ 48	

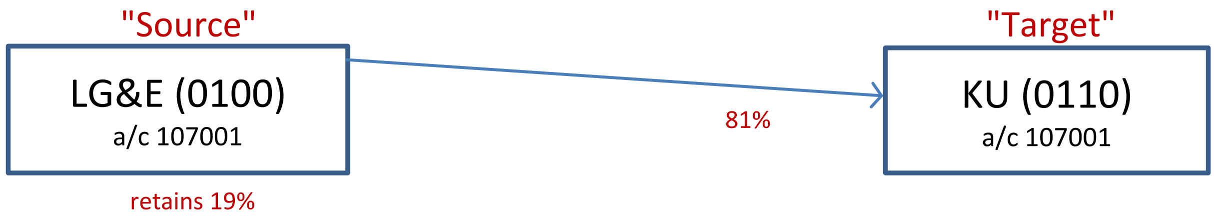
Reason for using 184xxx account: Every transaction has to have 2 accounts associated with the entry. The "charge" account and the "clearing" account. The use of the 184xxx allows us to use it as the "charge" when we reverse the original transaction (the clearing account for the reversal is the account charged in the original transaction) and it is used as the "clearing" account on the target expenditure (the "charge" for the Target expenditure is the account used on the target task). The net effect is zero. There should never be balance at month end for the 184xxx account.

Description of when this type of allocation would be used:

LG&E and KU jointly own the asset. LG&E is paying the bills. The source project should be set up on the company paying the bills.

Jointly owned generation or projects where LKS is not paying the bills:

Example TC2



		CO	Acct	IC			
①	Dr.	0100	107001 (CWIP)	0000	$ 100		**Original Transaction**
	Cr.	0100	232xxx/131xxx (AP Trade/Cash)	0000		$ 100	
②	Dr.	0100	184xxx (LKE Clearing)	0000	$ 81		**LKE Reversal**
	Cr.	0100	107001 (CWIP)	0000		$ 81	
③	Dr.	0110	107001 (CWIP)	0100	$ 81		**LG&E Target**
	Cr.	0100	184xxx (LKE Clearing)	0000		$ 81	

Intercompany created when target transaction transferred to GL

④	Dr.	0100	146100 (Intercompany)	0100	$ 81		**Batch 1**
	Cr.	0110	146100 (Intercompany)	0100		$ 81	

Reason for using 184xxx account: Every transaction has to have 2 accounts associated with the entry. The “charge” account and the “clearing” account. The use of the 184xxx allows us to use it as the “charge” when we reverse the original transaction (the clearing account for the reversal is the account charged in the original transaction) and it is used as the “clearing” account on the target expenditure (the “charge” for the Target expenditure is the account used on the target task). The net effect is zero. There should never be balance at month end for the 184xxx account.

660 – Contract Retainage

(Note: Text in italics indicates a key SOX control.)

Policy:

LG&E and KU Energy LLC and its subsidiaries ("LKE" or the "Company") will timely and accurately record contract retainage amounts.

Procedure:

The Company routinely enters into agreements with vendors to perform contract work or to purchase materials or equipment. Generally these agreements provide for the Company to withhold amounts (usually 10%) from payments as contract retainage to ensure work performed or materials received complies with contract provisions. Contract retainage can be used on various types of contracts, but generally is used for capital projects. The contract retainage must be recorded to the designated current or noncurrent general ledger account based on the estimated timing of the payment of the retainage amounts to the vendors.

Scope:

The policy applies to all contracts that contain contract retainage terms.

Objective of Procedure:

The procedure will ensure that contract retainage is accounted for and reported accurately and recognized in a separate general ledger account for current and noncurrent financial reporting.

General Requirements:

Detailed Procedures Performed:

Generally contract retainage is used on construction projects and major equipment purchases with progress payments in advance of the project being completed or receipt of the equipment. Retainage can also be used on contracts for professional services.

Prior to paying the invoices, the designated Budget Analyst will accrue the invoices via a journal entry and record the retainage to account 232030 for current and 253042 for noncurrent. The accruals are reversed when the invoices are received and entered into the Oracle Accounts Payable system for payment.

Invoices for contracts that contain retainage are initially reviewed by Budget Analysts. The Budget Analyst will ensure the retainage amount is deducted from the invoice amount to be paid prior to submitting them to A/P for posting and payment. The project will be debited to CWIP

660 – Contract Retainage

(Note: Text in italics indicates a key SOX control.)

107001 for the work being performed that includes the retainage and the current retainage withheld account 232030 is credited for the amount withheld. Retainage expected to be paid within 12 months is classified as current on the balance sheet and recorded in account 232030 Retainage Fees. Retainage that is not expected to be paid within 12 months is classified as noncurrent on the balance sheet and recorded in account 253042 Long Term Retainage. The classification of the balances in current and noncurrent must be monitored monthly by the designated Budget Analyst and adjusted as appropriate based on the estimated timing of payment.

The contract retainage is paid to the contractor upon satisfactory completion of the contract work or receipt of satisfactory product or materials. In the case of a contract dispute, the contract retainage must be cleared in the final settlement with the contractor. Any portion of the retainage not paid is credited to the account which was originally charged when the retainage was withheld. A Change of Distribution in Oracle Accounts Payable is initiated by the designated Budget Analyst to record the final retainage adjustment.

In the case of capital projects, the disposition of contract retainage should generally be completed before the capital project is unitized.

The designated Accounting Analyst responsible for the reconciliation of the retainage accounts must obtain and review a monthly list of all contracts that include retainage to be used as support for the monthly balance sheet reconciliation for accounts 232030 and 253042. This list is prepared by the designated Budget Analyst responsible for the capital projects with retainage and includes the vendor, project number, project name, contract term, estimated in-service date, estimated payment date, gross invoice amount, retainage amount, and net invoice amount. The designated Budget Analyst reviews any contracts containing retention clauses with the Project Engineering Contracts Administrator / Contracts Manager. The review will include when and how retainage is to be released based on the terms of the contract in order to avoid any misinterpretation. The list must accurately classify the current and noncurrent portions of retainage amounts. The Accounting Analyst reviews each contract to determine that the retainage amounts are correctly classified (current vs. noncurrent) and compares the estimated in-service date to the estimated payment date for reasonableness. When and how the retainage is to be released will be included in the balance sheet account reconciliation prepared by the Accounting Analyst to support understanding of the activity in the account.

Reports Generated and Recipients:

Monthly Retainage List obtained as support for the balance sheet reconciliations for the retainage accounts sent to Regulatory Accounting and Reporting and Accounts Payable.

660 – Contract Retainage

(Note: Text in italics indicates a key SOX control.)

Additional Controls or Responsibility Provided by Other Procedures:

250 - Balance Sheet Account Reconciliation policy

Regulatory Requirements:

None

660 – Contract Retainage

(Note: Text in italics indicates a key SOX control.)

Reference:

None

Corresponding PPL Policy No. and Name:

600 Contract Retention

Key Contact:

Manager, Regulatory Accounting & Reporting

Administrative Responsibility:

Director, Accounting & Regulatory Reporting

Date Created: 6/28/12
Dates Revised: 4/1/16

750 – Oracle Burdening Process

(Note: Text in italics indicates a key SOX control.)

Policy: This policy covers the processes and procedures for calculating and monitoring the burdens associated with labor related costs, warehouse costs and capital in Oracle.

Procedure: Labor related costs, warehouse and capital burdens are calculated annually as part of the budget process. These rates are entered in Oracle Project Accounting. Oracle delivered burden functionality is used to allocate these costs to the appropriate projects and tasks. The allocation is based on a combination of account, expenditure organization and expenditure type. Balances in the burden clearing accounts are monitored during the year (at least quarterly) and rates are adjusted, as needed. Rates are updated at year end to ensure that all burdens have been allocated to a project and task. A custom program sends the burden components to the General Ledger to the correct code combination, including changing the account and expenditure type. The account segment values are derived from lookups that are maintained in an Oracle flex value set.

Scope: This policy covers all labor related costs including benefits, off-duty, TIA and payroll taxes. Warehouse burdens and engineering overheads and general and administrative expense for capital are also included. It covers LG&E and KU Energy LLC (“LKE”) and its subsidiaries and includes:

1) Oracle Methodology and Functionality
2) Calculating Rates
3) Process of Monitoring Clearing Account Balances
4) Sending Burdens from Project Accounting to the General Ledger
5) Year /End True-up

Objective of Procedure: The objective of the burden process is to accurately allocate the labor related costs, warehouse costs, and capital burdens to the appropriate companies and accounts in a reasonable and consistent manner. The process allocates labor burden cost associated with capital and balance sheet accounts and certain components on income statement accounts to each functional area so that managers get a more accurate picture of the total cost of operating their business. Labor burdens on income statement accounts excluding the vacation, holiday, other off-duty, sick, and accrued team incentive award burden components are accumulated at the corporate cost center, and the functional departments are not held responsible for their control. Warehouse overheads are allocated to the functional departments.

General Requirements:

Detailed Procedures Performed:

750 – Oracle Burdening Process

(Note: Text in italics indicates a key SOX control.)

Oracle Methodology and Functionality

The Oracle burdening process for actual charges occurs in the Project Accounting module. A custom process sends the burden components to the General Ledger in the detail necessary for management reporting. The delivered burden functionality in Oracle is based on the creation of burden structures and burden schedules. As transactions are processed in Projects, the raw dollar amounts are entered, the system calculates the burden, adds the amount to the raw cost and stores the raw amount and a burdened amount.

1) Each account in the General Ledger is assigned to a specific burden structure. When new accounts are added to the General Ledger, a burden schedule must be assigned to the account. This assignment is included on the GLAFF Change Request Form for the Account segment and is approved by the list of individuals who are responsible for reviewing and approving GLAFF change requests

2) Four burden structures:
   A) Balance Sheet – Other
   B) Capital
   C) OM/Clearing/Below the Line
   D) Zero

3) Before a structure can be entered in Oracle, each burden cost component and each burden cost base used in the structure must be defined. A burden cost component is the type of burden to be allocated to each project / account. Benefits, off-duty, TIA and payroll taxes (see Burden Calculation section below for complete list) are allocated based on labor. In addition to the labor burdens, warehouse costs are allocated to each inventory issue. For capital and balance sheet accounts, a portion of administrative and general expenses are allocated. For capital only, engineering overheads are allocated.

A cost base is the criterion used to identify which source transaction the burden cost component will be applied. The cost base has been designed using the expenditure types.

COST BASE	**EXPENDITURE TYPE**
Straight-time	0101, 0110, 0115, 0120, 0125, 0150
Straight-time special	0102
Overtime	0111, 0112, 0121, 0126, 0127, 0131, 0146
Other	0130, 0145, 0148, 0151
Warehouse Generation – KU	0280, 0452, 0453
Warehouse TD – KU	0281, 0451, 0454
Warehouse Generation – LGE	0285, 0455, 0457

750 – Oracle Burdening Process

(Note: Text in italics indicates a key SOX control.)

COST BASE	EXPENDITURE TYPE
Warehouse TD – LGE	0286, 0456, 0458
Non-labor	0301-0699

(There are a few expenditure types within the non-labor range that do not get burdened, such as 0175, 0276, 0375, 0475, 0575, and 0699. Non-labor expenditure types are only potentially burdenable on capital and other balance sheet accounts.)

4) The burden structures are used to relate the burden cost components to the burden cost bases. The system uses the structures to determine which burden cost components should be applied to each burden cost base.

5) A burden schedule must be created and assigned to each structure. The schedules are used to enter the burden percentage rates. These rates are used to calculate the amount to be added to the raw cost for each burden cost component. The rates are effective based on the effective dates of the schedules. The burden schedules are effective at the beginning of a month. There can be multiple rates for each component based on the expenditure organization on the transaction. For most components, the rates are calculated at the company level. (For example: all labor from LG&E and KU Services Company (LKS) expenditure orgs is burdened with the same benefit rate.) The rates for engineering overheads are calculated for each line of business for each utility. The Budget Coordinators for Generation, Transmission and Distribution are responsible for calculating the rates based on the planned engineering overheads and capital expenditures.

Calculating the Rates

The rate for each burden component is calculated each year as part of the budget process. Rates are calculated for each company.

Requests are sent to the appropriate person to develop an estimate of the amount for each burden component.

Burden cost components include the following:

Burden Cost Component	Person Responsible for Developing Estimate
Life Insurance	Manager – Benefits
Dental Insurance	Manager – Benefits
Medical Insurance	Manager – Benefits

750 – Oracle Burdening Process

(Note: Text in italics indicates a key SOX control.)

Burden Cost Component	Person Responsible for Developing Estimate
Company Match – 401k	Manager – Benefits
Long Term Disability	Manager – Benefits
Pension	Mercer
Postretirement	Mercer
Postemployment	Mercer
TIA	Manager – Compensation
TIA Overtime	Manager – Compensation
Workers' Compensation	Risk Management Services Corporation
Vacation	Sr Financial Analyst – Forecast & Budgeting – Corporate
Holiday	Sr Financial Analyst – Forecast & Budgeting – Corporate
Other Off-duty	Sr Financial Analyst – Forecast & Budgeting – Corporate
Sick	Sr Financial Analyst – Forecast & Budgeting – Corporate
FICA Payroll Tax	Manager – Payroll
FICA Overtime	Manager – Payroll
Federal Unemployment Tax	Manager – Payroll
State Unemployment Tax	Manager – Payroll
Unemployment Tax Overtime	Manager – Payroll
Warehouse Issues	Accounting Analyst – Regulatory Accounting & Reporting
Administrative and General	Manager – Regulatory Accounting and Reporting
Engineering Overheads	Budget Coordinator for Budgeting & Forecasting Transmission Energy Supply
Engineering Overheads	Budget Coordinator for Budgeting & Forecasting Distribution Operations Customer Service Budget Coordinator for Budgeting & Forecasting - Generation Operations
Wage increase Assumption	Manager – Compensation

Calculating the burden components:

- Sr. Financial Analyst obtains information on current staffing levels, vacation entitlements and average hourly rates by expenditure organization and by employee

750 – Oracle Burdening Process

(Note: Text in italics indicates a key SOX control.)

type from HR PeopleSoft system. This information is then uploaded into PowerPlan and used to estimate the labor base for allocating the burden costs. Using the wage increase assumption from Compensation, the labor base is adjusted to estimate the amount of labor dollars that will be the base of the burden calculation. The Sr. Financial Analyst takes the estimate for each burden cost component and divides it by the appropriate labor base to calculate the percentage for each company. Labor burden clearing accounts are zeroed out at the end of the year, with burden components having target balances not equal to zero being moved to liability accounts monthly.

- Warehouse burdens – the balance in the burden clearing account is compared to the inventory balance and a ratio is developed to allocate the cost in the clearing accounts to the items in inventory. These accounts are not zeroed out at the end of the year.
- Administrative and General Expense is an allocation from O&M to capital. This burden allocates labor and expenses of employees that support the capital process but do not work directly on a particular capital project. (Ex: Property Accounting and Budget Coordinators working on capital budgets.) A survey is sent by the Regulatory Accounting & Reporting department to employees periodically to see how much of their time is spent supporting capital projects. Using these results, an estimate to the total dollars that should be capitalized is calculated. This amount is then divided by the estimated amount of raw capital dollars (labor and non-labor.)
- Engineering Overheads - using the balance in the engineering overhead clearing account and the estimated charges to those accounts, the Budget Coordinator calculates the amount that needs to be allocated to capital projects. The Budget Coordinator also must estimate the amount of raw capital dollars that will be spent. These accounts are reclassified to capital via a reversing journal entry at the end of the year.
- These rates are given to the Sr. Accounting Systems Support Analyst to update in OEBSPROD. The Oracle system will automatically apply burdens to projects and tasks based on the burden rates, expenditure organization and expenditure type.

Process of Monitoring Clearing Account Balances

Periodically during the year, Sr. Financial Analyst will analyze the balance in each clearing account. Revised estimates of the burden cost components and the labor bases are calculated as needed and the burden rates will be revised as necessary. This review is done at least quarterly. The rates are adjusted when any of the estimates change significantly. All the rates are revised in December. Rates are always changed effective the first day of the month.

750 – Oracle Burdening Process

(Note: Text in italics indicates a key SOX control.)

Sending Burdens from Oracle Project Accounting to the General Ledger

The burden process was implemented in Oracle Project Accounting to apply the burdens to raw cost and to store raw cost and burdened cost on the same transaction. A custom program was developed to change the account and expenditure type on the burden transaction before it is posted in the General Ledger. This process uses a custom table to provide the correct debit and credit entry to be made in the General Ledger for combination of project, task, account, burden cost component and company. If a new company or burden cost component is added, then this table must be updated.

A concurrent process is run, as needed, to send the summarized Oracle Project Accounting burden amounts to the General Ledger. This process is run approximately daily beginning with the 11th work day and on Days 1, 2, and 3 of the monthly close cycle.

Year-end True-up

After all the labor has been posted for the year, the Sr. Accounting System Support Analyst will run EiS queries to obtain the appropriate labor base for December and the balances in all the burden clearing accounts. The Sr. Financial Analyst uses the information from these queries to calculate the rates that are needed to ensure that all burdens are allocated to a project and task. The Sr. Accounting System Support Analyst will enter the revised percentages in the Oracle burden schedules and recalculate all the burdens for the month. All of these changes in the burden amounts are sent to the General Ledger. The Sr. Financial Analyst works with the Financial Accounting & Analysis department to ensure the balances in the clearing accounts are minimal, and the components with target balances have previously been reclassified to a liability. Any small remaining amounts are expensed to the corporate cost center.

<u>Reports Generated and Recipients:</u>

N/A

<u>Additional Controls or Responsibility Provided by Other Procedures:</u>

Balance Sheet Account Reconciliations

<u>Regulatory Requirements:</u>

N/A

750 – Oracle Burdening Process

(Note: Text in italics indicates a key SOX control.)

Reference:

N/A

Corresponding PPL Policy No. and Name:

700 – Compensated Absences

Key Contact:

Manager, Corporate Accounting

Administrative Responsibility:

Controller

Date Created: 06/10/05
Dates Revised: 07/01/05; 08/24/05; 10/19/09; 03/15/11; 9/8/11; 03/06/12; 09/16/13; 05/27/14; 03/15/16; 06/08/16; 06/30/16; 08/09/18

751 - Manual Accruals Policy and Procedures

Policy:
Costs for goods or services that have been provided by month-end are accrued or processed in the month incurred

Procedure:
Costs for any significant goods or services provided by the end of a period must be recorded by manual accrual, if the invoice associated with the cost is not validated in the Oracle AP module. For the purposes of this policy, significant is defined as the cost of a good or service that exceeds $50,000. Each month, Budget Analysts and/or Line of Business ("LOB") field personnel as project proponents with knowledge of unrecorded costs for provided goods or services at period-end, must accrue such costs. Journal entry accruals will be prepared and uploaded into Oracle by Budget Analysts.

Scope:
This procedure applies to all goods or services that have been provided during the period that have not been validated in the Oracle AP module.

This procedure excludes the following, which are included in other accrual processes:

- goods procured under a standard, 3-way Oracle purchase order ("PO")
- warehouse inventory items
- purchasing card transactions that occur prior to cycle end date

Objective of Procedure: To appropriately record the cost and liability for provided goods or services in the month in which they are incurred.

General Requirements:

Detailed Procedures Performed by Budget Coordinators*:*
Any known costs for goods or services that have been received or provided, are of a significant nature (exceed $50,000), and have not already been validated in the Oracle AP module must be manually accrued. The appropriate Budget Analyst will accumulate accrual information received from project proponents and enter it into an Oracle journal entry template for uploading into the Oracle general ledger. The journal entry is to be uploaded and posted by noon on Day 3 each month. Approval of the journal entry is completed by the Budget Analyst's manager or delegate. Manual journal entry accruals are reversed in the subsequent month.

Electronic evidence which is used to calculate, develop or support the amounts in the SEC financial statements, including disclosures and Management's Discussion and Analysis, must be provided to document the manual accrual line items (e.g., discrete invoices, purchase orders,

751 - Manual Accruals Policy and Procedures

estimates by vendor) which exceed the Sarbanes-Oxley Tolerable Misstatement Threshold for the lowest of the three Kentucky registrants. Electronic evidence should include:

- Verification of query parameters for reports run from an IT system to document time periods, accounts, business unit, etc. used as parameters;
- Tie out to an independent source, when available and appropriate;
- Tie out to a general ledger balance, when available and appropriate;
- Changes made to source data downloaded from an IT system; and/or
- Review and approval by a person from the operational area who is knowledgeable of the work performed. This review may be in the form of a physical signature or via an e-mail certification, as follows:

> Accrual Certification:
>
> "Based on my knowledge of the expenditures incurred, but not yet invoiced, through the month-end date, I have reviewed and I hereby approve the accrual of the following items in [MMM-YYYY]:
>
> "Vendor Amount
>
> "To the best of my knowledge, these items are a complete and accurate listing of the accruals for my area."
>
> [e-mail signature]

All queries used are subject to the rules that apply to the Spreadsheet Inventory Policy.

The Tolerable Misstatement Threshold will be recalculated annually approximately in the first quarter of each year after the 10-K is published.

See also PPL's guidance regarding Electronic Evidence Requirements.

Reports Generated and Recipients*:*

- Excel template completed by Budget Coordinators,
- Email exchanges,
- Additional support (i.e. vendor statement, letter, etc.)

Accruals for Specific Situations (See Appendix A for decision tree to record accruals for these specific situations)*:*

751 - Manual Accruals Policy and Procedures

I. Land purchases
   a. Ordinarily, rights (title) to the land does not pass to the purchaser until consideration has been paid and closing of the purchase occurs. Therefore, land should only be recorded after closing.
   b. Land should not be accrued for in advance of closing as the result of an executed purchase option.

II. Project with milestone/project payments
   a. If the item contains milestone or progress payments then the milestone or progress payment should be accrued at the point that the milestone or progress has been achieved.
      i. If the item is built-to-suit (assets constructed or manufactured by a vendor to LKE's own specification which would require significant modifications to be used by another company) and does not include milestone or progress payments then costs should be accrued based on a vendors report of project progress completed as approved by the project proponent. If an estimate of completion cannot be obtained from the vendor, costs should be accrued based on an internal estimate of project progress completed from the project proponent.

III. Material purchases (not built-to-suit and no milestone/progress payments in contract)
   a. Purchases should be accrued at the point that the materials have been physically received or at the point the company obtains title to the materials (if before receipt).
   b. No accrual should be made in advance of title passing to the company.

IV. Contracted services (not built-to-suit and no milestone/progress payments)
   a. Services should be accrued for as services are completed.
      i. If the contracted services are ongoing, services should be accrued for based on the vendors report of services completed as approved by the project proponent. If an estimate cannot be obtained from the vendor, costs should be accrued based on an internal estimate of services performed from the project proponent.

Additional Controls or Responsibility Provided by Other Procedures:
Other accrual procedures, such as the auto accrual process, include controls for accruals for goods procured using a purchase order.

Regulatory Requirements*:*
None

751 - Manual Accruals Policy and Procedures

Reference:
FASB Accounting Standards Codification 210, *Balance Sheet*
Electronic Evidence Requirements (see PPL Policies directory on the acctrestricted drive)
751 – Manual Accruals Appendix A – Decision trees for specific situations

Corresponding PPL Policy No. and Name:
701 Procedures AP Accrual

Key Contact:
Manager, Regulatory Accounting & Reporting

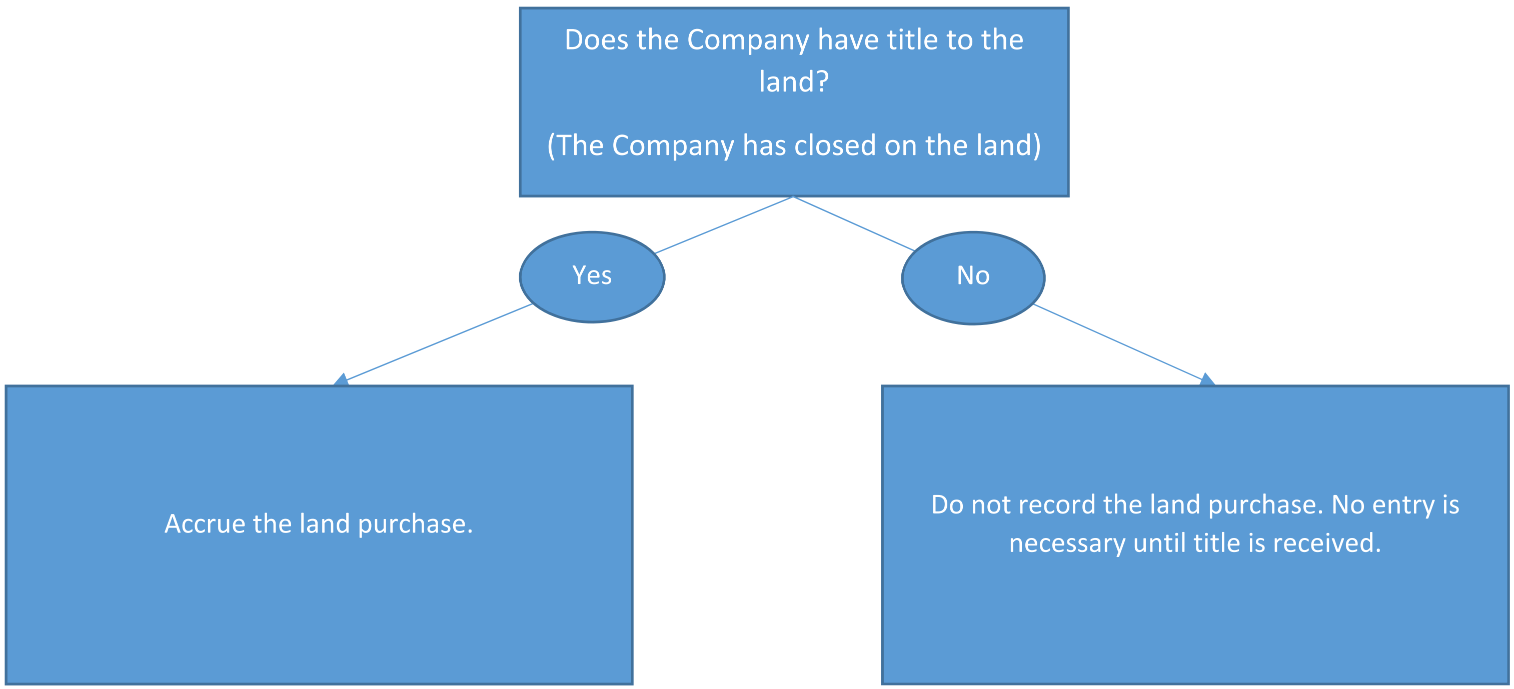
Administrative Responsibility:

Director, Accounting and Regulatory Reporting

Date Created: 9/01/2005
Dates Revised: 12/27/2006, 12/10/2007, 3/18/2009, 7/22/2010, 3/31/2011, 9/26/2011, 12/31/2013, 5/22/2014, 6/1/2017, 3/2/2018

Land Accrual Decision Tree

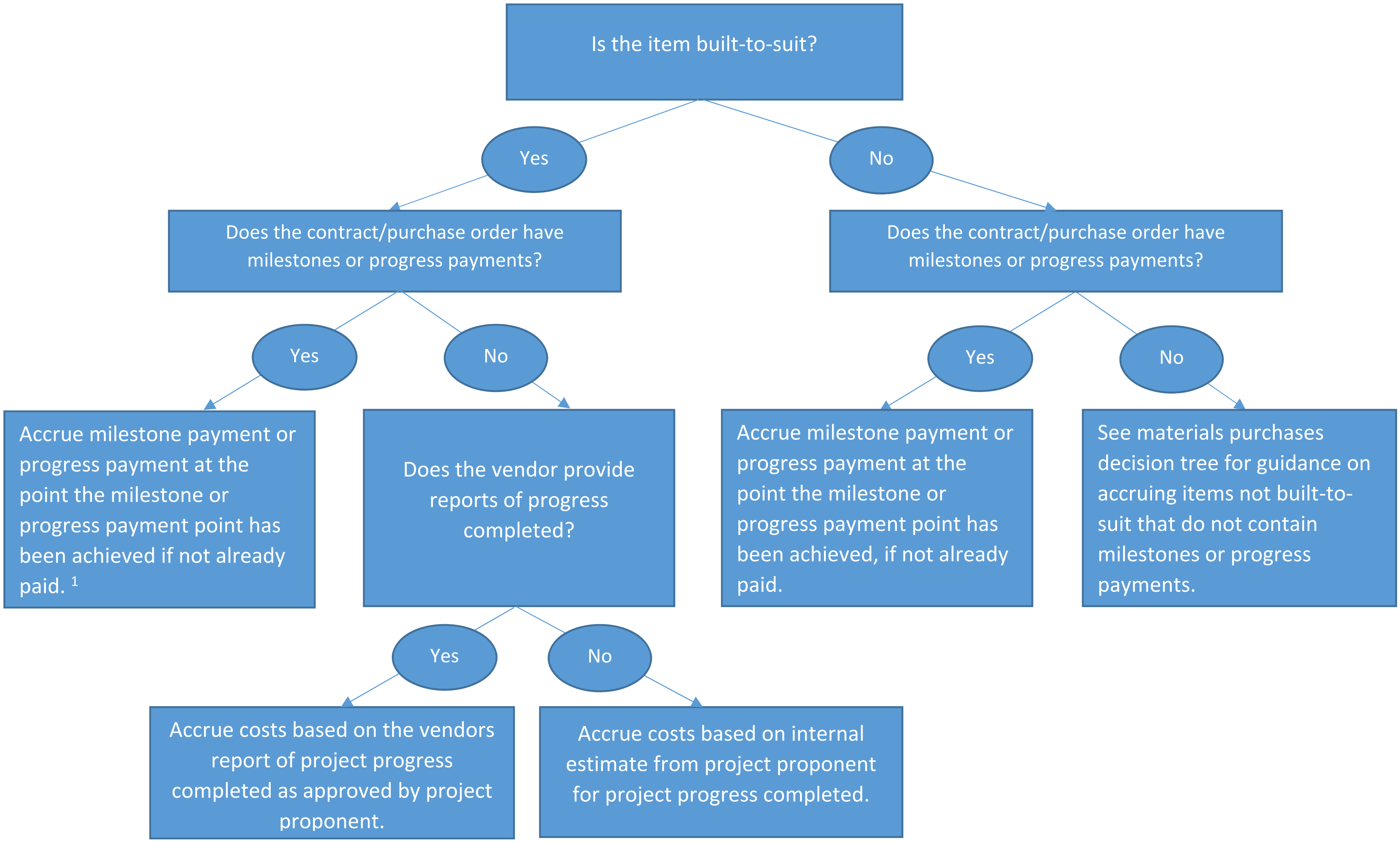
Note: The decision tree below should be used as a guide for recording the purchase of land.



Milestone/Progress Payment Accrual Decision Tree

Note: The decision tree below should be used as a guide for accruing asset transactions where the contracts/purchase orders may contain milestone or progress payments.

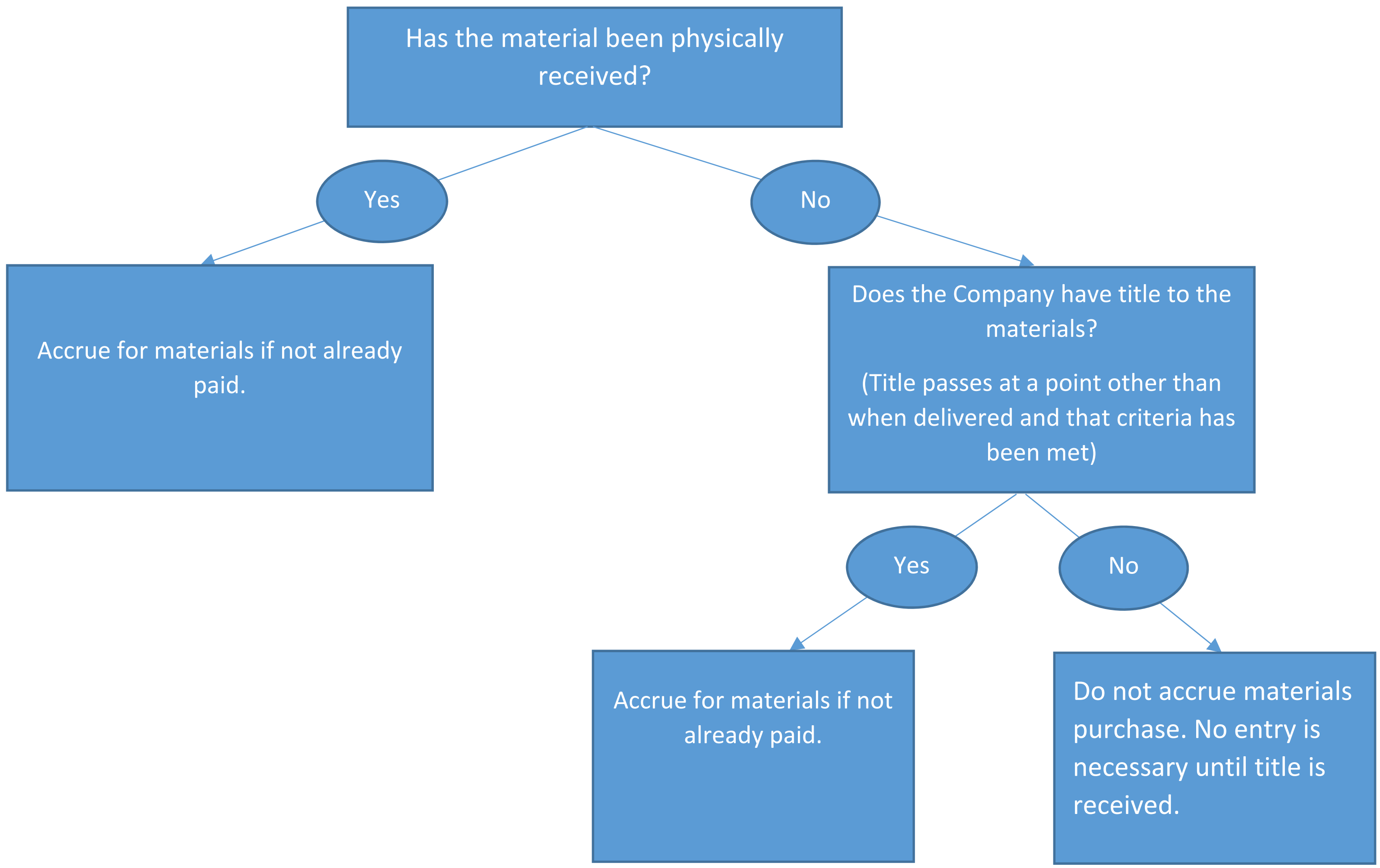
Definition: Built-to-suit items are assets constructed or manufactured by a vendor to the LKE's own specification which would require significant modifications (as determined by the Project Manager)to be used by another company.



[1]No partial milestone or percentage of milestone should be accrued.

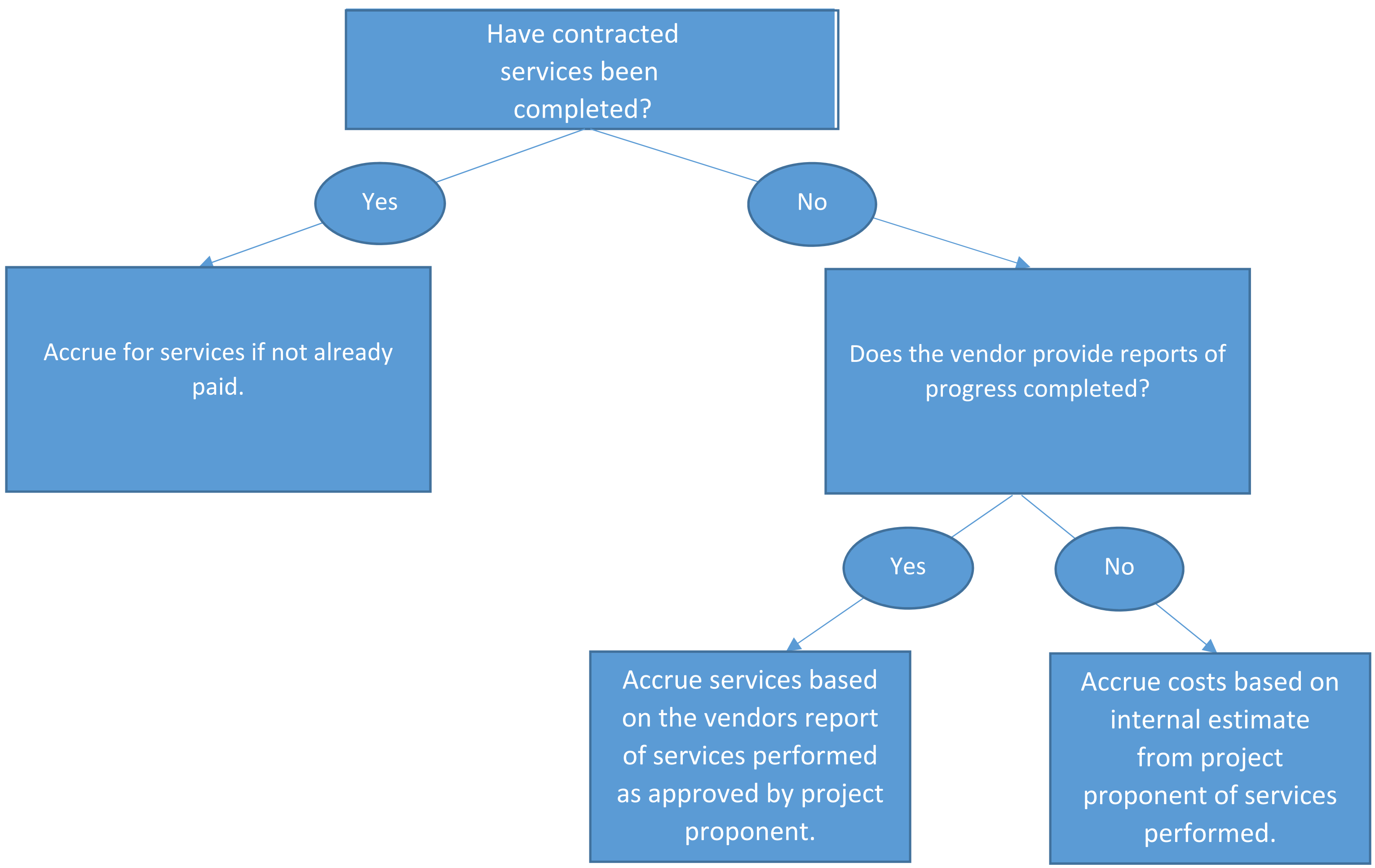
Materials Purchases Accrual Decision Tree

Note: The decision tree below should be used as a guide for accruing asset transactions that are not considered built-to-suit and where the contracts/purchase orders do not have milestones or progress payments.



Contracted Services Performed Accrual Decision Tree

Note: The decision tree below should be used as a guide for accruing contracted services performed that are not included as part of a built-to-suit asset transaction or where the contracts/purchase orders do not have milestones or progress payments.



Materials and Supplies Inventory Excess and/or Obsolete Review Form
As required by Internal Control 50.01.08

Business Line: ______ Drop down box **Company:** ______ Drop down box **Year-Quarter** ______ Drop down box

Number of items required to be reviewed this year: ________ Number of items reviewed year to date: ________

Yes/No

1) Is there "obsolete" inventory to be reported this Quarter? ______ Drop down box

If obsolete inventory does exist, please provide the following information:

Drop down Box

ORG	IIN	On-Hand Quantity	$ Value	Short Description

Yes/No

2) Is there "excess" inventory to be reported this Quarter? ______ Drop down box

If excess inventory does exist, please provide the following information:

Drop down Box

ORG	IIN	Excess Quantity	$ Value	Short Description

***If additional space is needed, please copy the form and attach.**

Prepared By: ____________________ **Date:** ____________
Print Name

____
Signature

Approved By: ____________________ **Date:** ____________
Print

____
Signature

Return Form To:

Mark Schmitt, Director, Supply Chain, BOC-2
LOB - Transmission Lines, Distribution Lines and Substation

or

Joe Clements, Director, Power Generation Commercial Ops, LGE Center-8
LOB - Generation

Director Initial: ____________ **Date:** ____________

No
Yes

GLO	GLOBAL
CRS	CANE RUN
ESC	EAST SERVICE CENTER
KBR	BROWN STATION
KBW	BARLOW FACILITY
KCR	CARROLLTON FACILITY
KCV	CAMPBELLSVILLE FACILITY
KDS	DANVILLE SUBSTATION
KDT	DANVILLE TRANSMISSION
KDV	DANVILLE FACILITY
KEA	EARLINGTON FACILITY
KED	EDDYVILLE FACILITY
KES	EARLINGTON SUBSTATION
KET	ELIZABETHTOWN FACILITY
KGF	GREENVILLE FACILITY
KGH	GHENT STATION
KGR	GREEN RIVER STATION
KGT	GO TRANSMISSION FACILITY
KHR	HARLAN FACILITY
KLD	LONDON FACILITY
KLS	LEXINGTON SUBSTATION
KLT	LEXINGTON TRANSMISSION
KLX	LEXINGTON FACILITY
KMG	MORGANFIELD FACILITY
KMS	MOUNT STERLING FACILITY
KMV	MAYSVILLE FACILITY
KMW	MIDWAY FACILITY
KNR	NORTON FACILITY
KPF	GO PANEL FABRICATION FACILITY
KPG	PENNINGTON GAP FACILITY
KPN	PINEVILLE FACILITY
KPR	PARIS FACILITY
KPS	PINEVILLE SUBSTATION
KPT	PINEVILLE TRANSMISSION
KRC	RICHMOND FACILITY
KSO	SOMERSET FACILITY
KSS	KENTUCKY SOUTH SERVICE
KSV	SHELBYVILLE FACILITY
KSY	SYSTEMS LABORATORY
KTD	KU TRANSMISSION & DISTRIBUTION
KTE	ELIZABETHTOWN TRANSMISSION
KTR	EARLINGTON TRANSMISSION

KWN	WINCHESTER FACILITY
LTD	LOUISVILLE TRANSMISSION & DELIVERY
MCS	MILL CREEK
SSC	SOUTH SERVICE CENTER
TCS	TRIMBLE CO.
TRF	TRANSFORMER SHOP

KU	Distribution Line
LGE	Generation
	Substation
	Transmission

2015-1st
2015-2nd
2015-3rd
2015-4th
2016-1st
2016-2nd
2016-3rd
2016-4th
2017-1st
2017-2nd
2017-3rd
2017-4th

LG&E and KU Energy LLC Accounting Policy

850 - Inventory Management

(Note: Text in italics indicates a key SOX control.)

Policy: The inventory of LG&E and KU Energy LLC and its subsidiaries (LKE) must be reviewed on a regular basis to verify that it is accounted for in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 330, Inventory.

Procedure: Review and analyze LKE inventory to determine whether inventory is properly accounted for and valued appropriately.

Scope: All LKE inventory.

General Requirements:

Stock material and supplies on hand must be treated as Inventory based on ASC 210, Balance Sheet, and ASC 330, Inventory. This guidance states that since materials and supplies are assets of the Company and have future economic benefit, the value of these assets must be included on the financial statements.

The Federal Energy Regulatory Commission (FERC) provides guidance on the proper valuation of inventory assets at 18 CFR Ch. 1, Pts. 101 & 201 for FERC Account No. 154. FERC states that materials and supplies inventory value must be valued at:

1) Original cost for new, and estimated if not known, for large reusable items
2) Current price, if the reusable item is relatively small and the original installed value cannot be easily determined
3) The net realizable value, for scrap and nonusable material

<u>Classification of Inventory</u>
Materials and Supplies inventory should consist of the following:

1) Stock Items – Inventory that has a specific, anticipated or generic use for the Company and can be tracked at individual locations (i.e. min/max…etc.). This should exclude items classified as Excess or Obsolete which is detailed in the Corporate Inventory Management Policy.
2) Emergency Spares – a spare part or spare equipment that is directly related to a particular piece of equipment and is required in order to avoid substantial operational time loss caused by emergency failure and is not readily available from a vendor or manufacturer without special ordering. This item is required to directly mitigate an emergency.

<u>Physical Inventory Count</u>
A complete physical inventory of materials and supplies inventory must be conducted at least every two years as required by FERC at 18 CFR Ch.1, Pts. 101 & 201, FERC Account No. 163. Although regulations only require inventory to be counted every two years, it is recommended that

850 - Inventory Management

(Note: Text in italics indicates a key SOX control.)

inventory be counted more often, close to once a year, to improve overall inventory accuracy (see the Company's Inventory Management procedures).

A coal stockpile inventory assessment will be conducted annually (See Corporate Fuels and By-Products Policies and Procedures).

Inventory Costing and Accounting
FERC Account Nos. 151, 154, and 164.1:
Fuel, Materials and Supplies, and Underground Gas Storage

Cost of inventory items must include the following cost when it can be directly identified with an item (in accordance with FERC at 18 CFR Ch. 1, Ferc Account Nos. 151 and 154).

a) Invoice price of fuel/materials less cash or other discounts.
b) Freight, switching or other transportation charges when practicable to include as part of the cost of particular materials to which they relate.
c) Customs duties and excise taxes.
d) Operating, maintenance, and depreciation expenses and ad valorem taxes on utility-owned transportation equipment used to transport fuel; Costs of inspection and special tests prior to acceptance for materials and supplies.
e) Lease or rental costs of transportation equipment to transport fuel; Insurance and other directly assignable charges for materials and supplies.

Note: When materials and supplies are purchased for immediate use, or for a unique scope of work, they need not be carried in inventory but may be charged directly to the appropriate utility plant or expense account (Project/Task).

See Accounting Policy 954 – Coal Inventory Valuation for fuel inventory valuation procedures.

163001 and 163011 Stores Expense Undistributed or Clearing Account:
Stores expense accounts are divided between line of business support groups (163001 Transmission & Distribution and 163011 Generation)

Stores expense accounts will be cleared by adding to the cost of materials and supplies issued by applying an appropriate loading charge which will distribute the expense equitably over all inventory material issues. The balance in the account at the close of the year must not exceed the amount of stores expenses reasonably attributable to the inventory of materials and supplies.

Items included in stores expense accounts 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. (See 18 CFR Ch. 1, Pts. 101 & 201 at FERC Account No. 163 and Inventory Management Procedures for other stores expense cost items.)

850 - Inventory Management

(Note: Text in italics indicates a key SOX control.)

Additional Controls or Responsibility Provided by Other Procedures:
The management of materials and supplies inventory is the responsibility of the Director, Power Generation Commercial Operations and the Director, Supply Chain and the detailed procedures are included in the Corporate Inventory Management policy and Inventory Management procedures.

The management of fuel and other by-products inventory is the responsibility of the Director, Corporate Fuels and By-Products and the detailed procedures are included in the Corporate Fuels and By-Products Policies and Procedures.

Regulatory Accounting and Reporting’s responsibilities include monitoring the balance in the stores expense account to ensure the balance in the account at the close of the year will not exceed the amount of stores expenses reasonably attributable to the inventory of materials and supplies and working with Forecast and Budgeting - Corporate to resolve any unexpected balances.

Regulatory Requirements:
18 CFR Ch. 1, Pts. 101 & 201

Reference:
- Inventory Management Policy
- Inventory Management Procedures
- Corporate Fuels and By-Products Policies and Procedures
- Coal Inventory Valuation
- Purchasing corporate policy
- Authority Limit Matrix
- Purchasing Card corporate policy
- Disposition of Company Assets corporate policy

Corresponding PPL Policy No. and Name:
- 800 Material Supplies Inventory – General
- 801 Material Supplies Inventory – Excess & Obsolete
- 802 Material Supplies Inventory – Refurbished Material

Key Contact:
Manager, Regulatory Accounting and Reporting

Administrative Responsibility:
Director, Accounting and Regulatory Reporting

850 - Inventory Management

(Note: Text in italics indicates a key SOX control.)

Revision: 4/07/08, 3/22/11, 9/22/11, 6/2/15, 3/22/16, 9/12/17

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy:

This policy sets standards and procedures for developing and maintaining controls related to spreadsheets. It provides criteria for evaluating the required spreadsheet controls and the appropriate procedures for changes and testing of changes to established spreadsheets.

Procedure:

The procedures for evaluating, controlling, changing and testing the spreadsheets are described in the detailed instructions below.

Scope:

This procedure applies to all spreadsheets used for accounting or financial reporting purposes.

Objective of Procedure:

This procedure is to ensure consistent and accurate control of all spreadsheets used for accounting or financial reporting purposes. In addition, this procedure is to ensure that all critical accounting spreadsheets are evaluated to determine whether spreadsheet controls are required and tested whenever changes to the spreadsheet occur. The purpose is to ensure accuracy of the spreadsheets.

General Requirements:

The recommended minimum spreadsheet controls require testing after changes are made to a critical accounting spreadsheet.

Detailed Procedures Performed – (Risk identification):

After development, a new spreadsheet must be evaluated based on the complexity and type of use to determine the level of risk.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Categorize "Type of Use"

The Pricewaterhouse (PwC) whitepaper, entitled, "The Use of Spreadsheets: Considerations for Section 404 of the Sarbanes-Oxley Act" (PwC's Guidance), defines three categories with regard to use of a spreadsheet as noted below.

Financial: Spreadsheets used to directly determine financial statement transaction amounts or balances that are populated into the general ledger and/or financial statements including all disclosures.

Analytical/Management Information: Spreadsheets used to support analytical review and management decision-making. These may be used to evaluate the reasonableness of financial amounts.

Operational: Spreadsheets used to facilitate tracking and monitoring of workflow to support operational processes, such as a listing of open claims, unpaid invoices and other information that previously would have been retained in manual, paper file folders. These may be used to monitor and control that financial transactions are captured accurately and completely.

Categorize Complexity

High: Spreadsheets which support complex calculations, valuations and modeling tools. These spreadsheets are typically characterized by the use of macros and multiple supporting spreadsheets where cells, values and individual spreadsheets are linked. These spreadsheets might be considered "applications" (i.e., software programs) in their own right. Also, any spreadsheet with greater than 100 rows could be considered complex. These spreadsheets are often used to determine transaction amounts or as the basis for journal entries into the general ledger or financial statement disclosures.

Moderate: Spreadsheets which perform simple calculations, such as using formulas to total certain fields or calculate new values by multiplying two cells. These spreadsheets might be used as methods to calculate amounts for journal entries, translate information, or analytical review and analysis.

Low: Spreadsheets which serve as electronic logging and information tracking systems. Low complexity spreadsheets are only operational spreadsheets.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Risk Level

The risk associated with each spreadsheet is evaluated based on the matrix below:*

<table>
<tr><th></th><th>High Complexity</th><th colspan="2">Moderate Complexity</th><th>Low Complexity</th></tr>
<tr><td>Financial</td><td>High Risk</td><td colspan="2">Medium Risk</td><td>N/A</td></tr>
<tr><td>Analytical</td><td>Medium Risk</td><td>Medium Risk</td><td>Low Risk</td><td>N/A</td></tr>
<tr><td>Operational</td><td>Medium Risk</td><td colspan="2">Low Risk</td><td>Low Risk</td></tr>
</table>

*If qualitative risk is present, adjust risk assessment accordingly

High risk (spreadsheet controls are required): High risk spreadsheets are those for which the "Use" is classified as "Financial", which have the potential to affect accounts or financial reporting disclosures by an amount greater than or equal to the accounting threshold used to identify high-risk journal entries[1] using the lowest of the LKE registrants (see the Materiality Thresholds tab of the Waived Adjustments file and for which the "Complexity" categorization is "High".

Includes:

- Complex calculations for journal entries
- JE-FAC file
- Spreadsheets for calculating regulatory mechanisms
- Unbilled revenue calculation
- All mark-to-market calculations

Does not include:

- Actual JE upload templates
- Account analyses
- Reconciliations

Medium risk (spreadsheet controls may be required): Spreadsheets may contain simple calculations. They may flow through to the financial statements and are more likely to relate to an account with less risk of material error or lower frequency of transactions. Spreadsheets used as a key control should be considered, at a minimum, medium risk.

Examples of medium risk spreadsheets include the following:

- Journal entries that foot and/or ensure debits equal credits.
- Those reviewed where reviewer should be able to pick up mathematical errors just by looking at a printed spreadsheet.
- Spreadsheets included in Sarbanes-Oxley (SOX) documentation.

[1] This threshold is calculated annually in the first quarter based on the previous year's 10-K.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Low risk (spreadsheet controls are not required): Spreadsheets are those used only for electronic logging and informational tracking.

Spreadsheet Controls

1. *The spreadsheet must then be evaluated based on the complexity and risk to determine appropriate spreadsheet controls, as follows: (See cycle/transaction 80.10 Control Activity 1 in the Sarbanes-Oxley Compliance documentation*.) (See Appendix D for further detail regarding the Spreadsheet Risk/Complexity Matrix).

	High Complexity	Moderate Complexity	Low Complexity
High Risk	Yes	N/A	N/A
Medium Risk	Evaluate	Evaluate	N/A
Low Risk	N/A	No	No

Low Risk Spreadsheets Controls:

- Files are stored on a share drive or Sharepoint site with limited access.
- Files are backed up systematically on a nightly basis.

Medium Risk Spreadsheet Controls:

- Files have all the same controls as those over low risk spreadsheets in addition to the controls listed below.
- Files may be tested at manager's discretion and testing is documented after the file has been changed. See Detailed Procedures Performed – (Changes).
- Files may be protected at manager's discretion via Excel Protection. (Procedures for Excel Protection are documented in Appendix A, Excel 2007 Technical Guidance, of this document).•

Additionally, see High Risk spreadsheet controls that may be used on Medium Risk spreadsheets as deemed necessary by management. Also, consider the use of additional Excel features that may be useful such as data validation, formula auditing, watch window and formula error checker. (Help for all Excel functions are available by clicking the "?" in the upper right corner of a spreadsheet or at the following link: http://office.microsoft.com/en-us/excel-help.)

1. *High Risk Spreadsheet Controls (See cycle/transaction 80.10 Control Activity 1 in the Sarbanes-Oxley Compliance documentation*.*):*

   - *Files have all the same controls as those over medium risk spreadsheets* in addition to the controls listed below.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

- *Someone independent of the process to develop the spreadsheet must assess the logic at the time the spreadsheet is developed and ensure it functions as intended.* Where appropriate, the logic should be documented to facilitate an efficient review of the accuracy of that logic.
- *At least annually, someone independent of the process to develop the spreadsheet must reassess the logic to ensure it continues to function as intended, while giving consideration to current business circumstances, such as regulatory and GAAP requirements. Documentation of the annual re-assessments must be maintained in each department.*
- It is recommended that "Track Changes" be on when making significant changes to a spreadsheet.
- *Files must be tested and testing must be documented after the file has been changed.* See <u>Detailed Procedures Performed – (Changes).</u>
- Files must be protected via Excel Protection (Procedures for Excel Protection are documented in Appendix A of this document).
- Cells that contain formulas or data, which do not change frequently, <u>should</u> be protected or locked as the spreadsheet allows.
- Reconciliation of data performed to ensure data entry is complete and accurate.
- *Validation checks on data input and calculation (including balancing, footing and cross-footing) are built into the spreadsheet or performed manually.*
- The spreadsheets are designed with a clear and self-explanatory layout.
- File naming conventions must be used that clearly indicate the date or version number. Files that are in final status must be clearly marked as such within the document (e.g., final or production).

See Appendix B for a summary of minimum recommended spreadsheet controls for each risk category based on SOX.

<u>Detailed Procedures Performed – (Spreadsheet Inventory):</u>

In addition, any new spreadsheet must be evaluated to determine whether it needs to be included in the spreadsheet inventory maintained as part of the Company's internal control system.

Include in the inventory

1. Spreadsheets that directly impact the financial statements or are listed as a key control in the internal control documentation.
2. All medium-risk and high-risk account reconciliations.
3. Underlying spreadsheets used to calculate standard journal entries. (See the 251 – Journal Entries Policy.)

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

4. Spreadsheets supporting amounts included in the following (including all underlying monthly activity).
   a. Covered by SOX
      i. Quarterly and annual LG&E and KU Energy LLC (LKE), LG&E and KU financial statements, footnotes, MD&A, and other information
      ii. Quarterly and annual PPL financial statements and footnotes
   b. Not covered by SOX
      i. Federal Energy Regulatory Commission (FERC) Form 1
      ii. Kentucky Public Service Commission (KPSC) version of FERC Form 1
      iii. KPSC version of FERC Form 2
      iv. FERC Form 3
      v. Monthly financial statements sent to the KPSC
      vi. FERC Form 60
5. All spreadsheets related to calculations of rates charged to customers. Some examples include the following:
   a. Base rates
   b. Fuel Adjustment Clause
   c. Environmental Cost Recovery
   d. Demand Side Management
   e. Gas Supply Clause
   f. Performance Based Ratemaking
   g. Weather normalization

See Appendix C, Required Data for Spreadsheets Inventory, for a listing of required data.

Exclude from the inventory

1. Budget only spreadsheets.
2. Spreadsheets containing nothing but the journal entry template completed for a particular journal entry, if there are no underlying calculations of the amounts in the journal entry.
3. Output of the financial system that is not used in compilation of the Company's quarterly or annual reports.
4. Internal management reports.

<u>Detailed Procedures Performed – (Changes):</u>

1. All spreadsheets that fall within the scope of internal control documentation to require spreadsheet controls must meet the minimum spreadsheet controls depending on the level of risk for the spreadsheet.
2. The owner of each spreadsheet is responsible for making appropriate changes to spreadsheets as necessary. Changes to the data in the spreadsheets are not considered changes to the spreadsheets; only changes to formulas, calculations, and/or anything that has an impact on the outcome of the spreadsheet are considered changes to the spreadsheets.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

3. All changes to spreadsheets must be documented, including the changes that were made, the reason for the changes, the person who made the changes, and the date of the changes. The documentation must be maintained within each department.
4. After making changes to a spreadsheet, the owner must solicit an additional level of review and testing of the changes that were made to the spreadsheet to ensure it is working properly.
5. The testing of the changes in the spreadsheet must be documented, including a detail of the testing that was performed, the person who performed the testing, the date the testing was performed, and the outcome of the testing. Documentation must be maintained in each department.
6. Testing and verification that the spreadsheet is working properly must be completed before the spreadsheet is relied upon.

Reports Generated and Recipients:

For new spreadsheet development, documentation must be created to identify the reason for the spreadsheet development, required controls and whether the spreadsheet will be included in the inventory. As part of this determination, documentation of an evaluation of the spreadsheet against all SOX criteria is necessary. This documentation may be a separate tab in each spreadsheet, a central list by department or other method, as long as the required information is maintained and able to be produced.

Documentation must be created to identify the changes that were made to any spreadsheet which has been identified as requiring testing (all High Risk and Medium Risk at manager discretion), who made the changes, the date of the changes, who reviewed/tested the changes, the steps that were taken to perform the review/test, and the date reviewed. Likewise, documentation must be created to record annual reassessments of High Risk spreadsheets, to include who performed the reassessment, the steps that were taken and the date performed. Documentation may be kept in a separate tab in each spreadsheet, a central list by department or other method, as long as the required information is maintained and able to be produced.

Additional Controls or Responsibility Provided by Other Procedures:

1. *Balance sheet reconciliations that are performed on a monthly basis on all balance sheet accounts are an additional control for many of the spreadsheets within this scope. (See cycle/transaction 80.05 Control Activity 9 in the Sarbanes-Oxley Compliance documentation.)* Any errors in the spreadsheets could be identified through the reconciliation process.

Regulatory Requirements:

N/A

Reference:

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

SOX 404
251 - Journal Entries Policy
354 - Materiality Policy and Procedures
Waived Adjustments File located at \\fs2\acctshare\Waived Adjustments\[YYYY QTR]\ErrorCorrecting EntriesUSGAAP[MonYY].xlsx

Corresponding PPL Policy No. and Name:

Guidelines for Spreadsheets and Other End User Computing Tools (see PPL Policies directory on the acctrestricted drive)

Key Contact:

Manager, Corporate Accounting

Administrative Responsibility:

Controller
Director, Accounting & Regulatory Reporting

Date Created: 6/17/09
Dates Revised: 3/16/11, 6/20/11, 8/11/11, 6/30/12, 1/31/13, 6/28/13, 7/8/14, 8/1/14, 1/30/15, 4/1/16

(Note: Text in italics indicates a key SOX control.)

Appendix A

Excel 2010 Technical Guidance

Secure a workbook with a password

To allow only authorized users to view or modify your data, you can help secure your entire workbook file with a password (password: A way to restrict access to a workbook, worksheet, or part of a worksheet. Excel passwords can be up to 255 letters, numbers, spaces, and symbols. You must type uppercase and lowercase letters correctly when you set and enter passwords.).

1. On the **File** menu, click **Protect Workbook**.
2. Do one or more of the following:

   - To protect the structure of a workbook so that worksheets in the workbook cannot be moved, deleted, hidden, unhidden, or renamed, and new worksheets cannot be inserted, click on Protect Workbook Structure and select the Structure check box.
   - To protect windows so that they are the same size and position each time the workbook is opened, click on Protect Workbook Structure and select the Windows check box.
   - To prevent others from removing workbook protection, click on Protect Workbook Structure, type a password, click OK, and then retype the password to confirm it.

   Note. Unlike passwords you specify in the **Encrypt Password** box to open the file, passwords you specify in the **Protect Workbook Structure** box are not encrypted. These passwords are only meant to give specific users permission to modify workbook data. For optimal password security, it's best to assign both passwords: an encrypted password to access the workbook, and one to provide specific users with permission to modify its content.
   Important: Use strong passwords that combine uppercase and lowercase letters, numbers, and symbols. Weak passwords don't mix these elements. Strong password: Y6dh!et5. Weak password: House27. Use a strong password that you can remember so that you don't have to write it down.
3. Click **OK**.
4. When prompted, retype your passwords to confirm them.
5. Click **Save**.
6. If prompted, click **Yes** to replace the existing workbook.

Protect workbook elements

1. On the **Review** tab, in the **Changes** group, click **Protect Workbook.**
2. Under **Protect workbook for**, do one of more of the following:
   - To protect the structure of a workbook, select the **Structure** check box.
   - To keep workbook windows in the same size and position every time the workbook is opened, select the **Windows** check box.
3. To prevent other users from removing workbook protection, in the **Password** (**optional**) box, type password, click **OK**, and then retype the password to confirm it.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

To remove protection from a worksheet

1. On the **Review** tab, in the **Changes** click **Unprotect Sheet.**
2. If prompted, type the password to unprotect the worksheet.

Lock specific cells and ranges in a protected worksheet=

1. On the **Review** tab, in the **Changes** group, click **Unprotect Sheet.** If prompted, type the password to unprotect the worksheet.
2. Select the whole worksheet by clicking the **Select All** button.
3. On the **Home** tab, in the **Font** group, click the **Format Cell Font** dialog box launcher.
4. On the **Protection** tab, clear the **Locked** check box, and then click **OK.**
5. In the worksheet, select just the cells that you want to lock.
6. On the **Home** tab, in the **Font** group, click the Dialog Box Launcher next to **Font**
7. On the **Protection** tab, select the **Locked** check box, and then click **OK**
8. On the **Review** tab, in the **Changes** group, click **Protect Sheet**.
9. In the **Allow all users of this worksheet to** list, select the elements that you want users to be able to change
10. In the **Password to unprotect sheet** box, type a password for the sheet, click **OK,** and then retype the password to confirm it.

For additional Excel 2010 technical guidance, please visit http://office.microsoft.com/en-us/excel-help/.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Appendix B
Recommended Minimum Spreadsheet Controls

	Risk category		
	Green	**Yellow**	**Red**
Change Controls			
Version Control	n/a	Version control - controls are in place	Version control - controls are in place and procedures documented
Change Control	n/a	Basic change controls are applied	A standard process is applied to the development process of the spreadsheet, covering the phases requirement specification, programming, testing and maintenance. Testing comprises an inspection/review by someone other than the developer of the spreadsheet. This testing / review should be formally documented.
Archiving	n/a	Historical files are maintained in segregated drive	Written procedures for archiving exist
Documentation	n/a	n/a	Comprehensive documentation of the spreadsheet's functionality and user guidance is available
Safety and Integrity Controls			
Access Control	n/a	Appropriate users have proper file and worksheet access	Strong access restrictions apply on file level (special directory with limited access to authorized people only) and spreadsheet level (password protection); full access is only granted to those individuals who input information directly onto the excel spreadsheet; other individuals only have read-only access to the spreadsheet
Backups	n/a	Regular and timely backup (e.g. regular network drive backups)	Spreadsheet is saved on network drives which are subject to regular and timely back-up procedures; specific back-up procedures ensure that information is retained and stored in case that evidence is longer required, e.g. for auditors.
Data Input Control	n/a	n/a	Data input controls exist, ensuring that data is entered completely and accurately
Integrated Analytic Controls	n/a	Basic self-spreadsheet checks apply	Strong validation checks on data input (batch total check), balance checks (self-balancing models), foot and cross foot checks, reconciliation controls (e.g. data download)

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

	Risk category		
	Green	**Yellow**	**Red**
Spreadsheet Protection	n/a	Basic protection of formulas against unintentional changes	Strong protection of the spreadsheet to prevent inadvertent or intentional changes to standing data, formulas etc.; further, the spreadsheet has a clear and self-explaining layout, e.g. variables, assumptions and flexible inputs are separated from the working area
Segregation of Duties/Roles and Procedures	n/a	n/a	Segregation of duties/roles and procedures are adequately considered and implemented

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Appendix C
Required Data for Spreadsheet Inventory

1. The following defines **required** data for each spreadsheet included in the inventory. Where provided, data values must be selected from the options provided. All items are required – none may be left blank.

    1. Cycle Name and Number (must be 10 characters and include all periods e.g., C.XX.YY.ZZ where XX is the process group, YY is the process, and ZZ is the subprocess, as in C.01.01.01)
    2. File Name
    3. File Location (full path including server and drive name – not just the drive letter to which you have the drive mapped)
    4. Owner (Only ONE Employee Name - the person responsible for updating the Spreadsheet). (Use both the first and last name of the owner.)
    5. Owner Dept. (Owner's Department Name) (Use full department name as there are several "Accounting" departments and some abbreviations may not be obvious.)
    6. Primary User (Employee Name(s) – likely someone in Accounting) (List both the first and last name of the primary user(s).The user must be an employee or contractor. Third parties (i.e., IMEA, IMPA, FERC, etc.) are not to be listed as users. Note that the user may be the owner.)
    7. Primary User Dept. (Primary User's Department Name (s)Use full department name as there are several "Accounting" departments and some abbreviations may not be obvious.)
    8. Description (what is calculated or the spreadsheet's purpose)
    9. Frequency of Changes (Daily, Weekly, Monthly, Quarterly, Semi-Annually, Annually, As Needed,)
    10. Risk: H/M/L (H-High; M-Moderate; L- Low). The owner and user of the spreadsheet must agree to the risk assessment.
    11. Type/Use: O/A/F (O – Operational; A – Analytical/Management Information; F – Financial)
    12. Complexity: H/M/L (H-High; M-Moderate; L- Low)
    13. Spreadsheet Controls Required? (Yes/No)
    14. Control Rationale (Brief explanation of decision for/against adding controls 200 characters)

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Appendix D – Spreadsheet Risk/Complexity Matrix

Complexity (and use of spreadsheet)

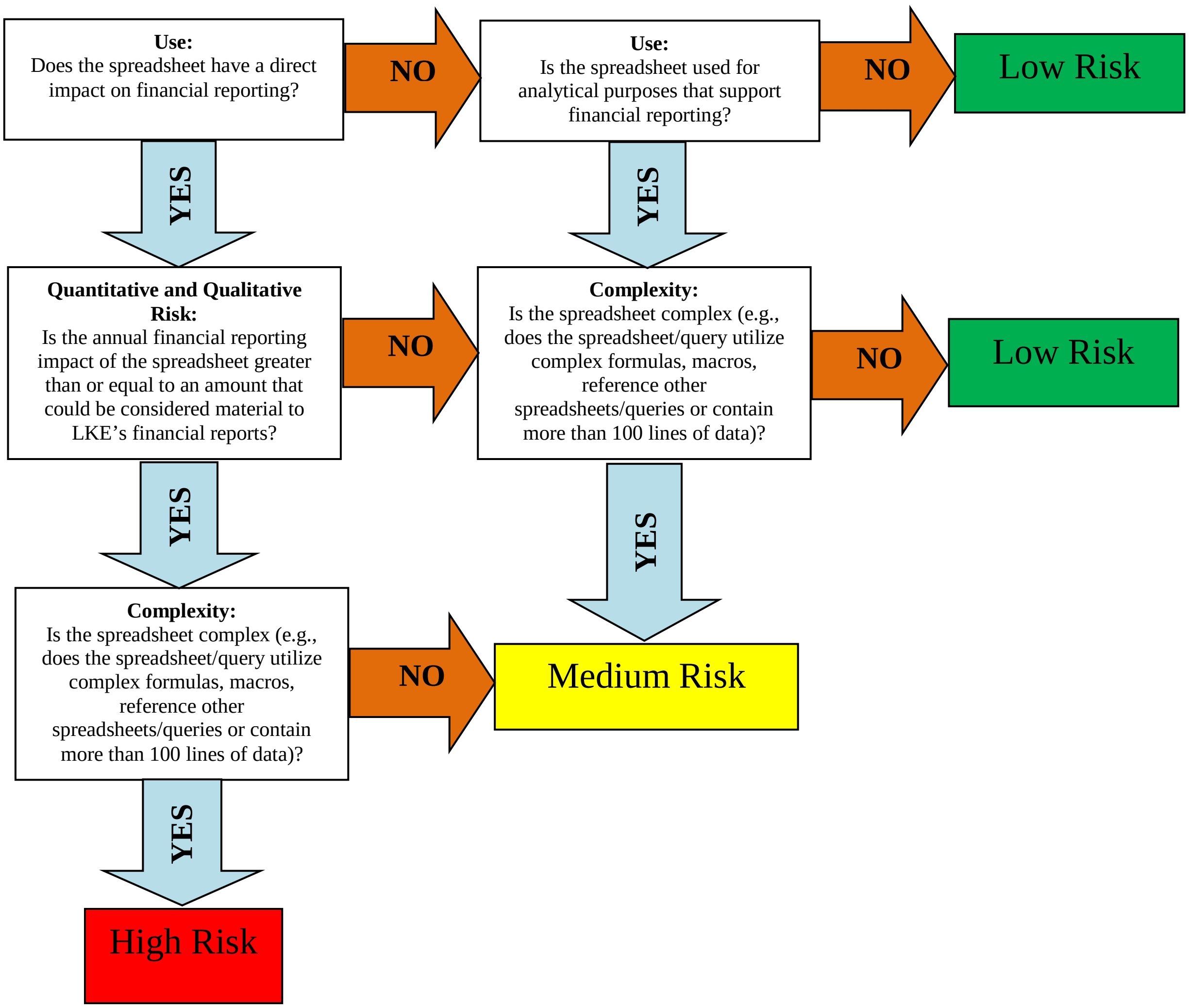
Risk (Nature and significance of the account or process that the spreadsheet supports)

	High	Medium	Low
High	·High $ value - high risk of material error ·Many manual inputs (or created Manually) ·Many calculations ·Complicated Referencing ·Significant Number of columns, rows and/or workbooks utilized ·Mathematical accuracy must be verified by recalculation ·Use of macros and linked spreadsheets ·Significant Dependency on output (large number of users) ·High frequency or great extent of changes to spreadsheet	N/A	N/A
Medium	·Medium risk of material error ·Many manual inputs (or created Manually) ·Many calculations ·Complicated Referencing ·Significant Number of columns, rows and/or workbooks utilized ·Mathematical accuracy must be verified by recalculation ·Use of macros and linked spreadsheets ·Significant Dependency on output (large number of users) ·High frequency or great extent of changes to spreadsheet	·Medium risk of material error ·Several manual inputs ·Several calculations ·Mathematical accuracy may require recalculation	· N/A
Low	·N/A	·Not SOA supporting ·Low $ value - low risk of material error ·Several manual inputs ·Several calculations ·Mathematical accuracy may require recalculation	·Not SOA supporting ·Low $ value - low risk of material error ·Minimal manual inputs (or system generated) ·Minimal calculations ·Can visually review for mathmatical accuracy ·Minimal Dependency on output (small number of users) ·Low frequency or small extent of changes to spreadsheet

Spreadsheet controls are required.
Spreadsheet controls may be required.
No spreadsheet controls are necessary.

950 - Spreadsheet Policy and Procedures

(Note: Text in italics indicates a key SOX control.)



953 – Reserve for Bad Debts (Retail & Wholesale)

(Note: Text in italics indicates a key SOX control.)

Policy:

The retail and wholesale accounts receivable balances are evaluated on a monthly basis to ensure that the accounts receivable reserve balances are not materially over or under accrued.

Procedure:

The reserve for retail bad debts is based on the ratio of amounts charged off over the last 12 months to retail revenues billed over the same period, times the retail revenues billed over the last four months. Accounts with no payment activity are charged off after four months, although collection efforts continue thereafter.

The reserve for wholesale and municipal customer and sundry bad debts is based on specific identification.

Scope:

Applicable to Louisville Gas & Electric Company (“LG&E”) and Kentucky Utilities Company (“KU”) retail, wholesale, municipal and sundry accounts receivable.

Objective of Procedure:

In accordance with FASB ASC 450, “Contingencies”, an estimated loss should be charged to expense if the following two conditions exist:

1. It is probable that an asset has been impaired, and
2. The amount of the loss can be reasonably estimated

The objective of evaluating the accounts receivable reserve balances is to identify, quantify, and correct any material over or under accrual and recognize bad debt expense in the same period as the related revenues.

General Requirements:

Detailed Procedures Performed:

Retail:

1. *Each month, the retail reserve balances for uncollectible accounts receivable, for LG&E and KU, are evaluated by the Revenue Accounting and Analysis department.*

953 – Reserve for Bad Debts (Retail & Wholesale)

(Note: Text in italics indicates a key SOX control.)

2. *A historical charge-off percentage is calculated by dividing the net charge-offs during the most recent twelve-month period by the total billed sales during the same twelve-month period. The monthly net charge-offs and total billed sales are accumulated on a spreadsheet using data from the following source documents:*
   - *The monthly net charge offs and forfeited discounts (late payment charges) are obtained from the Oracle Account Analysis reports for general ledger accounts 144002 (total charge-offs), 144003 (total recoveries), 450001 (electric forfeited discounts) and 487001 (gas forfeited discounts), as applicable, for LG&E and KU. KU and ODP data is segregated by organization when running these reports.*
   - *The total billed sales are obtained from the "LGE CM Revenue By Comp By Class – Test" and "KU Revenue By Comp By Class CM – Test" FSGs in Oracle. KU and ODP data is segregated by organization by running two versions of the KU FSG.*

3. *The historical charge-off percentage is then applied to (multiplied by) the billed retail (electric and gas) sales during the most recent four month period to yield a calculated reserve.*

4. *The actual reserve balance per the general ledger is compared to the calculated reserve, and a journal entry is created to record the net charge-offs in CCS to bad debt expense and adjust (true-up) the resulting reserve balance to the calculated balance.*

5. *In addition to the calculated reserve accrual, additions to the reserve balance are made by specific identification. If a customer balance is identified as uncollectible before it is 120 days old, the reserve is increased for the specific amount of the balance. (See cycle/transaction 10.04 Control Activity 13 in the Sarbanes-Oxley Compliance documentation.*)

6. The Revenue Collections department is responsible for the collection and dunning process for retail customers.

Wholesale:

1. The Financial Accounting and Analysis department performs counterparty checkouts via email and issues an invoice in the month following the month of flow.

2. *Balance sheet account reconciliations include an aging of the accounts receivable, showing balances over 30, 60 and 90 days past due. (See 250 - Balance Sheet Accounts Reconciliation Policy)*

953 – Reserve for Bad Debts (Retail & Wholesale)

(Note: Text in italics indicates a key SOX control.)

3. *After a receivable becomes over 30 days past due, the Financial Accounting and Analysis department will contact the counterparty and inquire about the payment status of the invoice.*

    a. *If the counterparty states the balance will be paid, the cash receipts is monitored to ensure payment is made as stated.*

        i. *If payment is not made as stated, the counterparty is contacted a second time.*

    b. *If the counterparty states it will not pay the invoice in full or in part, an explanation of the non-payment is requested and the validity of the counterparty's claim is investigated.*

        i. *If the counterparty's claim is that the bill was for an improper amount and the claim is validated, an adjusting entry is recorded and a corrected invoice is issued.*

        ii. *If the counterparty's claim of an incorrect bill is discredited, the counterparty is contacted to confirm that the invoice has been investigated and determined to be accurate.*

        iii. *If the counterparty still does not pay, the Financial Accounting and Analysis department will notify the Manager, Credit and Contract Administration, of the default and refusal to pay. The Manager, Credit and Contract Administration, makes a decision whether to grant additional credit and thus permit selling to this counterparty to continue.*

    c. *The Financial Accounting and Analysis department sends a dunning letter to the counterparty in default stating the invoice number, flow month of power sold, due date, amount invoiced, payment received (if any), open balance and "please respond by" date (which is 10 days from the date of the letter).*

    d. *If no response, or a negative response, is received by the date indicated in the letter, a second letter is sent to the counterparty offering assistance if it needs further information regarding the open balance. The counterparty would again be requested to respond within 10 days. This letter would be reviewed by the Legal department and sent via registered mail.*

953 – Reserve for Bad Debts (Retail & Wholesale)

(Note: Text in italics indicates a key SOX control.)

e. *If no response, or a negative response, is received from the second letter by the date indicated, the Financial Accounting and Analysis department notifies the Legal department of the situation and works with it to resolve the issue.*

f. *For transactions occurring outside the Independent System Operator (ISO) and Regional Transmission Organization (RTO) markets, a reserve for doubtful accounts is established for balances over 90 days past due, with the exception of a mutual agreement between parties that may constitute balances over 90 days. An additional reserve is established for any receivable that is denied by the counterparty or deemed impaired due to a triggering event (e.g. significant financial difficulty of the counterparty, a breach of contract, such as a default or delinquency in payments, the disappearance of an active market (ISO or RTO)).*

   For transactions that occur within the ISO and RTO markets, the administrator of the ISO and RTO markets will notify the company when a counterparty defaults. At that time the Financial Accounting and Analysis department adjusts the reserve for doubtful accounts accordingly.

g. *If a reserve for wholesale doubtful accounts is established, it is re-evaluated quarterly. Upon receipt of payment by a defaulting counterparty, the allowance account is adjusted accordingly for the bad debt expense originally recorded.*

Municipals:

Revenue Accounting & Analysis performs a process similar to the wholesale process for receivables from municipal customers.

Sundry:

Emails are sent at least quarterly to obtain the status of aged sundry receivables. Emails are sent to representatives from Cash Management, Legal, Revenue Collections and relevant Energy Delivery personnel. A determination of collectability of accounts over 60 days past due is made and appropriate follow up steps are taken (telephone calls, dunning letters, etc.). The Revenue Collections department is responsible for the collection and dunning process for sundry customers. Accounts with no payment activity are reserved after four months, and the bad debt reserve is adjusted based on information obtained from these meetings.

Reports Generated and Recipients:

953 – Reserve for Bad Debts (Retail & Wholesale)

(Note: Text in italics indicates a key SOX control.)

The evaluation of the retail accounts receivable reserve balance is documented within the respective files used to create the journal entry for each company (LG&E - "JE098 Adj Bad Debt Reserve YYYY.MM.xlsm" and KU - "J517 AR Reserve Adj YYYY.MM.xlsm").

For wholesale accounts, an aging of the open accounts receivable balance is maintained on the financial accounting shared drive (LG&E - "100.142003, 144009, 232010.xlsx"; KU - "100.142003, 144009, 232010.xlsx"). Additional reports include the first and second (if applicable) informational letters to the counterparties.

For municipal customers, an aging of the open accounts receivable from CCS is maintained on the revenue accounting (fs3:\\revacct) share drive (AR Aging Snapshot – yyyy.mm.xlsx).

For sundry accounts, an aging of the open accounts receivable balance is maintained in the Oracle AR module. The evaluation of the reserve balance is documented within the respective files used to create the quarterly journal entry for each company (LG&E - J075-0100; KU - J070-0110). Accounts included in the aging are 143006-AR Billed Projects, 143007-AR Non-Project, 143012-AR Miscellaneous, 143017-AR Damage Claims and 172001-Rents Receivable. The reserve account used is 144006-AR Miscellaneous.

Additional Controls or Responsibility Provided by Other Procedures:

- Counterparty checkout prior to issuance of wholesale invoices
- 250 - Balance Sheet Account Reconciliation Policy
- Review and approval of the monthly calculations, evaluations, and journal entries by the Manager, Revenue Accounting and Analysis, and the Manager, Financial Accounting and Analysis

Regulatory Requirements:

None

Reference:

- Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310-10-35, Assets - Receivables - Subsequent Measurement
- FASB ASC 450-20-25-2, Liabilities – Contingencies – Loss Contingencies – Recognition

Corresponding PPL Policy No. and Name:

953 – Reserve for Bad Debts (Retail & Wholesale)

(Note: Text in italics indicates a key SOX control.)

- 903 Reserve for Bad Debts
- 904 Reserve for Bad Debts – Unregulated

Key Contact:

Manager, Revenue Accounting and Analysis

Administrative Responsibility:

Director, Accounting and Regulatory Reporting

Date Created: 11/30/04
Dates Revised: 12/31/07, 7/12/10, 3/31/11; 9/19/11, 11/3/14, 3/9/16 (*formatting to new template)*

954 - Coal Inventory Valuation

(Note: Text in italics indicates a key SOX control.)

Policy:

To ensure the correct valuation of the MMBTU content and dollars of coal burned.

Procedure:

Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") calculate a daily weighted average inventory cost per MMBTU and use this cost to calculate daily burn expense.

Scope:

This policy applies to coal burned by LG&E and KU.

Objective of Procedure:

To accurately account for the value of fuel stock inventories, as well as the calculation of monthly coal burn expense.

General Requirements:

Detailed Procedures Performed:

The Corporate Fuels department uses a fuel supply management system to track receipts, consumption and inventory values for LG&E and KU.

Monthly coal inventory valuation:

1. Beginning inventory plus daily purchases equals a new daily subtotal (i.e. tons, dollars, weighted average cost/ton, MMBTUs, and weighted average $/MMBTU).

2. The plants determine the number of tons burned on a daily basis. The MMBTUs associated with these tons are multiplied by the subtotal weighted average $/MMBTU to determine the daily burn dollars. All of the daily amounts are then added together to determine total burn expense for the month.

3. The burn tons, dollars, and MMBTUs are then subtracted from the subtotal established in step 1 to determine a new ending inventory value, which becomes either the next day's or next month's beginning inventory (i.e. storage pile).

954 - Coal Inventory Valuation

(Note: Text in italics indicates a key SOX control.)

Annual coal inventory valuation:

An annual physical inventory is formally requested by Corporate Fuels and any adjustments related to the coal stockpile valuations are included on the general ledger before the end of the year. See Corporate Fuels and By-Products Procurement Procedures for additional details.

Reports Generated and Recipients:

Corporate Fuels produces the following reports from its fuel supply management system for LG&E and KU on the third day of closing, and distributes them to individuals in Corporate Fuels, Regulatory Accounting and Reporting and the plants:

1. Fuel Receipts Summary
2. Fuel Consumption
3. Fuel Inventory Rollforward Summary

Corporate Fuels produces the following report from its fuel supply management system for LG&E and KU and distributes to individuals from State Regulation and Rates:

1. Analysis of Coal Purchased for Fuel Clause Backup

Regulatory Accounting and Reporting generates the following reports to be provided to State Regulation and Rates:

- Form A Filing Data (includes monthly fuel expenses and generation, purchase and sale statistics)
- Form B Filing Data (includes unit statistics)
- Fuel Inventory Schedules
- Analysis of Other Fuel Purchases

Corporate Fuels prepares the EIA-923 Filing Data (includes monthly fuel expenses, fuel balances, and other generation related statistics) and adds additional reports generated by its fuel supply management system before electronically filing the EIA-923 monthly report with the Department of Energy.

Additional Controls or Responsibility Provided by Other Procedures:

954 - Coal Inventory Valuation

(Note: Text in italics indicates a key SOX control.)

Corporate Fuels and By-Products Procurement Procedures

Regulatory Requirements:

- Kentucky Public Service Commission Fuel Adjustment Clause mechanism
- Virginia State Corporation Commission Levelized Fuel Factor mechanism
- Department of Energy's Energy Information Administration filing form 923

Reference:

- FASB Accounting Standards Codification ("ASC") 330 – Inventory
- Title 18, Part 101 of the Code of Federal Regulation, Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Manager, Regulatory Accounting and Reporting

Administrative Responsibility:

Director, Accounting and Regulatory Reporting

Date Created: 6/21/05
Date Revised: 12/31/07, 7/8/10, 10/4/11, 6/09/15, 6/29/2015, 3/21/2016, 9/12/2017

959 - Escheatment

(Note: Text in italics indicates a key SOX control.)

Policy: Relevant Company unclaimed property will be escheated to the proper governmental agencies, largely the Kentucky Department of Treasury under Kentucky Revised Statute (“KRS”) Chapter 393.

Procedure: The escheat procedure is performed per the instructions below.

Scope: All unclaimed property that is required to be escheated for LG&E and KU Energy LLC (“LKE”) and its subsidiaries, including Louisville Gas & Electric Company (“LG&E”), Kentucky Utilities Company (“KU”), LG&E and KU Services Company (“LKS”), LG&E and KU Capital LLC (“LKC”) and Western Kentucky Energy Corp (“WKE”).

Objective of Procedure: The objective of escheatment is to comply with state laws, including KRS 393, in the identification and remittance of unclaimed funds or property to the state.

General Requirements:

1) Approximately in June of each year, the Legal and Accounting departments review the states’ unclaimed property guides (for Kentucky, Virginia and Tennessee) to become aware of any changes to the escheatment laws including changes in dormancy or remitting periods, forms, etc. and to resolve any questions about the upcoming filing or process. Any additional questions that occur during the filing and throughout the year are also coordinated with the Legal department.
2) The Unclaimed Property report filed with the Kentucky Department of Treasury includes unclaimed wages, dividends, customer account credit balances, and any type of outstanding check. Unclaimed property is required to be escheated as follows:
   - In Kentucky, items with no owner-initiated contact for three years.
   - In the Commonwealth of Virginia, customer deposit checks have a dormancy period of one year and all other unclaimed property has a dormancy period of five years.
   - In the State of Tennessee, wages have a dormancy period of one year, deposit checks have a dormancy period of two years, and all other unclaimed property has a dormancy period of five years.
3) Kentucky is an exchange state without a reciprocal agreement and, therefore, businesses located in the Commonwealth of Kentucky may file one unclaimed property report for all property owners, even those that reside in other states. However, there are some states that do require separate filings. Unclaimed property for Indiana, Nevada, Arkansas, Alabama, New Jersey, Maryland, Michigan, North Dakota, Delaware and Virginia should be reported directly to the appropriate state agency instead of the Commonwealth of Kentucky. If there are more than 10 Tennessee owner accounts or escheatable property in Tennessee that has a value of greater than $1,000, a separate escheatment report must also be filed with the State of Tennessee instead of with the Commonwealth of Kentucky.

(Note: Text in italics indicates a key SOX control.)

4) Attempts are made to locate the owners of the unclaimed property that is being held. Companies are required to send a notification letter to the owners of unclaimed property valued at over $100 for Kentucky, Virginia and Maryland and $50 for Tennessee, Michigan, Indiana, Nevada, Arkansas, Alabama, New Jersey, Delaware and North Dakota, between 60 and 120 days prior to when the reports are filed, . The Unclaimed Property report is filed in NAUPA II (National Association of Unclaimed Property Administrators) format using UPExchange, a web-based application that is used by the Kentucky Department of Treasury.

Detailed Procedures Performed:

Oracle Transactions:

LG&E and KU

1) Through the normal course of business, and at a minimum of once per year, outstanding accounts payable checks, which are one year or older, are removed from the Companies' and bank's outstanding check records by the Corporate Accounting department for LG&E, KU and LKS. The Corporate Accounting department inputs the information from these outstanding checks into the UPExchange unclaimed property database and makes the appropriate accounting entries to move the amount of these checks into a liability account.
2) Additionally, LG&E, KU and LKS have chosen to escheat certain funds before the State-established dormancy period. These funds include all checks issued from Oracle as a result of special CCS runs on closed customer accounts. The checks must be at least six months old in order to early escheat any items in special runs for which checks were written.
   - Attempts are made to locate the owners of the unclaimed property that is being held. For reports due on November 1 (for all states except Michigan and Delaware), an attempt to locate the owners between July 1 and September 1 is required.
   - The Michigan filing is due on July 1, so an attempt to locate the owners between March 1 and May 1 is required.
   - The Delaware filing is due March 1, so an attempt to locate the owners between November 1 and December 30 is required.
   - If the owner is located, a replacement check is issued and the UPExchange unclaimed property database is updated. If the owner is deceased and the estate files for the replacement, appropriate documentation is required from the estate before a replacement check is issued.

959 - Escheatment

(Note: Text in italics indicates a key SOX control.)

WKE and LKC

1) Balances eligible for escheatment are identified by an accounting analyst in Corporate Accounting by reviewing the list of outstanding checks for accounts payable.
2) Once identified, balances eligible for escheatment are maintained and updated in an Excel spreadsheet by the accounting analyst, which is then used to produce the owner notification letters.
   - For reports due on November 1 (for all states except Michigan and Delaware), an attempt to locate the owners between July 1 and September 1 is required.
   - The Michigan filing is due on July 1, so an attempt to locate the owners between March 1 and May 1 is required.
   - The Delaware filing is due March 1, so an attempt to locate the owners between November 1 and December 30 is required.
3) Checks remain outstanding in Oracle until ready to be escheated. The balance of the outstanding checks is transferred to a liability account in preparation for escheatment. A Corporate Accounting analyst posts a journal entry that debits cash and credits account 242014 (escheated deposits). The checks are then cleared from Oracle.
4) If an owner requests a check to be reissued, Accounts Payable cancels the original check and then issues its replacement. The Excel spreadsheet is updated with the replacement date.

CCS Transactions:

1) Balances subject to escheatment in the LG&E and KU Customer Care Solution (“CCS”) are identified annually via automated processes. These balances include customer credit receivables and customer deposits which have not been successfully refunded for those customers who have not had service with the utility for more than three years (one year for customer deposits and credit balances in the Commonwealth of Virginia). This automated process produces the notification letters sent to property owners and an Excel spreadsheet providing all data necessary for meeting the state’s reporting requirement.
2) Additionally, LG&E and KU have chosen to escheat certain funds before the State-established dormancy period. These early escheated funds include all items less than $1 from CCS since the administrative cost of resolving them outweighs the benefit. The items could be due to several items, including customer overpayments, deposit interest refunds, energy efficiency refunds, tax-related refunds, or other special runs for customer refunds on closed accounts.
   - Attempts are made to locate the owners of the unclaimed property that is being held. For reports due on November 1 (for all states except Michigan and Delaware), an attempt to locate the owners between July 1 and September 1 is required.
   - The Michigan filing is due on July 1, so an attempt to locate the owners between March 1 and May 1 is required.

(Note: Text in italics indicates a key SOX control.)

- The Delaware filing is due March 1, so an attempt to locate the owners between November 1 and December 30 is required.
- If the owner of the CCS account is located, a check is issued and documented in the Excel spreadsheet produced by CCS. If the owner is deceased and the estate files for the unclaimed property, appropriate documentation is required from the estate before a check is issued. At the appropriate time, transactions and the supporting accounting entries are generated in CCS to remove the credit balances and the customer deposits being escheated.

Payroll Transactions:

1) Balances eligible for escheatment are identified by an accounting analyst in Corporate Accounting by reviewing the list of outstanding Checks for the payroll accounts of all appropriate companies.
2) For LG&E, KU and LKS, any payroll checks eligible for escheatment are cleared from the Companies' and the bank's outstanding check records by the Corporate Accounting department. The Corporate Accounting department inputs the information from these outstanding checks into the UPExchange unclaimed property database and makes the appropriate accounting entries to move the amount of these checks into a liability account. The escheat process and the process for handling replacement checks are then identical to the checks processed through Oracle
3) For WKE and LKC, balances eligible for escheatment are maintained and updated in an Excel spreadsheet by the accounting analyst, which is then used to produce the owner notification letters.
   - For reports due on November 1 (for all states except Michigan and Delaware), an attempt to locate the owners between July 1 and September 1 is required.
   - The Michigan filing is due on July 1, so an attempt to locate the owners between March 1 and May 1 is required.
   - The Delaware filing is due March 1, so an attempt to locate the owners between November 1 and December 30 is required.
4) For WKE and LKC, checks remain outstanding in PeopleSoft until ready to be escheated. The balance of the outstanding checks is transferred to a liability account in preparation for escheatment. A Corporate Accounting analyst posts a journal entry that debits cash and credits account 242014 (escheated deposits). The checks are then cleared from PeopleSoft.
5) For WKE and LKC, if an owner requests a check to be reissued, Payroll cancels the original check and then issues its replacement. The Excel spreadsheet is updated with the replacement date.

Filing Process (All Companies):

959 - Escheatment

(Note: Text in italics indicates a key SOX control.)

- A disbursement request is submitted by Corporate Accounting for the amounts to be escheated and reports and funds are remitted to the appropriate state by November 1 (or July 1 for Michigan and March 1 for Delaware)
- The detail for all checks or account balances regardless of the amount, include all owner information available such as name, address, check number or account number and amount due to owner. Although the state allows a company to aggregate checks/accounts for amounts less than $100, each unclaimed property, no matter the amount, is separately reported.
- The report is filed using NAUPA II (National Association of Unclaimed Property Administrators) format. If required to file by CD, the report information may be input via upload from Excel into UPExchange, a web based application, and is then saved to CD and forwarded with the filing. WKE and LKC, with 10 or fewer owner accounts, file by paper copy. Most states now require electronic filing and will no longer filngs reported on paper or CD.

Reports Generated and Recipients:

1) Excel spreadsheet used in journal entry preparation. (LG&E, KU, WKE, LKS, LKC)

2) UPExchange unclaimed property database to monitor the escheatment balances (LG&E, KU and LKS)

3) CCS reports used in journal entry and filing preparation. (LG&E, KU)

4) UPExchange reports used in filing with the Kentucky Department of Treasury and with others states requiring separate unclaimed property filings

Additional Controls or Responsibility Provided by Other Procedures:

Bank statement reconciliations are performed each month that verify the outstanding check listing between the banks and the companies. Accounts Receivable CCS accounts are examined for credit balances.

Regulatory Requirements:

Kentucky Revised Statutes 393
Virginia Title 55, Section 55-210.1-30 of the Virginia Uniform Disposition of Unclaimed Property Act.
Tennessee Code Annotated, Section 66-29-101.ET SEQ Uniform Disposition of Unclaimed Personal Property Act
Indiana Code, Article 34 Lost or Unclaimed Personal Property

959 - Escheatment

(Note: Text in italics indicates a key SOX control.)

Michigan Uniform Unclaimed Property Act (Public Act 29 of 1995)
Delaware Code Title 12, Chapter 11 Unclaimed Property Law

Reference:

Kentucky Department of Treasury Report Forms and Instructions (www.kytreasury.com)
Virginia's Annual Holder Report Forms and Instructions (http://www.trs.virginia.gov/)
Uniform Disposition of Unclaimed Property Act Reporting Forms and Instructions (www.treasury.state.tn.us/unclaim)
Indiana's Managing Unclaimed Property Guide (www.indianaunclained.com/reporting)
Michigan Department of Treasury Manual for Reporting Unclaimed Property (http://www.michigan.gov/unclaimedproperty)
State of Delaware Escheat Handbook (https://finance.delaware.gov/unclaimedproperty.shtml)

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Manager, Corporate Accounting

Administrative Responsibility:

Controller

Date Created: 11/30/2004
Dates Revised: 3/17/2011; 8/10/2011; 2/26/2013; 3/15/2016; 9/25/2018

960 - Discounting

(Note: Text in italics indicates a key SOX control.)

Policy:

To ensure long-term assets and liabilities are discounted in accordance with FASB ASC 835, Interest, 310, Receivables, and 470, Debt.

Procedure:

Long-term assets and liabilities that meet the criteria of ASC 310, 470 and 835 must be reviewed to determine the propriety of discounting the asset or liability to present value. Discounts will be calculated using the credit-adjusted risk-free interest rate and record the discounted value of the asset or liability in the current period. An additional adjustment will be made at the end of each reporting period to adjust the asset or liability for the interest expense incurred for the passage of time.

Scope:

The policy applies to any long-term receivable or payable of LG&E and KU Energy LLC and its subsidiaries ("LKE" or the "Company") which represents contractual rights to receive money or contractual obligations to pay money on fixed or determinable dates covered by ASC 310, 470 and 835. These ASCs do not apply to capital leases or deferred tax items.

Objective of Procedure:

The procedure will ensure that assets and liabilities are reported at their current fair value.

General Requirements:

Detailed Procedures Performed:

Long-term assets or liabilities that meet the criteria of ASC 310, 470 or 835 must be discounted to present value, if significant. The credit-adjusted risk-free interest rate obtained from the Treasurer is used to calculate the discount and, if the discount equals or exceeds $25,000, then it is recorded. At the time the discount is established, an assessment is performed and documented to determine the amortization of the discount. If a straight-line amortization approximates the effective interest rate method, the discount is amortized using the straight-line method.

As an example, if the Company has a liability to pay a retiree supplemental retirement payments of $1,000 per month for 10 years (a total of $120,000) and the discounted liability is $90,000, then a debit of $30,000 would be made to retirement expense and a credit to retirement liability.

960 - Discounting

(Note: Text in italics indicates a key SOX control.)

The calculation is reviewed at the balance sheet date and interest expense is amortized by debiting interest expense and crediting the liability.

Reports Generated and Recipients:

None

Additional Controls or Responsibility Provided by Other Procedures:

250 - Balance Sheet Account Reconciliation policy

Regulatory Requirements:

None

Reference:

- FASB ASC 835, Interest
- FASB ASC 310, Receivables
- FASB ASC 470, Debt

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Manager, Financial Accounting & Analysis

Administrative Responsibility:

Director, Accounting & Regulatory Reporting

Date Created: 7/1/09
Dates Revised: 3/31/11; 9/23/11; 3/9/16

961 – Cash Surrender Value of Key Man Life Insurance

(Note: Text in italics indicates a key SOX control.)

Policy: The cash surrender value of the key man life insurance will be updated monthly on Kentucky Utilities Company's ("KU's") books.

Procedure: To calculate and record the cash surrender value of the key man life insurance policies in accordance with values provided by the insurer.

Scope: KU's key man life insurance policy on former and/or current employees.

Objective of Procedure: To ensure the accurate presentation of the cash surrender value of the life insurance policies on the accounting records of KU.

General Requirements:

Detailed Procedures Performed:

1. Kentucky Utilities obtains from MetLife (previously General American Life Insurance Company) an annual valuation summary, which provides the current statistics of the policies. Throughout the year the values are updated, as needed, and adjustments are made to reflect any updates.

2. Notification of an insured's death is communicated to the Financial Accounting & Analysis department and the Treasury department by the Human Resources department; notification of a repayment of loans is communicated to the Financial Accounting & Analysis department by the Treasury department. The Treasury department also notifies MetLife of an insured's death. The listing of individuals covered is confirmed by Treasury on an annual basis with the Human Resources department. In the event of the death of anyone covered under the policy, or repayment of loans, updated statistics are requested from MetLife.

3. KU can either pay the premiums or borrow against the policy value for the payment of the premium.

   a. If the payment of the premiums is made in cash by KU directly, the following monthly journal entries are prepared.

      To record the pre-payment of the premium:
      Debit: Account 165001 (Prepaid Insurance)
      Credit: Account 131092 (Cash-BOA Funding)

      To record monthly amortization of prepaid life insurance premiums:
      Debit: Account 426201 (Life Insurance)
      Credit: Account 165001 (Prepaid Insurance)

961 – Cash Surrender Value of Key Man Life Insurance

(Note: Text in italics indicates a key SOX control.)

To record monthly amortization of the estimated change in policy value:
Debit: Account 186035 (Key Man Life Insurance)
Credit: Account 426201 (Life Insurance)

b. When paying the cost of the premiums out of the cash surrender value of the policies, a monthly entry is prepared to recognize the decrease in the cash surrender value of the policies and to amortize the premium expense. The premiums are deducted from the CSV balance in lieu of the company making cash payment for the annual premiums.

To record payment of premiums from the cash surrender value monthly:
Debit: Account 426201 (Life Insurance)
Credit: Account 186035 (Key Man Life Insurance)

To record monthly amortization of the estimated change in policy value:
Debit: Account 186035 (Key Man Life Insurance)
Credit: Account 426201 (Life Insurance)

4. In the event of the death of anyone covered under the policy, Kentucky Utilities receives a check from MetLife. Typically, the payout upon death is more than the cash surrender value and a gain is recorded to 421003 (KM Life Ins-Cash Surrender Value).

To record receipt of the death benefit proceeds:
Debit: Account 131092 (Cash-BoA Funding)
Credit: Account 186035 (Key Man Life Insurance)

To record receipt of the refunds for prepayment of premiums:
Debit: Account 131092 (Cash-BoA Funding)
Credit: Account 426201 (Life Insurance)

To record true-up of actual asset value versus estimated asset value:
Debit: Account 131092 (Cash-BoA Funding)
Credit: Account 421003 (Key Man Life Insurance - CSV)

Reports Generated and Recipients:

- Annual valuation summary from MetLife to Financial Accounting & Analysis

Additional Controls or Responsibility Provided by Other Procedures:
250 - Balance Sheet Account Reconciliation policy

Regulatory Requirements:
N/A

961 – Cash Surrender Value of Key Man Life Insurance

(Note: Text in italics indicates a key SOX control.)

Reference:
N/A

Corresponding PPL Policy No. and Name:
N/A

Key Contact:
Manager, Financial Accounting & Analysis

Administrative Responsibility:
Director, Accounting and Regulatory Reporting

Date created: 4/29/05
Dates revised: 9/09/08
10/4/11
3/3/16

962 - Compliance with GAAP and Regulations

Policy: LG& E and KU Energy, LLC (“LKE” or the “Company”) and subsidiaries’ books and records shall be maintained in compliance with U.S. Generally Accepted Accounting Principles (“GAAP”), Federal Energy Regulatory Commission (“FERC”) regulations, Kentucky Public Service Commission (“KPSC”) regulations and Virginia State Corporation Commission (“VSCC”) applied on a consistent basis.

Procedure: The accounting procedures are performed per the detailed instructions below.

Scope: All books and records of the Company.

Objective of Procedure: Maintain compliance with GAAP, FERC, KPSC and VSCC regulations regarding all accounting issues applied on a consistent basis.

General Requirements:

Detailed Procedures Performed:

Compliance with GAAP, FERC, KPSC and VSCC regulations is ensured by the following procedures:

- **Review of available information.** The table below presents various regulations related to accounting requirements, the department or group within the Company responsible for monitoring and communicating additions/changes to regulations, and sources for this information. The “Responsible Party” should, at a minimum, monitor sources of information on a monthly basis and provide appropriate accounting groups with any updates to regulations/requirements in a timely manner.

Regulation	Responsible Party	Sources of Information
GAAP	All Accounting Analysts and Managers	FASB (www.fasb.org) AICPA (www.aicpa.org) Accounting Research Manager (www.accountingresearchmanager.com)
FERC Rules	Regulatory Affairs Dept. and Regulatory Accounting & Reporting Dept.	Federal Energy Regulatory Commission (www.ferc.gov)
KPSC Rules	State Regulation & Rates Dept. and Regulatory	Kentucky Public Service Commission website (www.psc.ky.gov)

962 - Compliance with GAAP and Regulations

	Accounting & Reporting Dept.	
VSCC Rules	State Regulation & Rates Dept. and Regulatory Accounting & Reporting Dept.	Virginia State Corporation Commission website (www.scc.virginia.gov)

- **Communication of new regulations.** The accounting departments share research on technical issues through a shared network directory (acctrestricted) and through specific communications, as appropriate.

- **Guidance from legal counsel.** Internal and external legal counsel provide guidance on issues as they arise through changes in laws/regulations, accounting standards, litigation, rate cases, etc.

- **Auditors.** Once pronouncements/regulations are identified, guidance may be sought from internal and/or external auditors regarding their interpretation or application.

- **External auditor automated disclosure checklist.** The external auditors maintain an automated disclosure checklist which is updated continuously by the external auditor for changes in GAAP and other disclosure requirements. See accounting policy and procedure *359 – Financial Statement Disclosures and Filing Requirements* regarding use of the checklist.

- **External auditor review and responses list.** For every LKE, LG&E and KU annual report the external auditor will submit a list of questions, comments, proposed changes, etc. to the document being filed. Before the document can be filed every item on the list must be resolved to both the Company's and the external auditor's satisfaction. Comments that are resolved to both the external auditor's and management's satisfaction are not maintained as part of the support for the issued financial statements. The comments are often based on current or future GAAP, various regulations, pending rulings, etc.

- **Training.** Employees involved extensively in financial reporting are encouraged to attend technical accounting training. All accounting analysts and managers are reviewed on maintaining their technical knowledge, as keeping current with and communicating new GAAP and other accounting developments is part of their job description and performance evaluation, including a minimum required amount of training on technical competency. In addition, outside auditors provide a year-end update of and participate in regular dialogue

962 - Compliance with GAAP and Regulations

regarding changes in accounting rules or regulations. Training is documented for each employee through the annual Performance Excellence Process (PEP) and in PeopleSoft.

Reports Generated and Recipients:

External auditor disclosure checklists are completed for all GAAP filings. They are maintained in the Financial Reporting department with the supporting papers for each document being filed.

All external auditor review and issues lists created during the various audits/reviews are received by and maintained in the Financial Reporting department with the supporting papers for each document being filed.

Additional Controls or Responsibility Provided by Other Procedures:

Senior Corporate Attorney responsible for reporting matters maintains communication with the Manager, Financial Reporting and the Manager, Regulatory Accounting and Reporting to ensure appropriate compliance with SEC and FERC regulations as well as timely filing of documents.

The Director, State Regulation and Rates, responsible for both KPSC and VSCC matters, maintains communication with the Manager, Regulatory Accounting and Reporting to ensure appropriate compliance with Kentucky and Virginia regulations as well as timely filing of documents with the KPSC and VSCC. Personnel from the Regulatory Accounting and Reporting department also review KPSC and VSCC websites to keep up on current issues in those areas.

Regulatory Requirements:

<u>GAAP:</u>

FASB Accounting Standards Codification is the single source of authoritative nongovernmental GAAP

<u>FERC:</u>

Federal Power Act, Sections 3, 4(a), 304 and 309, and 18 CFR 141.1 and 141.400

<u>KPSC:</u>

KPSC statutes and regulations

962 - Compliance with GAAP and Regulations

VSCC:

VSCC rules of practice and procedures

SEC

SEC Requirements, rules, regulations and interpretive guidance

Reference:

Federal Energy Regulatory Commission (www.ferc.gov)
Code of Federal Regulations (www.gpoaccess.gov/cfr/index.html)
Ernst & Young GAAIT (https://content.clientportal.ey.com/wps/myportal/content/Home)
Accounting Research Manager (www.accountingresearchmanager.com)
KPSC statutes and regulations (www.psc.ky.gov)
VSCC rules of practice and procedures (www.scc.virginia.gov)
Ernst & Young Automated Disclosure Checklist
AICPA (www.aicpa.org)
Kentucky Society of Certified Public Accountants (KSCPA) (www.kycpa.org)
Financial Accounting Standards Board (www.fasb.org)
Controller Group website (http://intranet/BusAreas/Finance/ControllerGrp/Pages/default.aspx)

Corresponding PPL Policy No. and Name:

N/A

Key Contacts:

Manager, Financial Reporting

Administrative Responsibility:

Controller

Date created: 6/22/05
Dates revised: 1/9/08, 3/31/11, 6/23/11; 8/3/11; 8/19/16

963 - Certain Investments in Debt and Equity Securities

(Note: Text in italics indicates a key SOX control.)

Policy: All investments in debt and equity securities of LG&E and KU Energy LLC (LKE) and subsidiaries are accounted for in compliance with U.S. GAAP, Federal Energy Regulatory Commission (FERC) General Instructions, Kentucky Public Service Commission (KPSC) Orders and Virginia State Corporation Commission (VSCC) Regulations, applied on a consistent basis.

Procedure: The accounting procedures are performed per the detailed instructions listed in this document.

Scope: Certain investments in equity securities that have readily determinable fair values and for all investments in debt securities of LKE and subsidiaries. This policy applies to LKE's 20% equity investment in Electric Energy, Inc. (EEI) and reacquired bonds held for resale, as well as other investments that may be acquired in the future. Additionally, LKE's cost method investment in Ohio Valley Electric Corporation (OVEC) is discussed below. The scope does not include temporary investments in cash and cash equivalents.

Objective of Procedure: To establish a consistent method of accounting and reporting for debt and equity securities in compliance with U.S. GAAP, FERC, KPSC and VSCC requirements.

General Requirements:

Any changes in debt security investments or reacquired bonds of LKE and subsidiaries must be communicated in writing from Treasury to accounting personnel. Communications should include supporting documents and schedules, when applicable. The Treasurer and the Manager, Corporate Finance are responsible for debt security investments.

Any changes in equity securities, including the investment in EEI, must be communicated in writing to Financial Accounting & Analysis, and Corporate Finance. Communications should include supporting documents and schedules, when applicable. The Controller, the Director, Accounting & Regulatory Reporting and the Manager, Financial Accounting & Analysis are responsible for equity security investments.

Personnel use appropriate written communication to prepare monthly journal entries and financial disclosures as required by U.S. GAAP, FERC General Instructions, KPSC Orders and VSCC Regulations for all debt and equity investments.

Definitions

Fair Value – As stated in ASC 820-10, "Fair Value Measurements and Disclosures" (ASC 820-10-35-2), "fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." ASC 820-10 introduces and requires documentation of fair value measurement concepts including: a) exit price (entry, transaction or settlement price does not necessarily equate to fair value), b) highest and best use, c) principal or most advantageous market and d) non-performance risk (e.g. credit risk) for an entity's own liabilities. In addition, ASC 820-10 expands the fair value disclosure requirements of other accounting pronouncements. When measuring fair value, these concepts, as well as the disclosures, should be considered and documented.

Security - A share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that (a) either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer, (b) is of a type commonly dealt in on securities exchanges or markets or when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investments, and (c) either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Debt Security - Any security representing a creditor relationship with an enterprise. It includes (a) preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor and (b) a collateralized mortgage obligation (or other instrument) that is issued in equity form but is required to be accounted for as a non-equity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position. Also, the definition includes U.S. treasury securities, U.S. government agency securities, municipal securities, corporate bonds, convertible debt, commercial paper, all securitized debt instruments and interest-only and principal only strips. However, it excludes option contracts, financial futures contracts, forward contracts and lease contracts.

Equity Security - Any security representing an ownership interest in an enterprise (for example, common, preferred or other capital stock) or the right to acquire (for example, warrants, rights and call options) or dispose of (for example, put options) an ownership interest in an enterprise at fixed or determinable prices. The term does not include convertible debt or preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor.

Holding gain or loss - Net change in fair value of a security exclusive of dividend or interest income recognized but not yet received and exclusive of any write-downs for other-than-temporary impairment.

Held-to-Maturity Securities - Debt securities that the enterprise has the positive intent and ability to hold to maturity.

Trading Securities - Debt and equity securities that are bought and held principally for the purpose of selling them in the near term. Trading generally reflects active and frequent buying, selling and trading securities and is generally used with the objective of generating profits on short term differences in price.

Available-for-Sale Securities - Debt and equity securities not classified as either held-to-maturity securities or trading securities.

Practicable – An estimate of fair value can be made without incurring excessive costs.

Credit loss – when the present value of cash flows expected to be collected for a security is less than the amortized cost basis of the security and the entire amortized cost basis of the security will not be recovered.

Responsible Officer – throughout this policy the Treasurer is the responsible officer for debt security investments and the Controller is the responsible officer for equity securities.

Responsible Manager – throughout this policy the Manager, Corporate Finance is the responsible manager for debt security investments and the Manager, Financial Accounting & Analysis is the responsible manager for equity securities.

Accounting Practice:

The accounting principles for certain investments in debt and equity securities are promulgated by ASC 320-10, "Accounting for Certain Investments in Debt and Equity Securities".

Classification

At acquisition, LKE will classify debt and equity securities into one of four categories: held-to-maturity, available-for-sale, trading, or cash equivalents. At each reporting date, the appropriateness of the classification will be reassessed.

- Investments in debt securities classified as held-to-maturity will be recorded at amortized cost.
- Investments in debt securities that are not classified as held-to-maturity and equity securities will be recorded at fair value.
- Realized gains and losses for securities are reported in earnings. The specific identification method will be utilized to calculate realized gains and losses.
- Unrealized holding gains and losses for trading securities will be recorded in earnings.
- Unrealized holding gains and losses on available-for-sale securities will be excluded from earnings and reported in other comprehensive income.

Impairment

963 - Certain Investments in Debt and Equity Securities

(Note: Text in italics indicates a key SOX control.)

- An investment is impaired if the fair value of the investment is less than its cost. At each reporting date, LKE will assess whether an impaired investment is temporarily impaired or other-than-temporarily impaired.

Indicators to consider when evaluating whether a security is other-than-temporarily impaired include:

1) A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee;
2) A significant adverse change in the regulatory, economic, or technological environment of the investee;
3) A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates;
4) A bona fide offer to purchase (whether solicited or unsolicited), an offer by the investee to sell, or a completed auction process for the same or similar security for an amount less than the cost of the investment;
5) Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants;
6) The intent and ability to hold an investment for a period of time sufficient to allow for any anticipated recovery in value.

* See ASC 320-10-35-33 for detailed guidance on evaluating whether a security is other-than-temporarily impaired.

- For individual securities classified as either available-for-sale or held-to-maturity, LKE will determine whether a decline in fair value below the amortized cost basis is other than temporary (See Section V-Procedures below for detailed steps). If a decline in fair value is determined to be other-than-temporary, the cost basis of the individual security will be written down to fair value (the new cost basis). The write-down will be accounted for in earnings as a realized loss. The new cost basis will not be adjusted for subsequent recoveries in fair value.

LKE has established certain criteria for determining impaired securities. Although the criteria outlined below should be utilized to evaluate securities for other-than-temporary impairment, there may be specific instances where there are significant indicators, as outlined above, which would indicate that a security has been other-than-temporarily impaired. In these instances, the other indicators should be evaluated to determine if the security is other-than-temporarily impaired. If it is determined that the security is other-than-temporarily impaired, then the security should be written down to its fair value even though it does not meet the criteria outlined below.

- Debt Securities*:*

- Fair value of the investment is less than its cost, and
- Issuer is in bankruptcy, or
- Security is downgraded from investment grade to non-investment grade.
- Intent to sell or required to sell before recovery of its amortized cost basis.
- Debt securities where a credit loss exists are considered other-than-temporarily impaired regardless of whether there is intent to sell.

➢ Equity Securities:
- Fair value is less than cost basis for 12 consecutive months, and
- The loss is greater than or equal to 25% of the cost basis.

Subsequent increases or decreases (if not an other-than-temporary impairment), in the fair value of available-for-sale securities will be included in other comprehensive income/loss.

Transfer of securities between categories

Transfer of securities between categories of investments will be accounted for at fair value. At the date of the transfer, the security's unrealized gain or loss will be accounted for as follows:

- ♦ Security transferred from trading category - the unrealized holding gain or loss was already recognized in earnings and will not be reversed.
- ♦ Security transferred into trading category - the unrealized holding gain or loss will be recognized in earnings immediately.
- ♦ For a debt security transferred into the available-for-sale category from the held-to-maturity category - unrealized holding gain or loss will be reported in other comprehensive income
- ♦ For a debt security, transferred into the held-to-maturity category from the available-for-sale category - the unrealized holding gain or loss will continue to be reported in a separate component of shareholders' equity but will be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

Reporting requirements

- ♦ Where a classified statement of financial position is presented, individual held-to-maturity securities, available-for-sale securities, and trading securities must be reported as either current or noncurrent in accordance with ASC 210-10-45, "Classification of Current assets" and FASB ASC 230-10, "Statement of Cash Flows".

- Held-to-maturity debt securities should be classified based on the individual maturity date (or call date if exercise of the call within the next operating period or fiscal year is probable).
- Trading or available-for-sale securities should be classified based on maturities (for debt securities) and management's reasonable expectation with regard to those securities (expectations of sales and redemptions). If management expects to convert securities to cash during the normal operating cycle (within a year), then the securities should be classified as current assets. Those securities that are not expected to be realized in cash within one year should be classified as non-current.
- Highly liquid investments purchased with original maturities of three months or less should be classified as cash equivalents.

- Cash flows from purchases, sales, and maturities of:
  - Available-for-sale securities and held-to-maturity securities will be classified as cash flows from investing activities and reported gross for each security classification in the statement of cash flows.
  - Trading securities will be classified in the statement of cash flows in accordance with the securities nature and purpose.
- By major security type as of each date for which a statement of financial position is presented:
  - For available-for-sale securities
    - the aggregate fair value,
    - the total gains for securities with net gains in accumulated other comprehensive income, and
    - the total losses for securities with net losses in accumulated other comprehensive income.
  - For held-to-maturity securities
    - the aggregate fair value,
    - gross unrecognized holding gains,
    - gross unrecognized holding losses,
    - the net carrying amount, and
    - the gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities.
- For investments in debt securities classified as available-for-sale and separately for securities classified as held to maturity, information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented will be disclosed.
- For each period for which the results of operations are presented
  - For available-for-sale securities

- The proceeds from sales and the gross realized gains and gross realized losses that have been included in earnings as a result of those sales.
- The basis on which the cost of a security sold or the amount reclassified out of accumulated other comprehensive income into earnings was determined (e.g., specific identification, average cost, or other method used).
- The amount of the net unrealized holding gain or loss for the period that has been included in accumulated other comprehensive income and the amount of gains and losses reclassified out of accumulated other comprehensive income into earnings for the period.

➢ The portion of trading gains and losses for the period that relates to trading securities still held at the reporting date.

➢ The gross gains and gross losses included in earnings from transfers of securities from the available-for-sale category into the trading category.

➢ For any sales of or transfers from securities classified as held-to-maturity the following information will be disclosed in the notes to financial statements for each period for which the results of operations are presented:
- The amount of the sold or transferred security
- the net carrying and the net gain or loss in accumulated other comprehensive income for any derivative that hedged the forecasted acquisition of the held-to-maturity security
- the related realized or unrealized gain or loss
- the circumstances leading to the decision to sell or transfer the security

♦ For fair value measurements related to trading and available for sale securities, the disclosures provided in ASC 820-10-50-1 are required in each interim and annual reporting period.

♦ If a held-to-maturity security is other than temporarily impaired, the disclosures (as a result of writing the security down to fair value) provided by ASC 820-10-50-2 are required in the applicable reporting period(s).

Impaired Investments

♦ For all investments in an unrealized loss position for which other-than-temporary impairments have not been recognized, the following should be disclosed in the annual financial statements:

➢ As of each date for which a statement of financial position is presented, the following quantitative information will be disclosed; aggregated by major security type and segregated between those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer:
- The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value), and
- The aggregate related fair value of investments with unrealized losses.

963 - Certain Investments in Debt and Equity Securities

(Note: Text in italics indicates a key SOX control.)

- As of the date of the most recent statement of financial position, additional information sufficient to allow financial statement users to understand the quantitative disclosures and the information that the investor considered (both positive and negative) in reaching the conclusion that the impairment is not other than temporary. This disclosure could include:
  - Nature of the investment
  - Cause(s) of the impairment
  - Number of investment positions that are in an unrealized loss position
  - Severity and duration of the impairment
- Other evidence considered by the investor in reaching its conclusions (e.g. industry analyst reports, sector credit ratings, volatility of the securities fair value). Additional disclosures are required when credit losses exist. Refer to ASC 320-10-50-8.

Procedures:

- Upon the acquisition of a security, the responsible accounting organization must determine appropriate classification of security and record the security in the financial statements based on that classification in accordance with the above policy. Original evaluation and conclusions reached must be evidenced in writing.
- The Responsible Officer should review classification determinations by accounting organizations in a timely manner.
- At least quarterly, the responsible accounting organization should review security classification to determine whether that classification is still appropriate. Changes in security classifications must be documented in writing and reviewed and approved by the Responsible Officer.
- Quarterly, for available-for-sale and held-to-maturity securities, the responsible accounting department must perform an impairment analysis. The steps outlined below are to be followed in connection with that analysis. Impairment analysis must be documented and evidenced in writing.

  - **Step 1: Determine Whether an Investment is Impaired**

    ✓ If the fair value of a security is less than its cost, proceed to Step 2

    Step 2: Evaluate Whether an Impairment Is Other Than Temporary

    ✓ See guidance listed on pages 4-5 above.
    If impairment is deemed other than temporary, proceed to Step 3.

  - **Step 3: If the Impairment is Other Than Temporary, Recognize an Impairment Loss Equal to the Difference between the Investment's Cost and Its Fair Value**

963 - Certain Investments in Debt and Equity Securities

(Note: Text in italics indicates a key SOX control.)

- ✓ If it is determined in Step 2 that the impairment is other than temporary, then an impairment loss should be recognized in earnings equal to the difference between the investment's cost and its fair value at the balance sheet date of the reporting period for which the assessment is made.

- ♦ Responsible Officer or Responsible Manager should review and approve impairment analysis before each quarter's close.
- ♦ Upon identification of security impairment, Responsible Manager must notify the Treasurer, Controller, and the Director Accounting and Regulatory Reporting of such impairment.
- ♦ Responsible accounting organization must submit required disclosure information, as outlined above, to Financial Reporting before each quarter's close.

963 - Certain Investments in Debt and Equity Securities

(Note: Text in italics indicates a key SOX control.)

Investments:

EEI Investment:

- Kentucky Utilities (KU) owns 20% of the common stock of EEI, which owns and operates a 1,162-Mw generating station in southern Illinois. EEI, through a power marketer affiliated with its majority owner, sells its output to third parties. KU is not the primary beneficiary of EEI and does not have explicit or implicit control of the entity. Dynegy is the majority shareholder and is the primary beneficiary. KU's direct exposure to loss as a result of its involvement with EEI is generally limited to the value of its investment. Therefore, it is not consolidated into the financial statements of KU and is accounted for under the equity method of accounting. In December 2012, KU concluded that an other-than-temporary decline in the value of its investment in EEI had occurred as documented in the memo, EEI Equity Investment Impairment (dated February 28, 2013). The investment balance is currently zero and only adjustments to Accumulated Other Comprehensive Income are currently recorded.

OVEC Investment:

- LG&E and KU each have an investment in OVEC, which is accounted for using the cost method. The investment is recorded in "Other noncurrent assets" on the LKE, LG&E, and KU Balance Sheets and in "Other investments" on the PPL Balance Sheets. LG&E and KU and 10 other electric utilities are equity owners of OVEC. OVEC's power is currently supplied to LG&E and KU and 11 other companies affiliated with the various owners. LG&E and KU own 5.63% (investment of $594,286) and 2.5% (investment of $250,000) of OVEC's common stock. Ownership percentages of the ten remaining stockholders range from 1.50% to 39.17%. Pursuant to a power purchase agreement, LG&E and KU are contractually entitled to their ownership percentage of OVEC's output, which is approximately 120 MW for LG&E and approximately 53 MW for KU. LG&E's and KU's combined investment in OVEC is not significant. The direct exposure to loss as a result of LG&E's and KU's involvement with OVEC is generally limited to the value of their investments; however, LG&E and KU may be conditionally responsible for a pro-rata share of certain OVEC obligations. As part of PPL's acquisition of LKE, the value of the power purchase contract was recorded as an intangible asset with an offsetting regulatory liability, both of which are being amortized using the units-of-production method until March 2026, the expiration date of the agreement in place at the date of PPL's acquisition. The amended expiration date is June 30, 2040. Future obligations for power purchases from OVEC are unconditional demand payments, comprised of annual minimum debt service payments, as well as contractually required reimbursement of plant operating, maintenance and other expenses.

963 - Certain Investments in Debt and Equity Securities

(Note: Text in italics indicates a key SOX control.)

- While LKE does have a variable interest in both OVEC and EEI, neither qualifies as a Variable Interest Entity (VIE) which must be consolidated as both fall under the voting interest model and LKE is not the primary beneficiary. VIE disclosure is not required, even though LKE participated in their design, under the exception provided in ASC 810-10-50-3, since the majority shareholder is the primary beneficiary and the assets of either entity is not restricted and can be used to pay dividends to the shareholders. Currently, there are no dividends being paid from OVEC to LG&E and KU or from EEI to KU.

  Reacquired Bonds (not retired or canceled):

  When bonds are reacquired, they are purchased from the remarketing agent and may be held by LKE to be reissued in the future. The face value of the bonds should be recorded to account 222 as a debit balance. For FERC reporting, these amounts are netted in the total debt outstanding. For GAAP reporting, per ASC 320-10 "Accounting for Certain Investments in Debt and Equity Securities" the reacquired bonds will be reported gross as an investment in debt security available-for-sale and the liability will be shown as current debt outstanding.

Reports Generated and Recipients:

None

Additional Controls or Responsibility Provided by Other Procedures:

250 – Balance Sheet Accounts Reconciliation policy
251 - Journal Entries policy

Reference:
Federal Energy Regulatory Commission (www.ferc.gov)
Code of Federal Regulations (www.gpoaccess.gov/cfr/index.html)
KPSC statutes and regulations (www.psc.ky.gov)
VASCC rules of practice and procedures (www.scc.virginia.gov)
Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) (www.asc.fasb.org)

Corresponding PPL Policy No. and Name:
900 – Accounting and Reporting for Certain Investments in Debt and Equity Securities

Key Contacts:
Manager, Corporate Finance
Manager, Financial Accounting and Analysis

963 - Certain Investments in Debt and Equity Securities

(Note: Text in italics indicates a key SOX control.)

Administrative Responsibility:
Treasurer

Date created: 3/28/11
Date revised: 6/24/11, 9/20/11, 3/2/16

964 - Debt and Interest Risk Management

(Note: Text in italics indicates a key SOX control.)

Policy: All debt and related financial instruments of LG&E and KU Energy LLC (LKE) and subsidiaries are accounted for in compliance with U.S. GAAP, Federal Energy Regulatory Commission (FERC) General Instructions, Kentucky Public Service Commission (KPSC) Orders and Virginia State Corporation Commission (VSCC) Regulations, applied on a consistent basis.

Procedure: The accounting procedures are performed per the detailed instructions below.

Scope: All debt and related financial instruments of LKE and subsidiaries.

Objective of Procedure: To establish a consistent method of accounting and reporting debt and related financial instruments in compliance with U.S. GAAP, FERC, KPSC and VSCC requirements.

General Requirements:

Detailed Procedures Performed:

Any changes in debt and/or related financial instruments of LKE and subsidiaries must be communicated to accounting personnel in Corporate Finance if the transaction does not originate with those accounting personnel. Communications should include supporting documents and schedules, when applicable. Such changes include (but are not limited to):

- new debt issuances
- retirement or refinancing of debt
- money pool transactions
- commercial paper transactions
- changes in interest rates and/or terms of existing debt
- issuance or termination of swaps
- changes in interest rates and/or terms of existing swaps
- lines and/or letters of credit issuances, extensions, or terminations
- debt covenants
- debt packages
- guarantees

Accounting personnel in Corporate Finance use monthly journal entries generated by Wall Street Treasury Management System (Wall Street) and prepare financial disclosures, as required by U.S. GAAP, FERC General Instructions, KPSC Orders and VSCC Regulations for all debt and related financial instruments.

<u>New Utility First Mortgage Bond or Pollution Control Bond Issue:</u>

964 - Debt and Interest Risk Management

(Note: Text in italics indicates a key SOX control.)

Treasury informs Corporate Finance, Regulatory Accounting, Financial Planning, and Financial Reporting, in writing (generally via email), of new utility bond financings including principal amount, interest rate, date of first interest rate reset, and use of bond proceeds. The following accounts are used in accounting for utility bonds: Bonds (221.1), Unamortized Debt Expense (181.3), Debt Premium (225), Debt Discount (226.1), Amortization of Debt Discount/Expense (428), Amortization of Debt Premium (429), Interest on Long-Term Debt (427.1), and Interest Accrued (237.1).

A Treasury Analyst in Corporate Finance records new bond issuances through Wall Street. The new bonds are added to the monthly calculation of interest expense on bonds and recorded via Wall Street in the interest accrual.

In order to process interest payments through Oracle Accounts Payable for bonds, the GLAFF is provided to Accounts Payable. 0100.141.006250.006250.184100.0000.0699.0000 is provided for LG&E and 0110.105.015590.015590.184100.0000.0699.0000 is provided for KU. Wall Street uses account 184100 as a suspense account that is offset by the payment made through 184100 in Oracle. Interest accruals are recorded through Wall Street using project number IA23700 for KU and project number 112969 for LG&E with the appropriate task, FMB or PCB.

For all LKE companies, deferred debit account 186, Financing Expense, is used to account for the expenses associated with any bond issue. Debt issuance costs are expensed only if immaterial. Activity in the Financing Expense account is reviewed by accounting personnel in Corporate Finance on a monthly basis. Expenses are transferred from account 186 to account 181.3 to be amortized once the debt, to which the expense is related, is issued. The expense side of the monthly amortization is debited to account 428 and amortized via journal entries generated by Wall Street using effective interest method and daily amortization over the life of the new bonds, with the exception of bonds that have a put. If the bond has a put, the expenses are amortized through the put date. The amortization schedules are adjusted each time expenses are transferred.

Debt discounts and premiums on bonds are amortized using the straight-line method of accounting over the life of the new bonds, as long as the results would not be materially different from the effective interest method. The journal entries for the amortization are generated by Wall Street.

<u>New Credit Facility:</u>

Treasury informs Corporate Finance, Regulatory Accounting, Financial Planning, and Financial Reporting of new credit facilities, including the principal amount, interest rate, maturity date and destination of the loan proceeds if applicable. The new transaction is set up in Wall Street by Corporate Finance. These facilities are drawn on as needed.

The following accounts are required for credit facilities: Unamortized Debt Expense (181.2), Notes Payable (231.1), Interest Accrued (237.1), Interest on Long-Term Debt (431.2) and Amortization of Debt Expense (428). The journal entries are generated by Wall Street based on the inputs entered by Corporate Finance accounting personnel.

<u>Retirement of Bonds</u>

A disbursement request, which will debit the bond payable account (221.1) for the bond being retired, is sent to Accounts Payable (see below for retirement of bonds that result from a bond refinancing).

In accordance with FERC General Instructions regarding the early retirement of bonds, remaining unamortized debt expense (account 181.3) and call premium/discount on bonds is transferred to a new account, Unamortized Loss on Reacquired Debt (account 189.1), by the accounting personnel in Corporate Finance. The expense continues to be amortized as a loss on reacquisition over the life of the retired bonds via journal entries generated by Wall Street. LKE is not subject to the FERC General Instruction and expenses remaining in unamortized debt expense upon the retirement of debt.

<u>Reacquired Bonds that are not retired or canceled:</u>

When bonds are reacquired, they are purchased from bondholders and held by the Company, possibly to be reissued in the future. The face value of the bonds is recorded to account 222 as a debit balance. For FERC reporting, these amounts are netted against the total debt outstanding. For GAAP reporting, per ASC 320-10 “Accounting for Certain Investments in Debt and Equity Securities”, the reacquired bonds will be reported gross as an investment in debt security available-for-sale and the liability will be shown as current debt outstanding.

<u>Refinancing of Bonds:</u>

New bonds and financing expenses entered into under refinancing agreements are processed in the same manner as “New Bond Issue” above. Additionally, for LG&E and KU, existing debt financing expenses in account 181.3 are moved to Unamortized Loss on Reacquired Debt (account 189.1) through Wall Street and amortized to Amortization of Loss on Reacquired Debt (account 428.1). As outlined in FAS ASC 980, which was previously covered by SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, the regulated utilities are allowed to recover losses of deferred financing expenses ratably over the life of the existing bond issue or over the life of the new bond issue. Losses for deferred financing expenses of non-regulated

964 - Debt and Interest Risk Management

(Note: Text in italics indicates a key SOX control.)

entities are recorded as a loss to be classified in the Other Income – net line item of the Statement of Income. Corporate Finance accounting records the transactions outlined above in Wall Street. The amortization period of the expenses is then determined by Corporate Finance accounting, which, according to FERC General Instructions, can be (1) the remaining life of the retired bonds, (2) the life of the new bonds or (3) written off if the amount is immaterial. For GAAP, the treatment of the Unamortized Loss on Reacquired Debt is treated the same as FERC because of FASB ASC 980. LKE, LG&E and KU have elected to expense the unamortized loss over the life of the new bond.

Intercompany Notes Payable with Non-LKE Affiliate:

LKE enters into long-term intercompany notes with PPL Capital Funding, Inc. The notes are set up in Wall Street by Corporate Finance in account 223.1, LT Notes Payable to PPL Capital Funding Principal, and the interest accrual is calculated in Wall Street each month. Interest payable is recorded in account 234, I/C Payable-PPL Capital Funding, Inc. and interest expense is recorded in account 430.1, I/C Interest Expense with PPL Capital Funding.

Commercial Paper:

LG&E and KU issue commercial paper to cover expenditures in excess of short term investments as needed on a daily basis. Transactions, including nominal amount, counterparty, issuer, interest rate and maturity, are entered into Wall Street daily by Corporate Finance as part of the daily cash management process. Entry into Wall Street generates accounting for each month’s total issuances, maturities, and interest. Accounts used are 231, Commercial Paper Payable, 231, Discount on Commercial Paper, and 431.2, Other Interest Expense.

Money Pool:

Monthly summaries of all money pool transactions are provided within Corporate Finance. Cash entries related to the Money Pool are recorded by Wall Street through daily wire transactions. Accounts 145.1, N/R Money Pool – LG&E and KU Energy LLC, 233 N/P – Money Pool and 430, Int-Debt to Assoc. Co are used to record amounts owed by LKE in the Money Pool and accounts 145, N/R – Money Pool, 233, N/P – Money Pool LKE Current and 419.2, INT-Adv fr Assoc Co. are used to record amounts owed to LKE in the Money Pool.

Changes in Interest Rates on Variable Rate Debt:

At each month-end, Corporate Finance prepares a report of the interest incurred and average interest rate for the month, year-to-date, and ECR six-month period for each bond issue. These reports are used to compare to interest accrued in Wall Street to verify accuracy and in the preparation of the embedded cost of capital report.

964 - Debt and Interest Risk Management

(Note: Text in italics indicates a key SOX control.)

Issuance and Termination of Swaps:

Treasury communicates to Corporate Finance, Regulatory Accounting, Financial Planning, and Financial Reporting any changes in interest rate swaps (i.e. issuances and terminations). The utilities recognize all unrealized gains and losses on swaps as regulatory assets or regulatory liabilities. Therefore, on a monthly basis, reports are prepared by Corporate Finance listing the unrealized gains and losses that are to be recorded to regulatory asset account 182.3 with an offset to the Interest Rate Swap Liability (244) or to regulatory liability account 254 with an offset to the Interest Rate Swap Asset (176). Interest accruals and interest payments on third party swaps held by LG&E are generated in Wall Street (see bond interest accruals) and compared to a spreadsheet calculated manually to verify accuracy.

Forward-Starting Swaps:

Treasury communicates to Corporate Finance, Regulatory Accounting, Financial Planning, and Financial Reporting for any forward-starting interest rate swaps (i.e. issuances and terminations). Forward-starting swaps are entered into to decrease the variability of interest for bonds to be issued at a future date. PPL Corp enters into forward-starting swaps with third parties and the swaps are mirrored through an arrangement with LG&E and KU. PPL enters the terms of the swaps into Wall Street and mirrors the swaps in LG&E and KU's Wall Street portfolios. On a monthly basis, reports are received from Wall Street listing the unrealized gains and losses that are to be recorded to a regulatory asset (182.3) or a regulatory liability (254.1) with an offset to the Interest Rate Swap Derivative Asset (176) or Liability (245).

Other:

Treasury communicates to Corporate Finance, Regulatory Accounting, Financial Planning, and Financial Reporting all other types of changes in financing arrangements including (but not limited to): letters of credit, debt covenants, debt packages, guarantees, etc. Changes in these types of arrangements typically do not require accounting transactions to be booked but generally require disclosure in published quarterly and annual financial statements.

Reports Generated and Recipients:

Embedded Cost of Debt Report:

LG&E and KU issue a report prepared monthly showing the embedded cost of all debt, including intercompany debt and external debt. This report is used in determining the overall cost when evaluating rate case timing, rate of return hurdle rates on investment proposals, ECR filings,

964 - Debt and Interest Risk Management

(Note: Text in italics indicates a key SOX control.)

DSM filings, etc. The report is prepared by a Corporate Finance Treasury Analyst, reviewed by other Treasury Analysts, and reviewed by the Manager, Corporate Finance, prior to distribution.

Distribution of Embedded Cost of Debt Report:
Regulatory Accounting & Reporting
State Regulation & Rates
Treasurer
Corporate Finance
Tax
Property Accounting
Financial Reporting
Revenue Accounting & Analysis
Director, Accounting & Regulatory Reporting
Controller

Additional Controls or Responsibility Provided by Other Procedures:

250 – Balance Sheet Accounts Reconciliation policy
251 – Journal Entries policy
550 – Chart of Accounts and GLAFF Updates policy

Regulatory Requirements:

FERC:
- Federal Power Act, Sections 3, 4(a), 304 and 309, and 18 CFR 141.1 and 141.400

KPSC:
- KPSC statutes and regulations

VSCC:
- VSCC rules of practice and procedures

Reference:
None

Corresponding PPL Policy No. and Name:
901 – Debt Issuance/Retirements

Key Contacts:
Manager, Corporate Finance

964 - Debt and Interest Risk Management

(Note: Text in italics indicates a key SOX control.)

Administrative Responsibility:
Treasurer

Date created: 5/31/05
Dates revised: 5/29/07
9/11/07
7/10/08
6/30/09
7/16/09
8/07/09
9/11/09
12/7/10
8/3/11
9/20/11
3/2/16
12/6/16

965 – Accounting for Century Receivable

(Note: Text in italics indicates a key SOX control.)

Policy: To ensure the Century receivable, including interest, is properly valued.

Procedure: Corporate Accounting monitors the London Metal Exchange Index to determine if Century owes LG&E and KU Energy LLC (LKE) a payment each month.

Scope: Century receivable owed to Western Kentucky Energy Corporation (WKEC).

Objective of Procedure: To ensure that bills are issued to and payments are received from Century according to the terms of the contract.

General Requirements:

Background:

Per the "Backstop Commodity Swap Transaction" agreement between LKE and Century Aluminum ("Century"), WKEC worked with Century to create a swap agreement, which locked-in Century's pre-Unwind pricing for 18 months. Century declined cash consent payments (approximately $81.7 million) at closing, commenting that although the Unwind was good for the long-run, it could not sustain the small increase in electric prices that it would experience in the short-term. In the agreement, and in lieu of the cash consent payments that were declined, WKEC agreed to make backstop payments to Century for energy curtailed by Century for which "surplus sales" or "potline reduction sales" have been requested under Century's agreement with BREC (through Kenergy, a co-op supplied by BREC). Additionally, through December 31, 2010, WKEC paid Century an aluminum production payment based on the amount of energy purchased by Century to run its potlines, pursuant to its retail agreement with BREC. The total of the aluminum production credits paid to Century are limited to a base amount that equaled the previously agreed-to cash consent payments Century declined to take.

Because the total backstop payments plus the aluminum production credit payments exceeded the base amount ($81.7M), Century is obligated to refund to WKEC the excess over the base amount in installment payments subject to both the London Metal Exchange Index price for aluminum and Century's Hawesville smelter production being above certain thresholds. The aluminum price must average $2,600 per ton in a given month and the production level in that month must be a minimum of 16,267 tons (which is the equivalent of four potlines running) before repayments are required. Refund payments may be made over 72 months beginning on January 1, 2011 through December 31, 2028. Century is not required to make payment in any month the two thresholds are not met. Accordingly, the full amount of the receivable is reserved.

Interest accrues monthly on the unpaid balance, including interest, at 10.94% per annum. In any month the two thresholds are met, Century is required to repay 1/72 of the original principle and

965 – Accounting for Century Receivable

(Note: Text in italics indicates a key SOX control.)

up to three times the current month's accrued interest until such time as prior months' accrued interest is repaid.

Detailed Procedures Performed:

Each month starting in January 2011, an Accounting Analyst will check the London Metal Exchange aluminum price. Once the aluminum price meets the average $2,600 per ton threshold, a Century officer will begin providing WKEC with a monthly certification of the Hawesville smelter production level.

The total amount exceeding the $81.7 million minimum is $13.3 million and has been recorded as a debit to Accounts Receivable and a credit to Loss on Disposal of Discontinued Operations. In addition, simple interest began accruing at 10.94% per annum on the unpaid receivable balance as of January 1, 2011, and is also being recorded monthly as a debit to Interest Receivable and a credit to Interest Income. Once refund conditions are met, interest begins to compound monthly on the remaining balance of principal and interest.

Due to the potentially lengthy amount of time before Century must begin repaying the receivable, the uncertainty of future economic conditions and according to the terms of the contract Century is not required to repay the full balance if the two thresholds are not met for at least 72 months, the entire receivable balance including the accrued interest is reserved as a debit to Bad Debt Expense and a credit to Allowance for Doubtful Accounts.

Reports Generated and Recipients:

Century officer certification of production level from the Hawesville, KY facility provided to Corporate Accounting when average monthly aluminum price reaches $2,600/ton.

Additional Controls or Responsibility Provided by Other Procedures:

250 - Balance Sheet Account Reconciliation policy

Regulatory Requirements:

N/A

Reference:

N/A

965 – Accounting for Century Receivable

(Note: Text in italics indicates a key SOX control.)

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Manager, Corporate Accounting

Administrative Responsibility:

Controller

Date Created: 2/9/11
Dates Revised: 9/23/11; 3/17/16

966 – Intracompany Interest

(Note: Text in italics indicates a key SOX control.)

Policy: Intracompany interest among LG&E and KU Energy LLC (LKE) and all subsidiaries will be calculated and billed monthly.

Procedure: Intracompany interest is billed monthly.

Scope: The policy covers all intracompany balances not settled within 30 days.

Objective of Procedure: To ensure that no entity subsidizes any other entity.

General Requirements:

Detailed Procedures Performed:

I. Procedures for recording interest owed between the regulated utilities

Interest is owed by either Louisville Gas & Electric Company ("LG&E") or Kentucky Utilities Company ("KU") to the other company for cash received or paid on behalf of the other company. A standard journal entry is prepared monthly by an Accounting Analyst to record the interest and it is paid the following month on a one-month lag. Interest is calculated on the daily balance multiplied by the current average money pool rate divided by 360 days. The average money pool rate is equal to the rate for high-grade, unsecured, A2/P2 30-day commercial paper (plus five basis points) of major corporations sold through dealers, as quoted by the Federal Reserve on the last business day of the prior calendar month. The journal entry is reviewed by an Accounting Manager or delegate before it is posted. The amounts owed are included as line items on the regular intracompany bills between the regulated utilities, as required by the Intercompany Billing and Settlement Policy and Procedures.

II. Procedures for billing intracompany interest for subsidiaries which participate in either the LKE Utility Money Pool or the LKE Non-Utility Money Pool:

While setting the daily cash position, money pool transactions are recorded both in the utility and non-utility (LKC only) money pools, via a suggested transfer initiated in Wall Street, based on cash needs by the utilities or LKC for the day. Money Pool transactions between LKE and non-utility companies other than LKC are ZBAs through the Bank of America. As transactions occur wires or ZBAs are sent through Bank of America between the entities. The BAI bank codes for these transactions are used to code the transactions within Wall Street when the BAI files interface daily to Wall Street, which creates the accounting and adjusts the balances in the money pools. The Cash Management Module in Wall Street houses the daily transactions and generates interest for the balances in the money pools (see accounting procedures for Wall Street in the debt journal entry file on generating interest on money pool balances). At the end of each

966 – Intracompany Interest

(Note: Text in italics indicates a key SOX control.)

month, interest is generated in Wall Street for each money pool balance and is added/deducted from the amount owed on the appropriate entities accounting ledger. For regulated entities, the interest will be added to the appropriate intercompany bill for settlement as outlined in item I. For non-regulated entities, the interest charged is not required to be cash settled, per 253 - Intercompany Billing and Settlement policy.

III. Procedures for intercompany interest with PPL:

LKE maintains a short-term credit facility with an affiliate of PPL Corp. through daily borrowings/repayments to CEP Reserves, Inc. (CEP). Each day when the cash position is set (as noted above for money pool borrowings) LKE either borrows or repays CEP as needed. The borrowing/repayment is entered daily into Wall Street as a Demand Note. Wires between LKE and CEP are captured in the BAI files that come from Bank of America each day and interest is generated at month-end in Wall Street based on the daily balance, charged at a rate of one month LIBOR, which feeds into Wall Street automatically, plus a spread that has been set up previously in Wall Street based on the agreement with CEP. The interest is settled monthly.

LKE maintains a short-term credit facility with an affiliate of PPL Corp. through daily investments/repayments from PPL Energy Funding. Each day when the cash position is set LKE may send excess funds, if any, to PPL Energy Funding. The investment/repayment is entered into Wall Street as a Demand Note. Wires between LKE and PPL Energy Funding are captured in the BAI files that come from Bank of America each day and interest is generated at month-end in Wall Street based on the daily balance, charged at a rate of one month LIBOR which feeds into Wall Street automatically plus a spread that has been set up previously in Wall Street based on the agreement with PPL Energy Funding. The interest is settled monthly.

LKE enters into long-term loans from PPL Capital Funding via notes. The terms of the note are set up in Wall Street and an interest accrual is calculated each month based on the terms. The interest is settled as noted in the terms of the note.

<u>Reports Generated and Recipients:</u>

Item I – Excel spreadsheet don by Accounting Analyst in Corporate Accounting
Item II and III - Interest calculation performed in Wall Street by a Corporate Finance Treasury Analyst.

966 – Intracompany Interest

(Note: Text in italics indicates a key SOX control.)

Additional Controls or Responsibility Provided by Other Procedures:

250 – Balance Sheet Account Reconciliation policy

Regulatory Requirements:

All of the following entities require that no subsidization occurs between the regulated utilities or their affiliates:

- Kentucky Public Service Commission
- Virginia State Corporation Commission
- Federal Energy Regulatory Commission

Reference:

253 - Intercompany Billing and Settlement policy

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Manager, Corporate Finance
Manager, Corporate Accounting

Administrative Responsibility:

Treasurer
Controller

Date Created: 5/31/05
Dates Revised: 8/19/05, 9/22/05, 9/29/05, 12/2/05, 6/30/09, 12/30/10, 9/23/11, 2/19/16, 3/24/16

967 – Prepaid Expenses

(Note: Text in italics indicates a key SOX control.)

Policy: Prepaid expenses of LG&E and KU Energy LLC ("LKE" or "the Company") and its subsidiaries are recorded in accordance with Financial Accounting Standards Board ("FASB") Accounting Codification ("ASC") 340, Other Assets and Deferred Costs and Federal Energy Regulatory Commission ("FERC") Code of Federal Regulations ("CFR"), Title 18, Part 101.

Procedure: Expenses that are paid prior to the Company receiving the related goods or services are recorded as prepaid expenses (assets) at the time of payment. The prepaid expense is then amortized over the period of services received or once the goods are received. Some examples of prepaids are insurance, rent, industry association dues, and service/maintenance agreements.

Scope: Prepaid expenses are recorded on LKE and its subsidiaries over $50,000 per company which is applied even if more than one company is presented on the same invoice. Exceptions are IT prepaids which do not have a materiality threshold, and expenses that pertain to a period of time within a financial quarter where the expense would be fully amortized within the quarter, which can be expensed as incurred.

General Requirements: To properly reflect prepaid expenses as assets on the balance sheet and to match the recognition of these expenses with the appropriate period in which the benefit is received in accordance with ASC 340. Prepaid expenses are assets that are typically used up or expire within the normal operating cycle of an entity. The term derives from the fact that they are paid in advance of their use or consumption.

In the event a prepaid expense covers a period beyond 12 months, the portion extending beyond 12 months should be classified as a noncurrent asset, in accordance with ASC 210-10-45.

The CFR requires prepayments to be recorded to FERC account 165 and states these amounts should be kept or supported in such a manner as to disclose the amount of each class of prepayment.

Detailed Procedures Performed:

Prepaid expenses are recorded as a prepaid asset to FERC account 165 at the time the payment is made and amortized to expense over the term of the contract or period applicable. The prepaid should be held at the Company which is incurring the expense.

Budget Analysts, Supply Chain Managers, and Commercial Operations Managers are requested to contact the Regulatory Accounting and Reporting (RAR) department when they have an invoice that qualifies as a prepayment, with the exception of prepaid IT expenses. This request is communicated at the Budget Analysts' annual meeting. Prepaid IT expenses are handled by the IT Contracts Administration team and the IT Budget Coordinator.

967 – Prepaid Expenses

(Note: Text in italics indicates a key SOX control.)

Criteria and items to report for prepaid expenses:

- Copy of prepaid invoice
- Description of goods or services provided if not explicitly listed on the invoice
- Contract term
- Allocation ratio, rule, and source project by company (if allocated based on Cost Allocation Manual)
- Projects and tasks to charge account 1651XX (Current Prepaid), 1652XX (Non-Current Prepaid), or 1659XX (Prepaid Other – Indirect), as appropriate
- Projects and tasks to charge income statement for amortizing
- Expenditure Type
- Expenditure Organization

The accounting for prepaid items will be charged to the designated prepaid account (165XXX) at the time of payment or a change of distribution form will be completed by the applicable Budget Analyst to record to the prepaid account if identified after the payment is charged to expense.

Reports Generated and Recipients:
None

Additional Controls or Responsibility Provided by Other Procedures:
250 - Balance Sheet Account Reconciliation policy

Regulatory Requirements:
FERC CFR, Title 18, Part 101 Accounting Guidance

Reference:
ASC 340 – *Other Assets and Deferred Costs*

Corresponding PPL Policy No. and Name:
None

Key Contact:
Manager, Regulatory Accounting and Reporting

Administrative Responsibility:
Director, Accounting & Regulatory Reporting

Date Created: 6/28/12
Dates Revised:3/12/15, 4/1/16, 11/2/16, 6/5/17, 4/24/18

968 – Accounting for Discontinued Operations

(Note: Text in italics indicates a key SOX control.)

Policy: This policy sets standards and procedures for accounting for Discontinued Operations.

Procedure: Corporate Accounting is responsible for properly classifying and recording the remaining activity for discontinued entities as either continuing operations or discontinued operations.

Scope: All remaining residual activity related to discontinued entities.

Objective of Procedure: The objective of this procedure is to ensure the proper accounting treatment of discontinued operations.

General Requirements:

Western Kentucky Energy Corp. (WKEC) Background:

LG&E and KU Energy LLC (LKE) and Big Rivers Electric Corp. (BREC) signed a Transaction Termination Agreement which returned the control of WKEC facilities to BREC as of the July 16, 2009 Unwind date. WKEC was properly classified as discontinued operations throughout the course of finalizing the Unwind transaction. According to SAB Topic 5.Z.5, *Classification and Disclosure of Contingencies Relating to Discontinued Operations*, items recorded as of the Unwind date and subsequent expenses directly related to the disposal are eligible to have adjustments made to and amounts recorded in discontinued operations. Any items that are a result of ongoing matters that are not directly related to the Unwind are required to be charged to continuing operations.

See the sections below to have a detailed account of what items are still being recorded to WKEC directly and which items are to be recorded to continuing operations.

<u>Detailed Procedures Performed:</u>

Activity currently on WKEC books:

Items that are currently recorded to WKEC are as follows:

- Century Receivable – Due to the Unwind, WKEC paid Century, an aluminum smelter, backstop payments to help the smelter maintain its ability to sustain the business during the short-term increased electricity costs that were a result of the Unwind transaction. The backstop payments were paid through January 31, 2011. Any amount paid by WKEC over the $81.7 contractual amount became a receivable for WKEC. WKEC currently has a receivable for the Century refund payment with interest accruing

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(Note: Text in italics indicates a key SOX control.)

monthly. See the "Century Receivable" policy and procedure for more details on this transaction.

- Various Accruals – WKEC maintains small accruals that were accrued as of the Unwind date and relate to when WKEC had operations. These accruals include fees required to store WKEC files with Data Vault and remaining legal fees owed to BREC pertaining to the settlement of the HMPL&L excess energy matter.
- Tax Items – All activity that is charged to WKEC as a result of discontinued operations is taxed on the WKEC income statement and is therefore considered discontinued operations.

- Pensions and Post-retirement Benefits – These items are a result of when WKEC had operations and are the remaining liabilities related to former WKEC employees. These items were moved to LG&E and KU Capital LLC (LKC) in January 2012.

WKEC activity to be charged directly to WKEC:

- Legal fees continue to be charged directly to WKEC for matters that relate to WKEC..
- Any straggler invoices or refunds that were a result of when WKEC operated should be booked to WKEC.

WKEC activity to be charged to LG&E and KU Capital LLC (LKC):

- Activity that is related to ongoing work for post-Unwind matters should be charged to continuing operations. Because WKEC is a subsidiary of LKC, all ongoing activity should be charged directly to LKC since these items did not result from WKEC's operations. Examples of these items include accounting, tax and payroll burdened labor charges.

Reports Generated and Recipients:

N/A

Additional Controls or Responsibility Provided by Other Procedures:

Monthly balance sheet reconciliations are completed to ensure that each company has the correct amounts recorded and to the proper set of books.

Regulatory Requirements:

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(Note: Text in italics indicates a key SOX control.)

N/A

Reference:

N/A

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Manager, Corporate Accounting

Administrative Responsibility:

Controller

Date Created: 10/05/2012

Dates Revised: 09/30/2015, 03/24/2016, 03/29/2018

969 – Liquidated Damages

(Note: Text in italics indicates a key SOX control.)

Policy:

LG&E and KU Energy LLC and its subsidiaries ("LKE" or the "Company") may need to record liquidated damages amounts as stated per agreements with vendors to perform contract work or to purchase materials or equipment.

Procedure:

The Company routinely enters into agreements with vendors to perform contract work or to provide materials or equipment. Parties to the contract agree that it would be extremely difficult and impracticable to ascertain and fix the actual damages that the Company would incur should the vendor fail to meet guaranteed performance or substantial completion. If the contract work is performed incorrectly or does not meet the commercial operation or substantial completion dates stated in the contract, the vendor will owe the Company for liquidated damages as stated in the contract. Generally, the contracts that contain liquidated damages terms are long-term construction contracts.

Scope:

The policy applies to all contracts that contain liquidated damages terms.

Objective of Procedure:

The procedure will ensure that liquidated damages are accurately accounted for and recognized in a general ledger account for financial reporting.

General Requirements:

Detailed Procedures Performed:

When the Company enters into an agreement with a vendor that includes liquidated damages terms, and if the work performed by the vendor does not meet guaranteed performance or substantial completion, the vendor will owe the Company. The liquidated damages amounts are generally stated for each day or portion thereof that the guaranteed performance or the substantial completion is delayed beyond the dates stated in the contract. In many cases there are multiple types of liquidated damages depending on the type of damage incurred by the Company and an overall limit for the vendor's cumulative liability for damages to the Company.

Liquidated damages are a type of gain contingency. Prior to when the liquidated damages are recorded to the general ledger the designated legal contact for the contract must confirm for the

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(Note: Text in italics indicates a key SOX control.)

business line contact that the realization of recovery is probable using the same threshold for recognizing a contingent loss (i.e., 75% or greater probability and minimum of $100,000 threshold). Documentation confirming the probability and threshold should be obtained from the Legal Department to support recording the accrual as listed in the steps below. This documentation should also be used to substantiate a reserve (if needed) to be recorded for the liquidated damages receivable due from the vendor.

For any liquidated damages which would represent a gain in excess of loss amounts, or incremental income, are not recorded until their realization is 100% probable (i.e., when payment is received).

The following steps below provide the accounting procedures performed:

1. The business line contact for the contract with the vendor will determine the amounts for recording the liquidated damages due from the vendor (per the contract terms) once the legal contact has confirmed that the realization of recovery is probable using the same threshold for recognizing a contingent loss (i.e., 75% or greater probability and minimum of $100,000 threshold).
2. The Financial Accounting and Analysis (FAA) department or designated Budget Analyst will accrue the amount received from the business line contact via a monthly journal entry that will Dr. the designated receivable account -143 and Cr. the construction work in progress (CWIP) account – 107 (with the project and task provided by the business line contact). For this policy as an example account 107 is being used, however, other accounts could be impacted besides CWIP for the recovery of the liquidated damages. This would be determined when the type of liquidated damage is confirmed from legal for realization of recovery.
3. The accrual can be an auto- reversing entry or entry that is adjusted as necessary as the amount may change periodically. Changes to the accrual amount require support from the business line contact and legal contact confirmation.
4. The business line contact will determine whether an accounts receivable reserve is established as the liquidated damages payment amount received could be a smaller amount than the amount accrued. This should be substantiated by the legal contact. If so, the business line contact will determine the amount and provide the required information to FAA or a Budget Analyst. The reserve is recorded as a Dr. 107 and Cr.144. This entry may be reversed each month or adjusted as necessary. The reserve amount is an estimate determined by the designated business line contact.
5. An invoice may be prepared by FAA to bill the vendor for the liquidated damages due once the amount is confirmed with the business line contact. The business line contact will provide FAA with the customer information, description of work, project and task number. In some cases a payment settlement agreement may be reached with the vendor

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(Note: Text in italics indicates a key SOX control.)

and an invoice is not required to be prepared. The invoice or payment settlement agreement would be recorded as a Dr. to 143 account receivable and a Cr. to the 107 CWIP account.

6. When payment is received from the invoice or settlement agreement, it is posted as a Dr. to cash and a Cr. to the 143 designated receivable account and the corresponding accounts receivable reserve 144 account is debited and the 107 account is credited. The payment is taken into account when the information for the reserve is sent to FAA.
7. FAA is responsible for reconciling the 143 and 144 accounts and will obtain the journal entries and support to review the account to ensure the liquidated damages are reconciled and cleared in a timely manner.
8. In some cases liquidated damages may continue after the contract has ended potentially requiring monthly auto reversing accrual entries.
9. FAA will ensure proper contingency reporting to PPL.
10. When the contract pertains to the Trimble County Generating Station, the IMEA and IMPA joint owners (25%) reimbursement for liquidated damages must be factored in along with the allocations to each Utility. The Utility allocations will be provided by Property Accounting.

Reports Generated and Recipients:

Documentation from the Legal department providing confirmation that the realization of the liquidated damages recovery is probable using the same threshold for recognizing a contingent loss (i.e., 75% or greater probability and minimum of $100,000 threshold).

Liquidated damages support from the business line contact provided to FAA for the journal entry accrual, invoicing, and reconciliation.

Additional Controls or Responsibility Provided by Other Procedures:

250 - Balance Sheet Account Reconciliation
451 - Contractual Review
455 – Contingencies
953 – Reserve for Bad Debts
Accounting Treatment for Legal Contingencies Technical Memo
Sundry Billing Policy and Procedures

Regulatory Requirements:

None

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(Note: Text in italics indicates a key SOX control.)

Reference:

Accounting Standards Codification (ASC) 450-30
Emerging Issues Task Force (EITF) Issue 01-10

Corresponding PPL Policy No. and Name:

None

Key Contact:

Manager, Financial Accounting & Analysis

Administrative Responsibility:

Director, Accounting & Regulatory Reporting

Date Created: 12/31/12
Dates Revised: 4/1/16

970 – Lower of Cost and Net Realizable Value Inventory

(Note: Text in italics indicates a key SOX control.)

Policy: To ensure all inventory transactions are measured on a cost and net realizable value basis for recovery. Net realizable value is defined as the "estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation."

Procedure: Review and observe Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") inventory to determine whether inventory is valued appropriately.

Scope: All inventory recorded for LG&E and KU, excluding amounts relating to materials and supplies (see 850-Inventory Management Policy).

Objective of Procedure: GAAP accounting guidance set forth in Accounting Standards Codification (ASC) 330, Inventory, and the FASB simplification initiative requires inventory be recorded at the lower of cost and net realizable value. ASC 980, Regulated Operations, supersedes ASC 330 for LG&E and KU due to the approved Fuel Adjustment Clause (FAC), Gas Supply Clause (GSC) and Levelized Fuel Factor (LFF) mechanisms prescribing that fuel and natural gas be recorded at cost and allowing for a nearly immediate recovery of these costs.

General Requirements:

Detailed Procedures Performed:
Inventory transactions are recorded at cost and net realizable value through normal operating procedures. While ASC 330 requires an entity to perform an analysis to determine if inventory should be valued at cost or market, whichever is lower, ASC 980 provides that ratemaking actions of regulatory agencies may supersede this standard. Under ASC 980, when an accounting order indicates the way a cost will be handled for ratemaking purposes, and thus has an economic effect, a departure from GAAP is justified.

Per PwC interpretive response, "inventory should be recorded based on LOCOM (see UP 11.2). ASC 330-10-20 states that "market" should not be less than net realizable value reduced by an allowance for an approximately normal profit margin. If a regulated utility has a direct pass-through mechanism for fuel or purchased natural gas costs, then it is permitted to recover from its customers an amount equivalent to the original cost of the inventory (the regulated utility's normal profit margin on the cost is zero). A reporting entity in this situation would therefore not be required to record a LOCOM adjustment for fuel or purchased natural gas, even if the spot market price has declined below cost."

Such ratemaking actions include the establishment of billing mechanisms outside of base rates such as the FAC and GSC for Kentucky and the LFF for Virginia.

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(Note: Text in italics indicates a key SOX control.)

FAC and LFF mechanisms:

The FAC and LFF permit utilities to regularly adjust the price of electricity to reflect fluctuations in the cost of fuel used to supply electricity, allowing for a nearly immediate recovery on a dollar-for-dollar basis. In addition, 807 KAR 5:056 details fuel costs should be the most recent actual cost of fossil fuel (coal-fired generation); this should only include the invoiced price of fuel (less any cash or other discounts) and any applicable transportation costs.

LG&E and KU recover allowed fuel expenses through the FAC and LFF mechanisms. Each month the Companies submit the FAC[1] rate calculation to the Kentucky Public Service Commission (KPSC), which is based upon current month expenses and kWh. The FAC rates are effective two months after the expense month, resulting in a regulatory lag. This lag does not have an impact on the financial statements since it is eliminated by the monthly over-/under-recovery calculation and accrual. This accrual ensures the recoverable fuel costs each month equal the fuel revenue.

Items not covered through the FAC and LFF include fuel used for off-system sales (OSS) and penalties. As discussed in the “Other Considerations” section of this document, the risk of loss related to OSS and the amount of OSS is deemed inconsequential given the small and decreasing percent of total revenue it comprises. Furthermore, the forced outage penalties and fees are less than one-half of one percent of LG&E’s and KU’s total fuel expense and are considered immaterial. Per ASC 105.10.05, “The provisions of the Codification need not be applied to immaterial items.”

GSC mechansim

The GSC mechanism is used by LG&E to recover its costs for natural gas supplies sold to its natural gas customers as set forth in KPSC-approved tariff, P.S.C of Ky. Gas No. 7. This tariff allows LG&E to recover expected costs of gas supplies sold and also contains provisions for adjustments as a result of previous under- or over- projections of gas costs. The rate calculated through the GSC is called the Gas Supply Cost Component (GSCC) and is filed with, and must be approved by the KPSC on a quarterly basis. The new rate is effective two months after the GSC quarterly data is filed. At that time, the over/under recovery for that quarter will be refunded or collected through the GSCC factor.

[1] The accounting for the LFF, including the calculation of an over- and under-recovery accrual is identical to that of FAC except that the LFF is submitted annually to the Virginia State Corporation Commission and relates to KU only.

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(Note: Text in italics indicates a key SOX control.)

Other Considerations:

Municipal customer rates are determined annually based on a formula rate using amounts reported in the FERC Form 1. Fuel costs incurred are recovered via the updated rates. No market valuation of the fuel transactions is calculated and incorporated into the rate. These customers are charged for fuel on a "fully synchronized fuel adjustment clause", which means the FAC factor used for a billing period is the factor produced from the expenses for the expense period. Since the billing period and expense period are the same, there is no regulatory lag or an over/under recovery. In order to eliminate regulatory lag, municipal customers are billed twice each month, once at the beginning of the month based upon an estimated factor. Then at mid month once the factor has been calculated, the municipals are rebilled for the difference between the estimated factor and the actual factor.

LG&E and KU also sell excess generation in the wholesale electricity market (i.e. OSS). The Companies transact only in the prompt (hour-ahead, day-ahead, week-ahead) market. No forward of futures positions are taken. The fuel costs associated with these sales are not recovered as part of the FAC. OSS can be transacted at a fixed or floating price. Sales with fixed prices constitute approximately 10% of OSS and have little to no risk of occurring at a loss. The remaining 90% of OSS are sold at a floating price through Regional Transmission Organizations (RTO). The risk of loss on the floating price transactions is mitigated by the process indicated below.

LG&E and KU traders continuously monitor RTO pools and other indicators to stay abreast of current market prices. When traders are notified by Dispatch of excess generation capacity, they use their knowledge of market prices as well as the "Gen Cost Calculator" to mitigate the risk of selling power at a loss. The "Gen Cost Calculator" is an internally developed tool maintained by Generation Planning that details the raw fuel, transmission, and emission costs (updated monthly) associated with generation. The "Gen Cost Calculator" is regularly updated with generation capacity information via a data extraction from the "Position Tool" maintained by Dispatch. The "Position Tool" is a shared Excel spreadsheet that is updated real-time to track available generation.

If the total cost of generation exceeds the anticipated market price, traders will recommend not increasing generation. If the cost of generation is less than the anticipated market price, traders will recommend that Dispatch increase generation with the intent to sell the excess generation through RTOs. While there is no guarantee a loss will not be incurred as market prices are

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(Note: Text in italics indicates a key SOX control.)

subject to fluctuate, because sales are initiated so close to the actual energy delivery date, the short time frame limits the window for price changes, and therefore limits the risk of loss.

Reports Generated and Recipients:

None

Additional Controls or Responsibility Provided by Other Procedures:

354 – Materiality Policy
850 – Inventory Management
954 – Coal Inventory Valuation

Regulatory Requirements:

N/A

Reference:

FASB ASC Topic 330-10-35-2 - Inventory
FASB ASC Topic 980-10-05-3 – Regulated Operations
807 KAR 5:056
Code of Virginia Title 56, Section 56-249.6 – Recovery of fuel and purchased power costs

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Accounting Managers

Administrative Responsibility:

Director, Accounting and Regulatory Reporting
Controller

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(Note: Text in italics indicates a key SOX control.)

Date Created: 3/5/13
Date Revised: 4/1/16

971 - Sundry Billing Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: Sundry billing consists of Louisville Gas & Electric Company (LG&E) and Kentucky Utilities Company (KU) invoices that cannot be processed through the CCS (Customer Care Solution) system. Invoicing is coordinated through the Financial Accounting & Analysis Department and the Oracle Accounts Receivable (AR) module. Damage claims are invoiced by Underwriters Safety & Claims (USCKY) via the custom Oracle Damage Tracking System (DTS) module and the receivable is set up in the Oracle AR module.

Procedure: The billing procedures are performed per the detailed instructions below.

Scope: LG&E and KU billings that are invoiced through the Oracle AR module and are not invoiced through the CCS system.

Objective of Procedure: To establish a consistent method for invoicing and to describe the flow of information through the system to the collections process.

General Requirements:

Detailed Procedures Performed:

Accounting for sundry billing results in charges to FERC Account No. 142, Customer Receivables, and FERC Account No. 143, Other Accounts Receivable (non-customers). Accounting for related customer deposits is charged to FERC Account No. 252, Customer Advances for Construction. In general, sundry transactions relate to the following:

Description	Discussion Paragraph Below	Account Debited	Account Credited	Source of Billing Information
Work for customer jobs	1 & 2	142012	O&M and/or capital account provided by lines of business	Business Offices & Various lines of business
LG&E & KU electric line extensions & LG&E gas line extensions:	3			Contracts for refundable jobs-Business Offices Advances -Cash Remittance Department Refund requests - Performance Metrics Department
– to invoice		142012	184650	
– to set up advance		184650	252011 (10 yr. refund) 252015 (mobile homes – 4 + 7 yrs. refund)	

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(Note: Text in italics indicates a key SOX control.)

Description	Discussion Paragraph Below	Account Debited	Account Credited	Source of Billing Information
KU electric line extensions – cash received as deposit at a KU business office	3	131050	252013	KU Business Offices
Work for Kentucky Transportation Department and Indiana Department of Transportation	4	142012	Capital, retirement and/or O&M account provided by lines of business	Property Accounting and Regulatory Accounting & Reporting
Property damages	5	143017	Capital, retirement and/or O&M account provided by lines of business	(USCKY)
Underground service jobs – run service underground to customer meter base (KU only)	6	142012	107001	KU Business Offices
Joint trenching	7	143012	107001	Distributions Operations Dept.
Rubber goods	7	143012	456008	Safety & Tech Training Dist. Dept.
Pole attachments	7	143012	454001 454002 454003	Electrical Engineering and Planning Group
Rental invoice	7	143012	418001 454002	Real Estate & Right of Way, Transmission Policy & Tariffs
Transmission sales	7	142004	456109	Transmission Policy & Tariffs
Beyond the meter	7	142012	173002	Various business offices
IMEA/IMPA	7	143003 143004	107001 417004	Property Accounting and Regulatory Accounting
Mutual assistance/aid	7	143012	143024	Distribution Operations Budgeting & Forecasting
IBEW	7	143012	426501 O&M account	Industrial Relations HRIS
Gypsum & Water	7	143012	502001	Gyspum- Finance & Budgeting- Power Prod KU Water- Production Dept- Mill Creek
Reservation Fee Payments for Refined Coal (Clean Coal Solutions)	7	143012	456008	Fuels Accounting

1. Work for Customer Jobs - Estimated Cost (primarily KU):
   - Support for the invoice is received from various individuals having authority in the various lines of business within the Company. The data includes the customer name, mailing address, type of work done, the project and task charged and the cost of the project.

- Estimated cost jobs for KU are processed through receipt of miscellaneous invoice requests by various departments. Miscellaneous invoice requests are forwarded through email/inter-office mail, by the person requesting the invoice, to Financial Accounting & Analysis.
- Customers are entered into Oracle AR and transactions are created for the customer in Oracle AR.
- Invoices are sent to the customer. Remittance and Collection is responsible for collecting all accounts receivable.
- Estimated cost jobs are insignificant for LG&E and are generally paid up-front, so an invoice is not created for the customer. Cash is received and applied directly to the project and task indicated on the receipt ticket.
- Most KU jobs are performed after payment is received based upon verbal agreements.
- Invoices for estimated jobs are not adjusted, even if costs differ from the estimate.

2. Work for Customer Jobs - Actual Cost:
   - As with estimated cost jobs, support for the invoices is received from various individuals having authority in the various lines of business within the Company. The data (contract) includes the customer name, mailing address, type of work done, and the project and task charged for the cost of the project.
   - The customer signs a contract, stating they want to pay for the actual charges, based on an estimated cost. The estimated cost is determined by operations personnel in the area through which the job has been requested. The customer pays the estimated cost upfront. In the event the job costs are less than originally calculated and quoted to the customer, the amount of the overpayment is refunded by Financial Accounting & Analysis with authorization from the Distribution Operations Engineering department.
   - In the event the job costs exceed the originally calculated and quoted amount to the customer, the actual cost will be invoiced. PowerPlant is checked regularly by Financial Accounting & Analysis to ensure the actual cost jobs are invoiced when the work is complete. The figures for invoicing come from an EiS Report, LKE Project Expenditures – Fully Burdened, which is run by Financial Accounting & Analysis. A process has been implemented that allows Financial Accounting & Analysis to run reports in the Distr Ops Web Reporting application. The last day of the month is entered into the date field, for the period just ended, and all actual cost jobs that are ready to invoice will be printed on a report with all essential information for invoicing for the period just ended. Contracts are kept on file in AR Sundry and compared to reports to make sure everything is invoiced. Once the final cost has been calculated, invoices are prepared in the same manner as estimated cost jobs.

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(Note: Text in italics indicates a key SOX control.)

3. LG&E and KU electric line extensions and LG&E gas line extensions:

   Electric and gas line extensions are generally charged to customers based upon contracted terms. Refunds due to customers according to contract terms are processed along with sundry receivables.

   - LG&E gas line extension customers deposit a pre-determined amount of money which is refunded based upon additional customer hookups to the main extension over the following ten years, pursuant to the contract. If a developer paid the entire cost prior to construction of the main, they are refunded a fixed amount for each lot that is hooked up. This information is retained in the Refund and Payment Process (RAPP) system and monitored by Distribution Operations.
   - LG&E electric line extension customers deposit a pre-determined amount of money which is refundable, pursuant to the contract. Refunds are based on revenues earned over a three to five year period. If electric revenue earned on the line extension is greater than the cost of the line extension, based on the terms of the contract, then the deposit is refunded. The Sales Representatives analyze the revenue earned, to determine if the terms of the contract have been met and whether a refund is due. Line extensions are manually tracked by the Sales Representatives, who authorize Financial Accounting & Analysis to refund the customer.
   - KU electric line extension customers deposit a pre-determined amount of money, which is refunded based upon additional customer hook-ups to an electric extension over the following ten years, pursuant to the contract. The refund is a fixed amount for each hook-up. Each month, KU Business Operation personnel review the LKE AR Customer Advances Transaction Register sent by Financial Accounting & Analysis to determine if any additional customer hook-ups have occurred. If a hook-up has occurred, the responsible personnel notifies Financial Accounting & Analysis, who then initiates the refund process.
   - KU has mobile home line extensions. Customers are refunded 25 percent of their deposit every year for four years (part A contract only); a line extension hook-up is not required for these refunds. These refunds can also extend up to ten years, if it is a two part (A & B) contract. If the contract includes both part A & B, the customer deposits a pre-determined amount of money, which is refundable, based upon additional customer hook-ups to a main extension over the following ten years. For each additional customer hookup, the original customer receives a refund (part B of contract).
   - KU has refunds that are generated according to electric usage and/or line extension hookups. The customer makes a deposit. Every year the customer’s account is checked for electric usage and additional hookups, if applicable. The refund is figured

according to the contract. These jobs can be refundable for five to ten years. An Accounting Analyst in Financial Accounting & Analysis runs the LKE AR Customer Advances Transaction Register from Oracle EiS, which lists the customers that could be due a refund. The report is sent to various Business Office personnel to authorize a refund. The personnel authorizing refunds are primarily Line Construction & Maintenance Team Leaders.

- KU takes deposits for electric line extensions in its business offices. When cash deposits are received at the business office, no invoice is generated and the balance of the deposit is recorded in FERC Account No. 252013 until service is turned on. Once service is turned on the balance is transferred to FERC Account No. 252011 or 252015 and is processed through the refund processes noted above. LG&E does not accept cash deposits for electric line extensions.
- If at the end of the KU electric line extension agreement period there is a balance remaining, the Company is not required to refund the final balance to the customer and the balance is forfeited. The advance is also forfeited if the customer violates the line extension terms or fails to maintain service for the duration of the agreement period. The forfeited balance will be credited back to the respective plant account.

4. Highway jobs performed for the Kentucky Transportation Department (KTD) or Indiana Department of Transportation (INDOT). (Invoicing information is submitted by Property Accounting and Regulatory Accounting & Reporting, Accounting Analysts):
   - Property Accounting and Regulatory Accounting & Reporting Departments receive notification from the Project Manager to bill the KTD or INDOT.
   - Property Accounting and Regulatory Accounting & Reporting Departments run EIS Reports to generate information to invoice.
   - Property Accounting and Regulatory Accounting & Reporting send the information for invoicing to Financial Accounting & Analysis, who prepares invoices using the Oracle AR module. The invoice is sent to the customer with a special state form.
   - The Property Accounting and Regulatory Accounting & Reporting, Accounting Analysts, will provide support for each invoice submitted for processing.
   - See Property Accounting and Regulatory Accounting & Reporting Departments for detailed procedures.

5. Property damage items (Damage Tracking System (DTS) – invoicing submitted by USCKY):
   - Damage is sustained and reported to Distribution.
   - Distribution sets in motion the process for investigating and repairing the damage and charges the cost to a blanket damage project. USCKY is notified to begin the process of determining the responsible party, based on information provided by Distribution.

- The service centers are responsible for gathering damage costs and initiating damage claims. The invoice sent to the responsible party is printed from DTS and issued by USCKY.
- Damage claim repair charge costs are processed via blanket projects and tasks selected and submitted by the service center to USCKY. Support for the invoiced charges will come in the form of invoice detail generated from Oracle DTS, using the damage claim number, and will include details, such as miscellaneous cost i.e. meal ticket, material cost, transportation/equipment cost, labor cost and contractor cost, if applicable.
- The invoice data is interfaced from Oracle DTS to Oracle AR and to the general ledger.
- In the case of collection issues, instances will occur where the responsible party and the Company/USCKY will negotiate a settlement.
- The Company's originating department/USCKY notifies Remittance and Collection of the settlement and the balance of the invoice will be charged back in Oracle DTS by Financial Accounting & Analysis to the originating department(s) operating budget or capital.
- Oracle DTS and Oracle AR are balanced on a monthly basis prior to closing the books.
- If the party identified as responsible can provide proof that they are not liable, USCKY will notify the originating department of the dispute, requesting additional information to attempt to identify the responsible party.
- If the additional information is not received within the predetermined 15 days or if USCKY is not able to identify the responsible party, the charges will be reversed in Oracle DTS and Oracle AR and charged back to the originating department(s) operating budget or to capital, based on authorization from the originating department.
- If the additional information is received within the predetermined 15 days and USCKY is able to identify the responsible party, the original invoice will be reversed in Oracle DTS and Oracle AR and re-invoiced to the newly identified responsible party.

6. Underground service to the customer's meter base (KU):
   - Business Office personnel will receive supporting documentation (such as a miscellaneous invoice form, contract, and/or work request charges quote), indicating the customer name, address and invoicing amount from the Distribution Operations Business Representative.
   - Business Office personnel will create the customer record and invoice in Oracle AR. The original supporting documentation and a copy of the invoice, printed by the

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(Note: Text in italics indicates a key SOX control.)

Business Office for its records only, will be retained by the Business Office for audit purposes. A copy of the documentation will be forwarded to Remittance and Collection upon request, for collection purposes.

- The invoice entered into Oracle AR by Business Office personnel will be reviewed for project and task entry and description, then printed and mailed to the customers on a weekly basis by Financial Accounting & Analysis. To ensure all invoices are printed, invoices will be printed every Monday using transaction type (1UGIN) and the date range from Monday through Sunday of the previous week as the parameters.
- An incomplete invoice report is processed weekly by Financial Accounting & Analysis, prior to printing the underground invoices, to make sure all transactions were completed. If there are incomplete transactions, the creator of the transaction will be notified by Financial Accounting & Analysis to review the transaction and determine if the transaction should be completed. Once the Business Office personnel determine how the invoice should be handled, an email must be sent to Financial Accounting & Analysis so it can move forward with the process (i.e. printing invoices, AR upload).
- Credit memos will be processed when an invoice must be voided. An email must be sent to Financial Accounting & Analysis by Business Office personnel, indicating the invoice number, customer name, credit amount and an explanation detailing the reason for the credit. Financial Accounting & Analysis will process the credit memo in Oracle AR.

7. Other Sundry Billings:
   - Joint Trenching - Creating a trench, so other utility companies can install their underground services.
   - Rubber Goods – Testing and selling rubber protective equipment such as sleeves, blankets, gloves, etc.
   - Pole Attachments – Various attachments to our poles, such as for cable television, fiber optic line and cell phone service.
   - Rental Invoices – Rental of property such as transformers and vacant lots.
   - Transmission Sales - Customers that purchase power through the OATT Transmission Service.
   - Beyond the Meter – Work performed on customer owned equipment.
   - IMEA & IMPA – Cost for operations and maintenance, construction work performed on TC1 & TC2 due to joint ownership, and special projects at the request of IMEA and IMPA. (This is invoiced outside of the Oracle AR module and is paid in the same month that it is billed.)
   - Mutual Assistance/Aid – Assist utility companies that have major storm damage.

971 - Sundry Billing Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

- IBEW – Invoicing the union (IBEW) for an employee's hourly rate, workers compensation and FICA that have worked for the union.
- Gypsum – Invoicing for by-product that comes from the KU Ghent Generating Station stockpile.
- Water – Invoicing for water used by Charah at our Mill Creek plant.
- Refined Coal-Reservation fee paid by Clean Coal Solutions

This list is not comprehensive but information for invoicing is received from various Company personnel. All of these other types of work are entered into Oracle AR.

8. Cash posting related to sundry receivable accounts:
   Payment reports are received from Remittance and Collection with backup. The Business Offices forward support for payments received in the office, which were deposited locally. They are posted by Financial Accounting & Analysis to Oracle AR by batch, using the date the cash is posted by Remittance and Collection, and a receipt register is printed. The total on the receipt register for LG&E/KU equals the total for "Sundry and Miscellaneous Cash" on the "Receipts and Deposits" listing each day less miscellaneous items processed through J001.

9. Processing of various journal entries related to sundry billing:
   - Although cash receipts are posted into Oracle AR, journal entries are posted for sundry cash receipts, to allow for the correct project and tasks to be assigned to transmission sales and so that the sundry AR module in Oracle is not affected. These are cash entries that are posted to sundry ledger accounts on a monthly basis. The information for these entries is provided by Remittance and Collection on a daily basis, consisting of credit slips prepared and submitted by various employees, along with necessary backup.
   - LG&E & KU miscellaneous journal entries are posted to set up and reclass charges.
   - LG&E & KU monthly journal entries are posted to process accruals for billable charges, when the billings are held for future periods for various reasons, typically an invalid project and task. An email is distributed quarterly by an Accounting Analyst to Business Office personnel who are knowledgeable of projects that should be accrued, ensuring all known receivables are accounted for properly.
   - An accrual journal entry is prepared monthly for highway jobs by Property Accounting (Distribution and Gas jobs) and Finance & Budgeting (Transmission jobs) for billable charges of a significant nature (exceed $50,000 per job) which have not been invoiced to the Kentucky Transportation Department.

971 - Sundry Billing Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

10. On a monthly basis, the Oracle AR module is interfaced to the GL, to record all transactions for the month in the general ledger. An unposted journal entry report is reviewed to ensure that all items are posted to the correct company, as well as to ensure that all items requiring a project and task have a project and task assigned. An incomplete invoice report is processed at month end and is reviewed to ensure that all invoices entered for the month will be picked up in the interface. An interface process is then ran in Oracle AR to complete the process.

11. A transaction register is ran, sorted by amount and vendor, prior to the end of monthly close, to check for duplicate invoices and the balance sheet reconciliation for all LG&E and KU transactions created for the month.

12. On a quarterly basis, all sundry AR accounts are reconciled to the general ledger. This is performed through printing of the AR aged trial balances for each account and reconciling this amount with what is recorded in the GL. As the Oracle DTS also holds claims that are being tracked, the Oracle DTS aged trial balance is reconciled to the Oracle GL.

13. On a monthly basis, in order to monitor collections, EiS aging reports are prepared and distributed to the Manager, Financial Accounting & Analysis; the Manager, Remittance & Collection; our contact at USCKY, the legal department, and Remittance and Collection employees. The status of invoices over 120 days old are provided to Financial Accounting & Analysis by Remittance and Collections. Meetings are held as needed to review the information and discuss any potential collection issues.

14. Invoice requests are received daily in Financial Accounting & Analysis. All invoices are processed as soon as practical, within 30 days of when they are received, unless there is an issue with the invoice or projects and tasks need to be set up. In rare instances, invoices are accrued at quarter-end, if they have not been billed.

Reports Generated and Recipients:

- Printed invoices – to customers and to Revenue Collection, upon request
- Various Oracle EiS reports

Additional Controls or Responsibility Provided by Other Procedures:

All accounts related to sundry billings are reconciled at least quarterly to the general ledger (See 80.09 in the Sarbanes-Oxley Compliance documentation). Internal controls are set in Oracle AR to maintain the integrity of the data (for example, no deletion of invoices is allowed). Additional controls include the separation of duties between collection of money, entering of invoices, handling of payments and reversals of invoices.

971 - Sundry Billing Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Regulatory Requirements:
N/A

Reference:
Electric line extension contracts
Gas line extension contracts
Work for customer contracts
State transportation contracts
Signed purchase/testing agreements
Clean Coal Solutions contract

Key Contact:
Manager, Financial Accounting & Analysis

Administrative Responsibility:
Director, Accounting & Regulatory Reporting

Date Created:	December 09, 2004
Dates Revised:	May 11, 2005
	May 22, 2007
	November 8, 2007
	January 28, 2008
	April 16, 2009
	October 20, 2010
	January 17, 2013
	June 30, 2014
	June 9, 2015
	March 3, 2016
	August 5, 2016

1050 - Purchase Accounting

Policy: Upon the completion of a business combination transaction whereby LG&E and KU Energy LLC ("LKE") was acquired by PPL Corporation ("PPL"), LKE recorded adjustments to its financial statements and the financial statements of Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") for push-down accounting for certain valuations and reserves. This accounting was implemented in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 805, *Business Combinations* and ASC 820, *Fair Value Measurements and Disclosures*. Because PPL is a SEC registrant and LKE, LG&E and KU were to issue exchange traded senior notes and first mortgage bonds, push-down accounting is appropriate as LKE became a wholly owned subsidiary of PPL and its subsidiaries, and LG&E and KU, became indirect wholly owned subsidiaries because of the acquisition.

Procedure: Subsequent to the date of acquisition, LKE's accounting for these assets and liabilities, including methods of depreciation and amortization, are based upon the nature of the asset or the liability, not the manner of acquisition.

Scope: This policy shall apply to all purchase accounting adjustments of LKE, LG&E and KU.

Objective of Procedure: The objective of this policy is to ensure timely, accurate and consistent accounting application for the purchase accounting adjustments.

General Requirements:

Detailed Procedures Performed

Purchase accounting is recorded on separate Oracle G/L companies specifically established for this purpose. The general ledgers established for each company prior to the acquisition continue to be the primary general ledgers.

Each month the amortization journal entries relating to purchase accounting adjustments are recorded by the respective accounting departments maintaining the balance sheet accounts. These amortization entries relate to:

- The following intangibles and related regulatory liabilities created as a result of purchase accounting:
    - coal contracts,
    - emission allowances, and the
    - OVEC power purchase contract
- The following other deferred credits and related regulatory assets created as a result of purchase accounting:
    - coal contracts, and the
    - lease agreement
- The fair value adjustment relating to the pollution control bonds

1050 - Purchase Accounting

The Tax department is responsible for evaluating the impact on deferred taxes of the amortization.

The journal entries are prepared and posted no later than day 3 of closing and uploaded to Oracle. The Accounting Analyst performing the balance sheet reconciliation communicates and coordinates with other Accounting Analysts, the respective department manager, Manager, Financial Reporting, the Tax and Treasury departments.

For U.S. GAAP reporting purposes, property, plant and equipment was recorded at its net book value at the acquisition date based on the original cost of the assets less the life reserves. Cost of removal and salvage were not considered in the calculation of net book value since they were classified as regulatory liabilities. For FERC reporting purposes, property, plant and equipment continued to be reported at its historical cost as required by the FERC uniform system of accounts. Depreciation continued to be calculated on the gross asset value on the regulatory accounting set of books since the depreciation rates had previously been approved by various regulatory agencies. Depreciation is not recorded on the purchase accounting ledger, however, when the primary general ledger and the purchase accounting general ledger are combined for U.S. GAAP reporting purposes, depreciation expense, retirements and additions are properly reflected.

Retirement benefit costs under purchase accounting are less than retirement benefit costs for regulatory accounting since the other comprehensive impact of retirement benefits was written off as part of the purchase accounting adjustments. Burdens have been established using a regulatory accounting methodology to ensure that amounts are properly recovered through rates. The difference between retirement benefit costs for regulatory and purchase accounting purposes is recorded on the purchase accounting general ledgers for LG&E and KU Services Company and LG&E and KU Capital LLC.

No other purchase accounting adjustments resulted in changes in the on-going accounting processes.

Reports Generated and Recipients:

None

Additional Controls or Responsibility Provided by Other Procedures:

Account analyses for purchase accounting adjustments are prepared and reviewed monthly, in accordance with the Balance Sheet Accounts Reconciliation Policy.

Goodwill impairment testing is performed at least annually, by the Financial Planning group, in accordance with ASC 350, *Intangibles – Goodwill and Other*, in accordance with LKE's policy for Impairment Testing on Goodwill.

Regulatory Requirements:

1050 - Purchase Accounting

None

Reference:

FASB ASC 350, *Intangibles – Goodwill and Other*
FASB ASC 805, *Business Combinations*
FASB ASC 820, *Fair Value Measurements and Disclosures*

Corresponding PPL Policy No. and Name:

N/A

Key Contact:

Manager, Financial Reporting

Administrative Responsibility:

Controller

Date Created: 8/17/05
Dates Revised: 10/31/05, 4/2/09, 7/16/09, 8/07/09, 8/19/09, 3/17/11, 8/11/11

1051 - Emission Allowances

(Note: Text in italics indicates a key SOX control.)

Policy: Provide guidance for the accounting related to the emission allowances of LG&E and KU Energy LLC ("LKE") and its affiliates.

Procedure: LKE maintains an inventory of emission allowances at Louisville Gas & Electric Company ("LG&E") and Kentucky Utilities Company ("KU"). These emission allowances are used for consumption in each of the respective subsidiary's generating units. The companies are required to remit emission allowances based on generating units' emissions.

Scope: Emission allowances used by generating units

Objective of Procedure: To ensure proper accounting of emission allowances according to Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 350, *Intangibles – Goodwill and Other*, ASC 980, *Regulated Operations*, and the FERC Uniform System of Accounts ("USofA").

General Requirements:
The Clean Air Act Amendment of 1990 and corresponding regulations by EPA and/or Kentucky established requirements to reduce the levels of SO_2 and NOx emissions. These regulations resulted in the creation of emissions trading systems administered and tracked by the EPA. The trading systems created tradable "authorizations to emit", known as an SO_2 or NOx emission allowances. Each allowance has a specified "vintage", representing the first year in which it can be used. Emission allowances have financial value since they can be bought, sold, traded or held for future use (banking). The EPA disburses a fixed number of fully transferable emission allowances to each generating unit. The EPA withholds a certain percentage of the SO_2 allowances for use in an annual auction. For EPA compliance purposes, the owners of the plant must have enough allowances as of 60 days following the end of each compliance period to cover the plant's emissions to avoid penalties.

Detailed Procedures Performed:

According to ASC 350 Intangibles – Goodwill and Other, emission allowances should be accounted for as intangible assets. Because these allowances are intangible in nature, this does not allow the company to use the inventory scope exception within ASC 845, Non-Monetary Transactions to avoid fair value accounting when these allowances are submitted in exchange for actual emissions generation in a nonmonetary exchange. Although, for LG&E and KU, this fair value accounting for emission allowances is superseded by ASC 980, Regulated Operations, which states that there are certain public utility regulations that permit rates (prices) to be set at levels intended to recover the estimated costs of providing regulated services or products, including the cost of capital. If these regulations provide assurances that incurred costs will be recovered in the future, the company is required to capitalize those costs.

1051 - Emission Allowances

(Note: Text in italics indicates a key SOX control.)

Furthermore, as a result of the Environmental Cost Recovery ("ECR") mechanism, which is allowed by the Kentucky Public Service Commission ("KPSC") and provided for by law through Kentucky Revised Statute ("KSR") 278.183, and is in place at each of the utilities in question, the costs associated with certain environmental initiatives are recovered through this ECR surcharge on customers' bills. Gains on sales of emission allowances are returned to the customer and expenses for emission allowances are recovered through the mechanism.

If LG&E and KU want to exchange allowances between companies due to need, ASC 845 requires that transactions that have commercial substance be accounted for at fair value, although EITF 04-13 states that inventory exchanges of the same character of inventory with counterparties in the same line of business should be recognized at the carrying amount of the inventory transferred, not at fair value (EITF 04-13 ¶7). With this, LG&E and KU are allowed to transfer emission allowances between the companies at cost and not at fair value.

As public utilities under FERC guidelines, LG&E and KU will follow General Instruction 21 of Chapter 18 of the USofA to address the regulatory accounting treatment for public utilities of emission allowances. Detailed points of LG&E's and KU's current accounting procedures are below:

A) Public utilities owning allowances, other than those acquired for speculative purposes, shall account for such allowances at cost in Account 158.1, Allowance Inventory, or Account 158.2, Allowances Withheld, as appropriate. Allowances acquired for speculative purposes shall be accounted for in Account 124, Other Investments. Since LG&E and KU currently do not acquire emission allowances for speculative purposes, allowances are only accounted for in account 158.1 or 158.2 in the FERC chart of accounts.
B) When purchased allowances become eligible for use in different years, and the allocation of the purchase cost cannot be determined by fair value, the purchase cost allocated to allowances of each vintage shall be determined through use of a present-value based measurement. The interest rate used in the present-value measurement shall be the utility's incremental borrowing rate, in the month in which the allowances are acquired, for a loan with a term similar to the period that it will hold the allowances and in an amount equal to the purchase price. Current Company practice is to purchase emission allowances only when necessary to meet monthly emissions usage and/or annual EPA compliance needs.
C) The underlying records supporting Accounts 158.1 and 158.2 shall be maintained in sufficient detail so as to provide the number of allowances and the related cost by vintage year.
D) Issuances from inventory shall be accounted for on a vintage basis using a monthly weighted-average method of cost determination. The cost of eligible allowances not used in the current year shall be transferred to the vintage for the immediately following year.

1051 - Emission Allowances

(Note: Text in italics indicates a key SOX control.)

E) Account 158.1 or 158.2 shall be credited and Account 509, Allowances, debited for the cost of allowances related to steam power generation or Account 549, Miscellaneous Other Power Generation Expenses, debited for the cost of allowances related to other power production (Natural Gas Combined Cycle and Combustion Turbine) so that the cost of the allowances to be remitted for the year is charged to expense monthly based on each month's emissions.

F) In any period in which actual emissions exceed the amount allowable based on eligible allowances owned, the utility shall estimate the cost to acquire the additional allowances needed. Current Company practice is for Environmental Affairs to monitor emission allowance usage and to authorize purchase, if necessary, of additional emission allowances from intercompany inventory at weighted average cost, before actual annual emission amounts would exceed current allowance inventories. Weighted average cost of Company allowances is generally less than $1 per allowance. If no excess allowances are available via intercompany inventory, market purchases will be accrued. However, Company practice is to always have adequate emission allowances in inventory.

Under ASC 350 Intangibles – Goodwill and Other, emission allowances should be accounted for as intangible assets. Therefore, emission allowances should be analyzed for impairment on an annual basis in accordance with 350, Intangibles – Goodwill and Other. The companies have determined the values would not be impaired because the amounts are recoverable through the ECR and no impairment test is required.

See also 1050 – Purchase Accounting policy for information on purchase accounting adjustments related to emission allowances.

<ins>Summary:</ins>

LG&E and KU, as subsidiaries of LKE, record emission allowances as intangible assets on the balance sheet of the financial statements in accordance with ASC 350, Intangibles – Goodwill and Other, but are carried at weighted average cost to comply with ASC 980, Regulated Operations. Emission allowances are technically included within the balance sheet financial statements within account 158.1 allowance inventory and 158.2 allowances withheld per the FERC CFR guidelines. On an annual basis, LG&E and KU must surrender allowances based on their emissions. Should the utilities emit less than the allowances granted to them, the excess allowances can be banked and used in future years. In the event that any one of the utilities emit more than they have in banked allowances, they must acquire additional allowances, either through intercompany transfer or on the open market, or incur penalties to the EPA. Due to the fact that the allowances will be carried at cost on the balance sheet for recovery through the ECR mechanism, there is no risk of impairment. Emission allowances are presented as intangible assets in the financial statements in accordance with ASC 350.

1051 - Emission Allowances

(Note: Text in italics indicates a key SOX control.)

Regulatory Requirements:

18 CFR, Ch. I, Part 10, 1General Instruction 21
Kentucky ECR Mechanism

Reference:

- ASC 350, Intangibles – Goodwill and Other
- ASC 980, Regulated Operations
- EITF 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty
- 1050 – Purchase Accounting

Corresponding PPL Policy No. and Name:

1001 – Emission Allowances

Key Contact:

Manager, Regulatory Accounting & Reporting

Administrative Responsibility:

Director, Accounting and Regulatory Reporting

Date Created: 3/31/11, 9/8/11, 11/4/15, 3/21/16, 9/13/17

1055 – Regulatory Assets and Liabilities Accounting

(Note: Text in italics indicates a key SOX control.)

Policy: The books and records of Louisville Gas and Electric Company ("LG&E"), Kentucky Utilities Company ("KU"), and LG&E and KU Services Company ("LKS"), (cumulatively, "the Companies"), shall be maintained in a manner to provide compliance with the regulations set forth by the Federal Energy Regulatory Commission ("FERC"), the Kentucky Public Service Commission ("KPSC"), the Virginia State Corporation Commission ("VSCC"), the Tennessee Regulatory Authority ("TRA"), the Internal Revenue Service (IRS) and the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 980, Regulated Operations, applied on a consistent basis. Responsibility for compliance with the guidelines established in this policy resides with the accounting departments initiating transactions affecting the books and records of the Companies.

Procedure: The Companies will defer regulatory assets and liabilities when the amounts are to be included in rates charged to customers at a later date and comply with ASC 980. The regulatory assets and liabilities will be relieved and charged to revenue or expense when they impact the rates charged to customers.

Scope: All books and records of the Companies.

Objective of Procedure: Proper identification and recording of regulatory assets and regulatory liabilities in the Companies' financial statements in accordance with ASC 980, and the FERC Uniform System of Accounts. [http://www.ferc.gov/legal/acct-matts/usofa.asp]

General Requirements:

Background:

LG&E and KU (collectively "the Utilities") are public utility companies regulated by the KPSC and the FERC. KU is also regulated by the VSCC and the TRA. LKS is a centralized service company regulated by the FERC and provides services to the Utilities.

Accounting for the Utilities must conform to United States Generally Accepted Accounting Principles (GAAP), as well as, principles prescribed by the Securities and Exchange Commission (SEC), FERC, the KPSC, the VSCC and the TRA. Under GAAP the Utilities are subject to ASC 980 which supersedes Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS No. 71) and other U.S. GAAP literature in accounting matters related to regulated entities.

ASC 980, paragraph 340-25-1 states that a regulated enterprise may defer certain costs of providing services if the rates established by its regulators are designed to recover the enterprise's specific costs and the economic environment gives reasonable assurance that those rates can be charged and collected throughout the periods necessary to recover the costs.

1055 – Regulatory Assets and Liabilities Accounting

(Note: Text in italics indicates a key SOX control.)

Definition 31 of 18 CFR Chapter I, used for regulatory reporting and ratemaking purposes, provides a similar description of regulatory assets and liabilities. 18 CFR, Chapter I, prescribes Uniform Systems of Accounts ("USofA") for regulated electric (Part 101) and gas (Part 201) utilities and centralized service companies, which includes the following accounts to be used for regulatory assets and liabilities:

182.3 Other Regulatory Assets
254 Other Regulatory Liabilities

Regulatory assets and liabilities arise from several different circumstances.

The Utilities may initiate a filing with a Commission (generally only the KPSC or the FERC) requesting that a regulatory asset or liability be allowed to be recorded. The filing explains the reason for the request, dollar amounts involved and requested amortization period. The filing can be a stand-alone filing or part of another filing, such as a general base rate filing. The filing is prepared by the State Regulation and Rates Department (Rates) with assistance from the Regulatory Accounting and Reporting (RAR) and Legal departments. Once filed with the appropriate Commission, discovery occurs and the Commission issues an order. If the Commission approves the request, RAR receives the order from Rates or obtains a copy from the Commission website and records the amount authorized by the Commission. RAR prepares the amortization schedule and begins recording the amortization as stipulated in the order.

A commission could order that a regulatory asset or liability be recorded for the Utilities without a request from the Utilities. In this instance, RAR would receive the order from Rates and record the appropriate amount per the order. Likewise, from a GAAP accounting perspective, the Companies could record a regulatory asset or liability if adequate precedence has been set by regulatory bodies that recovery of the amounts will be allowed in future rates (e.g., rate case expenses) or if current rates include amounts that are expected to be incurred in the future (e.g., net cost of removal included in depreciation rates).

In certain situations, the Utilities may rely on orders or other regulatory authority as the basis of a specific type of charge and for GAAP accounting purposes may choose to record the amount in question as a regulatory asset or liability as opposed to recording revenue, expense, a gain or a loss due to the timing of the event in relation to the end of a quarter or the year. Due to the relative certainty of the ruling based upon prior history, the Utilities take this GAAP accounting approach to maintain consistency from a financial reporting perspective. In this case, the Utilities may file a request for an accounting order or rely upon other actions of a regulator (such as approval of financing), and record the regulatory asset or liability if all indications are that the precedence for inclusion in future rates will be upheld.

1055 – Regulatory Assets and Liabilities Accounting

(Note: Text in italics indicates a key SOX control.)

It is at the discretion of the Utilities to determine if FERC jurisdictional regulatory treatment is necessary through an internal review process. At which point the use of FERC generation and transmission formula rate calculations would be utilized to determine the amount of the regulatory asset or liability to be established and the period of recovery, refund or future costs is specifically identified.

Controls performed:

The attached Appendix documents the regulatory assets and regulatory liabilities recorded on Companies' Balance Sheets. The Appendix provides the description, order number or regulatory authority, additional regulatory or accounting support, department responsible for recording the accounting transactions, and the recovery/payback period.

On a quarterly basis, RAR coordinates a review of all regulatory assets and liabilities recorded by the Companies with the State Regulation and Rates and Legal departments. This review is based on the Appendix to this policy and is performed to ensure that documentation of all regulatory Orders has been received, or precedence exists, related to each regulatory asset and liability. This review also ensures that future recovery is expected for all regulatory assets and future refunds are expected for all regulatory liabilities.

Balance Sheet classification:

For GAAP purposes, regulatory assets and liabilities expected to be recovered from or refunded to customers within the next twelve months are classified as current assets and liabilities on the balance sheet, respectively. Regulatory assets and liabilities not expected to be recovered from or refunded to customers within the next twelve months are classified as noncurrent assets and liabilities on the balance sheet, respectively. Regulatory assets or liabilities are considered long-term with no current portion if they relate to items that lend themselves to a long-term nature (for example deferred financing costs since debt is typically long-term in nature). Under the FERC USofA, all regulatory assets and regulatory liabilities are considered long-term in nature.

Disclosure requirements:

In accordance with ASC 980, the following disclosures related to regulatory assets are required for SEC registrants:

1) Nature of the cost deferred
2) Amount deferred
3) Where regulatory assets are classified on balance sheet
4) Recovery period
5) Whether a return is being provided (i.e. included in rate base)

1055 – Regulatory Assets and Liabilities Accounting

(Note: Text in italics indicates a key SOX control.)

If at any point, the Companies would discontinue the application of ASC 980, they will disclose the reasons for the discontinuation and identify the portion of their operations to which this discontinuation was applied and the net adjustment of the discontinuation will be classified as an extraordinary item, if material, to segregate the item from the results of ordinary operations in the income statement. The nature and amount of any extraordinary item will be disclosed as well.

Reports Generated and Recipients:

Federal Energy Regulatory Commission (FERC):
FERC Form 1 and Form 3
- Page 232 – Other Regulatory Assets
- Page 278 – Other Regulatory Liabilities

Securities and Exchange Committee (SEC):
SEC Form 10-K and Form 10-Q
- Rates and Regulatory Matters footnote

Additional Controls or Responsibility Provided by Other Procedures:

LG&E and KU Energy LLC Accounting Policies and Procedures
- 250 - Balance Sheet Accounts Reconciliation policy
- 962 - Compliance with GAAP policy

Regulatory Requirements:

ASC 980
FERC Uniform System of Accounts
Various orders issued by regulatory commissions

Reference:

Federal Energy Regulatory Commission (www.ferc.gov)
Code of Federal Regulations (www.gpoaccess.gov/cfr/index.html)
FERC Uniform System of Accounts (http://www.ferc.gov/legal/acct-matts/usofa.asp)
VSCC rules of practice and procedures (www.scc.virginia.gov)
Controller Group website (http://intranet1.lgeenergy.com/controllergrp/)
Kentucky Public Service Commission (http://www.psc.state.ky.us)

1055 – Regulatory Assets and Liabilities Accounting

(Note: Text in italics indicates a key SOX control.)

Corresponding PPL Policy No. and Name:

None

Key Contact:

Director, Accounting & Regulatory Reporting
Manager, Regulatory Accounting & Reporting

Administrative Responsibility:

Controller
Director, Accounting and Regulatory Reporting

Date created: 11/19/09
Date revised: 12/17/09; 3/18/10; 3/31/11, 9/8/11, 6/21/13, 3/21/16, 12/06/16

Kentucky Utilities
Regulatory Asset and Liability Matrix

Regulatory Asset under US GAAP (ASC 980)	Description	Case No. / Order Approving Regulatory Asset / Liability or Providing Precedence/Other Support	Recovery / payback period	Responsible Department
Asset Retirement Obligation	The on-going depreciation of the ARO asset (account 403.1) and the accretion of the ARO liability (account 411.1).	KPSC 2003-00427 (regulatory assets established by adopting FAS 143 are approved) KPSC 2003-00434 (subsequent rate case) KPSC 2008-00251 (subsequent rate case) KPSC 2009-00548 (subsequent rate case) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case) ARO accounting entries provided: FERC FA 12-12-000 FERC ER08-1588-000 VSCC PUE 2011-00013 VSCC PUE 2013-00013 VSCC PUE 2015-00063	Ongoing	Property
ARO-Generation-CCR	The on-going depreciation of the ARO asset (account 403.1) and the accretion of the ARO liability (account411.1) related to the Combustion Coal Residuals (CCR) ash and environmental plants included in the 2016 ECR Plan.	KPSC 2003-00427 (regulatory assets established by adopting FAS 143 are approved) KPSC 2003-00434 (subsequent rate case) KPSC 2008-00251 (subsequent rate case) KPSC 2009-00548 (subsequent rate case) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case) KPSC 2016-00026 (approval for amortizing CCR costs) FERC FA 12-12-000 (ARO accounting entries provided) FERC ER17-234-000 (in progress)	KPSC: 10 years (from 7/2016 through 6/2026) for closed plants and 25 years (from 7/2016 through 6/2041) for open plants	Property
ASC 740 - Income Taxes	Deferred income tax assets and liabilities which are recognized for temporary book/tax differences related to AFUDC, and asset basis adjustments related to ITC, and are recovered through base rates.	KPSC 2009-00548 (proforma adjustment related to ITC approved) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case)	Ongoing	Tax
Forward Starting Swaps - 2015	Loss realized upon termination of forward starting swaps used to protect against rising interest rates between the date of the swaps and the date the bonds were priced in 2015.	KPSC 2014 - 00082 (order to enter into swap) KPSC 2014-00371 (subsequent rate case) Report of action, dated 10/16/2015 indicated cash settlement of swaps would be amortized over life of associated bonds.	There are two bond series. One of the series has a 10 years recovery period (from 9/2015 through 10/2025) and the other series has a 30 years recovery period (from 9/2015 through 10/2045)	Treasury
Winter (Ice) Storm 2009	January and February 2009 Kentucky Ice Storm restoration costs	KPSC 2009-00174 (established) KPSC 2009-00548 (recovery) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case)	August 2010 through July 2020	Regulatory
Green River Units 3 & 4	Costs of retiring Green River Units 3 & 4 beginning in 2015	KPSC 2014-00371 (established and recovery) KPSC 2016-00370 (subsequent rate case)	July 2015 through the next rate case	Budget & Forecast
Rate Case Expenses	Rate case expenses are charged to a regulatory asset account and amortized over the period authorized in the order. These costs are associated with consulting services, engineering services, advertising expenses and legal services in preparation of the testimony and support of each rate case.	KPSC 2009-00548 ((2009 rate case expenses recovery) KPSC 2012-00221 (2012 rate case expenses approved to be deferred as regulatory asset and recovery) KPSC 2014-00371 (subsequent rate case) KPSC 2016-00370 (subsequent rate case) 307 U.S. at 120-121 294 U.S. at 73	2014 rate case expenses: July 2015 through June 2018 2016 rate case expenses: July 2017 through the next rate case of projected rate case expenses in the filing	Regulatory
Wind (Hurricane Ike) Storm 2008	September 2008 Kentucky wind storm restoration costs	KPSC 2008-00457 (established) KPSC 2009-00548 (recovery) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case)	August 2010 through July 2020	Regulatory
Mountain Storm 2009	December 2009 Virginia storm restoration costs	VSCC PUE 2011-00013 (established and recovery) VSCC PUE 2013-00013 (subsequent rate case) VSCC PUE-2015-00063 (subsequent rate case)	November 2011 through December 2017	Regulatory
Carbon Management Research Group	Contributions to the CMRG of up to $2M over ten years ($200K per year starting in August 2010) for the development of technologies for reducing carbon dioxide emissions from existing coal-fired electric plants.	KPSC 2008-00308 (establishment) KPSC 2009-00548 (recovery) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case)	August 2010 through July 2020	Regulatory
Regulatory Liability under US GAAP (ASC 980)	**Description**	**Case No. / Order Approving Regulatory Asset / Liability or Providing Precedence/Other Support**	**Recovery / payback period**	**Responsible Department**

Forward Starting Swaps - 2013	Gain realized upon termination of forward starting swaps used to protect against rising interest rates between the date of the swaps and the date the bonds were priced in 2013.	KPSC 2012-00232 (order to enter into swap) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case) Report of action, dated 12/13/2013 indicate cash settlement of swaps would be amortized over life of associated bond.	30 years (from 9/2015 through 10/2045)	Treasury
ASC 740 - Income Taxes	Deferred income tax assets and liabilities which are recognized for temporary book/tax differences related to unamortized investment tax credits (ITC), excess deferred taxes and enacted changes in tax laws or rates, and are recovered through base rates.	KPSC 2005-00181 (change in tax rates beginning 2005) KPSC 2006-00456 (change in tax rates beginning 2007) KPSC 2009-00548 (proforma adjustment related to ITC approved) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case)	Ongoing	Tax
Refined Coal	Proceeds from Tinuum Group, LLC contract that include license and coal yard service fees and exclusivity and termination fees for a process to refine coal to reduce Nox and mercury emissions from coal at Ghent and Trimble County generating stations.	KPSC 2015-00264 (established) KPSC 2016-00370 (subsequent rate case) FERC EL 15-92-000 (FERC denial to pass the proceeds of the refined coal arrangements to their customers through their Fuel Adjustment Clause)	Ghent: annual amortization of $9,341K through the next rate case. TC: no amortization, reservations fees are added to the reg. liability	Corp Fuels / FAA
Regulatory Asset or Liability under US GAAP (ASC 980)	**Description**	**Case No. / Order Approving Regulatory Asset / Liability or Providing Precedence/Other Support**	**Recovery / payback period**	**Responsible Department**
Fuel Adjustment Clause	Over- or under-recovered fuel expenses through the FAC mechanism. Over-recoveries result in a regulatory liability and under-recoveries result in a regulatory asset.	807 KAR 5:056	Ongoing	Revenue
VA Fuel Component(Levelized Fuel Factor)	Over- or under-recovered fuel expenses through the LFF mechanism. Over-recoveries result in a regulatory liability and under-recoveries result in a regulatory asset.	Title 56 of the Code of Virginia, Chapter 10; Section 56-249.6	Ongoing	Revenue
Environmental Cost Recovery	Over- or under-recovered return on approved environmental capital projects and the associated O&M expenses. Over-recoveries result in a regulatory liability and under-recoveries result in a regulatory asset.	KRS 278.183	Ongoing	Revenue
Muni Gen True-up	Over- or under-collection calculated as the difference between the amount billed to municipal customers under the FERC formula rate (estimated charges based on prior year's FERC Form 1 and projected municipal load) and the actual amounts that should have been collected based on actual costs and load incurred for the rate year.	FERC ER-13-2428 (settlement on the terms of the revised formula rate)	Ongoing	Revenue
Off-System Tracker	Over- or under-recovered off-system sales margin via the Off-System Sales Tracker ("OST"), which is included within the Fuel Adjustment Clause ("FAC") mechanism on customers' bills. Margins are split between customers (75%) and the company (25%). Over-recoveries result in a regulatory liability and under-recoveries result in a regulatory asset.	KPSC 2014-00371 (Off-System Sales Tracker is approved) 807 KAR 5:056	Ongoing	Revenue
DSM Cost Recovery	Over- or under-recovered actual costs of approved demand programs, revenue from lost sales and incentive, and return on capitalization earned related to capital investments as compared to the estimated program costs for the 12-month period.	KRS 278.285	Ongoing	Revenue
ASC 715 - Pension and Postretirement	The over- or under-funded status of defined benefit pension and postretirement plans that would otherwise be recorded as accumulated OCI that is expected to be recovered through base rates at a future date.	KPSC 2003-00434 (regulatory asset approval) KPSC 2008-00251 (subsequent rate case) KPSC 2009-00548 (subsequent rate case) KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case) FERC AI04-2-000 (FERC guidance to utilities on recognition of a regulatory asset for the amount of liability that otherwise chargeable to accumulated other comprehensive income) FERC AI07-1-000 (recognition of regulatory liability or asset for the funded status asset or liability otherwise chargeable to accumulated other comprehensive income under SFAS No. 158)	Ongoing	Risk
Pension Gain-Loss Amortization - 15 Year	Deferred pension plan actuarial gain or loss amortization using a 15-year amortization period (for Kentucky jurisdictional rates) instead of amortizing the actuarial gains and losses in excess of 10% of the greater of the plan's projected benefit obligation or the market-related value of plan assets and less than 30% of the plan's projected benefit obligation (double corridor method) on a straight-line basis over the expected average remaining service period of active plan participants (under US GAAP).	KPSC 2014-00371 (established and recovery)	Rolling 15 years	Risk

Plant Outage Normalization	Generator outage expenses that are greater or less than the eight-year average of KU's generator outage expenses are recorded as regulatory assets / liabilities	KPSC 2016-00370 (approval)	To be determined in the next rate case	Budgt & Forecast - Gen Ops

Regulatory Assets or Liabilities recorded under US GAAP (ASC 980)	Description	Case No. / Order Approving Regulatory Asset / Liability or Providing Precedence/Other Support	Recovery / payback period	Responsible Department
Cost of Removal	Represents the cost of removal (COR) component of KPSC approved depreciation rates for the underlying assets, which is recovered from customers through base rates. COR is only reported as a regulatory liability for SEC reporting purposes and is reported in accumulated depreciation for regulatory reporting purposes.	ASC 980-410-25-2 PwC Guide to Accounting for Utilities and Power Companies - 2013, Question 13-4 & section 18.8.1.1	N/A	Property
Unamortized Debt Expense	Purchase Accounting adjustment for the reclassification of deferred debt issuance costs from a long-term asset (other noncurrent) to a regulatory asset. Deferred debt issuance costs are generally eliminated in purchase accounting since no future value is assigned to them. However, debt issuance costs on the general ledger of KU at October 31, 2010 are recoverable in base rates. Regulatory offset is appropriate as KU has the right to recovery. As such, these costs were treated as a regulatory asset and were not eliminated as a result of the acquisition.	FERC AC11-83-000 FERC EC10-77-000 Change in control proceeding: KPSC 2010-00204 KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case) VSCC PUE 2010-00060 VSCC PUE 2011-00013 (subsequent rate case) VSCC PUE 2013-00013 (subsequent rate case) VSCC PUE-2015-00063 (subsequent rate case) TRA 10-00118 This amount is a purchase accounting adjustment only and purchase accounting is not recognized for rate making purposes.	Over the life of the bonds that are outstanding at the acquisition (December 2005 through February 2037)	Regulatory
OVEC Power Purchase Contract	Purchase Accounting market valuation of the power purchase contract between the company and Ohio Valley Electric Company (OVEC) due to the PPL acquisition of LG&E and KU Energy. This liability is offset by an intangible asset.	FERC AC11-83-000 FERC EC10-77-000 Change in control proceeding: KPSC 2010-00204 KPSC 2012-00221 (subsequent rate case) KPSC 2014-00371 (subsequent rate case) VSCC PUE 2010-00060 VSCC PUE 2011-00013 (subsequent rate case) VSCC PUE 2013-00013 (subsequent rate case) VSCC PUE-2015-00063 (subsequent rate case) TRA 10-00118 This amount is a purchase accounting adjustment only and purchase accounting is not recognized for rate making purposes. This amount and the offsetting intangible asset are both removed for rate making.	November 2010 though March 2026	Regulatory

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(Note: Text in italics indicates a key SOX control.)

Policy: LG&E and KU Energy LLC ("LKE" or "the Company") will account for and disclose guarantees as required by U.S. GAAP.

Procedure: Review the applicable contracts to determine the existence of guarantees.

Scope: All guarantees entered into by LKE and its subsidiaries.

Objective of Procedure: Ensure proper accounting and disclosure of guarantees in the financial statements.

General Requirements:

Definitions
Guarantee – Agreement that provides assurance (financial and/or performance) to third parties.

Underlying- A specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself. An underlying is a variable that, along with either a notional amount or a payment provision, determines the settlement of a derivative instrument.

Fair Value –As defined in the Codification, "fair value" is "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." Fair value measurement concepts include: a) exit price (entry, transaction or settlement price does not necessarily equate to fair value), b) highest and best use, c) principal or most advantageous market and d) non-performance risk (e.g. credit risk) for an entity's own liabilities. Refer to ASC 820-10-30 and 820-10-35 for the guidance on fair value measurement and subsequent measurement. When measuring fair value, these concepts as well as any additional disclosures should be considered and documented. Refer to ASC 820-10-50 for the guidance on fair value disclosures.

Accounting Practice

1. Background

   A guarantee consists of both noncontingent and contingent aspects. The noncontingent aspect is the ongoing obligation to stand ready to perform over the term of the guarantee in the event the specified triggering events or conditions occur, while the contingent

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aspect is the possibility of having to perform if the specified triggering events or conditions occur.

The following accounting principles provide the primary guidance around the accounting and disclosure requirements for guarantees.

ASC 460-10-25 clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee for the noncontingent obligation that the guarantor has undertaken in issuing the guarantee. ASC 460-10-50 addresses the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under guarantees. ASC 460-10-35 does not specify the subsequent measurement of the guarantor's recognized liability for either the noncontingent aspect of the guarantee or the contingent aspect of the guarantee. Generally, the liability initially recognized (under ASC 460-10-25-4) would be reduced (by a credit to earnings) as the guarantor is released from its risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from its risk under the guarantee would typically be recognized over the term of the guarantee using one of the three methods:

1.) Only upon either expiration or settlement of the guarantee
2.) By a systematic and rational amortization method
3.) As the fair value of the guarantee changes.

Although these three methods are currently used in practice, ASC 460-10-35 does not provide comprehensive guidance regarding the circumstances in which each of these methods would be appropriate. A guarantor is not free to choose any of the three methods in deciding how the liability for its obligations under the guarantee is measured subsequent to the initial recognition of the liability. For example, a guarantor will not use the fair value in subsequently accounting for the liability of its obligation under a previously issued guarantee unless the use of that method is justified under GAAP. Specifically, fair value is used to subsequently measure guarantees accounted for as derivatives under Topic 815.

Accounting for the contingent aspect of the guarantee is governed by ASC 450-20, "Contingencies" unless it is accounted for as a derivative. If it is accounted for as a derivative then the guidance in ASC 815, "Derivatives and Hedging" is applied. The disclosure provisions in ASC 450-20-50 regarding disclosure of a loss that is reasonably possible still apply.

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(Note: Text in italics indicates a key SOX control.)

2. Accounting

For guarantees that fall within the scope of the recognition (section 25) and measurement (section 30) provisions of ASC 460, guarantors must recognize a liability equal to the fair value of the guarantee at inception for any guarantees issued or modified after December 31, 2002. For guarantees issued prior to that date, the previous accounting was not revised or restated. However, the disclosure requirements in ASC 460-10-50 apply to all qualifying guarantees no matter when the guarantee was issued or modified.

In the event that the guarantor is required to recognize a liability under ASC 450 for the related contingent loss at the time a guarantee is issued, the liability to be recognized will be the greater of (a) the amount that satisfies the fair value objective as discussed in ASC 460 or (b) the contingent liability amount required to be recognized at inception of the guarantee by ASC 450.

The recognition and measurement provisions of ASC 460 apply to guarantee contracts that have any of the following characteristics (see ASC 460-10-15-4):

- ✓ Contracts that contingently require the guarantor to make payments (either in cash, financial instruments, other assets, shares of stock or provision of services) to the guaranteed party based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party (e.g., financial and market value guarantees). Examples include a financial standby letter of credit, a market value guarantee on either a financial asset or a nonfinancial asset owned by the guaranteed party, guarantee of the market price of common stock, a guarantee of collection of the scheduled contractual cash flows from individual financial assets held by a special purpose entity, or a minimum revenue guarantee.
- ✓ Contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement (performance guarantees).
- ✓ Indemnification agreements (contracts) that contingently require the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party. Examples are an adverse judgement in a lawsuit or the imposition of additional taxes due to either a change in the tax laws or an adverse interpretation of the tax law.
- ✓ Indirect guarantees of the indebtedness of others, even though the payment to the guaranteed party may not be based on changes in an underlying that is related to an asset, liability, or an equity security of the guaranteed party.

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(Note: Text in italics indicates a key SOX control.)

ASC 460 does **not** apply to the following guarantee contracts (see ASC 460-10-15-7):

- ✓ A guarantee or an indemnification that is excluded from the scope of ASC 450 (see ASC 450-20-15-2). Therefore, items like vacation pay, deferred compensation contracts, stock issued to employees and other employment related costs are excluded.
- ✓ Guarantees issued by insurance and reinsurance companies and accounted for under ASC 944.
- ✓ Residual value guarantees provided by lessees in capital leases.

Items accounted for as contingent rent under ASC 840-30.

- ✓ Vendor rebates.
- ✓ Guarantees whose existence prevents the guarantor from recognizing a sale or the earnings from a sale.
- ✓ Commercial letters of credit and other loan commitments.
- ✓ Indemnifications or guarantees of an entity's own future performance.
- ✓ Noncontingent forward contracts for which the net settlement can flow from either party to the other party.
- ✓ Registration payment arrangement within the scope of ASC 825-20.
- ✓ A guarantee that is accounted for as a credit derivative at fair value under Topic 815.

The liability recognition and measurement provisions of ASC 460 do **not** apply to the types of transactions listed below (see ASC 460-10-25-1). However, these transactions are still subject to the disclosure requirements of ASC 460-10-50.

- ✓ A guarantee for which the underlying is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party (e.g., product warranties).
- ✓ Guarantees that are accounted for as derivative instruments at fair value under ASC 815.
- ✓ Guarantees issued in a business combination that represent contingent consideration under ASC 805, "Business Combinations."
- ✓ Guarantees for which the guarantor's obligations would be reported as an equity item (rather than a liability) under generally accepted accounting principles.
- ✓ A guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligor under the original lease.
- ✓ Guarantees issued between either parents and their subsidiaries or corporations under common control.
- ✓ A parent's guarantee of a subsidiary's debt to a third party, and a subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

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(Note: Text in italics indicates a key SOX control.)

3. Disclosure requirements

A. Under ASC 460-10-50-4, a guarantor is required to disclose the following information in its interim and annual financial statements about each guarantee, or each group of similar guarantees, even if the likelihood of the guarantor's having to make any payments under the guarantee is remote:

- ♦ The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee
- ♦ The maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee. Such amount will not be reduced by the effects of any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee. If the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact will be disclosed. If the guarantor is unable to develop an estimate of the maximum potential amount of future payments, the guarantor will disclose the reasons why it cannot estimate the maximum potential amount.
- ♦ The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee, regardless of whether the guarantee is freestanding or embedded in another contract; and
- ♦ The nature of any recourse provisions that would enable the guarantor to recover the amounts paid under the guarantee and any assets held either as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee. The guarantor will indicate, if estimable, the approximate extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the guarantee.
- ♦ The current status of the payment/performance risk of the guarantee
- ♦ If internal groupings are used (for the purposes of determining payment/performance risk above), how these groupings are determined and used for managing risk.
- ♦ ASC 820, "Fair Value Measurements and Disclosures" (see "Fair Value" in definitions) has specific disclosure requirements for items subsequently measured at fair value. Measurements to initially recognize an item at fair value are exempt from the ASC 820 disclosure requirements.

For product warranties, instead of disclosing the maximum potential amount of future payments under the guarantee, a guarantor is required to disclose the following according to ASC 460-10-50-8:

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(Note: Text in italics indicates a key SOX control.)

- The information required to be disclosed by ASC 460-10-50-4 (see above; except for disclosing the maximum potential amount of future payments).
- The accounting policy and methodology used in determining the liability for product warranties.
- A tabular reconciliation of the changes in the guarantor's aggregate product warranty liability for the reporting period. The reconciliation should present
  - ✓ the beginning balance of the aggregate product warranty liability,
  - ✓ the aggregate reductions in that liability for payments made under the warranty,
  - ✓ the aggregate changes in the liability for accruals related to product warranties issued during the reporting period,
  - ✓ the aggregate changes in the liability for accruals related to preexisting warranties (including adjustments related to changes in estimates) and the ending balance of the aggregate product warranty liability.

B. Under ASC 460-10-50-1 through 50-3, an entity will disclose certain loss contingencies even though the possibility of loss may be remote. The common characteristic of those contingencies is a guarantee that provides a right to proceed against an outside party in the event that the guarantor is called on to satisfy the guarantee. Examples include:

- Guarantees of indebtedness of others, including indirect guarantees of indebtedness of others
- Obligations of commercial banks under standby letters of credit
- Guarantees to repurchase receivables that have been sold or otherwise assigned
- Other agreements that in substance have the same guarantee characteristic

The disclosure will include the nature and the amount of the guarantee. Consideration will be given to disclosing (if estimable) the value of any recovery that could be expected to result, such as from the guarantor's right to proceed against an outside party.

C. According to ASC 460-10-50-5, the disclosures required by this Overall Subsection for the Guarantees Topic do not eliminate or affect the following disclosure requirements:

- The requirements in the General Subsection of ASC 825-10-50 that certain entities disclose the fair value of their financial guarantees issued
- The requirements in paragraphs ASC 450-20-50-3 through 50-4 that an entity disclose a contingent loss that has a possibility of occurring
- The requirements in the Disclosure Sections of Topic 815 which apply to guarantees accounted for as derivatives

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- The requirements of ASC 275-10-50 that an entity disclose information about risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term.
- According to ASC 460-10-50-6, some guarantees are issued to benefit entities that are related parties. In these cases, the disclosures required by ASC 460 are incremental to the disclosures required by ASC 850.

D. SEC registrants must also comply with the guidance outlined under Financial Reporting Release No. 61 (FR 61), Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations. FR 61 suggests that registrants consider aggregation of information about contractual obligations and commercial commitments in a single location so that a total picture of obligations would be readily available.

Procedures

The following explains the procedures for identifying, valuing and disclosing guarantees, including indemnifications, that are required to be accounted for and/or disclosed in accordance with ASC 460 and related guidance. All references to guarantees also apply to indemnifications.

A. Identification and Measurement of Guarantees
   - Individuals involved in executing contracts are responsible for identifying guarantees issued by LKE in the contracts. These individuals may include personnel in Legal, Supply Chain, Treasury, Operations, Credit and Contract Administration or whoever is directly involved with the execution of a new agreement.
   - A Financial Accounting and Analysis (FAA) Accounting Analyst, FAA Manager, and designated Line of Business contacts (for the contractual review process) perform guarantee reviews during the contract review process and ensure the appropriate controls and accounting are applied. See LKE's Accounting Policy and Procedures 451 – Contractual Review. For the purposes of this policy, the designee will be referred to as the Line of Business (LOB) contact.
   - The LOB contacts are responsible for determining whether such guarantees are in the scope of ASC 460, and if so, whether they are in scope for purposes of initial recognition, measurement and disclosure or just for disclosure purposes. If the LOB contact is unsure about the applicability of the guarantee under ASC 460, then he or she should contact FAA.
   - The LOB contact will notify the individual who originally identified the guarantee about the applicability of the guarantee under ASC 460 and the need to record and/or disclose such guarantees. If necessary, the individuals involved in executing the contract are responsible for determining the fair value of guarantees

requiring recognition and measurement, with assistance from the LOB Contact and/or FAA in determining a method for valuing the guarantees.

B. Documentation and Disclosure

- Conclusions regarding the applicability of ASC 460 are documented by the LOB contact in the contract review template that is completed for each contract within scope. See Accounting Policy and Procedures 451 – Contract Review for an example of the review template.

- The LOB contacts will forward a copy of the completed and approved contract review templates that include the section on Guarantees to FAA before the end of a quarter-end month. The designated FAA Accounting Analyst will review the contract review template to determine if he/she agrees with the conclusion and if a journal entry should be recorded. The FAA Accounting Analyst coordinates any changes to the template with the LOB contact and the Credit/Contract Administration department. A Credit Analyst from the Credit/Contract Administration department sends the final summary to Financial Reporting and FAA soon after the end of the quarter close.
- For new guarantees that only require disclosure, FAA will notify Financial Reporting. For existing guarantees already disclosed, Credit/Contract Administration provides Financial Reporting with any updates to the list for updates to the required disclosures for purposes of the 10-Q and 10-K filings to the SEC. Workpapers will be prepared to support the disclosures and are maintained in Financial Reporting's files. Additionally, Legal provides a quarterly memo to Financial Reporting and PPL Technical Accounting that provides information regarding if any payments were made under ASC 460 Indemnification Provisions and outstanding claims being requested on behalf of LKE under these provisions for updates to the disclosures.

C. Examples (consistent with section IV. “Accounting Practice”).
Any questions regarding inclusion should be directed to the applicable LOB contact.

- The following types of guarantees are not in the scope of ASC 460:

  - ✓ Guarantee agreements issued by a LKE entity for the benefit of third parties for assurance against nonperformance by a subsidiary, direct or indirect, of the issuing entity.
  - ✓ Letters of credit issued by a bank at the direction of a LKE entity for the benefit of third parties for assurance against nonperformance by the requesting LKE entity or a subsidiary, direct or indirect, of that LKE entity.

(Note: Text in italics indicates a key SOX control.)

- ✓ Surety bonds issued by an insurance provider at the direction of a LKE entity for the benefit of third parties for assurance against nonperformance by the requesting LKE entity or a subsidiary, direct or indirect, of that LKE entity.
- ✓ Residual value guarantees of leased property or equipment for which the lease is accounted for as a capital lease.
- ✓ Guarantees related to an entity's own future performance or the future performance of a direct or indirect subsidiary of the issuing entity entering into the guarantee (e.g. guarantee to complete a project on time or in accordance with the contract).

The following are examples of types of guarantees that **are** in the scope of ASC 460:

- ✓ Guarantees of an unconsolidated entity's obligations (e.g. debt, lease and other payment obligations).
- ✓ Residual value guarantees of leased property or equipment for which the lease is accounted for as an operating lease.
- ✓ Tax and environmental indemnifications provided in connection with the sale of a business.
- ✓ A guarantee of the performance (i.e. regarding function) of nonfinancial assets (e.g. warranties and maintenance/service contracts).
- ✓ Contingent purchase price payments required in connection with the acquisition of a business.
- ✓ Written put option contracts.
- ✓ Indemnifications related to patent infringement.
- ✓ Indemnifications related to responsibilities/duties to be performed by unconsolidated entities.
- ✓ Guarantee agreements issued for assurance against nonperformance of a LKE entity that is not a subsidiary, either directly or indirectly, of the issuing LKE entity.
- ✓ Letters of credit issued for assurance against nonperformance of a LKE entity that is not a subsidiary, either directly or indirectly, of the requesting LKE entity.
- ✓ Surety bonds issued for assurance against nonperformance of a LKE entity that is not a subsidiary, either directly or indirectly, of the requesting LKE entity.

A guarantee granted to a business or its owner(s) that the revenue of the business (or a specific portion of the business) for a specified period of time will be at least a specified amount.

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(Note: Text in italics indicates a key SOX control.)

Reports Generated and Recipients:

- Inventory listing of contracts within scope of contract review that include review for guarantees provided by FAA to PPL Technical Accounting
- Contract review logs provided by LOB Contacts to FAA
- List of existing guarantee contracts from the Credit and Contract Administration to FAA
- ASC 460 Indemnification Provisions memo from Legal sent to FAA, Financial Reporting, and PPL Technical Accounting

Additional Controls or Responsibility Provided by Other Procedures:

See 451 - Contractual Review

Regulatory Requirements:

None

Reference:

Accounting Pronouncements

- ASC 460, Guarantees
- ASC 450, Contingencies
- ASC 850, Related Party Disclosures
- ASC 825, Financial Instruments
- ASC 815, Derivatives and Hedging
- ASC 820, Fair Value Measurements
- SEC Financial Reporting Release No. 61, Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations

- SEC Financial Reporting Release No. 67, Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Corresponding PPL Policy No. and Name:

1007 Accounting for Guarantees

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(Note: Text in italics indicates a key SOX control.)

Key Contact:

Manager, Financial Accounting and Analysis

Administrative Responsibility:

Director, Accounting and Regulatory Reporting
Controller

Date Created: 3/21/11
Dates Revised: 9/21/11, 4/1/16

1058 - Variable Interest Entities

(Note: Text in italics indicates a key SOX control.)

Policy: To account for and disclose variable interest entities (VIEs) in conformity with FASB ASC 810, Consolidations.

Procedure: To review the applicable contracts within scope and consult with appropriate departments to identify and report all VIEs.

Scope: Any VIEs per the definition below evidenced in any contracts that fall under 451 – Contractual Review policy.

Objective of Procedure: To identify VIEs that need to be consolidated in the financial statements.

General Requirements:

I. Definitions

Corporate joint venture: A corporation owned and operated by a small group of entities (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A noncontrolling interest held by public ownership, however, does not preclude a corporation from being a corporate joint venture.

Variable interest entity: A legal entity subject to consolidation in accordance with the provisions of the variable interest entities subsections of ASC 810-10.

Variable interest (explicit or implicit): The investments or other interests that will absorb portions of a VIE's expected losses or receive portions of the entity's expected residual returns are called variable interests. Variable interests in a VIE are contractual, ownership, or other pecuniary interests in a VIE that change with changes in the fair value of the VIE's net assets exclusive of variable interests. Equity interests with or without voting rights are considered variable interests if the legal entity is a VIE and to the extent that the investment is at risk as described in ASC 810-10-15-14. ASC 810-10-25-55 explains how to determine whether a variable interest in specified assets of a legal entity is a variable interest in the entity. ASC 810-10-55-16 through 55-41 describe various types of variable interests and explain in general how they may affect the determination of the primary beneficiary of a VIE.

Expected losses: A VIE's expected losses are the expected negative variability in the fair value of its net assets exclusive of variable interests and not the anticipated amount or variability of the net income or loss.

Expected losses and expected residual returns: Amounts derived from expected cash flows as described in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements. However, expected losses and expected residual returns refer to amounts discounted and otherwise adjusted for market factors and assumptions rather than to undiscounted cash flow estimates. The definitions of expected losses and expected residual returns specify which amounts are to be considered in determining expected losses and expected residual returns of a VIE.

Expected residual returns: A VIE's expected residual returns are the expected positive variability in the fair value of its net assets exclusive of variable interests.

Fair value: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurement concepts include: a) exit price (entry, transaction or settlement price does not necessarily equate to fair value), b) highest and best use, c) principal or most advantageous market and d) non-performance risk (e.g; credit risk) for an entity's own liabilities. Refer to ASC 820-10-30 and 820-10-35 for the guidance on fair value measurement and subsequent measurement. When measuring fair value, these concepts as well as any additional disclosures should be considered and documented. Refer to ASC 820-10-50 for the guidance on fair value disclosures.

- If the entity to be consolidated includes financial assets and financial liabilities, or non-financial assets and non-financial liabilities that are recognized or disclosed at fair value on a recurring basis, they must be valued in accordance with ASC 820, Fair Value Measurements and Disclosures.

Implicit variable interest: An implied pecuniary interest in an entity that changes with changes in the fair value of the entity's net assets exclusive of the variable interest. An implicit variable interest acts the same as an explicit variable interest except it involves

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(Note: Text in italics indicates a key SOX control.)

the absorbing and (or) receiving of variability **indirectly** from an entity rather than directly from the entity. An implicit variable interest commonly arises in arrangements involving related parties.

Primary beneficiary: An entity that consolidates a VIE. See "Determine the primary beneficiary" below.

Subordinated financial support: Variable interests that will absorb some or all of a VIE's expected losses.

II. Accounting Practice

Background

General Consolidation

The purpose of consolidated financial statements is to present the results of operations and the financial positions of a parent and all its subsidiaries as if the consolidated group were a single economic entity. The first step in determining whether a reporting entity has a controlling financial interest in a legal entity is to establish the basis on which the entity is to be evaluated for control (i.e., whether the consolidation determination should be based on ownership of the entity's outstanding voting interests or its variable interests). If the reporting entity has an investment in another entity that is not determined to be a VIE, the reporting entity should use the guidance in the general subsections of ASC 810 to determine whether that interest constitutes a controlling financial interest. Paragraph 810-10-15-8 states that the usual condition for a controlling financial interest is ownership of a majority voting interest, directly or indirectly, of more than 50 percent of the outstanding voting shares. ASC 810-10-45 indicates that in the preparation of consolidated financial statements, intra-entity balances and transactions shall be eliminated. Refer to the subsections under ASC 810-10-45 for additional guidance relating to preparation of consolidated financial statements.

An investment of 20-50 percent in an entity is generally accounted for under the equity method because significant influence exists, but not control. Refer to the subsections under ASC 323-10 for guidance relating to equity method investments.

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The procedures set forth in ASC 323-10 shall be followed by an investor in applying the equity method of accounting to investments in common stock of corporate joint ventures.

An investment of less than 20 percent in an entity is generally accounted for under the cost method because significant influence does not exist. Refer to the subsections under ASC 325-20 for guidance relating to cost method investments.

Investments in partnerships and limited liability companies should be evaluated for potential consolidation pursuant to ASC 810-20.

Accounting for VIEs

The VIE subsections of ASC 810-10 are intended to provide guidance on the identification of, and financial reporting for these entities over which financial control is achieved through means other than voting rights.

The VIE subsections of ASC 810-10 address consolidation of entities, which, by design, have one or more of the following characteristics as detailed in ASC 810-10-15-14:

- ♦ The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by any parties, including the equity holders. An equity investment of **less than 10 percent** of the entity's total assets shall not be considered sufficient.
- ♦ The equity investors as a group lack one or more of the following essential characteristics of a controlling financial interest:
  - ✓ The power through voting rights or similar rights to direct the activities of an entity that most significantly impact the entity's economic performance.
  - ✓ The obligation to absorb the expected losses of the entity.
  - ✓ The right to receive the expected residual returns of the entity.
- ♦ The equity investors have voting rights that are not proportional to their economic interests (i.e., their obligations to absorb the expected losses of the entity, their rights to receive the expected residual returns of the entity, or both), and substantially all of the activities of the entity involve or are conducted on behalf of an investor that has disproportionately few voting rights.

Variable interests can include, but are not limited to, financial interests such as equity and debt securities, guarantees of assets or liabilities, and other instruments

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(Note: Text in italics indicates a key SOX control.)

whose values change with changes in the fair value of the VIE's net assets as well as certain service contracts. (See "Attachment C –Listing of Arrangements That May Indicate an Interest in a Potential VIE" for a more comprehensive listing of potential variable interests.)

VIEs must be consolidated by the entity that is determined to be the primary beneficiary. Certain disclosures are required to be made by the primary beneficiary and by an enterprise that holds a significant variable interest in a VIE but is not the primary beneficiary.

Disclosure requirements- The disclosure requirements are outlined in ASC 810-10-50.

III. Procedures

Note: Detailed step-by-step procedures are included in "Attachment A".
These procedures are a guide for accounting personnel responsible for performing and documenting VIE evaluations and disclosures.

- 451 - Contract Review policy, as administered by the Financial Accounting and Analysis department ("FAA"), governs the process for identifying contracts which meet designated thresholds for which VIE review is required.
- FAA is responsible for reviewing all applicable contracts and determining whether the agreement is within the scope of the VIE subsections of ASC 810-10 and if so, performing an analysis of the agreement to determine whether the agreement is a variable interest.
- FAA is responsible for coordinating the assessment procedures for reconsideration of initial determination of VIE status on an annual or as needed basis. (See Attachment B for reconsideration procedures.)

Overview of Procedures

- Upon entering into a new arrangement with an entity that is potentially within the scope of the VIE subsections of ASC 810-10, an analysis must be performed to determine if the agreement results in the reporting enterprise having a variable interest in the entity, unless it meets a scope exception.
- If the reporting enterprise has a variable interest in the entity, then an analysis should be performed to determine whether the entity is a VIE.

NOTE: Particular attention should be given to affiliate entities qualifying as VIEs. Evaluation should be performed at individual SEC registrant levels if necessary as there may not be an impact at a consolidated LKE level but there may be implications to another SEC registrant.

- If the analysis indicates that the entity is a VIE, then a determination needs to be made as to the primary beneficiary. For entities that meet a scope exception or do not qualify as VIEs, other appropriate generally accepted accounting principles regarding consolidation should be followed.
  - If the reporting enterprise is the primary beneficiary, then the initial measurement and consolidation requirements outlined in Step 5 of Attachment A-Detailed Procedures must be applied.
  - After initial measurement, the assets, liabilities and noncontrolling interests of a consolidated VIE shall be accounted for in the consolidated financial statements as if the entity were consolidated based on voting interests.
  - If a variable interest holder is not the primary beneficiary, the holder must ensure compliance with disclosure requirements as outlined in ASC 810-10-50.
- A re-evaluation of the initial determination as to whether an entity qualifies as a VIE is required upon the occurrence of one or more of the following events as outlined in ASC 810-10-35-4.
- A re-evaluation of the initial determination as to primary beneficiary is continuous but there are certain events that may cause the reviewer to believe the primary beneficiary of a VIE has changed. Some examples may include: acquisition/sale of interests that constitute a change of control, lapse of certain participating or substantive kick-out rights, and termination of arrangements that conveyed power.
- Conclusions, along with any supporting analysis performed, must be documented in writing, reviewed and approved. Decisions and economic analysis supporting the determinations made must be reviewed with the Controller (or designee).
- Significant changes in consolidation or deconsolidation should be reviewed and approved by the Controller (or designee).

Reports Generated and Recipients:

- Inventory listing of contracts within scope of contract review that include review for VIEs provided by FAA to PPL
- Contract review templates provided by VIE Reviewers to FAA

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Additional Controls or Responsibility Provided by Other Procedures:

See 451 - Contractual Review policy

Regulatory Requirements:

None

References:

Accounting Pronouncements

- ASC 810, Consolidation
- ASC 820, Fair Value Measurements and Disclosures
- ASC 860, Transfers and Servicing

Other

- PPL Energy Supply Financial Services White Paper, ESFS 04-2, “Accounting for the Discontinuance of Hedge Relationships from Changes in Consolidation Related to the Adoption of FIN 46”
- PPL Energy Supply Financial Services White Paper, ESFS 04-12, “FIN 46 Assessment for Energy Contract”
- PPL Research & Special Projects White Paper, R&SP 04-09, “Deconsolidation of Trusts under FIN 46”
- PPL Research & Special Projects White Paper, R&SP 04-16, “FIN 46 Analysis for Transition Bond Company”
- PPL Research & Special Projects White Paper, R&SP 04-23, “Analysis of the NUG Contracts under FIN 46(R)”
- PPL Research & Special Projects White Paper, R&SP 04-25, “Adoption of FIN 46 and 46(R)” and related Exhibits
- PPL Research & Special Projects White Paper, R&SP 04-43, “Summary of FIN 46 Assessments for the Quarter ended September 30, 2004”
- PPL Research & Special Projects White Paper, R&SP 06-17, “FIN 46(R) – Analysis of Locust Ridge Wind Farm”
- PPL Technical Accounting White Paper, TA 08-04, “FSP FAS 140-4 and FIN 46R-8 Adoption.”

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- PPL Technical Accounting White Paper, TA 10-01, "Implementation of New Guidance on Consolidation of Variable Interest Entities" and the related attachments.
- LKE Technical Research Memo, Contract Review for VIEs
- LKE Technical Research Memo - Evaluation of Brown Combustion Turbine Lease Agreement under FIN 46(R), Consolidation of Variable Interest Entities

Corresponding PPL Policy No. and Name:

1008 Accounting for Variable Interest Entities FIN 46 Policy

Key Contact:

Manager, Financial Accounting and Analysis

Administrative Responsibility:

Director, Accounting and Regulatory Reporting
Controller

Date Created: 3/31/11
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Dates Revised 9/15/14
Dates Revised 3/24/16

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ATTACHMENT A

Procedures Related to the Evaluation of a Variable Interest Entity under ASC 810

Procedures to Evaluate Potential VIEs

Initial Steps (Note: When using the ASC guidance listed, pay attention to transition guidance as this may provide updated information that is applicable to LKE)

Step 1: Determine if the Variable Interest Entities Subsections of ASC 810-10 apply to the entity (Is the entity within the scope of the guidance as outlined in ASC 810-10-15?)

- VIE guidance applies to legal entities. A "legal entity" is defined as any legal structure used to conduct activities or to hold assets. Examples include corporations, partnerships, limited liability companies and grantor trusts and trusts.
- Certain types of entities are excluded from the scope of VIE guidance under ASC 810-10-15-12 and 17:

    a) Not-for-profit organizations
    b) Employee benefit plans
    c) Separate accounts of life insurance entities
    d) Investments accounted for at fair value in accordance with the specialized accounting guidance in ASC 946
    e) Governmental organizations
    f) Inability to obtain information about an entity ("Information Out")

        An enterprise (the holder) with an interest in a VIE or potential VIE created before December 31, 2003, if after making an exhaustive effort, is unable to obtain the information necessary to determine if an entity is a VIE, determine if the enterprise is the primary beneficiary, or the enterprise is unable to perform the accounting required to consolidate the VIE for which it is determined to be the primary beneficiary.

        NOTE: This exception only applies as long as the reporting enterprise continues to be unable to obtain the necessary information. Exhaustive effort must be continuous, adequately documented and disclosed.

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h) Certain entities that meet the definition of a business, as defined in the Codification, unless one or more of the following conditions exist:

- The reporting enterprise, its related parties or both participated significantly in the design or redesign of the entity. However, this condition does not apply if the entity is an operating joint venture under joint control of the reporting enterprise and one or more independent parties or a franchisee.
- The entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting enterprise and its related parties.
- The reporting enterprise and its related parties provide more than half of the total equity, subordinated debt, and other forms of subordinated financial support to the entity based on an analysis of the fair values of the interests in the entity.
- Activities of the entity are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements.

Step 2: Determine if the contract gives a LKE entity a variable interest (as defined in the Codification) in the counterparty. Determine if the contract gives the counterparty a variable interest in a LKE entity.

Note for contracts that are derivatives: According to ASC 810-10-25-34 through 36 (formerly FSP FIN 46(R)-6), derivative contracts are often creators of variability and therefore not variable interests:

The following characteristics, if both are present, are strong indications that a derivative instrument is a creator of variability (and thus not an absorber of variability and not a variable interest):

- Its underlying is an observable market rate, price, index of prices or rates, or other market observable variable (including the occurrence or nonoccurrence of a specified market observable event. Any contract that is classified as Level 3 in the fair value hierarchy because its fair value measurement requires significant unobservable inputs would not meet this criterion. As such, the derivative contract could NOT automatically be determined to not be a variable interest.

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- The derivative counterparty is senior in priority relative to other interest holders in the legal entity.

For a listing of potential arrangements that may indicate an interest in a potential VIE see **Attachment C- Listing of Arrangements That May Indicate an Interest in a Potential VIE**

If a variable interest does not exist, the entity is not a VIE. If a variable interest does exist, continue to Step 3 to determine if the entity is a VIE.

Step 3: Determine if the entity is a VIE (ASC 810-10-15)

An entity would be considered a VIE and be subject to consolidation if any of the conditions listed in ASC 810-10-15-14 exist as follows:

a. The total equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by any parties, including equity holders.

    - For this purpose, the total equity investment at risk has all of the following characteristics:

        - Includes only equity investments in the legal entity that participate significantly in profits and losses even if those investments do not carry voting rights.

        - Does not include equity interests that the legal entity issued in exchange for subordinated interests in other VIEs.

        - Does not include amounts provided to the equity investor directly or indirectly by the legal entity or by other parties involved with the legal entity (for example, by fees, charitable contributions, or other payments), unless the provider is a parent, subsidiary, or affiliate of the investor that is required to be included in the same set of consolidated financial statements as the investor.

        - Does not include amounts financed for the equity investor (for example, by loans or guarantees of loans) directly by the legal entity or by other parties involved with the legal entity, unless that party is a parent, subsidiary, or affiliate of the investor that is

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required to be included in the same set of consolidated financial statements as the investor.

Paragraphs 810-10-25-45 through 25-47 discuss the amount of the total equity investment at risk that is necessary to permit a legal entity to finance its activities without additional subordinated financial support.

b. As a group the holders of the equity investment at risk lack any one of the following three characteristics:

1. The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance. The investors do not have that power through voting rights or similar rights if no owners hold voting rights or similar rights (such as those of a common shareholder in a corporation or a general partner in a partnership). Legal entities that are not controlled by the holder of a majority voting interest because of noncontrolling shareholder veto rights as discussed in paragraphs 810-10-25-2 through 25-14 are not VIEs if the shareholders as a group have the power to control the entity and the equity investment meets the other requirements of the variable interest entities subsections. Kick-out rights or participating rights held by the holders of the equity investment at risk shall not prevent interests other than the equity investment from having this characteristic unless a single equity holder (including its related parties and de facto agents) has the unilateral ability to exercise such rights. Alternatively, interests other than the equity investment at risk that provide the holders of those interests with kick-out rights or participating rights shall not prevent the equity holders from having this characteristic unless a single reporting entity (including its related parties and de facto agents) has the unilateral ability to exercise those rights. A decision maker also shall not prevent the equity holders from having this characteristic unless the fees paid to the decision maker represent a variable interest based on paragraphs 810-10-55-37 through 55-38.

2. The obligation to absorb the expected losses of the legal entity. The investor or investors do not have that obligation if they are

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directly or indirectly protected from the expected losses or are guaranteed a return by the legal entity itself or by other parties involved with the legal entity. See paragraphs 810-10-25-55 through 25-56 and Example 1 (see paragraph 810-10-55-42) for a discussion of expected losses.

3. The right to receive the expected residual returns of the legal entity. The investors do not have that right if their return is capped by the legal entity's governing documents or arrangements with other variable interest holders or the legal entity. For this purpose, the return to equity investors is not considered to be capped by the existence of outstanding stock options, convertible debt, or similar interests because if the options in those instruments are exercised, the holders will become additional equity investors.

If interests other than the equity investment at risk provide the holders of that investment with these characteristics or if interests other than the equity investment at risk prevent the equity holders from having these characteristics, the entity is a VIE.

c. The equity investors as a group also are considered to lack the characteristic in (b)(1) if both of the following conditions are present:

1. The voting rights of some investors are not proportional to their obligations to absorb the expected losses of the legal entity, their rights to receive the expected residual returns of the legal entity, or both.

2. Substantially all of the legal entity's activities (for example, providing financing or buying assets) either involve or are conducted on behalf of an investor that has disproportionately few voting rights. This provision is necessary to prevent a primary beneficiary from avoiding consolidation of a VIE by organizing the legal entity with non-substantive voting interests. Activities that involve or are conducted on behalf of the related parties of an investor with disproportionately few voting rights shall be treated as if they involve or are conducted on behalf of that investor. The term related parties in this paragraph refers to all parties identified in paragraph 810-10-25-43, except for de facto agents under paragraph 810-10-25-43(d).

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For purposes of applying this requirement, reporting entities shall consider each party's obligations to absorb expected losses and rights to receive expected residual returns related to all of that party's interests in the legal entity and not only to its equity investment at risk.

NOTE: If the VIE Reviewer is unsure about whether the entity qualifies as a VIE then he or she should contact FAA for assistance in the assessment.

If it is determined that the entity is a VIE, the primary beneficiary must be determined. Therefore, continue to Step 4.

Step 4: Determine the primary beneficiary

Determine if a PPL entity has a controlling financial interest in the VIE by answering the following two questions:

1.) List the activities that most significantly impact the economic performance of the VIE and indicate who has the power to control those activities. Indicate which party has the power to direct the activities that most significantly impact the VIE's economic performance.
2.) Determine which party (parties) has (have) the obligation to absorb losses and/or the right to receive benefits that could be potentially significant to the VIE.

The entity that has the power as determined in 1) and the obligation to absorb losses/right to receive benefits as determined in 2) is the primary beneficiary and must consolidate the VIE.

If the enterprise is the primary beneficiary, continue to Step 5.
If the enterprise is not the primary beneficiary, disclosures may still apply in Step 6.

Step 5: Consolidate the VIE (Refer to ASC 810-10-30 for Initial Measurement and 810-10-35 for Subsequent Measurement)

Entities under Common Control

If the primary beneficiary of a VIE and the VIE are under common control, the primary beneficiary shall initially measure the assets, liabilities, and non-controlling interests of the VIE at amounts at which they are carried in the accounts of the reporting entity that controls the VIE (or would be carried if the reporting entity issued financial statements prepared in conformity with GAAP.

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Entities Not under Common Control

The initial consolidation of a VIE that is a business is a business combination and shall be accounted for in accordance with the provisions in ASC 805.

When a reporting entity becomes the primary beneficiary of a VIE that is not a business, no goodwill shall be recognized. The primary beneficiary initially shall measure and recognize the assets (except for goodwill) and liabilities of the VIE in accordance with ASC 805-20-25 and 805-20-30. However, the primary beneficiary initially shall measure assets and liabilities that it has transferred to that VIE at, after, or shortly before the date that the reporting entity became the primary beneficiary at the same amounts at which the assets and liabilities would have been measured if they had not been transferred. No gain or loss shall be recognized because of such transfers.

The primary beneficiary of a VIE that is not a business shall recognize a gain or loss for the difference between (a) and (b):

a. The sum of:

   1. The fair value of any consideration paid

   2. The fair value of any noncontrolling interests

   3. The reported amount of any previously held interests

b. The net amount of the VIE's identifiable assets and liabilities recognized and measured in accordance with ASC 805.

Step 6: Prepare appropriate disclosures in accordance with ASC 810-10-50.

All enterprises with variable interest in VIE’s are subject to the disclosure requirements.

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Excerpt from Accounting Standards Codification
Consolidation — Overall Disclosure – Variable Interest Entities

810-10-50-2AA

The principal objectives of this Subsection's required disclosures are to provide financial statement users with an understanding of all of the following:

a. The significant judgments and assumptions made by a reporting entity in determining whether it must do any of the following:
    1. Consolidate a variable interest entity (VIE)
    2. Disclose information about its involvement in a VIE.

b. The nature of restrictions on a consolidated VIE's assets reported by a reporting entity in its statement of financial position, including the carrying amounts of such assets and liabilities.
c. The nature of, and changes in, the risks associated with a reporting entity's involvement with the VIE.
d. How a reporting entity's involvement with the VIE affects the reporting entity's financial position, financial performance, and cash flows.

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On-going steps for Reconsideration of a VIE and whether an enterprise is the primary beneficiary

Determine if a reconsideration event has occurred which could change the status of the VIE as outlined in ASC 810-10-35.

The assessment to determine if the primary beneficiary of a VIE has changed is continuous and therefore must be done at least annually or on an as needed basis.

Below is an excerpt from ASC 810-10-35-4 that lists some reconsideration events for a VIE.

Excerpt from Accounting Standards Codification

Consolidation — Overall

Subsequent Measurement — Variable Interest Entities

810-10-35-4

A legal entity that previously was not subject to the Variable Interest Entities Subsections shall not become subject to them simply because of losses in excess of its expected losses that reduce the equity investment. The initial determination of whether a legal entity is a VIE shall be reconsidered if any of the following occur:

a) The legal entity's governing documents or contractual arrangements are changed in a manner that changes the characteristics or adequacy of the legal entity's equity investment at risk.
b) The equity investment or some part thereof is returned to the equity investors, and other interests become exposed to expected losses of the legal entity.
c) The legal entity undertakes additional activities or acquires additional assets, beyond those that were anticipated at the later of the inception of the entity or the latest reconsideration event, that increase the entity's expected losses.
d) The legal entity receives an additional equity investment that is at risk, or the legal entity curtails or modifies its activities in a way that decreases its expected losses.
e) Changes in facts and circumstances occur such that the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance.

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Additionally, a reconsideration assessment of whether an enterprise is the primary beneficiary should be performed. This assessment should occur when circumstances warrant a change in an enterprise's status as the primary beneficiary. The primary beneficiary changes when there is a change in an enterprise's power or benefits. Some examples of circumstances that may cause a change in the primary beneficiary include, but are not limited to:

- Acquisition or sale of interest that constitute a change in control
- Lapse of certain rights such as participating or substantive kick-out rights (e.g. a lapse in participating rights held by one party to determine the operating budget of a VIE after the first two years of a VIE's existence)
- Termination of contractual arrangement that conveyed power.

Only substantive terms, transactions and arrangements should be considered when applying the VIE model. Any term, transaction or arrangement is disregarded if it does not have a substantive effect on (1) an entity's status as a VIE; (2) an enterprise's power over a VIE; or (3) an enterprise's obligation to absorb losses or its right to receive benefits of the entity.

See steps below for LKE's annual process of the reconsideration assessment of initial determination of VIE status. This process will need to be completed during the 4th quarter of each calendar year.

Step 1: The FAA department will request from the Supply Chain department a list of Suppliers with spend greater than $10 million (threshold for significant contracts) for the calendar year. This list demonstrates significant contracts with LKE for the calendar year.

Step 2: Based on this list, the criteria below will be reviewed for each Supplier by the following departments: Credit and Contract Administration, Supply Chain, and Power Generation Commercial Operations

A legal entity deemed to be a business does not need to be evaluated by a reporting entity to determine if the legal entity is a VIE under the requirements of the Variable Interest Entities Subsections unless any of the following conditions below exist (however, for legal entities that are excluded by this provision, other generally accepted accounting principles [GAAP] should be applied):

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a) The reporting entity, its related parties (all parties identified in paragraph 810-10-25-43, except for de facto agents under paragraph 810-10-25-43(d)), or both participated significantly in the design or redesign of the legal entity. However, this condition does not apply if the legal entity is an operating joint venture under joint control of the reporting entity and one or more independent parties or a franchisee.
b) The legal entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting entity and its related parties.
c) The reporting entity and its related parties provide more than half of the total of the equity, subordinated debt, and other forms of subordinated financial support to the legal entity based on an analysis of the fair values of the interests in the legal entity.
d) The activities of the legal entity are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements.

Step 3: This initial review will be summarized by the Manager of Supplier Diversity and sent to the FAA department and the Controller. This summary will contain the Supplier list with comments stating which requirements from Step 2 are/are not met.

Step 4: If any Supplier meets any of the criteria from Step 2 for a VIE, further analysis will be performed to determine if consolidation or financial statement disclosures are required as stated above in **Attachment A Procedures Related to the Evaluation of a Variable Interest Entity under ASC 810 Steps 3-6.**

Step 5: The FAA department will update the memo for the **Contract Review of VIE's** on an annual basis to provide the current year results of the reconsideration of initial determination of VIE status review.

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Listing of Arrangements That May Indicate an Interest in a Potential VIE

Some examples of common interest/ arrangements/entities that may be subject to consolidation are as follows:

- Equity securities
- Debt instruments
- Guarantees
- Put/call options
- Franchise arrangements
- Management and service contracts
- Derivatives (According to ASC 810-10-25-34 through 36, derivative contracts are often creators of variability and therefore not variable interests)
- Residual value guarantees and purchase options in connection with operating leases
- Single purpose insurance and reinsurance entities
- Investment companies-private equity funds and venture capital funds
- Leasing arrangements
- Limited liability companies – lot option deposits of homebuilders, land banks used by homebuilders
- Partnerships - real estate, investment
- Product and inventory financing arrangements-vendor financing arrangements
- Research and development ventures
- Sale or transfer of assets to entities owned by related parties (including members of management and employees)
- Securitization vehicles – commercial paper conduits, collateralized debt obligations, collateralized bond obligations and collateralized loan obligations
- Tax-motivated structures – affordable housing partnerships, synthetic fuel partnerships, wind farms
- Trusts – trust preferred securities, grantor trusts
- Joint ventures

Some specific arrangements that may have a variable interest in an entity and requires further evaluation:

- **Leasing/real estate**
  - ✓ Sale-leasebacks of real estate or equipment
  - ✓ Built-to-suit real estate or equipment subject to an operating lease (e.g. office buildings, manufacturing plants, airplanes)

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  - ✓ Synthetic leases (lease structures that are treated as operating leases for accounting purposes, even though for tax purposes the lessee is considered the owner)
  - ✓ Certain partnerships in real estate investments
- ♦ **Financial assets**
  - ✓ Transactions involving the sale/transfer of financial assets such as receivables (e.g. factoring arrangements or securitizations) to a special purpose entity
  - ✓ Transactions involving a commercial paper conduit, such as sponsoring a conduit to purchase and securitize assets from third parties
  - ✓ Vehicles used to hedge off-balance sheet positions
- ♦ **Start-ups, research and development**
  - ✓ Funding arrangements for research and development
  - ✓ Newly formed entities that are designed to manage or fund the start-up of a new product or business
  - ✓ Entities sponsored by venture capital enterprises
- ♦ **Transactions involving management, officers and employees**
  - ✓ The transfer or sale of assets to an entity owned by a single employee or by members of an entity's management
  - ✓ Management of an unconsolidated asset or business by an enterprise or its officers
  - ✓ Funding of an entity's independent equity by another enterprise's managing members
- ♦ **Insurance**
  - ✓ Insurance associations (reciprocals)
  - ✓ Reinsurance securitizations
- ♦ **Vendor financing**
  - ✓ Structures designed to help customers finance the purchases of products and services (i.e. vendor financings) often in collaboration with a financial institution
- ♦ **Obligations associated with other entities**
  - ✓ Certain captive arrangements operated on behalf of an investor
  - ✓ An enterprise's guarantee of (i) an unconsolidated entity's performance or debt or (ii) the value of an asset held by the unconsolidated entity (including explicit and implicit guarantees)
  - ✓ An enterprise's contingent liability should an unconsolidated entity default
  - ✓ A transaction with an embedded "put" option that enables the entity or an outside party to sell the assets and/or operations back to an enterprise
  - ✓ A transaction with an embedded call option that allows an enterprise to repurchase the assets and/or operations that were previously sold to another entity
  - ✓ An enterprise's enhancement of another entity's credit (i.e. via escrow funds, collateral agreements, discounts on transferred assets, take-or-pay arrangements)

Variable Interest Entities Policy and Procedures

ATTACHMENT C

- ✓ An agreement requiring an enterprise to make a payment if its credit is downgraded
- ♦ **Rights to assets**
  - ✓ Rights to use an “under construction” asset not recorded in the enterprise’s balance sheet (the debt used to fund the construction being recourse only to that specified asset)
  - ✓ Leasing assets from an entity that financed these assets with debt that is recourse to the individual asset rather than to all of the lessor entity’s assets
  - ✓ The transfer of financial assets to an entity subject to debt that is recourse only to those financial assets rather than to all of the entity’s assets
  - ✓ Variable lease payments, variable license-fee payments, or other variable payments for the right to use an asset (i.e. the payments change with the fluctuations in market interest rates)
  - ✓ Ownership of an asset that an enterprise holds for tax purposes but does not record on its balance sheet
- ♦ **Other**
  - ✓ Sale of assets or operations where the seller retains some governance rights and/or an economic interest
  - ✓ The purchase of businesses or assets by a third party or a newly formed entity on behalf of another company (i.e. an off-balance-sheet acquisition vehicle)
  - ✓ Investments made through intermediaries in entities that generate losses from a financial-reporting perspective
  - ✓ Tolling arrangements with project finance companies
  - ✓ Transactions in which an enterprise’s primary counterparties are financial institutions (i.e. banks, private equity funds, insurance companies)
  - ✓ Arrangements with an entity whose capital structure (often the equity) is partially owned by (or provided by) a charitable trust
  - ✓ An unconsolidated entity whose name is included in the enterprise’s name
  - ✓ When an enterprise provides administrative or other services on behalf of an unconsolidated entity or services its assets
  - ✓ When an unconsolidated entity provides financing or other services exclusively to an enterprise, its vendors or customers

1059 – Unbilled Revenue

(Note: Text in italics indicates a key SOX control.)

Policy:

For each reporting period, Louisville Gas and Electric (LG&E) and Kentucky Utilities (KU) must accrue revenue earned but not billed or invoiced.

Procedure:

The procedures for calculating unbilled and un-invoiced electric and gas revenue accruals are described below.

Scope:

Applicable to unbilled and un-invoiced retail and wholesale revenues of LG&E and KU. KU's retail revenues include those for customers served by Old Dominion Power Company (ODP).

Objective of Procedure:

The calculation of unbilled and un-invoiced revenues, and the resulting accruals, must be performed by the Revenue Accounting and Analysis (for retail revenues and wholesale municipal revenues) and the Financial Accounting and Analysis (for other third party wholesale revenues) departments in a consistent manner to ensure that earned revenues for each reporting period are properly recognized (per CON 5: Recognition and Measurement in Financial Statements of Business Enterprises[1]).

General Requirements:

Detailed Procedures Performed:

LG&E, KU, and ODP Unbilled and Un-invoiced Electric Revenues (Retail)

In accounting terms, billed and invoiced are typically used synonymously. However, in CCS these terms refer to two separate processes. When an item is billed in CCS, dollar amounts are calculated on usage (i.e., consumption charges). Subsequent to the billing process in CCS is the invoicing process where taxes, late payment fees and other non-consumption charges are added, the actual invoice is created, and the amounts are posted as revenues.

[1] Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts (SFAC) CON 5: Recognition and Measurement in Financial Statements of Business Enterprises

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(Note: Text in italics indicates a key SOX control.)

Unbilled retail revenues consist of the unbilled revenue accrual associated with cycle billing, which is designed to accrue revenues for usage after the meter read date, and the accruals for amounts invoiced after month-end cut-off in CCS and un-invoiced amounts in CCS, which are designed to ensure completeness of revenues (i.e., revenue is recorded for each customer every month, even if the customer is not billed that month)[2].

The process of calculating the unbilled amounts (due to cycle billing) is as follows:

1) The daily kWh available to retail customers (including generation and net wholesale sales and purchases) is calculated by taking the total daily output (load) and reducing it by the following:
    a. line losses;
    b. sales to wholesale municipal customers (KU only);
    c. kWh to serve ODP customers[3] (KU only);
    d. company usage;
    e. free kWh[4] (ODP only); and
    f. specifically identified cycle 20 customers[5] (LG&E and KU only).

2) An unbilled percentage of each day's available load is estimated by dividing the month-to-date number of meters read by the total number of meters read applicable to the current month. (This percentage is an estimate of the consumption by day that will not be billed until the next month; thus, it is "unbilled" for the current month).

3) Each day's unbilled percentage (calculated in 2 above) is multiplied by the respective day's available load to estimate the billed and unbilled kWh for each day. The sum of the daily unbilled amounts equals the total unbilled kWh for the current month.

[2] Wholesale municipal revenues are also billed and invoiced through CCS. However, because their meters are read on the last day of the month, they are excluded from the unbilled revenue accrual resulting from cycle billing but included, as applicable, in the after cut-off and/or un-invoiced accruals.

[3] The kWh to serve ODP customers are excluded from KU's load in the calculation of KU's Kentucky unbilled revenue but included in ODP's load for the calculation of ODP's unbilled revenue.

[4] Certain municipal buildings in the ODP service territory receive a small amount of free energy in lieu of a franchise fee. Since no revenue is derived from the free energy, the kWh is removed from ODP's load for the calculation of ODP's unbilled revenue.

[5] The meters for certain very large customers are generally read and recorded near the last day of the month. As a result, there is no unbilled revenue associated with these customers. Because their energy usage is significant, the kWh is removed from LG&E's and KU's load used in the unbilled revenue calculations. ODP does not have any significant cycle 20 customers.

4) The total unbilled kWh for each day is then allocated to individual revenue classes[6] using an estimated daily usage factor for each customer group. The allocation factors are determined by the Sales Analysis and Forecasting department using historical data of monthly sales trends by revenue class and the correlation of Heating Degree Days (HDD) and Cooling Degree Days (CDD) to energy consumption by revenue class. The total unbilled kWh during the month is then determined for each type of customer by adding the daily unbilled kWh by revenue class.

5) Unbilled revenues are then calculated by individual revenue class and component, as applicable for each company, by multiplying the total unbilled kWh for each revenue class (calculated in 4 above) by the applicable rates for each underlying revenue component (e.g., base energy non-fuel revenues, base energy fuel revenues, base service charge, etc.) as described below*:

   a. For the base energy non-fuel and the base energy Environmental Cost Recovery (ECR) unbilled accruals, the rates per unbilled kWh are fixed rates that are calculated for each revenue class by component based on the first billing month after a rate change that does not include prorated rates (i.e., if new rates become effective in January on a service rendered basis, the calculation will be based on fixed amounts for February).

   b. For the Fuel Adjustment Clause (FAC) and Demand-Side Management (DSM) rate mechanism unbilled accruals, the average rates per unbilled kWh are determined for each revenue class by component based on the average rates billed per kWh during the current month and are adjusted for applicable billing rate changes during the following month.

   c. Because the base service charge and demand charge (including the base demand ECR component) revenue components are not kWh based charges, the unbilled pricing for these amounts are determined differently from the kWh dependent revenue components previously discussed. The unbilled base service charge, demand charge, and demand ECR charge unbilled accruals are fixed amounts that are calculated based on the first billing month after a rate change that does not include prorated rates (i.e., if new rates become effective in January on a service rendered basis, the calculation will be based on fixed amounts for February). The calculation consists of the billed revenue for the base service charge, demand

[6] Electric retail revenue classes include Residential, Commercial, Industrial, Street Lighting, and Public Authority.

charge, and demand ECR charge multiplied by the unbilled percentage (i.e., total unbilled kWh for the month/total kWh available). The amounts are then accrued and reversed each month until the next rate change.
Analysis of the demand charge is performed monthly to ensure any significant customer changes (e.g., permanent or temporary discontinued operations, customer plant expansion or additions, etc.) are recognized before the books are closed each month. Additionally, the fixed amount will be adjusted twice a year to reflect the changes in those demand rates with a seasonal (summer/winter) price difference.

d. The base energy fuel unbilled accrual is based on the base fuel factor in place for the following month per the FAC tariff.

e. The ECR rate mechanism unbilled accrual is based on the ECR surcharge/billing factor in place for the following month per the applicable Monthly Environmental Surcharge Report filed with the Kentucky Public Service Commission. Because the ECR rate mechanism revenues are calculated based on revenues rather than volumes, the ECR component unbilled revenues are calculated by multiplying the ECR surcharge/billing factor by the sum of the revenue component unbilled accruals previously discussed in a through d.

* The above calculations may be revised/updated as business needs change.

6) The Revenue Accounting and Analysis department prepares journal entries to record the current month's unbilled electric revenue accruals based on the results of the calculations described above. These entries are reversed in the subsequent month when the unbilled amounts are actually billed.

As illustrated in the documentation above, the unbilled electric revenue calculations are performed at a disaggregated level sufficient to delineate unbilled revenues by revenue class and component. Thus, consistent with the accounting for billed electric revenues, unbilled electric revenues are posted to unique GLAFFs for each revenue class and revenue component.

In addition to the unbilled electric revenue calculations, which account for unbilled electric revenues resulting from cycle billing, additional accruals are made for:

- Amounts invoiced after cut-off: These accruals relate to customer bills, including municipals, that were invoiced after CCS has closed for the current period but relate to the current month being reported. The invoiced after cut-off accruals are determined by identifying customers billed during the first two days after cut-off, where the CCS billing period includes only dates from the previous months (i.e., they should have been billed during the month being closed), and recording an accrual for the amount of those revenues.

- Un-invoiced amounts: These accruals relate to all customers, including municipals, that should have been billed during the current month but were not because of CCS billing issues, out-sorts, implausibles or other factors[7]. The un-invoiced accruals are determined by identifying all customers that were not billed in CCS during the current month[8] (excluding customers already included in the invoiced after cut-off accruals) and estimating an accrual for the current period based on historical data (i.e., customer usage during prior months). The un-invoiced accruals capture revenues for meters previously read (and billed in CCS) but not invoiced by the end of the current month.

The items identified in both the after cut-off accrual and the un-invoiced accrual represent transactions that should have been billed and therefore would have been excluded from the amounts allocated to unbilled (described in 2 and 3 above). Therefore, accrual of these amounts does not represent double counting or an overlap with the unbilled accrual.

LG&E Unbilled and Un-invoiced Gas Revenues (Retail)

A corresponding accrual for the gas delivered during the month but unbilled at the end of the month is made similar to the electric unbilled (due to cycle billing). The process of calculating the gas unbilled amounts is as follows:

1) The daily gas net output (excluding wholesale sales and purchases) in thousand cubic feet (Mcf) is calculated by taking the total daily output (load) and reducing it by the following:

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[7] CCS reviews all meter reads and billing amounts to determine that they are within certain predetermined parameters. When meter reads are negative or very high compared to prior periods, they are identified as implausible and do not progress through the invoicing process until manually approved by the Billing Integrity department, Similarly, billing amounts that are not within the established parameters are out-sorted until manually approved by the Billing Integrity department.

[8] The accrual for un-invoiced customers only includes an estimated un-invoiced amount for the current month and does not include amounts for prior months that may still be un-invoiced. However, these additional periods may be detected and accrued through other analytical procedures (i.e., the demand analysis, the pricing of the large un-invoiced customers, and the after cut-off procedures). Historically, the dollar amount that remains un-invoiced for multiple periods has been insignificant relative to the total un-invoiced accrual.

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(Note: Text in italics indicates a key SOX control.)

a. gas transport[9];
b. line losses;
c. company usage[10];
d. gas used in generation[10]; and
e. specifically identified cycle 20 customers[5].

2) An unbilled percentage of each day's available load is estimated by dividing the month-to-date number of meters read by the total number of meters read applicable to the current month. (This percentage is an estimate of the consumption by day that will not be billed until the next month; thus, it is "unbilled" for the current month).

3) Each day's unbilled percentage (calculated in 2 above) is multiplied by the respective day's net output to estimate the billed and unbilled Mcf for each day. The sum of the daily unbilled amounts equals the total unbilled Mcf for the current month.

4) The total unbilled Mcf for the month is then allocated to individual revenue classes[11] using an estimated daily usage factor for each customer group. The allocation factors are determined by the Sales Analysis and Forecasting department using historical data of monthly sales trends by revenue class and the correlation of HDD and CDD to gas consumption by revenue class. The total unbilled Mcf during the month is then determined for each type of customer by adding the daily unbilled Mcf by revenue class.

5) Unbilled revenues are then calculated by individual revenue class and component by multiplying the total unbilled Mcf for each revenue class (calculated in 4 above) by the applicable rates for each underlying revenue component (e.g., base service charge, distribution charge, etc.) as described below*:

   a. For the distribution charge unbilled accrual, the rate per unbilled Mcf is a fixed rate that is calculated for each revenue class based on the first billing month after a rate change that does not include prorated rates (i.e., if new rates become effective in January on a service rendered basis, the calculation will be based on

[9] The meters for gas transport customers are all read and recorded on the last day of the month. As a result, there is no unbilled revenue associated with these customers. Because their energy usage is significant, the Mcf is removed from LG&E's load used in the unbilled revenue calculations.

[10] The gas used in the combustion turbines is classified as gas used in generation while all other gas used by LG&E or KU is considered company usage.

[11] Gas retail revenue classes include Residential, Commercial, Industrial, and Public Authority.

fixed amounts for February) and is adjusted for applicable rate changes during the following month. Additionally, the fixed amount will be adjusted twice a year to reflect the changes in the distribution charge rates with a seasonal (summer/winter) price difference.

b. The DSM rate mechanism unbilled accrual is based on the DSM factors in place for the current month per the DSM tariff as adjusted for applicable billing rate changes during the following month.

c. The Gas Supply Clause (GSC) unbilled accrual is based on the GSC factor in place for the current month per the GSC tariff. GSC is billed at the rate in effect when the gas is delivered, not when the gas is billed. Therefore, the GSC factor for unbilled purposes is not adjusted for billing rate changes during the following month.

d. Because the base service charge revenue component is not a Mcf based charge, the unbilled pricing for this amount is determined differently from the Mcf dependent revenue components previously discussed. The unbilled base service charge is a fixed amount that is calculated based on the first billing month after a rate change that does not include prorated rates (i.e., if new rates become effective in January on a service rendered basis, the calculation will be based on fixed amounts for February). The calculation consists of the billed revenue for the base service charge multiplied by the unbilled percentage (i.e., total unbilled Mcf for the month/total gas net output). The amounts are then accrued and reversed each month until the next rate change.

e. The Weather Normalization Adjustment (WNA) unbilled accrual is calculated separately and is based on the formula provided in the WNA tariff.

* The above calculations may be revised/updated as business needs change.

6) The Revenue Accounting and Analysis department prepares a journal entry to record the current month's unbilled gas revenue based on the results of the calculations described above. This entry is reversed in the subsequent month when the unbilled amounts are actually billed.

As illustrated in the documentation above, the unbilled gas revenue calculation is performed at a disaggregated level sufficient to delineate unbilled revenues by revenue class and component. Thus, consistent with the accounting for billed gas revenues, unbilled gas revenues are posted to unique GLAFFs for each revenue class and revenue component.

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(Note: Text in italics indicates a key SOX control.)

In addition to the unbilled gas calculation, which accounts for unbilled gas revenues resulting from cycle billing, additional accruals are made for amounts invoiced after cut-off and un-invoiced customers. The processes for determining the invoiced after cut-off and un-invoiced accruals for gas are the same as the corresponding accruals for electric described above.

LG&E and KU Unbilled Electric Revenues (Wholesale Excluding Municipals)

Most wholesale counterparties are not billed until after-the-fact (after the month is closed); therefore, most of the counterparties to whom energy is sold are considered unbilled, and the receivable is recorded to FERC Account 173005 (Accrued Utility Revenues). The exception to this practice is trades with Independent System Operators (ISO) or Regional Transmission Organizations (RTO).

ISO and RTO counterparties directly bill LG&E and/or KU whether a receivable or payable on a weekly basis (on a two week lag). Because the ISO and RTO counterparties are partially billed when the month is closed, the billed and unbilled receivable is recorded to FERC Account 142003 (Customer Accounts Receivable).

All wholesale customers (except MISO & PJM) are billed on a monthly basis, on or around the fifth day of the following month. In order to report the revenues in the correct period, an accrual entry is made during month-end close before the invoices have been generated. The unbilled wholesale revenue accrual uses actual sales volumes and prices based on transaction details within the Commodity Trading System (CTS) and confirmations received from counterparties to record the correct amount of wholesale revenues during the period.

The initial entry to record wholesale electric revenues during month-end close includes a debit to Unbilled Wholesale Accounts Receivable (173005) and a credit to Wholesale Electric Revenues (447050). Once the invoices have been generated and submitted to the purchasing counterparties, an entry is made to reclassify the asset amounts from Unbilled Wholesale Accounts Receivable (173005) to Billed Wholesale Accounts Receivable (142003). These journal entries are prepared and recorded by the Financial Accounting and Analysis department.

<u>Reports Generated and Recipients:</u>

- Revenue Volume Analysis
- Unbilled revenue calculations and related journal entry files

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(Note: Text in italics indicates a key SOX control.)

- Invoiced after cut-off and un-invoiced accrual journal entry files
- Unbilled wholesale sales accounts receivable aging schedule
- Wholesale accounts receivable aging schedule
- Wholesale accounts payable aging schedule

Additional Controls or Responsibility Provided by Other Procedures:

None

Regulatory Requirements:

None

Reference:

- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts (SFAC) CON 5: Recognition and Measurement in Financial Statements of Business Enterprises
- FASB Accounting Standards Codification (ASC) 605 Revenue Recognition

Corresponding PPL Policy No. and Name:

- 1009 Revenue Recognition – Regulated

Key Contact:

Manager, Revenue Accounting and Analysis
Manager, Financial Accounting and Analysis

Administrative Responsibility:

Director, Accounting and Regulatory Reporting

Date Created: 11/30/04
Dates Revised: 12/31/07, 7/12/10, 8/31/10, 12/1/10, 3/31/11, 9/8/11, 04/02/13, 12/18/14, 3/9/16
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(Note: Text in italics indicates a key SOX control.)

Policy: The books and records of Louisville Gas and Electric Company ("LG&E"), Kentucky Utilities Company ("KU"), and LG&E and KU Services Company ("LKS"), (cumulatively, "the Companies"), shall be maintained in compliance with the regulations set forth by the Federal Energy Regulatory Commission ("FERC"), the Kentucky Public Service Commission ("KPSC"), the Virginia State Corporation Commission ("VSCC"), Tennessee Public Utility Commission ("TPUC"), Internal Revenue Service (IRS), Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB"). The KPSC, VSCC and TRA generally follow the guidance provided by FERC.

Responsibility for compliance with the guidelines established in this policy resides with the department or organization initiating transactions affecting the books and records of the Companies.

Procedure: The accounting procedures are performed per the detailed instructions below.

Scope: All books and records of the Companies.

Objective of Procedure: Proper recording of transactions in the Companies' financial statements to ensure compliance and efficiency when providing data to regulatory agencies, specifically the FERC, the KPSC, the VSCC, the TRA and the IRS regarding all regulatory accounting issues applied on a consistent basis. Proper recording of transactions must also comply with the FERC Uniform System of Accounts [http://www.ferc.gov/legal/acct-matts/usofa.asp] and relevant Orders issued by FERC and is critical to the proper determination of rates charged to customers.

Where FERC guidance differs from the SEC and FASB (generally considered "US GAAP") separate sub accounts within the FERC account structure will be used to provide details needed for US GAAP reporting.

General Requirements:

Background:

The regulated utility subsidiaries of LG&E and KU Energy LLC are LG&E and KU. LKS is a regulated Services Company under the Public Utilities Holding Company Act of 2005. All other LG&E and KU Energy LLC subsidiaries, including LG&E and KU Capital LLC (LKC), are non-regulated, but are subject to the IRS. Rates for regulated utilities are established by an independent, third-party regulator as required by statute and/or other authority. For these reasons, it is imperative that all transactions of the Companies be properly coded to the regulated and non-regulated entities according to the Uniform System of Accounts established by the

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(Note: Text in italics indicates a key SOX control.)

FERC. For regulated utilities, transactions are considered to be "above-the-line" or "below-the-line". **Above-the-line** ("ATL") transactions are included in the operating income of the Companies. Amounts ATL are included in determining the rates charged to customers, subject to the specific rate making calculations of various jurisdictions. **Below-the-line** ("BTL") treatment (generally charged to FERC Account No. 426) is for revenue and expenses not included in the operating income of the Companies and thus not included in determining the rates charged to customers. Additionally, charges must be properly allocated between the regulated and non-regulated companies and to the jurisdictions of ratepayers. KU has the following jurisdictions – Kentucky Retail, Kentucky Wholesale (Regulated by the FERC), Virginia and Tennessee. LG&E has both gas and electric retail customers (or jurisdictions), all in Kentucky. LG&E and KU have joint transmission formula rates also regulated by FERC.

Detailed Guidelines & Procedures Performed:

Regulated utilities are required to account for transactions according to the FERC Uniform System of Accounts (USofA), which is detailed within the FERC Code of Federal Regulations. In addition to compliance with the USofA, the utilities must also comply with the Cost Allocation Manual (CAM), which details the proper allocation methods between affiliate companies.

When recording transactions on the Companies' books, the following guidelines must be followed to ensure appropriate regulatory treatment of all transactions:

Accounting Guidelines:

- All costs should be charged to the appropriate company. The LKS CAM should be used to determine when LKS costs are directly charged, directly attributed or indirectly allocated and the appropriate allocation methods to be used for indirect charges.
- Types of charges required for proper cost allocation:
    - Direct Charges
        - Directly Assignable – Expenses incurred for activities and services exclusively for the benefit of one affiliate.
            - Example: a labor hour worked specifically on storm restoration in a single utility's service territory.
        - Directly Attributable – Expenses incurred for activities and services that benefit more than one affiliate and which can be apportioned using direct measures of costs causation.
            - Example: Cost related to billing inserts for affiliate companies.
    - Indirect Charges

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    - Indirectly Attributable - Expenses incurred for activities and services that benefit more than one affiliate and which can be apportioned using general measures of cost causation.
        - Example: Servco employees in Accounting who charge their labor costs to affiliated companies based on predetermined ratios.
  - Unattributable Charges
    - Expenses for activities and services that have been determined as not appropriate for allocation. These costs primarily relate to activities such as corporate diversification, political or philanthropic endeavors and should be charged to LKC.

- Within the LKE Account structure, in the majority of cases, direct charge coding are to the xxx100 level accounts and indirect charges are coded to the xxx900 level accounts. For example: General & Administrative Salaries/Labor, FERC Account 920 – direct charges for this labor account are coded to 920100 and indirect charges are coded to 920900. This structure is generally, but not universally, the same format with other FERC accounts. Contact the Regulatory Accounting & Reporting (RAR) department with any questions regarding use of accounts.
- Employee personal information, such as names listed for drug screenings, etc. should not be used in any description field for the transaction.
- Merger-related costs often take two primary forms, transaction and transition costs:
  - Transaction costs are primarily legal, consulting, and professional services in nature that are predominantly incurred prior to the consummation of the merger. They usually relate to the direct merger transaction itself, including the negotiating, documenting, approval and closing phases thereof. These types of expenses are not considered operating in nature. Should the merger impact an entity that is required to keep its books in accordance with the USofA, FERC has required those entities to record such transaction costs in Account 426.5. However, as merger transactions do not ordinarily relate to the provision of the utility service, such transaction costs normally should not be allocated or charged (or allowed to remain charged/recorded) to utilities, unless in an appropriate below-the-line or similar status. Thus, regardless of where recorded or charged, such transaction costs should not be recovered by utilities in state retail or federal wholesale power or transmission formula rates.
  - Transition costs, such as integration costs and other operational costs are often incurred subsequent to the merger. They usually relate to business, operational or administrative changes which are beneficial or otherwise useful as a result of the combination of the merging companies, but less directly related to the merger

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transaction itself. Often they are incurred to effectuate savings. These transition costs are considered operating in nature. Should the merger impact an entity with USofA accounts, FERC has stated that it is not appropriate to record transition costs in Account 426.5. Rather these costs are typically recorded in an operating expense account or capitalized in an asset account, as appropriate. Transition costs, as with any beneficial utility operating changes or improvements, may often be appropriately allocated or charged to utilities and recovered in rates or formula rates. However, such rate recovery cannot occur in circumstances where the companies have committed, agreed or been ordered to hold rate-payers harmless from, or otherwise pass thru, any merger-related costs. In such cases, either a new regulatory approval to include in rates will be needed, or such cost should be charged or re-allocated to a non-utility entity or otherwise excluded from rates, including formula rates.

- FERC has also described a third type of merger-related costs, acquisition premiums and adjustments, including goodwill. FERC has stated that they are not transaction costs and further does not permit their recovery in rates, absent specific authorization.

Expenditure Type guidelines:

The appropriate expenditure type code should be used to properly describe/explain the transaction. This coding assists in the dissemination of large volumes of data for all LKE affiliates for use in departmental and company-wide reporting activities.

Current expenditure types have general ranges of transactions that start at 0100 and go through 0799. These ranges are as follows:

0100-0199 – Labor
0200-0299 – Warehouse Materials
0300-0399 – Outside Services
0400-0499 – Purchase Materials
0500-0599 – Transportation
0600-0699 – Administrative & Accounting
0700-0799 – Overheads/Burdens

Below are specific expenditure type coding guidelines that should be followed to ensure the proper documentation of these transactions:

- Expenditure types ending in “75” (e.g. 375 “O/S - ACCTNG USE - MISC JE – NONALLOCATED” and expenditure type 576 “T/E - EQUIP - ACCTNG USE - MISC

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JE – NONALLOCATED" are deemed "Accounting Use Only" and should only be used with prior approval of an accounting manager within the Controller Group)

- Other GLAFF segments deemed "Accounting Use Only", whether they are Organization, Account, or Product, should only be used with prior approval of an accounting manager within the Controller Group for example: account number 142999 "CUST A/R KU SUSP ACCT'G USE ONLY").
- Expenditure type 0670, Miscellaneous, should only be used on income statement expenses when no other expenditure type is appropriate. The RAR department must give approval to use this expenditure type.
- Expenditure type 0699, Corporate Default, is primarily reserved for use on the balance sheet and in journal entries. It should be used only when no other expenditure type is appropriate.
- Expenditure type 0642, Meals/Entertainment – Partially Deductible, or 0643, Meals/Entertainment – Fully Deductible, should be used for all meals and entertainment expenses regardless of the purpose of the expense. For example, payment to a facility (i.e. the Marriott Hotel) for a meal related to an employee recognition event should be charged to 0642, not 0636, Employee Recognition. For additional guidance regarding the proper classification of meals between expenditure type 0642 and 0643, refer to the Tax Treatment of Meals policy.
- Expenditure type 0650, Company Dues/Memberships, should be used for all dues related expenses that are directly for company use and should be charged to only a 930.2 FERC account.
- Expenditure type 0654, Employee Dues/Memberships, should be used for all dues related to expenses that are personal to the employee (i.e. AICPA or bar association dues for the employee) and should be charged to only a 921 FERC account.
- Expenditure type 0649, Subscriptions, should be used for all subscriptions and not be combined with dues in expenditure types 0650 or 0654.
- Outside Service (or Contractor) expenditure types, Expenditure types 0300-0399, cannot be used with FERC accounts 920 & 921 as these are internal office expense accounts and are incompatible with these expenditure types.

Transaction guidelines:

Regulated utility transactions are included in two basic sections within each company's income statement, operating income or non-operating income. Those transactions that are included in the operating function of the utility and the calculation of rates that the utility's customers are responsible for should be included above the net operating income line on the financials or "above-the-line" (ATL) and those of a non-operating nature, are found below the net operating income line or "below-the-line" (BTL).

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(Note: Text in italics indicates a key SOX control.)

The table below provides a guide of common transactions of the utility and whether or not these transactions are considered operating, non-operating or excluded from the utilities:

Item Description	**Treatment**
O&M expenses related to power production, distribution, transmission, regional markets, customer accounts, sales and related administrative and general charges	ATL
Informational and instructional advertising (FERC account 909) for safety, DSM, environmental.	ATL
Brand or promotional advertising (FERC account 913) – these charges are not allowed in rates, and are adjusted out during rate cases, but should initially be coded to account 913	ATL
Safety events/employee recognition	ATL
Meeting room rental and meals for management meetings, all hands, post project wrap-up, etc.	ATL
Meals with a documented business purpose	ATL
Employee relocation expenses – requires support maintained by HR that the cost was to facilitate employment of a qualified individual not readily available in the new location.	ATL
Entertainment related to company business	ATL
Severance or separation expenses (allocate to entities by following the labor charges and using expenditure type 0152) when position is eliminated	ATL
Social meetings or events with no general or specific business purpose (retirement celebrations, holiday parties, etc.)	BTL
Lobbying	BTL
Fines and penalties	BTL
Charitable contributions, sponsorships (UK/UofL, Little League, Junior Achievement, YMCA, orchestras, etc.), golf outings, event tables/galas, community events, not-for-profit organizations benefiting low income customers, community development in the service territory - should use expenditure type 0646.	BTL
Severance or separation expenses (allocate to entities by following the labor charges and using expenditure type 0152) when position is not eliminated	BTL
Merger transaction costs charge to LKC or, if related to utility-provided service, use account 426.5 for LG&E and KU	LKC or BTL (if recorded on LG&E or KU)

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(Note: Text in italics indicates a key SOX control.)

Merger transition costs, where the companies have committed, agreed or been ordered to hold rate-payers harmless from, or otherwise not pass through, any merger-related costs	LKC
Merger transition costs, where the companies have not committed, agreed or been ordered to hold rate-payers harmless from, or otherwise pass through, any merger-related costs	ATL or BTL, using normal operating expense
Company paid spousal travel	LKC
Officer benefits - reserved parking; physicals; tax planning & financial advice, club memberships, STI, LTI, etc.	LKC
Deferred compensation expenses for all eligible employees, STI and LTI	LKC
Race sponsorship at Churchill Downs/Keeneland	LKC
Suites (Churchill Downs, Slugger Field, UK, UofL)	LKC
Derby events	LKC
Casinos (Horseshoe, Belterra, French Lick…etc.)	LKC
Tickets to sporting events (non-utility company functions)	LKC
Expenses that do not directly or indirectly relate to the Company's utility operations	LKC

NOTE: Items to be charged to/paid by LKC should not be charged back to LG&E or KU.

Additional Procedures Performed**:**

All individuals responsible for the coding of transactions into the accounting system must maintain compliance with these guidelines. Prior to the coding of any transaction, responsible individuals must review these guidelines to ensure compliance. Review of financial information occurs in many different departments through various methods including:

- Periodic review by Budget Coordinators
- External auditor fluctuation analysis (performed quarterly)
- Financial statement analysis by RAR department (e.g. preparation of company financial reports, monthly detailed expense review, etc.)
- Analysis by various departments through methods such as balance sheet account reconciliations, income statement reconciliations, and Oracle queries designed to detect inconsistencies, for example, in product codes.
- Monthly review of intercompany transactions

Ensuring proper classification in the financial statements of the Companies is the responsibility of the individual initiating the coding of the transaction and the individual approving the payment of the transaction. If a transaction was incorrectly coded a Change of Distribution

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(Note: Text in italics indicates a key SOX control.)

(“COD”) is used to correct it in accordance with the Change of Distribution Request Procedure. There is no dollar threshold for reclassifying an expense between an ATL and BTL or vice versa. However a threshold of $1,000 is used for reclassifying expense between one ATL to another ATL.

Regulatory Accounting and Reporting Transaction Review:

For each general ledger period, RAR performs a review of selected general ledger transactions within the following categories; BTL, LKC, company and employee dues, advertising expenses, special pay, meals and social activities, FERC account 923, executive expense reimbursement, and miscellaneous expenditure (Expenditure type 0670). Through this process RAR identifies transactions needing revision and communicates with the budget coordinators to insure the transactions are corrected at the input source (i.e. A/P Invoice, Timekeeping system, Change of Distribution, etc.). RAR also tracks revisions to verify resolution. In order to ensure that future transactions are properly recorded and to reduce time spent analyzing and reclassifying transactions, the RAR department will communicate with each individual and that individual’s manager, as appropriate, regarding corrections that are required and/or failure to adhere to these policies and guidelines. Continued issues will be further escalated to the appropriate director and/or officer.

Questions regarding proper coding of transactions should be directed to the RAR department.

Disclosure requirements:

Incorrectly coded charges impact amounts reported in FERC Form 1/3, FERC Form 60, and may be publicly disclosed in the event of a rate case. Additionally, errors in recording transactions impact FERC jurisdictional formula rate calculations and may impact retail rates established by the KPSC and VSCC.

Reports Generated and Recipients:

None

Additional Controls or Responsibility Provided by Other Procedures:

LG&E and KU Energy LLC Accounting Policies and Procedures

- 250 - Balance Sheet Accounts Reconciliation policy
- 962 - Compliance with GAAP policy
- 1055 – Regulatory Asset & Liability policy

1060 - Regulatory Compliance

(Note: Text in italics indicates a key SOX control.)

- Change of Distribution Request Procedure: https://teams.sp.lgeenergy.int/sites/SupplyChain/Documents/Change%20of%20Distribution%20Request%20Procedure.docx

LG&E and KU Energy LLC Policies
- Community Investments and Partnerships
- Travel and Expense Reimbursement policy

LG&E and KU Services Company Cost Allocation Manual

Corresponding PPL Policy No. and Name:

104 – Differences Between FERC/SEC Reporting
906 – Cost Allocation and Transfer Pricing Manual

Reference:

Federal Energy Regulatory Commission (www.ferc.gov)
Code of Federal Regulations (www.gpoaccess.gov/cfr/index.html)
FERC Uniform System of Accounts (http://www.ferc.gov/legal/acct-matts/usofa.asp)
VSCC rules of practice and procedures (www.scc.virginia.gov)
Controller Group website (http://intranet1.lgeenergy.com/controllergrp/)
Kentucky Public Service Commission (http://www.psc.state.ky.us)

Key Contact:

Director, Accounting & Regulatory Reporting
Manager, Regulatory Accounting & Reporting

Administrative Responsibility:

Controller

Date created: 11/19/09;
Date revised: 12/17/09; 3/18/10; 3/31/11, 9/8/11, 9/30/13, 1/12/15, 06/09/15, 3/21/16, 10/23/17

1061 – Renewable Energy Credits

(Note: Text in italics indicates a key SOX control.)

Policy:

Each reporting period, the Companies must determine the amount of Renewable Energy Certificates ("RECs") to be purchased on behalf of customers participating in the Green Energy[1] program and the amount of Green Energy revenue to recognize.

Procedure:

The accounting procedures related to REC purchases are described below.

Scope:

This policy is applicable to Green Energy billed to, and payments received from, all customers voluntarily participating in Green Energy programs of Louisville Gas & Electric Company ("LG&E") and Kentucky Utilities Company ("KU") (together, the "Companies").

Objective of Procedure:

Green Energy revenue must be calculated and recognized in the proper accounting period. Additionally, the Companies must purchase an accurate number of RECs on the customers' behalf according to the Kentucky Public Service Commission ("KPSC") Order, Case No. 2009-00467.

General Requirements:

Because Kentucky, the state in which LG&E and KU have generation assets, does not have a renewable energy portfolio standard, the Companies are not required to purchase RECs. However, in response to customer interest in renewable technology, the Companies implemented a Green Energy program in June 2007.

Detailed Procedures Performed:

1) The Green Energy program offers customers the option to purchase green energy credits in increments of $5 (for residential and small commercial customers) and $13 (for large commercial and industrial customers). Customers voluntarily participating in the Companies' Green Energy program are invoiced through the Customer Care Solution ("CCS") each billing period for the amount of green energy credits purchased.

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[1] Green energy relates to energy produced from renewable energy resources, including biomass, hydro, geothermal, biodiesel, trash combustion, fuel cells, solar and wind.

1061 – Renewable Energy Credits

(Note: Text in italics indicates a key SOX control.)

Accounts Impacted	DR	CR
Accounts Receivable	Total RECs Billed	
Green Energy REC Liability		Total RECs Billed

2) Each month, the Revenue Accounting and Analysis department calculates the portion of green energy credits billed to customers, to be used for purchasing RECs on behalf of the customers and the portion to be used for marketing, promotional and educational expenses to increase enrollment in the programs, as mandated by the KPSC Order, Case No. 2009-00467. A liability is established for the cost of RECs to be purchased on behalf of the customers, and unearned revenue is recorded for the portion of Green Energy billed to customers that is to be used for marketing, promotional and educational expenses. The following table illustrates the accounting entry and percentages used to allocate amounts billed for Green Energy.

Accounts Impacted	DR	CR
Green Energy REC Liability	Total RECs Billed	
Sm Green Energy REC Liability		75% Sm RECs Billed
Lg Green Energy REC Liability		96.15% Lg RECs Billed
Sm Green Energy Unearned Inc		25% Sm RECs Billed
Lg Green Energy Unearned Inc		3.85% Lg RECs Billed

3) After the Companies receive payment for previously billed green energy credits, the Revenue Accounting and Analysis department calculates and records the portion of green energy receipts to recognize as revenue. These funds will be used to offset expenses for marketing, promotional and educational activities to increase enrollment in the programs. The remaining portion of payments received for green energy credits will be used to purchase RECs on behalf of the customers.

Accounts Impacted	DR	CR
Sm Green Energy Unearned Inc	25% Sm RECs Rec	
Lg Green Energy Unearned Inc	3.85% Lg RECs Rec	
Sm Green Energy Revenue		25% Sm RECs Rec
Lg Green Energy Revenue		3.85% Lg RECs Rec

4) The Revenue Accounting and Analysis department reports the amount of green energy payments received, to be used for REC purchases, to the Regulated Trading & Dispatch department for procurement.

1061 – Renewable Energy Credits

(Note: Text in italics indicates a key SOX control.)

5) Invoices for the RECs are coded to the Small and Large Green Energy REC Liability accounts. Invoices for marketing, promotional and educational activities associated with the program are coded to the Small and Large Green Energy Revenue accounts.

Reports Generated and Recipients:

A summary of the amounts to be used to purchase RECs is prepared by the Revenue Accounting and Analysis department and provided to the Regulated Trading & Dispatch department. This summary is located on the Revenue Accounting and Analysis department shared drive (revacct on 'fs3').

Additional Controls or Responsibility Provided by Other Procedures:

None

Regulatory Requirements:

- KPSC Order, Case No. 2009-00467.

Reference:

- 250 – Balance Sheet Accounts Reconciliation policy
- Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350 Intangibles - Goodwill and Other

Corresponding PPL Policy No. and Name:

- 1011 RECs Policy

Key Contact:

Manager, Revenue Accounting and Analysis

Administrative Responsibility:

Director, Accounting and Regulatory Reporting

Date Created: 3/31/11

1061 – Renewable Energy Credits

(Note: Text in italics indicates a key SOX control.)

Dates Revised: 9/8/11, 3/9/16 –*formatting to SOX templat*e

1150 - Technical Research/Whitepapers

Policy: Technical research/whitepapers will be prepared to document accounting and/or reporting matters involving new accounting pronouncements, interpretations of U.S. GAAP or unusual transactions.

Procedure: A technical research/whitepaper must be prepared to document the following:

1) The implementation of new accounting and financial reporting guidance that may have a significant impact on LKE.

2) Research performed and conclusions reached on significant accounting and/or financial reporting issues or transactions.

In addition to the above requirements, technical research/whitepapers may also be prepared at the discretion of the Controller, the Director, Accounting and Regulatory Reporting or the accounting managers.

Scope: A significant accounting and/or financial reporting issue or transaction that may impact any registrant's pre-tax net income by at least $5 million or may have a balance sheet impact of $20 million or more. (Error assessment memos per 354 – Materiality Policy should be used to document errors.)

Objective of Procedure: To ensure that technical accounting or reporting positions taken by the Company are adequately supported and documented.

General Requirements:

Detailed Procedures Performed:

All technical research/whitepapers must be presented in the standard template format which is saved on the shared drive 1150 - Technical Research and Whitepapers Template 12-7-12.docx. The template should be completed in its entirety. Additional requirements are as follows:

- The drafter is responsible for circulating the document for review by relevant manager; Manager, Financial Reporting; Director, Accounting and Regulatory Reporting, Manager Sarbanes-Oxley, Director, Audit Services and Controller.
- All *final* technical research memos/whitepapers are saved on \\lgeenergy.int\shares\group3\technical research drive\directory after approved by the Director, Accounting and Regulatory Reporting and the Controller.
- Files containing the technical research memos/whitepapers can only be saved to the \\lgeenergy.int\shares\group3\technical research drive/directory by the Director,

1150 - Technical Research/Whitepapers

Accounting and Regulatory Reporting and the Controller or their designees to ensure only approved technical memos/whitepapers are presented. All other access to the directory is set as "read-only".

- Once review is complete, the technical research/whitepaper is provided to Deloitte
- On a quarterly basis, the list of technical research/whitepapers is sent by Financial Reporting to PPL. Copies of the actual memos are provided by the Manager, Financial Reporting as requested.

Reports Generated and Recipients:
LG&E and KU Energy LLC technical research/whitepapers

Additional Controls or Responsibility Provided by Other Procedures:
354 - Materiality Policy

Regulatory Requirements:
None

Reference:
354 - Materiality Policy

Corresponding PPL Policy No. and Name:
1100 – Documenting Accounting & Financial Reporting Research in White Papers

Key Contact:
Manager, Financial Accounting

Administrative Responsibility:
Controller

Date Created: 4/1/05
Dates Revised: 1/9/08, 9/3/10, 3/31/11, 8/9/11, 8/11/11, 10/4/12, 11/13/17

220 West Main Street
P.O. Box 32030
Louisville, Kentucky 40232

PPL companies

Memo

PROPRIETARY & CONFIDENTIAL

Note: The file naming convention to be used for this memo is "Topic from "Re" line below MM-DD-YYYY"

Date: Insert Date here & in 2nd page header

To: Controller

From: Insert name of memo preparer &/or relevant manager/director and the following recipients

Re: Insert topic here & in 2nd page header

cc: Insert name of relevant Director or Officer
Director, Accounting and Regulatory Reporting
Relevant Manager if not from the manager
Manager, Financial Reporting
Deloitte
Director, Audit Services
Manager, SOX Compliance
Controller, PPL
(Draft & final distribution of the memo is the responsibility of the manager responsible preparing the memo. No distribution should occur before memo has been reviewed and approved by the Controller.)

Background

The documentation within the Background section should be in enough detail to provide a reviewer with the appropriate information to fully understand the issue or new standard being assessed.

Research

Consult with Financial Reporting department before beginning all technical research.

Provide all technical references that apply to the issue (SFAS, EITF, APB, SOP, FERC, SEC Regulation S-K or S-X, technical whitepapers, or other guidance). Include a reference to the specific paragraphs detailing the issue. Topical research may be performed using E&Y's GAAIT tool or CCH's Accounting Research Manager.

Analysis

Explain how the technical guidance relates to the specific issue and how the guidance should be interpreted.

Federal and State Income Tax Impact

Provide an analysis of the income tax impact of the accounting position taken.

Conclusion

Conclude as to the resolution of the issue. Explain how the item should be recorded (including any relevant disclosures) and why.

Related Technical Research/Whitepapers

List related technical research memos or whitepapers prepared by LKE or PPL.

1151 - Policy and Procedures Development and Maintenance

(Note: Text in italics indicates a key SOX control.)

Policy: All accounting policies and procedures will follow a uniform system for developing, formatting and maintaining policy documents.

Procedure: Accounting policies and procedures are developed and updated per the detailed instructions below.

Scope: All accounting policies and procedures.

Objective of Procedure: Written policies provide clear direction and establish accountability for each department's activities. Standardization of the procedure for promulgating policies helps assure the quality of policies as a whole, as well as provides a mechanism for ensuring that each policy meets the objectives and strategy of the affected department and the Company as a whole.

General Requirements:

Detailed Procedures Performed:

- Each department is responsible for creating and updating accounting policies and procedures within its purview. Coordination with other departments may be required for procedures which span work groups. Each policy is assigned a primary owner with responsibility for regular (at least quarterly) review.
- Accounting policies and procedures must be kept up-to-date and must remain consistent with Company strategy.
- All accounting policies and procedures are stored on the shared acctrestricted drive (\\lgeenergy.int\shares\Group3\Accounting Policies) in the appropriate subdirectory for each department.
- LKE accounting policies and procedures with an equivalent PPL accounting policy and procedure will contain a reference to the PPL accounting policy and procedures.
- All accounting policies and procedures must be presented in the standard template format which is saved on the shared drive (\\lgeenergy.int\shares\Group3\Accounting Policies\Corporate\1151 - Policy and Procedures Development and Maintenance Template 1-1-16.docx).
- Certain accounting policies may be referenced in Sarbanes-Oxley controls. The specific controls must be identified within these policies by the use of italics. A reference to the specific control number should follow: e.g., " (See cycle/transaction XXX.YY Control Activity Z in the Sarbanes-Oxley Compliance documentation.)" Italics should not be used for other purposes within accounting policies and procedures.
- All accounting policies and procedures are named with the title of the policy followed by the date created or revised (mm-dd-yy).

1151 - Policy and Procedures Development and Maintenance

(Note: Text in italics indicates a key SOX control.)

- All current accounting policies and procedures are saved in the appropriate departmental directory on the shared \\lgeenergy.int\shares\Group3\Accounting Policies drive\directory after approved by the Director, Accounting and Regulatory Reporting and the Controller.
- Files containing the Accounting Policies and Procedures can only be saved to the \\lgeenergy.int\shares\Group3\Accounting Policies drive/directory by the Director, Accounting and Regulatory Reporting and the Controller or their designees to ensure only approved policies are presented. All other access to the directory is set as "read-only".
- All files that have been replaced with revisions are saved on the shared \\lgeenergy.int\shares\Group3\Accounting Policies\ Replaced Files directory and removed from the departmental directory, which must only contain current policies.
- Review procedures for modifications or new policies:
  - Any new policies or changes to existing policies must be reviewed and approved prior to being finalized and updated on the shared drive. Draft documents should not be saved to the \\lgeenergy.int\shares\Group3 (acctrestricted) shared drive, only final versions of documents should be to the \\lgeenergy.int\shares\Group3 (acctrestricted) shared drive.
  - Policy revisions should be reviewed by the manager of the individual making the changes as well as the Director, Accounting and Regulatory Reporting and the Controller. Other reviews may be performed by Audit Services, Legal Services or other accounting managers, as appropriate.
  - The drafter is responsible for circulating the document to the above reviewers, as appropriate, prior to submitting it to the Director, Accounting and Regulatory Reporting and the Controller for final review.
- In addition to these accounting policies and procedures, there are Corporate Financial Policies and other Corporate Policies located on the intranet at Quick Links/Company Policies/Employee Information/Policies. These policies and procedures have their own policy for development, approval and maintenance and do not fall within the scope of this document.

Reports Generated and Recipients:
LG&E and KU Energy LLC Accounting Policies and Procedures

Additional Controls or Responsibility Provided by Other Procedures:
None

Regulatory Requirements:
None

Reference:

1151 - Policy and Procedures Development and Maintenance

(Note: Text in italics indicates a key SOX control.)

None

Corresponding PPL Policy No. and Name:
None

Key Contact:
Manager, Corporate Accounting

Administrative Responsibility:
Director, Accounting and Regulatory Reporting
Controller

Date Created: 4/1/05
Dates Revised: 1/9/08, 9/3/10, 8/11/11, 2/12/12, 1/1/16, 3/11/16

Tax Audits Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: The Company will cooperate with various third parties (Kentucky Revenue Cabinet, IRS, others states, etc.) as part of the auditing of the tax information submitted. These audits can take place either in person or via correspondence. The Company's goal is to complete the audit in a timely and cost effective manner.

Procedure: Records are to be maintained in accordance with the Company record retention policy. Tax returns are reviewed by at least one other tax professional prior to filing, to ensure quality and completeness. All notices of tax due, penalties or interest are reviewed by Director, Corporate Tax on a quarterly basis.

Individual Data Responses (IDR) from the IRS are tracked and assigned to various personnel within the Tax Department. The IDR responses are compiled supporting the Company's position, if applicable, and returned to the IRS in a timely fashion.

In areas of material exposures, the Company may seek outside opinions or memos to support conclusions reached. Material exposures are reviewed with upper management on at least an annual basis. In regards to Federal or State Income tax exposures, there are procedures that are done through ASC 740-10(FIN 48) that in place to ensure that these are recorded properly. This can be found in the Sarbanes transaction cycle 60.01 Income Tax Provision. This procedure is prepared by the Tax Analyst in the Tax Department. The recording of these procedures are reviewed with the Company's external auditors.

Scope: Tax Audits (Federal & State, Sales and Use, Property) of LG&E and KU Energy and subsidiaries

Objective of Procedure:

- Timely completion of audits
- Cooperation with third parties
- Minimization of tax liabilities

General Requirements:

Reports Generated and Recipients:
The summary of Governmental notices and penalties is revised quarterly by the Senior Secretary who receives updates for audits or other governmental notices from members of the Tax Department. The summary is then reviewed by the Director, Corporate Tax.

Tax Audits Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Periodically, the Company compiles a summary of outstanding audit activity for review with Senior Management and with the Parent Company's tax representative.

Additional Controls or Responsibility Provided by Other Procedures:
For additional controls or responsibilities provided by other procedures, please see the attached Sarbanes Oxley documentation on Record Retention.

Regulatory Requirements:
IRS and State Tax Authorities

Reference:
Sarbanes Oxley: Record Retention Policy

Corresponding PPL Policy No. and Name:

N/A

Key Contact:
Tax Coordinator

Administrative Responsibility:
Director, Corporate Tax

Date Created: 11/8/04
Dates Revised: 6/10/14, 2/2/16

Income Tax Provision Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: Income taxes are a significant component of the Company's income statement for each periodic financial statement including monthly/quarterly/annual reporting. The provision will be timely determined to allow the Company to close the books in accordance with the closing policy. The income tax provision will be recorded in accordance with Generally Accepted Accounting Principles (APB 11/ASC 740) recognizing the related assets and liabilities.

Procedure: The tax accrual process begins with pre-tax income and adjusts for permanent and temporary differences. The tax system accrues federal and state taxes based on taxable income taking into account the prevailing tax rates and apportionment information. The tax related accounts are progressed based on the provision, plus/minus payments/settlements, and other adjustments including mergers, acquisitions, liquidations, estimate to actuals and other comprehensive income and audit adjustments.

Scope: All income tax accounts (current and deferred, federal and state)

Objective of Procedure:

- Issuance of properly stated financial statements.
- Tax groupings are consistent.
- Tax accounts records are reconciled on a timely basis to general ledger accounts.
- Documentation maintained within legal and regulatory requirements.

General Requirements:

Detailed Procedures Performed:
For a listing of detailed procedures performed, please see the Sarbanes Oxley documentation on Income Tax Provision maintained in the Tax Department.

Reports Generated and Recipients:
Reports generated monthly:

(1) General ledger account analysis; (also use of EIS reports)
(2) Individual Income Tax Provision (by company, maintained in the Power Tax Provision system)

Reports generated monthly for manager review:

(3) Consolidated Tax Accrual (compiles all LG&E and KU Energy LLC and subsidiaries)
(4) Comparison of Power Tax Provision pre-tax income to Accounting pre-tax income
(5) Comparison of Power Tax Provision tax balance sheet accounts to Accounting General Ledger balance sheet
(6) Comparison of Power Tax Provision current tax expense to Accounting current tax expense

Income Tax Provision Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

(7) Comparison of Power Tax Provision deferred tax expense to Accounting deferred tax expense

Quarterly reports:
(1) Tax Accrual by Company – sent to external auditor
(2) Current Tax Rollforward – sent to external auditor
(3) Consolidated cash flow (tax refunds / payments) to Accounting
(4) Deferred Tax Detail – sent to external auditor
Deferred Tax Rollforward to Accounting

Additional Controls or Responsibility Provided by Other Procedures:
For additional controls or responsibilities provided by other procedures, please see the Sarbanes Oxley write-up on Income Tax Provision.

Regulatory Requirements:
Information provided used in connection with ASC 740/ APB 11, Public Service Commission, Federal Electricity Regulatory Commission, and Securities and Exchange Commission.

Reference:
Sarbanes Oxley Record Retention Policy, Sarbanes Oxley Income Tax Provision, Closing Policy

Corresponding PPL Policy No. and Name:

(Provide the policy number and name of the corresponding PPL Accounting Policy.)

Key Contact:
Manager Tax Accounting & Compliance

Administrative Responsibility:
Director Corporate Tax

Date Created: 11/8/04
Dates Revised: 6/5/14, 2/2/16

Tax Return Compliance Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: The Tax Department prepares accurate, complete and timely returns and other informational filings.

Procedure: Tax returns are prepared by Company tax professionals in compliance with government statutory filing requirements. Tax returns and other filings are reviewed by at least one other tax professional to ensure accuracy. A tax calendar software program maintained by a tax department professional tracks all tax returns to ensure they are prepared and timely filed in accordance with regulatory requirements. Taxes due are paid by the applicable entity and/or settled through intercompany payments/refunds.

Scope: Includes all federal, state, and local taxes (excluding payroll taxes prepared by the Payroll Department), property taxes, intangible taxes, license taxes and other taxes (excise, utility gross receipts, coal, transportation or any other tax, custom, duty, governmental fee or other like assessment or charge of any kind imposed by any governmental body for federal, state, county, local and foreign tax law).

Objective of Procedure:

- Corporate tax computations and other filings are completed accurately and timely.
- Tax relevant information is completely and timely collected.
- Compliance with retention requirements for tax-relevant documents is maintained.
- Tax payments/refunds are processed and recorded correctly.
- Tax-related data is protected against unauthorized access or alteration.

General Requirements:

<u>Detailed Procedures Performed:</u>
For a detail listing of procedures performed, please see the Sarbanes Oxley documentation for Property Taxes.

<u>Reports Generated and Recipients:</u>
A monthly tax calendar report listing all required tax filings and related items with statutory due dates and individual responsible for completing is generated and distributed to the Corporate Tax Department.

<u>Additional Controls or Responsibility Provided by Other Procedures:</u>
For a detail listing of additional controls or responsibilities provided by other procedures, please see the Sarbanes Oxley documentation for Property Taxes.

Tax Return Compliance Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Regulatory Requirements:
Compliance required by federal / state / local taxing authorities

Reference:
Sarbanes Oxley, Record Retention Policy and Property Taxes.

Corresponding PPL Policy No. and Name:

N/A

Key Contact:
Manager, Tax Accounting & Compliance

Administrative Responsibility:
Director, Corporate Tax

Date Created: 6/5/14
Dates Revised: 2/2/16

Sales and Use Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Policy: All sales and use tax returns are timely and accurately filed in accordance with the government requirements. Preparation of the returns should take advantage of all legally available exemptions to minimize the Company's use tax costs.

Procedure: Sales and use returns are prepared by the Corporate Tax Department or designated business unit accounting department (LEM,) to remit customer collected sales tax and to compute and remit use tax owed on company purchases.

Scope: All sales and use returns for LG&E and KU Energy LLC and subsidiaries

Objective of Procedure:

- Timely completion of return
- Minimization of tax liabilities

General Requirements:

Detailed Procedures Performed:
For detailed procedures performed, please see Tax Department for information and previous Sarbanes Oxley write-ups on:

- Record Retention

Reports Generated and Recipients:
Preparation of Monthly/Quarterly/Annual Sales and Use Return.

Monthly account reconciliations are prepared, printed and reviewed.

Starting in 2005, a second review of LG&E, KU and WKE purchases will be performed by other appropriate departments within the Company. Evidence of their review will be maintained within the appropriate departments. Certifications will be maintained by the Sr. Tax Analyst.

Additional Controls or Responsibility Provided by Other Procedures:
For detailed procedures performed, please see Sarbanes Oxley write-ups on:

- Record Retention

Regulatory Requirements:
Compliance required by state taxing authorities

Sales and Use Policy and Procedures

(Note: Text in italics indicates a key SOX control.)

Reference:
Please see Sarbanes Oxley write-ups on:

- Record Retention

Corresponding PPL Policy No. and Name:

N/A

Key Contact:
Tax Coordinator

Administrative Responsibility:
Director, Corporate Tax

Date Created: 12/22/04
Dates Revised: 6/5/14, 2/2/16