

Kentucky Power Company
KPSC Case No. 2025-00257
Commission Staff's First Set of Rehearing Data Requests
Dated April 24, 2026
Page 1 of 4

DATA REQUEST

KPSC Provide any testimony, explanation, or other evidence that Kentucky
RH 1_17 Power contends supports the assertions made in Kentucky Power's motion
for rehearing, limited to the issues for which rehearing was granted in the
Commission's April 9, 2026 Order.

RESPONSE

In addition to the information provided in the Company's motion for rehearing, Kentucky Power supports the assertions made in its motion for rehearing in the following:

- Treatment of Vegetation Management Expense: Rehearing Testimony of Amy J. Elliott and the Company's responses to Commission Staff Rehearing Data Requests RH 1-1 and RH 1-6 through RH 1-10.
- Treatment of PJM OATT Expense: Rehearing Testimony of Amy J. Elliott and the Company's response to Commission Staff Rehearing Data Requests RH 1-2 through RH 1-4.
- Treatment of Incentive Compensation tied to reliability: Rehearing Testimony of Amy J. Elliott.
- Treatment of Other Compensation: The Company's response to Commission Staff Rehearing Data Requests RH 1-11 through RH 1-13, RH 1-15 and RH 1-16.
- Calculation of recoverable rate case expense: The Company's response to Commission Staff Rehearing Data Request RH 1-14.

August 24, 2026 Supplemental Response

As explained in the Company's Motion for Rehearing¹ and Post-Rehearing Brief², the five issues on which the Company was granted rehearing equate to approximately \$15M in annual revenue requirement that was denied in the Commission's February 28, 2026 Final Order ("Original Order"). This is before considering the potential write-off of approximately \$17M in prudently incurred vegetation management investments since the end of the Company's test year in this case. These issues represent a significant financial impact to the Company and further diminish the Company's opportunity to earn the authorized return on equity (ROE) of 9.75%.

¹ See KPCO_Motion_for_Rehearing at Pg.9

² See KPCO_Post_Rehearing_Brief at Pg.2

Kentucky Power Company
KPSC Case No. 2025-00257
Commission Staff's First Set of Rehearing Data Requests
Dated April 24, 2026
Page 2 of 4

The denial of the Company's ability to recover standard labor costs and prudently incurred transmission costs together comprise an approximate 2% reduction in the Company's earned ROE potential. Indeed, four months after the Commission's Original Order took effect, the Company's earned ROE for the 12 months ended June 2026 was only 4.06%, far less than the Commission authorized return of 9.75%.

Furthermore, while the portion of the Commission's Original Order regarding the treatment of the Company's vegetation management programs increased the annual revenue requirement by approximately \$0.5M, it resulted in an annual reduction in funds to be used in the Company's planned Trees Outside of Rights-of-Way ("TOR") program of roughly \$11M in 2026. That reduction increases to \$18M in 2027 and in 2028.

Company Witness Elliott noted in her Rehearing Testimony that the reduction in the TOR program will undoubtedly have a negative impact on customer reliability, as TOR continues to be the leading cause of outages. Had the Commission's order not reduced the TOR program, the Company would have removed approximately 16,500 more trees outside of the rights-of-way across the service territory so far this year.

The reduction to the TOR program has real-world customer impacts. From August 11th to August 18th, the Company's service territory was impacted by several severe thunderstorms that resulted in a total of 56,289 customers interrupted over the course of the week. Preliminary estimates indicate that approximately 58% of the outages associated with these storms were caused by damage from TOR.

More than half of these outages occurred in the portion of the Company's service territory around Hazard. The area around Hazard is notoriously challenging to operate in mostly because of the forested, mountainous terrain. In fact, the Commission's 2003 management audit confirmed that, stating:

The mountainous terrain and significant tree exposure make it a more difficult service territory to provide a comparable level of service than other areas of Kentucky.

Kentucky Power Company
KPSC Case No. 2025-00257
Commission Staff's First Set of Rehearing Data Requests
Dated April 24, 2026
Page 3 of 4

At hearing in this case, Company Witness Ross highlighted the importance of the Company's TOR program in relation to storms:

So, we can take a proactive approach and spend the dollars and be able to analyze each area and be prudent in how we're spending each dollar, or we can be reactive and have no control on what that spend could potentially be.

As I said, the Commission recognized in Ike and ice that with the severe weather and the impacts to that weather, right, hazard trees, it's a problem. And the extent of damage it caused throughout the Commonwealth was quite costly to the customers.

So we can either be proactive or we can be reactive. I think our customers want us to be proactive.³

The best tool that the Company has to proactively manage vegetation in the service area and reduce outages is to continue capitalizing the annual TOR program costs. This approach also minimizes customer rate impact because removal of TOR generally has a 30-year depreciable life, such that customers only pay 1/30 of the investment plus a return at the Company's weighted average cost of capital each year.

Finally, as a reminder, the Company is still proposing to apply deferred tax liability credits to offset customer rate impact from changes to the annual revenue requirement as a result of rehearing in this case.

Witness: Amy J. Elliott

Witness: Michele Ross

September 30, 2026 Supplemental Response

Kentucky Power supplements its response to inform the Commission of relevant developments in two other jurisdictions on the topic of whether it is acceptable for utilities to continue to capitalize certain distribution vegetation management costs such as costs associated with removal of trees outside of right of way ("TOR").

³ Ross Hearing Test. at 625.

Kentucky Power Company
KPSC Case No. 2025-00257
Commission Staff's First Set of Rehearing Data Requests
Dated April 24, 2026
Page 4 of 4

West Virginia

On September 8, 2026, the West Virginia Public Service Commission (“WVPSC”) issued an order in Case No. 26-0575-E-P granting AEP-affiliated utilities’ Appalachian Power Company (“APCO”) and Wheeling Power Company’s (collectively, the “WV Companies”) June 12, 2026 petition to continue the historical practice of capitalizing certain distribution vegetation management costs to utility plant for West Virginia ratemaking purposes. Relevant portions of the WVPSC’s order are provided below

“The Commission grants the Companies’ request to continue to capitalize the Referenced Costs associated with distribution assets for West Virginia ratemaking purposes...The Commission finds the appropriate time to consider a change in ratemaking adjustment associated with the FERC audit finding is in the Companies’ next base rate case, where a complete evidentiary record can be developed.

The Commission will consider in the next base rate case whether any adjustment to the West Virginia plant balances is warranted to reflect FERC accounting treatment retroactive to January 1 , 2026. If an adjustment is approved, the Commission will consider any associated request for regulatory asset treatment.

The Companies should provide details regarding ongoing changes in expense levels if the capitalization of right-of-way clearing is changed. The Companies should maintain appropriate records sufficient to permit a review and audit of differences between vegetation management right of way capitalized costs for FERC accounting purposes and for West Virginia ratemaking purposes. The Companies shall also be prepared in their next base rate case to quantify any ongoing changes in expense levels attributable to the FERC accounting treatment...

FINDINGS OF FACT

- 1. The Companies filed a Petition and requested that the Commission approve the Companies’ proposed ratemaking treatment and recovery for certain vegetation management costs as a result of a recent FERC audit of SWEPCo’s accounting.*
- 2. In light of FERC’s audit findings and resulting accounting requirements, the Companies requested the Commission authorize them to continue to capitalize the Referenced Costs for distribution to utility plant for ratemaking purposes...*

CONCLUSIONS OF LAW

1. *The Companies should continue to capitalize the Referenced Costs associated with the distribution assets for West Virginia ratemaking purposes ... unless and until otherwise authorized by the Commission....*

ORDER

IT IS THEREFORE ORDERED that Appalachian Power Company and Wheeling Power Company's request to continue to capitalize the Referenced Costs for distribution to utility plant for West Virginia ratemaking purposes is granted...

The WV Companies' June 12, 2026 petition is provided at KPCO_SR_KPSC_RH_1_17_SupplementalAttachment1. The WVPSC's September 8, 2026 order is provided at KPCO_SR_KPSC_RH_1_17_SupplementalAttachment2.

Virginia

On September 16, 2026, Virginia State Corporation Commission ("VASCC") Staff witness Janille Olario filed testimony in response to APCO's May 29, 2026 application for a biennial review of its base rates in Case No. PUR-2026-00044, which included a request to continue the historical practice of capitalizing certain distribution vegetation management costs to utility plant for Virginia ratemaking purposes. VASCC Staff Witness Olario provided on page 24, lines 8-16 of her pre-filed testimony that VASCC staff, "...generally does not take issue with continuing the Company's capitalization policy of recording costs in FERC Plant Account 365 and continuing the use of the currently authorized depreciation rates for Account 365." VASCC Staff Witness Olario's pre-filed testimony is provided as KPCO_SR_KPSC_RH_1_17_SupplementalAttachment3.

Witness: Amy J. Elliott

04:33 PM JUN 12 2026 EXEC SEC DIV



Keith D. Fisher
Senior Counsel

200 Association Drive, Suite 201
Charleston, WV 25311
304.348.4154
kdfisher@aep.com

June 12, 2026

Via Electronic Filing

Karen Buckley
Executive Secretary
Public Service Commission of West Virginia
201 Brooks St.
Charleston, WV 25301

Re: **CASE NO. 26-** 0575-E-P
APPALACHIAN POWER COMPANY and
WHEELING POWER COMPANY
Petition for approval of ratemaking treatment and
recovery for certain vegetation management costs

Dear Ms. Buckley:

On behalf of Appalachian Power Company and Wheeling Power Company (the "**Companies**"), please find enclosed the Companies' "*Petition for Approval of Ratemaking Treatment and Recovery for Certain Vegetation Management Costs.*"

Please note my appearance and the appearance of my co-counsel, Kurt L. Krieger, Steptoe & Johnson, PLLC, P.O. Box 1588, Charleston, WV 25326-1588, kurt.krieger@steptoe-johnson.com, as counsel of record for the Companies and include us on the electronic service list for this matter.

04:33 PM JUN 12 2026 EXEC SEC D11

Sincerely,

A handwritten signature in black ink, appearing to read "Keith D. Fisher".

Keith D. Fisher (WV State Bar #11346)
Counsel for
Appalachian Power Company and
Wheeling Power Company

Enclosure

TABLE OF CONTENTS

PETITION.....4

ATTACHMENT 1.....16

VERIFICATION.....71

Petition

**PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON**

**CASE NO. 26- 057S-E-P
APPALACHIAN POWER COMPANY and
WHEELING POWER COMPANY**

*Petition for approval of ratemaking treatment and
recovery for certain vegetation management costs*

**PETITION FOR APPROVAL OF RATEMAKING TREATMENT AND
RECOVERY FOR CERTAIN VEGETATION MANAGEMENT COSTS**

Appalachian Power Company (“**APCo**”) and Wheeling Power Company (“**WPCo**”) (collectively, the “**Companies**”), pursuant to the Commission’s general jurisdiction over public utility ratemaking in West Virginia,¹ hereby petition the Commission to issue an order approving the Companies’ proposed ratemaking treatment and recovery for certain vegetation management costs for the reasons set forth herein (“**Petition**”). In support hereof, the Companies state as follows:

Petitioners

1. APCo is an electric public utility incorporated in the Commonwealth of Virginia and authorized to do business in West Virginia. WPCo is an electric public utility incorporated in West Virginia. The Companies provide electric service in West Virginia, subject to regulation by the Commission. The mailing address of the Companies in West Virginia is 200 Association Dr, Charleston, West Virginia

¹ See *W. Va. Code* §§ 24-2-2 and -3.

25311. Both of APCo and WPCo are direct, wholly-owned subsidiaries of American Electric Power Company, Inc. ("**AEP**").

Background

2. As the Commission is well aware, the Companies have and continue to incur and recover the expenses and the costs of capital investment related to vegetation control and management with respect to both their distribution and transmission assets. This has included Commission approval of a Vegetation Management Program ("**VMP**")² and approval of a cost recovery mechanism for recovery of related prudently incurred costs ("**VMP Surcharge**").³

3. The Companies' affiliate, Southwestern Electric Power Company ("**SWEPCo**"), is also a wholly-owned subsidiary of AEP.

4. SWEPCo was recently the subject of an audit on various issues conducted in the normal course by the Federal Energy Regulatory Commission's ("**FERC**") Division of Audits and Accounting, including with respect to "compliance with (1) approved terms, rates, and conditions of its transmission formula rate mechanism...; (2) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities ... under 18 C.F.R. Part 101; (3) reporting

² *Appalachian Power Co., et al.*, Case No. 13-0557-E-P (Comm. Ord., Mar. 18, 2014) ("**VMP Order**").

³ *Appalachian Power Co., et al.*, Case No. 14-1152-E-42T, at 91 (Comm. Ord., May 26, 2015) ("**2014 Order**"). "The VMP has been in effect since March 18, 2014." 2014 Order at 91. The Companies' VMP Surcharge was terminated pursuant to the Commission's order in the Companies' most recent Rule 42T base rate case proceeding. *Appalachian Power Co., et al.*, Case No. 24-0854-E-42T (Comm. Ord., Aug. 28, 2025).

requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities....”

The final audit report pertaining to that audit was filed on March 19, 2026, in Docket No. FA24-2-000 (“**Audit Report**”), which is attached as “APCo/WPCo Attachment 1.”

5. One of the Audit Report’s findings relevant to this Petition pertains to whether to expense or capitalize certain categories of vegetation management costs:

Capitalization of Vegetation Management Costs – SWEPCo’s vegetation management policy was not consistent with the Commission’s accounting regulations. Specifically, SWEPCo (1) improperly capitalized ... vegetation management costs that were not related to the initial or original clearing of land and rights-of-way (ROW)....⁴

6. Based on a review of relevant sections of the USofA and its instructions, FERC reasoned:

Under the Commission’s accounting regulations, costs of widening an existing ROW, clearing vegetation growing in an existing ROW not previously cleared as part of the initial asset construction, and trimming vegetation bordering an existing ROW not previously cleared are required to be recorded as maintenance expense.⁵

* * *

.... Under the Commission’s accounting regulations, SWEPCo should have ... recorded those costs in the appropriate O&M expense account....⁶

⁴ Audit Report at 1-2 (emphasis added).

⁵ Audit Report at 22.

⁶ Audit Report at 23.

7. This was not SWEPCo's accounting practice or approach; instead, SWEPCo – like the Companies – have historically capitalized the italicized, described costs in the above quotation ("**Referenced Costs**") with respect to both distribution and transmission asset vegetation management activities. SWEPCo disagrees with this Audit Report finding, but is accepting it and the related recommendations.⁷

8. Consequently, for FERC *accounting and reporting* purposes, AEP operating companies, including the Companies, must abide by FERC's determination in the Audit Report as to the proper accounting and reporting for the Referenced Costs; that is, for FERC *accounting and reporting* purposes, to account for the Referenced Costs incurred with respect to both the Companies' distribution and transmission assets as expense rather than to capitalize such costs effective January 1, 2026.

⁷ Audit Report at 49, which states, "AEPSC accepts this finding and the related recommendations but maintains that capitalization of the disputed vegetation costs was appropriate from both an accounting and ratemaking perspective. The capitalized vegetation management costs extend the lives and improve the efficiency of the transmission and distribution assets to which they relate. SWEPCO's capitalization of these costs has also resulted in lower historical customer rates than otherwise would have been charged had these costs been expensed."

Petition

9. FERC's prospective determination as to the proper accounting for the Referenced Costs (as expense rather than as capitalized costs), beginning January 1, 2026, is for FERC *accounting and reporting* purposes; however, such FERC-directed treatment does not necessarily determine the Companies' *ratemaking* treatment before this Commission for the Referenced Costs, which ratemaking treatment is the purpose and subject of this Petition.

10. For ratemaking purposes, the Companies respectfully request (1) that the Companies be authorized to continue to *capitalize* the Referenced Costs for *distribution* to Utility Plant⁸ as doing so is more beneficial for the Companies' customers, and (2) that the Companies be authorized to modify the ENEC to match recovery of the increased *expense* associated with the Referenced Costs for *transmission* assets with the corresponding increased PJM OATT transmission revenue credits already approved to flow through the ENEC as set forth below.

⁸ The Companies would continue to capitalize the Referenced Costs to Account 101, Electric Plant in Service (specifically, Plant Account 365, Overhead Conductors and Devices). Capitalized costs would be depreciated at the authorized depreciation rate and therefore be included in rates over the useful life of the underlying distribution assets, with accumulated depreciation recorded to Account 108 and depreciation expense recorded to Account 403.

Ratemaking Treatment – Referenced Costs for Distribution

11. The Companies, like SWEPCo, have historically capitalized the Referenced Costs to Utility Plant (instead of treating them as expense) and recovered through their base rates or VMP Surcharge only the costs pertaining to the capitalization of such Referenced Costs (*i.e.*, depreciation, taxes, return). As a result, by capitalizing the Referenced Costs, the rate impact on the Companies' customers has been reduced versus the Companies collecting the Referenced Costs, dollar-for-dollar, as expense.⁹

12. Consequently, because it is beneficial to customers' current rates, the Companies recommend and request that the Commission issue an order confirming and authorizing that the Companies continue to capitalize the Referenced Costs incurred with respect to the Companies' distribution assets to Utility Plant, instead of expensing them, for *ratemaking* purposes because continuing that capitalization approach results in a lower rate impact on the Companies' customers. This recommended capitalization approach to such costs is what is reflected and embedded in the Companies' currently effective base rates.

13. If the Commission *disagrees* with the Companies' recommendation and request; that is, if the Commission's preference is for the Companies to follow

⁹ Presumably, this does not need an explanation. However, by way of example, if one expends \$10,000 annually and it can be capitalized, the annual recovery via utility ratemaking is of the costs of that capitalization (*i.e.*, depreciation, taxes, return), which is a fraction or percentage (*e.g.*, 10-15%) of the \$10,000 expenditure. If the \$10,000 annual expenditure must be expensed, the \$10,000 for that one item is recovered annually.

FERC's interpretation of the USofA and expense the Referenced Costs incurred with respect to distribution assets for ratemaking purposes on a going forward basis beginning January 1, 2026; the Companies request that they be permitted to defer such costs, effective January 1, 2026, to a regulatory asset, plus carrying costs based on the Companies' currently-authorized pre-tax weighted average cost of capital, so that the Companies can then make a proposal in the Companies' next Rule 42T general base rate case proceeding for their (a) inclusion in rate base and (b) recovery over a reasonable time period that would possibly lessen the impact on the Companies' customers.

Ratemaking Treatment – Referenced Costs for Transmission

14. AEP operating companies, including the Companies, must abide by the Audit Report's requirement that the Referenced Costs incurred with respect to *transmission* assets on and after January 1, 2026, now be expensed, instead of capitalized, for FERC accounting, reporting, *and ratemaking* purposes; since, in the first instance, it is the FERC that has jurisdiction over AEP's transmission cost of service, rates, and ratemaking.¹⁰ The Companies' OATT, or PJM, revenues, and their PJM expenses are accounted for and reconciled annually in the Companies' ENEC.

¹⁰ The FERC Annual Transmission Revenue Requirement ("**ATRR**") using a FERC-approved formula rate collected pursuant to the Companies' FERC-regulated Open Access Transmission Tariff ("**OATT**").

15. However, as the Commission is aware, embedded in the Companies' West Virginia base rates is a cost of service for their transmission assets, which includes a representative level of O&M expense (a level of the Referenced Costs was not included in base rate O&M, because these costs were expected to be capitalized to Utility Plant) incurred with respect to those transmission assets, which representative level amount is approximately \$6.8 million ("**Base Rate Level**").

16. Consequently, going forward, FERC's requirement to treat the Referenced Costs incurred with respect to transmission assets as expense instead of as capitalized items for both accounting and ratemaking purposes means the Base Rate Level will no longer be representative of the Companies' underlying, actual, going-forward transmission vegetation management *activities* and their corresponding expenditures for the Referenced Costs items.

17. The ATRR is calculated using a traditional cost of service model where the Referenced Costs for transmission would be taken into account, and the ATRR is trued-up in the subsequent year to reflect actual costs. If the Companies spend beyond the level in base rates for transmission vegetation management, these additional costs will be reflected in the ATRR and ultimately in PJM OATT revenues which are credited to the ENEC. To fairly compensate the Companies for this FERC-directed accounting and ratemaking change with respect to transmission assets, which is outside of the Companies' control and with respect to what is in the first instance a FERC-jurisdictional matter, the Companies

respectfully request that the Commission issue an order authorizing the Companies to include in their annual ENEC filings for recovery from their customers through ENEC rates the Companies' annual, actual amount of Referenced Costs incurred and expenses with respect to transmission assets in excess of the Base Rate Level.¹¹

18. Granting this request is justified for two reasons. First, the Companies' proposal aligns the additional Referenced Costs with the revenues that the Companies are receiving via PJM OATT revenues that are directly correlated to the Referenced Costs (*i.e.*, if Companies spend more on transmission vegetation management, OATT revenue will increase by a similar amount). This proposal is consistent with matching principles since these costs and revenues bear a consistent and matching relationship to each other. This avoids over (and under) charging customers or the trapping of costs.

19. Second, the Base Rate Level, which treated the Referenced Costs as being capitalized for accounting and ratemaking purposes, is based on an underlying level of actual annual vegetation management *activities*. However, going forward, as expenditures for those activities must now be expensed, the Base Rate Level will fund fewer vegetation management activities.¹² Thus, this accounting and ratemaking change for transmission for the Referenced Costs,

¹¹ The Companies initially believe this is best accounted for in FERC Account No. 571, but this remains subject to the Companies' ongoing review.

¹² See *infra* n. 9.

which is outside the Companies' control, creates the unfortunate disincentive to conduct fewer vegetation management activities with respect to the Companies' transmission assets (*i.e.*, fewer than had been contemplated and were represented on an annual basis when the Referenced Costs could be capitalized as reflected in the Base Rate Level).

WHEREFORE, the Petitioners respectfully request that the Commission

- (i) retain this matter and not assign it to the Division of Administrative Law Judges;
- (ii) issue an order granting the requests in this Petition and any additional authorizations deemed necessary to implement those requests; and
- (iii) waive any requirement for notice and hearing on this Petition.

Respectfully,

**APPALACHIAN POWER COMPANY
WHEELING POWER COMPANY**

By Counsel,



Keith D. Fisher (WV State Bar #11346)
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/s/Kurt L. Krieger
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Date: June 12, 2026

APCo/WPCo Attachment 1

APCo/WPCo Attachment 1
Page 1 of 54

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement and
Regulatory Accounting
Docket No. FA24-2-000
March 19, 2026

Southwestern Electric Power Company
Attention: Jeffrey W. Hoersdig
Assistant Controller
1 Riverside Plaza
Columbus, OH 43215

Dear Mr. Hoersdig:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement and Regulatory Accounting (OERA) of the Federal Energy Regulatory Commission (Commission) has completed an audit of Southwestern Electric Power Company (SWEPCo). The audit covered the period January 1, 2021 through December 31, 2025.
2. The audit evaluated SWEPCo's compliance with (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment H-28 of the Southwest Power Pool, Inc. Open Access Transmission Tariff; (2) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, and Supplemental Form 3-Q, Quarterly Financial Report, under 18 C.F.R. §§ 141.1 and 141.400; and (4) requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125. The enclosed audit report contains seven findings of noncompliance and 37 recommendations that require SWEPCo to take corrective action.
3. On March 16, 2026, SWEPCo notified DAA that it accepts the findings and recommendations and will submit within 30 days of the issuance of the audit report a plan for implementing the audit recommendations. A verbatim copy of SWEPCo's response is included as Section V of the accompanying audit report. I hereby approve the audit report.
4. SWEPCo should submit its implementation plan to comply with the recommendations within 30 days of the date of issuance of this delegated letter order. SWEPCo should make quarterly submissions to DAA describing the progress made to

APCo/WPCo Attachment 1
Page 2 of 54

Southwestern Electric Power Company

Docket No. FA24-2-000

comply with the recommendations, including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

5. The Commission delegated the authority to act on this matter to the Director of OERA under 18 C.F.R. § 375.311. This letter order constitutes final agency action. SWEPCo may file a request for rehearing with the Commission within 30 days of the date of issuance of this order under 18 C.F.R. § 385.713.

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

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Kristen Fleet, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-8063.

Sincerely,

**JANEL
BURDICK**

Digitally signed by
JANEL BURDICK
Date: 2026.03.18
10:56:25 -04'00'

Janel Burdick
Director
Office of Enforcement and
Regulatory Accounting

Enclosure

The following is applicable to small entities including businesses with 1,500 or fewer employees, independent schools / universities, trade associations, other non-profits, cities, counties, towns, townships, villages, school districts, and other special districts: The National Ombudsman resolves concerns of uneven or excessive federal regulatory enforcement. Reviews are confidential and do not waive the right to pursue administrative appeals or any other legal action. 888-REG-FAIR / Ombudsman@SBA.gov



Federal Energy Regulatory Commission
Office of Enforcement and Regulatory Accounting
Division of Audits and Accounting

AUDIT REPORT

Audit of Southwestern Electric Power Company's
Compliance with the following:

- Approved terms, rates, and conditions of its transmission formula rate;
- Accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101;
- Reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, and Supplemental Form 3-Q, Quarterly Financial Report, under 18 C.F.R. §§ 141.1 and 141.400; and
- Requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125.

Docket No. FA24-2-000
March 19, 2026

Table of Contents

I. Executive Summary.....	1
A. Overview.....	1
B. Southwestern Electric Power Company	1
C. Summary of Compliance Findings	1
D. Recommendations.....	3
E. Compliance and Implementation of Recommendations.....	7
II. Background	9
A. American Electric Power Company, Inc.	9
B. Accounting and Financial Reporting	9
C. Construction Cost Tracking and Reporting	10
D. Transmission Formula Rate	10
III. Audit Objectives, Scope, and Methodology	12
A. Audit Objectives	12
B. Audit Scope and Methodology	12
IV. Findings and Recommendations	19
1. Capitalization of Vegetation Management Costs	19
2. Prepaid Pension AFUDC.....	26
3. Allowance for Funds Used During Construction	30
4. Prepayments.....	36
5. Accounting Misclassifications.....	38
6. Excess Accumulated Deferred Income Tax	43
7. FERC Form No. 1 Reporting.....	46
V. SWEPCo's Response to the Audit Report.....	49

Southwestern Electric Power Company

Docket No. FA24-2-000

I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement and Regulatory Accounting of the Federal Energy Regulatory Commission (Commission or FERC) has completed an audit of Southwestern Electric Power Company (SWEPCo). The audit evaluated SWEPCo's compliance with (1) approved terms, rates, and conditions of its transmission formula rate as provided in Attachment H-28 of the Southwest Power Pool, Inc. (SPP) Open Access Transmission Tariff (SPP OATT); (2) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, and Supplemental Form 3-Q, Quarterly Financial Report, under 18 C.F.R. §§ 141.1 and 141.400; and (4) requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125. The audit covered the period January 1, 2021 to December 31, 2025.

B. Southwestern Electric Power Company

SWEPCo is a wholly owned subsidiary of American Electric Power Company, Inc. (AEP). SWEPCo owns, operates, and manages plant, property, and equipment used for the production, transmission, and distribution of electricity to approximately 550,000 electric customers across Northwest and Central Louisiana, East Texas, and Western Arkansas. SWEPCo has approximately 5,000 MW of owned generating capacity: 1,789 MW from coal, 2,411 MW from natural gas, and 809 MW from wind. SWEPCo has over 4,000 circuit miles of transmission lines and approximately 26,000 circuit miles of distribution lines. SWEPCo is a transmission-owning member of SPP. SPP serves as the provider of transmission service on SWEPCo's transmission facilities pursuant to the SPP OATT. In 2023, SWEPCo reported approximately \$2 billion in operating revenue and \$220 million in net income.

C. Summary of Compliance Findings

DAA's compliance findings are summarized immediately below. Details of these findings are in Section IV of this report. DAA found the following seven areas of noncompliance:

1. *Capitalization of Vegetation Management Costs* – SWEPCo's vegetation management policy was not consistent with the Commission's accounting regulations. Specifically, SWEPCo (1) improperly capitalized \$97 million of vegetation management costs that were not related to the initial or original clearing

Southwestern Electric Power Company

Docket No. FA24-2-000

of land and rights-of-way (ROW); (2) accrued Allowance for Funds Used During Construction (AFUDC) on the improperly capitalized vegetation management costs; and (3) included the same vegetation management costs in two different accounts and included both accounts as input for the purposes of computing its annual transmission revenue requirement (ATRR). As a result, SWEPCo overstated its electric plant and overbilled transmission customers.

2. *Prepaid Pension AFUDC* – SWEPCo improperly accrued AFUDC on its prepaid pension asset and included this AFUDC in the electric plant in service accounts. As a result, SWEPCo overstated its electric plant by \$10 million and overbilled transmission customers.
3. *Allowance for Funds Used During Construction* – SWEPCo's AFUDC rate derivation, AFUDC accrual, and AFUDC accounting were inconsistent with the Commission's accounting regulations. Specifically, SWEPCo incorrectly (1) calculated its long-term debt cost rate; (2) included balances of Accounts 181, Unamortized Debt Expense, 189, Unamortized Loss on Reacquired Debt, and 226, Unamortized Discount on Long-Term Debt, in the long-term debt balances; (3) accrued AFUDC on completed projects, suspended projects, and equipment purchases; and (4) recorded the state portion of AFUDC debt and equity accumulated deferred income taxes (ADIT) in Account 283, Accumulated Deferred Income Taxes – Other, instead of Account 282, Accumulated Deferred Income Taxes – Other Property. As a result, SWEPCo over accrued AFUDC included in electric plant in service accounts and overbilled its transmission customers.
4. *Prepayments* – SWEPCo improperly recorded certain advance payments that were applicable to future accounting periods in administrative and general (A&G) and operation and maintenance (O&M) expense accounts, instead of in Account 165, Prepayments. As a result, SWEPCo did not accurately recognize certain expenses in the period in which they were incurred, leading to the misstatement of A&G, O&M, and other account balances reported in its FERC Form No. 1 filings.
5. *Accounting Misclassifications* – SWEPCo recorded various A&G expenses in a manner contrary to the Commission's accounting regulations. Some of the improper accounting resulted in SWEPCo overstating its ATRR and overbilling its transmission customers.
6. *Excess and Deficient Accumulated Deferred Income Tax* – SWEPCo improperly netted the excess and deficient ADIT related to the corporate tax rate change and associated adjustments required due to the Tax Cuts and Jobs Act of 2017 (TCJA) and recorded the amount that resulted from this improper netting in Account 254,

Southwestern Electric Power Company

Docket No. FA24-2-000

Other Regulatory Liabilities. This action affected the transparency and accuracy of the excess and deficient ADIT amounts reported in SWEPCo's FERC Form No. 1 filings.

7. *FERC Form No. 1 Reporting* – SWEPCo did not properly follow the FERC Form No. 1 page instructions and, therefore, did not accurately report all required information on certain pages of its FERC Form No. 1 filings. These actions affected the transparency, accuracy, and usefulness of the affected pages of the FERC Form No. 1 filings.

D. Recommendations

DAA's recommendations to remedy the audit findings are listed below. They are repeated after the respective findings in Section IV. DAA recommends that SWEPCo:

Capitalization of Vegetation Management Costs

1. Revise and implement policies and procedures to ensure that vegetation management costs are recorded and reported in accordance with the Commission's accounting regulations and related orders.
2. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 1, and repeat such trainings as needed.
3. Perform a comprehensive analysis to identify all capitalized vegetation management costs, including AFUDC, by electric plant in service account that were not part of an initial clearing since 2009. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.
4. Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the electric plant in service accounts, as well as AFUDC, accumulated depreciation, ADIT, and other accounts impacted by the improper capitalization of vegetation management costs, within 60 days of the date of issuance of this audit report.
5. Revise electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by the improper capitalization of vegetation management costs after receiving DAA's assessment of the proposed accounting entries submitted per Recommendation 4.
6. Submit a refund analysis to DAA within 90 days of the date of issuance of this audit report explaining the following: (1) the calculation of refunds that resulted

Southwestern Electric Power Company

Docket No. FA24-2-000

from correcting for the double counting and recovery of vegetation management costs incurred for the Texas jurisdiction, plus interest; (2) the determinative components of the refund; (3) the refund method(s); (4) customers to receive refunds; and (5) the period(s) in which refunds will be made.

7. File a refund report with the Commission that accords with DAA's assessment of the refund analysis.
8. Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Prepaid Pension AFUDC

9. Revise and implement policies and procedures for accruing and accounting for AFUDC on the prepaid pension asset consistent with the Commission's accounting regulations.
10. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 9, and repeat such trainings as needed.
11. Perform an analysis to identify all AFUDC accrued on the prepaid pension asset from 2013 through the date of the audit report and submit the results of the analysis to DAA for review within 60 days of the issuance of this audit report.
12. Within 60 days of the date of issuance of this audit report, submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the Construction Work in Progress (CWIP), electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by accrual of AFUDC on the prepaid pension asset.
13. Revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by the accrual of AFUDC on the prepaid pension asset after receiving DAA's assessment of the proposed accounting entries submitted per Recommendation 12.
14. Submit a refund analysis, within 90 days of the date of issuance of this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amount of AFUDC accrued on the prepaid pension asset and impacts on related accounts included in customer charges under SWEPCo's transmission formula rate since January 1, 2013, plus interest computed in accordance with section 35.19a of the Commission's regulations; (2)

Southwestern Electric Power Company

Docket No. FA24-2-000

determinative components of the refund; (3) refund method(s); (4) customers to receive refunds; and (5) period(s) refunds will be made.

15. File a refund report with the Commission that accords with DAA's assessment of the refund analysis.
16. Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Allowance for Funds Used During Construction

17. Revise policies and procedures to ensure that AFUDC is calculated consistent with Electric Plant Instruction No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to ensure that: (1) the long-term debt cost rate is calculated in accordance with 18 C.F.R. § 35.13; (2) the gross long-term debt outstanding is used in the calculation; (3) AFUDC is not accrued on completed or suspended projects, and (4) AFUDC is not accrued on purchased assets that are not under construction and ready for use.
18. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 17, and repeat such trainings as needed.
19. Recalculate accrued AFUDC, in a manner consistent with Electric Plant Instruction No. 3(A)(17) that corrects for the calculation of the long-term debt rates and balances, suspended projects, completed projects, and purchased assets that are not under construction and ready to be used in the utility operations from 2021 through the date of issuance of this audit report and submit to DAA for review within 60 days of this audit report.
20. Within 60 days of the date of issuance of this audit report, submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over accrual of AFUDC.
21. Revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over accrual of AFUDC after receiving DAA's assessment of the proposed accounting entries submitted per Recommendation 20.
22. Submit a refund analysis to DAA for review, within 90 days of the date of issuance of the audit report, that explains and details the following: (1) calculation of refunds that include the amount of excess AFUDC and impacts on related accounts included in customer billings under SWEPCo's transmission formula rate

Southwestern Electric Power Company

Docket No. FA24-2-000

since January 1, 2021, plus interest computed in accordance with section 35.19a of the Commission's regulations; (2) determinative components of the refund; (3) refund method(s); (4) customers to receive refunds; and (5) period(s) for which refunds will be made.

23. File a refund report with the Commission that accords with DAA's assessment of the refund analysis described in the previous recommendation.
24. Refund the amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Prepayments

25. Revise and implement policies and procedures to ensure that SWEPCo properly records all advance payments that are applicable to future periods in accordance with the Commission's regulations.
26. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 25, and repeat such trainings as needed.

Accounting Misclassifications

27. Revise and implement policies and procedures to ensure that SWEPCo properly accounts for operating expenses consistent with the Commission's accounting regulations.
28. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 27, and repeat such trainings as needed.
29. Perform an analysis of A&G expense accounts from 2021 through the date of this audit report to identify costs that were improperly accounted for and included in SWEPCo's ATRR and customer billings. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.
30. Submit a refund analysis to DAA for review, within 90 days of the date of issuance of this audit report, that explains and details the following: (1) calculation of refunds resulting from inappropriate recoveries due to the improper accounting for expenses recorded in A&G accounts from 2021 to the present, plus interest; (2) determinative components of the refund; (3) refund method(s); (4) customers to receive refunds; and (5) the period(s) for which refunds will be made.

Southwestern Electric Power Company

Docket No. FA24-2-000

31. File a refund report with the Commission that accords with DAA's assessment of the refund analysis described in the previous recommendation.
32. Refund the amounts disclosed in the refund report to transmission customers with interest calculated in accordance with section 35.19a of the Commission's regulations.

Excess and Deficient Accumulated Deferred Income Tax

33. Revise and implement policies and procedures to ensure that SWEPCo properly accounts for and reports the effect of changes in tax laws or tax rates consistent with the Commission's accounting regulations.
34. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 33, and repeat such trainings as needed.
35. Submit correcting journal entries to DAA, within 60 days of issuance of this audit report, with proposed accounting entries and supporting documentation that reflect corrections to recorded excess and deficient ADIT in the appropriate Uniform System of Accounts.

FERC Form No. 1 Reporting

36. Revise and implement policies and procedures to ensure that SWEPCo reports correct, accurate, complete information in the FERC Form No. 1 consistent with the page instructions of the form. Include footnotes to the FERC Form No. 1 when software limitations prevent reporting complete information.
37. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 36, and repeat such trainings as needed.

E. Compliance and Implementation of Recommendations

DAA further recommends that SWEPCo submit the following for audit staff's review:

- Within 30 days after the audit report is issued in this docket, a plan for implementing the corrective actions that address each audit recommendation;

Southwestern Electric Power Company

Docket No. FA24-2-000

- Quarterly reports to DAA describing SWEPCo's progress in completing each corrective action taken in response to the recommendations in this audit report. These quarterly nonpublic submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all corrective actions taken in response to the audit recommendations are completed; and
- Copies of written policies and procedures developed in response to the recommendations in this audit report. These documents should be submitted in the first quarterly filing after SWEPCo completes a written policy or procedure.

Southwestern Electric Power Company

Docket No. FA24-2-000

II. Background

A. American Electric Power Company, Inc.

AEP is a public utility holding company headquartered in Columbus, Ohio. AEP, through its subsidiaries, provides electric service to approximately 5.6 million customers in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia, and West Virginia. AEP's subsidiaries include regulated utilities, transmission companies, and unregulated entities. Specifically, AEP's holding company system includes one centralized service company, American Electric Power Service Corporation (AEPSC), twenty-three Commission-jurisdictional subsidiaries, and multiple non-jurisdictional companies.¹ AEP's regulated utilities are members of two regional transmission organizations, PJM Interconnection, L.L.C. (PJM) and SPP. AEP, through its subsidiaries, owns, operates, and maintains approximately 40,000 circuit miles of transmission lines and approximately 225,000 circuit miles of distribution lines. AEP provides power to its customers from a mix of generation resources that use coal, natural gas, nuclear energy, renewables, and hydroelectric energy.

B. Accounting and Financial Reporting

¹ The AEP jurisdictional utilities are:

In PJM: Appalachian Power Company; Indiana Michigan Power Company; Kentucky Power Company; Kingsport Power Company; Ohio Power Company; Wheeling Power Company; AEP Appalachian Transmission Company, Inc.; AEP Indiana Michigan Transmission Company, Inc.; AEP Kentucky Transmission Company, Inc.; AEP Ohio Transmission Company, Inc.; AEP West Virginia Transmission Company, Inc.; Indiana-Kentucky Electric Corporation; Ohio Valley Electric Corporation; AEP Generating Company; Transource West Virginia, LLC; Transource Maryland, LLC; and Transource Pennsylvania, LLC; and

In SPP: SWEPCo; Public Service Company of Oklahoma; AEP Oklahoma Transmission Company, Inc.; AEP Southwestern Transmission Company, Inc.; Transource Oklahoma, LLC; and Transource Missouri, LLC.

The non-jurisdictional subsidiaries include, but are not limited to, AEP Coal, Inc.; AEP Credit, Inc.; AEP Energy Supply, LLC; and AEP Texas.

Southwestern Electric Power Company

Docket No. FA24-2-000

SWEP Co uses Oracle's PeopleSoft Finance application to record and report its financial and operational information. The application includes modules for accounts receivable, billing, accounts payable, general ledger, project costing, and treasury. Multiple other systems interface with the PeopleSoft Finance application, which include, but are not limited to, tax accounting, plant and property, payroll, and various other operational systems. SWEP Co uses, for its internal accounting system, the Commission's Uniform System of Accounts numbering system that is prescribed for public utilities in 18 C.F.R. Part 101 and used for FERC Form No. 1 reporting.

AEPSC provides support services for AEP electric utilities, including corporate management, accounting and financial reporting, tax, legal, engineering, treasury and cash management, regulatory and case management, customer operations, human resources, information technology and telecommunications, and supply chain services. AEPSC either directly assigns or, alternatively, uses a formula or other method to allocate the costs associated with these services to SWEP Co and the other affiliates in the AEP corporate structure. AEPSC's cost allocation methods utilize various allocators, such as proportionate share of plant assets, number of employees, and number of customers, among other allocators, depending on what AEPSC views as the cost driver for a particular shared service or transaction.

C. Construction Cost Tracking and Reporting

AEP and SWEP Co document, categorize, and prioritize construction projects identified through an evaluation process based on need and benefit. Additionally, the SPP planning process identifies and evaluates transmission projects. Projects selected are reviewed and approved in accordance with AEP's policies and are included in a monthly report to SWEP Co's Board of Directors for final approval.

Once a capital project is approved and included in the appropriate accounting system, authorized individuals open a capital work order to receive and track project charges. These charges include (1) labor, (2) fringe benefits, (3) overhead, (4) outside services, (5) materials and supplies, and (6) other costs. The construction period starts when physical construction begins on the utility asset and ends when the asset is placed into service. AFUDC is applied to eligible construction projects during the construction period. From 2021 through 2023, SWEP Co's AFUDC rate ranged from 4.3 to 6.1%, and SWEP Co incurred approximately \$333 million in construction costs.

D. Transmission Formula Rate

SWEP Co is a transmission-owning member of SPP and has transferred operational control of its transmission assets to SPP pursuant to the SPP OATT. On June 24, 2009,

Southwestern Electric Power Company

Docket No. FA24-2-000

the Commission approved an uncontested settlement establishing SWEPCo's transmission formula rate for determining its ATRR.² SWEPCo recovers its costs of owning, operating, and maintaining its transmission system using the transmission formula rate approved by the Commission and included in Attachment H – Addendum 4 of the SPP OATT.

SWEPCo's transmission formula rate was designed to provide a reasonable opportunity for the company to (1) recover the costs and expenses associated with providing transmission service and (2) earn a reasonable return on transmission investments. Recording costs accurately and maintaining accounts consistent with the Commission's regulations is essential to the accurate computation of SWEPCo's ATRR each year and a proper determination of billings to wholesale transmission customers.

² *American Elec. Power Serv. Corp.*, 127 FERC ¶ 61,292 (2009) (Order Approving Uncontested Settlement).

Southwestern Electric Power Company

Docket No. FA24-2-000

III. Audit Objectives, Scope, and Methodology

A. Audit Objectives

The audit evaluated SWEPCo's compliance with (1) approved terms, rates, and conditions of its transmission formula rate as provided in Attachment H-28 of the SPP OATT; (2) accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q, and Quarterly Financial Report, under 18 C.F.R. §§ 141.1 and 141.400; and (4) the requirements in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125. The audit covered the period January 1, 2021 through December 31, 2025.

B. Audit Scope and Methodology

Audit staff performed the following audit steps to facilitate testing and evaluation of SWEPCo's compliance with Commission requirements relevant to the audit objectives:

Audit Planning, Processes, and Administration

Audit staff performed these actions to identify audit risks and plan the audit fieldwork:

- *Reviewed Public Information* – Conducted an extensive review of public information before commencing the audit. This review provided audit staff with an understanding of SWEPCo's corporate structure, the services it provides, major events affecting operations and finances, significant contracts, prior audit issues with AEP and its affiliates, and other key regulatory and business activities. Examples of materials reviewed include AEP's SEC Form 10-K and 8-K filings, SWEPCo's FERC Form No. 1 and 3-Q reports, prior Commission audit reports pertaining to AEP and its affiliates, the AEP website, and other relevant regulatory documents and media sources.
- *Identified Standards and Audit Criteria* – Identified the regulatory requirements and criteria for evaluating SWEPCo's compliance with each audit objective. These included Attachment H-28 of the SPP OATT; Commission accounting, reporting, and record preservation requirements; and Commission orders relevant to the audit.

Southwestern Electric Power Company

Docket No. FA24-2-000

- *Issued Data Requests* – Issued data requests to collect information not commonly available to the public. This included internal policies, procedures, and controls; nonpublic information about business practices, risk management, corporate structure, and contractual agreements; financial accounting and reporting activity; corporate compliance and regulatory filings; and other pertinent information. This information was used to evaluate SWEPCo’s compliance with Commission requirements relevant to the audit’s objectives.
- *Conducted Teleconference Interviews* – Conducted multiple teleconferences with SWEPCo employees to discuss audit objectives, processes, procedures and operations, testing, data request responses, technical and administrative matters, and compliance concerns.
- *External Auditor Working Papers Review* – Reviewed SWEPCo’s external auditor’s working papers covering the 2021 through 2023 time period.
- *Conferred with Subject-Matter Experts* – Conferred with Commission staff in other offices to ensure that audit report findings were consistent with Commission precedent and policy.
- *Conducted Site Visits* – Conducted two site visits at AEP’s offices in Columbus, OH. The site visits enabled audit staff to:
 - Discuss SWEPCo’s corporate structure, departmental functions, and employee responsibilities with key company officials;
 - Learn about SWEPCo’s transmission system and operations, in particular the assets, departments, activities, functions, systems, and processes used;
 - Interview executives, managers, and staff responsible for accounting, financial reporting, transmission operations, and corporate compliance;
 - Review the Board of Directors’ and Audit Committee’s meeting minutes and internal and external audit reports;
 - Discuss and observe internal accounting and reporting procedures, processes, and controls relevant to the scope of the audit; and
 - Discuss SWEPCo’s policies, procedures, and practices related to the preservation of records.

Southwestern Electric Power Company

Docket No. FA24-2-000

Compliance with Transmission Formula Rate

Audit staff performed these actions to evaluate SWEPCo's compliance with the requirements of its transmission formula rate:

- *Formula Rate Schedules* – Reviewed SWEPCo's Commission-approved transmission formula rate, the schedules included therein, and input data as reported in SWEPCo's FERC Form No. 1 filings.
- *Commission Orders* – Reviewed the Commission orders approving SWEPCo's transmission formula rate. Reviewed Commission orders for background information about specific cost treatments, unique inputs, and other matters disclosed as part of approving SWEPCo's transmission formula rate.
- *Formula Rate Input Reconciliation* – Reconciled the transmission formula rate data inputs to figures reported in SWEPCo's FERC Form No. 1 filing for 2022. Evaluated the adequacy of disclosures provided by SWEPCo for transmission formula rate inputs not derived from its FERC Form No. 1 filing.
- *Interviewed Employees* – Interviewed SWEPCo employees responsible for providing data inputs for the transmission formula rate and calculating the ATRR submitted each year. Assessed the level of oversight and controls employed by SWEPCo to attempt to ensure complete and accurate transmission formula rate inputs.
- *Mathematical Accuracy* – Evaluated the mathematical accuracy of computations performed by SWEPCo in applying its transmission formula rate to test whether inputs and computations were accurate.
- *Formula and Input Analysis* – Reconciled the components of the approved formula rate to the corresponding calculations in the ATRR filings. Analyzed and assessed SWEPCo's compliance with the Commission's required accounting treatment of select formula rate inputs. Reviewed SWEPCo's calculation and application of the allocation factors used in the transmission formula rate to test whether the correct amounts were used.

Compliance with Commission Accounting Regulations

Audit staff performed these actions to evaluate SWEPCo's compliance with the Commission's accounting regulations under 18 C.F.R. Part 101:

Southwestern Electric Power Company

Docket No. FA24-2-000

- *Accounting Processes and Procedures* – Evaluated SWEPCo’s financial accounting processes, procedures, and internal controls for consistency with Commission accounting regulations under 18 C.F.R. Part 101. Interviewed SWEPCo employees about accounting practices, reviewed system processes for account assignments, and observed controls for achieving compliance with the Commission’s accounting regulations.
- *Accounting Applications and Classifications* – Evaluated SWEPCo’s chart of accounts used during the audit period to determine whether it was consistent with the Commission’s accounting regulations. Reviewed descriptions of accounting practices and tested specific accounts by sampling transactions within the audit period to determine whether accounting classifications complied with the Commission’s accounting regulations.
- *Accounting Systems* – Reviewed SWEPCo’s financial accounting systems used to manage company financial records, such as systems for recording and tracking SWEPCo costs, including the general ledger, work order, expense, billing, and accounts payable systems. Reviewed practices and procedures around the accounting cycle for charges recorded in the FERC accounts.
- *Significant Accounting Matters* – Tested select accounts impacting or comprising inputs to SWEPCo’s transmission formula rate to evaluate whether the nature of costs recorded in those accounts complied with the Commission’s accounting regulations and SWEPCo’s transmission formula rate requirements. Testing included, but was not limited to, the following accounting matters:
 - *Transmission versus Production and Distribution* – Reviewed certain transmission, production, and distribution O&M expense accounts and electric plant-in-service accounts to test whether costs related to transmission, production, or distribution were appropriately recorded in the correct functional accounts.
 - *Administrative and General Expenses* – Tested select A&G expense accounts to determine whether SWEPCo recorded salaries, office supplies, outside services (e.g., consultant fees), pensions, material and supplies, employee benefits expenses, etc. consistent with the accounts’ instructions.
 - *Cost Allocations* – Examined the support for, and tested the application of, corporate and associated company allocation methodologies for allocating and recording shared service costs among affiliates and billing and accounting for non-power goods and services provided among

Southwestern Electric Power Company

Docket No. FA24-2-000

associated companies. For example, audit staff reviewed allocation ratios and tested selected costs to determine whether SWEPCo was allocated and had accounted for shared services correctly. Also reviewed affiliate billing procedures and select invoices to test whether SWEPCo recorded the proper amounts in accordance with those procedures.

- *Income Taxes and Tax Allocation Agreements* – Evaluated AEP’s consolidated income tax allocation agreement and the tax payment structure between SWEPCo and the consolidated group, including the methodology used to allocate the tax benefits/burden to members. Reviewed supporting documentation to test the calculation of current tax expense and deferred income taxes.
- *Accumulated Deferred Income Taxes* – Reviewed monthly summaries of deferred taxes that were recorded in the FERC ADIT accounts. Analyzed supporting documentation to evaluate how SWEPCo calculated the deferred tax amounts and underlying accounting entries made to FERC ADIT accounts (i.e., Accounts 190, Accumulated Deferred Income Taxes; 282, Accumulated Deferred Income Taxes – Other Property; and 283, Accumulated Deferred Income Taxes – Other).
- *Tax Cuts and Jobs Act of 2017* – Reviewed SWEPCo’s ADIT remeasurement calculations that resulted from implementation of the TCJA. In addition, audit staff reviewed SWEPCo’s accounting for the ADIT remeasurement to determine whether SWEPCo used the proper accounts and recorded the correct amounts per Commission accounting regulations.
- *Depreciation* – Reviewed monthly depreciation expense and supporting calculations to determine whether SWEPCo used the proper accounts and recorded the correct amounts. Reviewed SWEPCo’s depreciation expense calculation to test whether it derived monthly depreciation expenses using approved depreciation rates on file with the Commission.
- *Contingent Liabilities* – Reviewed the Notes to the Financial Statements in SWEPCo’s FERC Form No. 1 filings to identify information about accruals for potential future obligations. Analyzed information on commitments, environmental obligations, employment discrimination actions, and legal contingencies to determine whether these transactions affected the inputs to SWEPCo’s transmission formula rate, resulting ATRR, and billing rates.

Southwestern Electric Power Company

Docket No. FA24-2-000

- *Capitalization of Administrative and General Costs* – Evaluated the method used by SWEPCo to allocate overhead labor and labor-related costs to CWIP.
- *Allowance for Funds Used During Construction* – Reviewed SWEPCo's AFUDC rate calculation for consistency with Electric Plant Instruction No. 3(A)(17), Order No. 561,³ and other Commission AFUDC guidance. Reviewed SWEPCo's methodology for determining the annual AFUDC rate to assess whether it was based on SWEPCo's own debt and equity book balances and to examine whether differences between estimated short-term debt and CWIP balances used in AFUDC rate calculations and actual amounts did not result in an AFUDC rate that exceeded the maximum rate allowed by 25 basis points or more. Reviewed work orders to test whether SWEPCo ceased accruing AFUDC during the following instances: (1) when an asset was placed in-service, (2) during periods of suspension of construction, and (3) when a project was abandoned. Examined the components of SWEPCo's CWIP balances to determine whether SWEPCo only included amounts related to construction activities and properly allocated overheads.

Compliance with FERC Form No. 1 Reporting Requirements

Audit staff performed these actions to evaluate SWEPCo's compliance with the Commission reporting requirements under 18 C.F.R. Part 141:

- *Reporting Process and Procedures* – Evaluated SWEPCo's financial reporting processes, procedures, and quality controls relating to the preparation of SWEPCo's FERC Form No. 1 filings.
- *Financial Reporting Instructions* – Evaluated SWEPCo's financial reports for 2021-2023 to determine whether the company complied with the account and page instructions of the FERC Form No. 1 filings.

³ Order No. 561, *Amendments to Uniform Sys. of Accounts for Pub. Utils and Licensees and for Natural Gas Cos. (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*, 57 FPC 608, *reh'g denied and clarification granted*, Order No. 561-A, 59 FPC 1340 (1977), *clarification granted*, Order No. 561-B, 2 FERC ¶ 61,050 (1978).

Southwestern Electric Power Company

Docket No. FA24-2-000

- *Financial Statement Account Balances* – Tied the account balances reported in SWEPCo's FERC Form No. 1 filings to SWEPCo's books and records (i.e., general ledger). To facilitate the review, audit staff reviewed select transactions to confirm the balances.
- *Account Variance Analysis* – Performed variance analyses for a sample of accounts reported in SWEPCo's FERC Form No. 1 filings with large balances, unusual activity, and/or significant year-over-year fluctuations.
- *Notes to Financial Statements* – Reviewed the Notes to the Financial Statements in SWEPCo's FERC Form No. 1 filings for significant accounting matters and followed up with SWEPCo to understand financial statement and wholesale transmission formula rate implications.

Compliance with Record Retention Regulations

Audit staff performed these actions to evaluate SWEPCo's compliance with the regulations in Preservation of Records of Public Utilities and Licensees under 18 C.F.R. Part 125:

- *General Retention Practices* – Reviewed SWEPCo's administration of its record retention program to ascertain compliance with 18 C.F.R. Part 125. Interviewed employees responsible for record retention to understand processes, procedures, and controls for administration and maintenance of records.
- *Transactional Testing and Document Retention* – Requested documents and records to perform compliance testing for each audit scope area, and reviewed compliance relating to premature destruction and retention periods.

Southwestern Electric Power Company

Docket No. FA24-2-000

IV. Findings and Recommendations

1. Capitalization of Vegetation Management Costs

SWEPCo's vegetation management policy was not consistent with the Commission's accounting regulations. Specifically, SWEPCo (1) improperly capitalized \$97 million of vegetation management costs that were not related to the initial or original clearing of land and rights-of-way (ROW); (2) accrued AFUDC on the improperly capitalized vegetation management costs; and (3) included the same vegetation management costs in two different accounts and included both accounts as inputs for the purposes of computing its ATRR. As a result, SWEPCo overstated its electric plant and overbilled transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Electric Plant Instruction No. 3, Components of Construction Costs, states in part:

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:

- (1) Contract work....
- (2) Labor....
- (3) Materials and supplies....
- (4) Transportation....

- 18 C.F.R. Part 101, Electric Plant Instruction No. 8, Structures and Improvements, states in part:

A. The accounts for structures and improvements shall include the cost of all buildings and facilities to house, support, or safeguard property or persons, including all fixtures permanently attached to and made a part of buildings ... and improvements of a permanent character on or to land. Also include those costs incurred in connection with the first clearing and grading of land and rights-of-way....

- 18 C.F.R. Part 101, Operating Expense Instruction No. 2, Maintenance, states in part:

Southwestern Electric Power Company

Docket No. FA24-2-000

A. The cost of maintenance chargeable to the various operating expense and clearing accounts includes labor, materials, overheads and other expenses incurred in maintenance work....

ITEMS

....

3. Work performed specifically for the purpose of preventing failure, restoring serviceability or maintaining the life of plant.

- 18 C.F.R. Part 101, Account 571, Maintenance of Overhead Lines (Major Only), states in part:

This account shall include the cost of labor, materials used and expenses incurred in maintenance of transmission plant, the book cost of which is includable in accounts 354, Towers and Fixtures, 355, Poles and Fixtures, 356, Overhead Conductors and Devices, 359, Roads and Trails. (See operating expense instruction 2.)

ITEMS

....

3.b. Trimming trees and brush to maintain previous roadway clearance.

- In *Pacific Gas and Electric Co.*, the Commission stated:

We disagree with PG&E's assertions that the tree removal associated with the ROW expansion is analogous to the clearance of land for initial construction activities, as described in Electric Plant Instruction No. 8(A). Rather, such activities, taking place after the initial clearing associated with construction of an asset, are considered maintenance expense, unless such activities result in a substantial addition to plant. The Commission has previously clarified that to qualify as a substantial addition, an item added to the cost of an in-service asset must extend the useful life of the asset beyond its original estimated useful life, or increase operating capacity or efficiency of the asset. PG&E has not demonstrated that tree removal associated with its ROW expansion qualifies as a substantial addition to plant, nor a construction of a new asset, and accordingly, PG&E must record such

Southwestern Electric Power Company

Docket No. FA24-2-000

costs in the appropriate O&M expense account.⁴

Background

SWEPCo uses its vegetation management policy and procedures as the basis for determining whether to record vegetation management costs (e.g., costs of clearing land and ROW and tree trimming) as a capital or maintenance activity. Based on audit staff's review of SWEPCo's policy and related procedures for accounting for vegetation management costs and review of SWEPCo's accounting records, audit staff identified the following instances of noncompliance:

Accounting for Vegetation Management

Vegetation management for a utility's existing transmission and distribution systems includes costs to trim trees, remove trees, prune, and clear brush to ensure the reliability of the electric system by preventing failure caused by vegetation. Under the Commission's regulations, costs of this nature are recorded as maintenance expense.⁵ These costs do not extend the life of the asset or improve its efficiency.⁶ Audit staff reviewed SWEPCo's vegetation management policy and related procedures to determine whether the company complied with the Commission's regulations.

SWEPCo's vegetation management policy identified two types of costs to be recorded in the electric plant in service accounts (i.e., capitalized in the transmission and distribution accounts): "Initial or Original" Clearing costs⁷ and Other Capitalizable Costs. The policy defined Other Capitalizable Costs as those incurred to (1) widen an existing ROW; (2) clear vegetation growing in an existing ROW not previously cleared;

⁴ *Pacific Gas and Electric Co.*, 189 FERC ¶ 61,021, at P 37 (2024) (footnotes omitted).

⁵ According to Operating Expense Instruction No. 2(A), Item No. 3, "work performed specifically for the purpose of preventing failure, restoring serviceability, or maintaining [the] life of plant," are operating and maintenance in nature.

⁶ According to Electric Plant Instruction No. 10(C)(1), "When a minor item of property which did not previously exist is added to plant, the cost thereof shall be accounted for in the same manner as for the addition of a retirement unit, as set forth in paragraph B(1), above, if a substantial addition results, otherwise the charge shall be to the appropriate maintenance expense account."

⁷ The Initial or Original Clearing costs are for clearing the land for construction through tree and brush removal.

Southwestern Electric Power Company

Docket No. FA24-2-000

and (3) trim vegetation bordering an existing ROW not previously cleared. SWEPCo stated that it capitalized these amounts because SWEPCo was clearing the vegetation for the first time. However, under the Commission's accounting regulations, costs of widening an existing ROW, clearing vegetation growing in an existing ROW not previously cleared as part of the initial asset construction, and trimming vegetation bordering an existing ROW not previously cleared are required to be recorded as maintenance expense.⁸ Therefore, SWEPCo's practice of recording Other Capitalizable Costs associated with its vegetation management program is contrary to the Commission's accounting regulations. From 2009 through 2024, SWEPCo improperly recorded approximately \$97 million of Other Capitalizable Costs associated with its vegetation management program in the various electric plant in service accounts, resulting in SWEPCo over accruing AFUDC by approximately \$504,000 on these amounts.

Texas-Jurisdictional Capitalized Vegetation Management Costs

In a December 2016 Texas rate case, the Public Utility Commission of Texas (PUCT) ruled that SWEPCo improperly capitalized transmission and distribution vegetation management costs (Other Capitalizable Costs, as discussed above).⁹ The PUCT stated that "SWEPCo's capitalization . . . is contrary to the clear language of the FERC uniform-system-of-accounts instruction that costs incurred 'in connection with the first clearing and grading of land and rights-of-way' may be capitalized."¹⁰ The PUCT disallowed recovery in rate base but allowed some of these costs to be recovered as O&M expenses for cost of service purposes in PUCT-jurisdictional rates. As a result, SWEPCo was required to remove the related costs from the electric plant in service accounts.

In response to the PUCT ruling, SWEPCo improperly recorded the PUCT-disallowed capital vegetation management costs in Account 116, Other Electric Plant Adjustments, and depreciated the disallowed costs in Account 116 to Account 403,

⁸ See *Pacific Gas and Elec. Co.*, 189 FERC ¶ 61,021, at P 37 (2024) ("We disagree with PG&E's assertions that the tree removal associated with the ROW expansion is analogous to the clearance of land for initial construction activities, as described in Electric Plant Instruction No. 8(A). Rather, such activities . . . are considered maintenance expense, unless such activities result in a substantial addition to plant") (footnotes omitted).

⁹ Application of Southwestern Electric Power Co. for Authority to Change Rates, PUCT Docket No. 46449 ([Public Utility Commission of Texas] Jan. 11, 2018).

¹⁰ *Id.* at P 25.

Southwestern Electric Power Company

Docket No. FA24-2-000

Depreciation Expense (the initial entry).¹¹ Under the Commission's accounting regulations, SWEPCo should have removed the vegetation management costs from the electric plant in service accounts and recorded those costs in the appropriate O&M expense account (if recovery was allowed) or in Account 426.5 (if recovery was not allowed).¹²

Following the initial entry, SWEPCo continued to record the Other Capitalizable Costs associated with its vegetation management program in the electric plant in service accounts. In addition, in its ongoing effort to comply with the PUCT ruling, SWEPCo recorded the PUCT-jurisdictional portion of the same vegetation management costs in Account 116, as an offset against the electric plant in service accounts and in the O&M expense account(s). In essence, SWEPCo's accounting for the Other Capitalizable Costs associated with its vegetation management program ensured it complied with the PUCT's cost of service order and prevented over recovery from the PUCT-jurisdictional customers. However, this improper accounting was problematic when SWEPCo calculated its ATRR under its transmission formula rate.

SWEPCo's transmission formula rate includes the electric plant in service accounts and O&M expenses, but excludes Account 116 balances, as inputs in the computation of SWEPCo's ATRR. Therefore, the same Other Capitalizable Costs associated with SWEPCo's vegetation management program recorded in the electric plant in service and O&M accounts were improperly included as inputs for the calculation of the ATRR and billings to transmission customers. As a result, SWEPCo overstated its ATRR and billings to wholesale transmission customers.

Summary

¹¹ SWEPCo's accounting to comply with the PUCT Order did not remove the improper vegetation management costs from the electric plant in service accounts on a gross basis but rather created an artificial credit balance in Account 116 that it used to offset the amounts in the electric plant in service accounts on a net basis. In addition, SWEPCo depreciated the costs in Account 116 to Account 403 to offset the depreciation of the disallowed vegetation management costs from the electric plant in service accounts in Account 403. This means the improper vegetation management costs in the electric plant in service accounts, Account 116 and Account 403, did not impact cost of service in SWEPCo's PUCT-jurisdictional rates.

¹² 18 C.F.R. Part 101, General Instruction 2(E), Records ("All amounts included in the accounts prescribed herein for electric plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5, Other Deductions.")

Southwestern Electric Power Company

Docket No. FA24-2-000

SWEPCo's policy of capitalizing vegetation management costs incurred after the initial clearing of land or ROW, and accruing AFUDC on these costs, is contrary to the Commission's accounting regulations. Further, SWEPCo's improper accounting in response to the PUCT ruling resulted in over-recovery of the PUCT-jurisdictional portion of its Other Capitalizable Costs associated with its vegetation management program, which led SWEPCo to overbill its wholesale transmission customers.

Recommendations

DAA recommends that SWEPCo:

1. Revise and implement policies and procedures to ensure that vegetation management costs are recorded and reported in accordance with the Commission's accounting regulations and related orders.
2. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 1, and repeat such trainings as needed.
3. Perform a comprehensive analysis to identify all capitalized vegetation management costs, including AFUDC, by electric plant in service account that were not part of an initial clearing since 2009. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.
4. Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the electric plant in service accounts, as well as AFUDC, accumulated depreciation, ADIT, and other accounts impacted by the improper capitalization of vegetation management costs, within 60 days of the date of issuance of this audit report.
5. Revise electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by the improper capitalization of vegetation management costs after receiving DAA's assessment of the proposed accounting entries submitted per Recommendation 4.
6. Submit a refund analysis, within 90 days of the date of issuance of the audit report, to DAA that explains and details the following: (1) the calculation of refunds that resulted from correcting for the double counting and recovery of vegetation management costs incurred for the Texas jurisdiction, plus interest; (2) the determinative components of the refund; (3) the refund method(s); (4) customers to receive refunds; and (5) the period(s) in which refunds will be made.

Southwestern Electric Power Company

Docket No. FA24-2-000

7. File a refund report with the Commission that accords with DAA's assessment of the refund analysis.
8. Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Southwestern Electric Power Company

Docket No. FA24-2-000

2. Prepaid Pension AFUDC

SWEP Co improperly accrued AFUDC on its prepaid pension asset and included this AFUDC in the electric plant in service accounts. As a result, SWEP Co overstated its electric plant by \$10 million and overbilled transmission customers.

Pertinent Guidance

- 18 C.F.R. § 35.25, entitled “Construction work in progress,” states in part:

(f) *Accounting procedures.* When a public utility files to include CWIP in its rate base pursuant to this section, it must propose accounting procedures in that rate schedule filing that:

(1) Ensure that wholesale customers will not be charged for both capitalized AFUDC and corresponding amounts of CWIP proposed to be included in rate base; and

(2) Ensure that wholesale customers will not be charged for any corresponding AFUDC capitalized as a result of different accounting or ratemaking treatments accorded CWIP by state or local regulatory authorities.

- 18 C.F.R. Part 101, Account 182.3, Other Regulatory Assets, states in part:

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

Background

SWEP Co operates in three state jurisdictions (Louisiana, Texas, and Arkansas) and is subject to regulation by each state commission. The PUCT regulates Texas’s electric utilities and implements respective legislation. SWEP Co typically files rate cases with the PUCT every three to four years, although SWEP Co is not required to file rate cases on a predetermined schedule.

For over 20 years, SWEP Co made periodic contributions to fund its pension plan. The overall contributions were greater than SWEP Co’s recognized pension expense; therefore, SWEP Co recorded a prepaid pension asset for the amount of pension

Southwestern Electric Power Company

Docket No. FA24-2-000

contributions in excess of pension expense recognized. During the audit period, the balance of the prepaid pension asset ranged from \$67.6 million (Dec. 31, 2021) to \$45 million (Dec. 31, 2024). Per SWEPCo's wholesale transmission formula rate, the prepaid pension asset is included as an input to working capital for the purpose of determining its ATRR and billings to transmission customers.¹³

In a July 2012 PUCT rate case,¹⁴ SWEPCo asserted that it had a prepaid pension asset of \$113.2 million for the test year, 2011. Using its O&M labor ratio, SWEPCo determined that 71.3% of the prepaid pension asset was related to O&M and that the remaining 28.7% was related to capital. The PUCT allowed SWEPCo to include the O&M portion of the prepaid pension asset in its PUCT-jurisdictional rate base. The PUCT disallowed the inclusion of the capital portion in rate base, but it permitted SWEPCo to accrue AFUDC on this portion of the prepaid pension asset for PUCT ratemaking purposes.¹⁵ Beginning in February 2013, SWEPCo calculated AFUDC on the portion of the prepaid pension asset allowed by the PUCT for AFUDC accrual.

From February 2013 through December 2024, SWEPCo accrued approximately \$10 million in AFUDC related to the prepaid pension asset. SWEPCo improperly recorded the \$10 million of AFUDC it accrued on the prepaid pension asset in Account 107, Construction Work in Progress—Electric, across all SWEPCo jurisdictions. The AFUDC accrued on the prepaid pension asset was transferred to Account 101, Electric Plant in Service, when construction of the asset was complete. However, under the Commission's accounting regulations, prepaid pension asset is not a component of CWIP and, hence, the associated AFUDC should not have been recorded in that account.¹⁶ In addition, the accrual of AFUDC on the prepaid pension asset was a result of ratemaking action in Texas; therefore, SWEPCo should have recorded the AFUDC in Account 182.3, Other Regulatory Assets, and amortized that cost to the appropriate O&M account based on the recovery period approved by the PUCT.

¹³ Order Approving Uncontested Settlement, 127 FERC ¶ 61,292.

¹⁴ Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs, PUCT Docket No. 40443 ([Public Utility Commission of Texas] Oct. 10, 2013).

¹⁵ *Id.* at paragraph 137.

¹⁶ 18 C.F.R. Part 101, Electric Plant Instruction 3, Components of construction cost.

Southwestern Electric Power Company

Docket No. FA24-2-000

SWEPCo's transmission formula rate includes Account 101 balances as an input in the computation of SWEPCo's ATRR. Therefore, the AFUDC accrued on the prepaid pension asset and recorded in Account 101 was improperly included as an input for the calculation of the ATRR and billings to transmission customers. As a result, SWEPCo overstated its ATRR and billings to wholesale transmission customers

Recommendations

DAA recommends that SWEPCo:

9. Revise and implement policies and procedures for accruing and accounting for AFUDC on the prepaid pension asset consistent with the Commission's accounting regulations.
10. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 9, and repeat such trainings as needed.
11. Perform an analysis to identify all AFUDC accrued on the prepaid pension asset from 2013 through the date of the audit report and submit the results of the analysis to DAA for review within 60 days of the issuance of this audit report.
12. Within 60 days of the date of issuance of this audit report, submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by accrual of AFUDC on the prepaid pension asset.
13. Revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by the accrual of AFUDC on the prepaid pension asset after receiving DAA's assessment of the proposed accounting entries submitted per Recommendation 12.
14. Submit a refund analysis, within 90 days of the date of issuance of this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amount of AFUDC accrued on the prepaid pension asset and impacts on related accounts included in customer charges under SWEPCo's transmission formula rate since January 1, 2013, plus interest computed in accordance with section 35.19a of the Commission's regulations; (2) determinative components of the refund; (3) refund method(s); (4) customers to receive refunds; and (5) period(s) refunds will be made.
15. File a refund report with the Commission that accords with DAA's assessment of the refund analysis.

Southwestern Electric Power Company

Docket No. FA24-2-000

16. Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Southwestern Electric Power Company

Docket No. FA24-2-000

3. Allowance for Funds Used During Construction

SWEPCo's AFUDC rate derivation, AFUDC accrual, and AFUDC accounting were inconsistent with the Commission's accounting regulations. Specifically, SWEPCo incorrectly (1) calculated its long-term debt cost rate; (2) included balances of Accounts 181, Unamortized Debt Expense, 189, Unamortized Loss on Reacquired Debt, and 226, Unamortized Discount on Long-Term Debt, in the long-term debt balances; (3) accrued AFUDC on completed projects, suspended projects, and equipment purchases; and (4) recorded the state portion of AFUDC debt and equity ADIT in Account 283, Accumulated Deferred Income Taxes – Other, instead of Account 282, Accumulated Deferred Income Taxes – Other Property. As a result, SWEPCo over accrued AFUDC included in electric plant in service accounts and overbilled its transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Electric Plant Instructions, Instruction No. 3(A)(17) states, in part:

(17) *Allowance for funds used during construction* (Major and Nonmajor Utilities) includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds....

....

(b) 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.

- Accounting Interpretation 93-5, Accounting for Income Taxes, Question No. 6, Equity AFUDC, states:

Question: [Statement of Financial Accounting Standards No.] 109 considers the equity component of AFUDC a temporary difference for which deferred income taxes must be provided. How should an entity record the deferred tax liability for the equity component of AFUDC and the related regulatory asset in its accounts?

Southwestern Electric Power Company

Docket No. FA24-2-000

Response: An entity shall record the deferred tax liability for the equity component of AFUDC in Account 282, Accumulated Deferred Income Taxes – Other Property, and any corresponding regulatory asset in Account 182.3, Other Regulatory Assets. The regulatory asset is itself a temporary difference for which deferred income taxes shall be recognized and recorded in Account 283, Accumulated Deferred Income Taxes – Other. This accounting shall be followed for the adjustments required upon initial application of the statement and for all amounts of equity AFUDC capitalized in subsequent periods.¹⁷

- Accounting Release 5 (Revised) (AR-5), *Capitalization of Allowance for Funds Used During Construction*, states in part:

No AFUDC should be accrued during periods of interrupted construction unless the company can justify the interruption as being reasonable under the circumstances.¹⁸

- Revision to Accounting Release No. 5, *Capitalization of Allowance for Funds Used During Construction*, Docket No. AI11-1-000 (delegated order) (Feb. 16, 2011), states in relevant part:

[I]f construction is interrupted or suspended, AFUDC accruals must cease unless the company can justify the interruption as being reasonable under the circumstances.

- Order No. 561 states in part:

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 as set forth in §

¹⁷ *Accounting for Income Taxes*, Docket No. AI93-5-000 (Apr. 23, 1993) (delegated order by the Chief Accountant), *reh'g denied sub nom.*, *Accounting for Income Taxes Under SFAS 109*, 64 FERC ¶ 61,352 (1993).

¹⁸ *Accounting Release No. 5 (Revised)*, *Capitalization of Interest During Construction*, January 1, 1968, FERC Stats. & Regs. ¶ 40,005 (1968).

Southwestern Electric Power Company

Docket No. FA24-2-000

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.¹⁹

Background

AFUDC represents the financing cost of construction and consists of two components: Allowance for Borrowed Funds (debt) and Allowance for Other Funds (equity). The Commission's predecessor agency, the Federal Power Commission, in Order No. 561, established the current formula for capturing these two components of AFUDC. Electric Plant Instruction No. 3(A)(17) provides the uniform formula for calculating a utility's maximum AFUDC rate. SWEPCo received a waiver from the Commission to calculate the AFUDC rate monthly using the prior month's balances and cost rates of long-term debt, preferred stock, and common equity, instead of annually using prior year balances as specified in Electric Plant Instruction No. 3(A)(17).²⁰ Audit staff reviewed SWEPCo's AFUDC rate calculations, debt and equity component inputs, and the application of the calculated AFUDC rate to CWIP during the audit period. This process included interviewing SWEPCo plant accounting staff and testing a sample of AFUDC calculations and other supporting documents.

Based on audit staff's review of SWEPCo's AFUDC rate computation, accrual, application, and accounting, audit staff identified the following instances of noncompliance.

Long-Term Debt Cost Rate

SWEPCo inappropriately calculated its long-term debt cost rate, an input in the AFUDC calculation. SWEPCo calculated the long-term debt rate by dividing the annual long-term interest by the long-term debt balance and multiplying the result by 12 months.

¹⁹ *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*, Order No. 561, 57 FPC 608, 611 (1977), *reh'g denied*, Order No. 561-A, 59 FPC 1340 (1977), *order on clarification*, 2 FERC ¶61,050 (1978).

²⁰ *Central and Southwest Services, Inc.*, Docket No. AC95-35-000 (Jan. 23, 1995) (delegated order).

Southwestern Electric Power Company

Docket No. FA24-2-000

Section 35.13 of the Commission's regulations requires that the cost rate for long-term debt be the weighted average cost. SWEPCo's practice of calculating its long-term debt cost rate for AFUDC rate computation did not follow the rate calculation described in §35.13 (h)(22)(ii) (Cost of service statements; AV—Rate of return; Debt capital) of the Commission's regulation.

Long-Term Debt Balances

SWEPCo inappropriately reduced its long-term debt balance by amounts recorded in Accounts 181, Unamortized Debt Expense; 189, Unamortized Loss on Reacquired Debt; and 226, Unamortized Discount on Long-Term Debt, for purposes of computing its AFUDC rates. This practice understated SWEPCo's outstanding long-term debt causing SWEPCo to include net, rather than gross, long-term debt proceeds in its AFUDC rate calculations. The Commission's regulations require that SWEPCo use the gross proceeds of long-term debt (i.e., the total principal outstanding) in the capital structure for the purposes of AFUDC rate calculation. SWEPCo may not use a long-term debt balance reduced by an unamortized discount, an unamortized debt expense, or an unamortized loss on reacquired debt.²¹ As a result of SWEPCo's improper inclusion of unamortized discount, unamortized debt expense, and unamortized loss on reacquired debt in the long-term debt balance in its AFUDC calculation, SWEPCo over accrued AFUDC included in electric plant in service accounts and overbilled transmission customers.

Accrual of AFUDC on Completed/Suspended Projects and Purchased Equipment

SWEPCo's practice is to stop accruing AFUDC when projects are completed or suspended. For completed projects, SWEPCo stops accruing AFUDC in the month after the in-service date. For suspended projects, SWEPCo ceases accruing AFUDC in the month of suspension, until the month the work order is reopened. The accrual of AFUDC automatically ceases if a project has no direct charges (labor, material, outside services, etc.) for a period exceeding six months.

²¹ See *System Energy Res., Inc.*, Opinion No. 446, 92 FERC ¶ 61,119, at 61,449 (2000) ("It is the gross proceeds of a company's long-term debt, i.e., the total principal outstanding, that belong in the capital structure because this reflects the company's total obligation with respect to long-term debt."), *reh'g denied*, Opinion No. 446-A, 96 FERC ¶ 61,165, at 61,740 ("Using the total principal outstanding, or gross proceeds, accurately represents the amount of debt outstanding and allows for a more accurate picture of SERI's capital structure, and, in turn, results in the correct calculation of SERI's cost of capital.").

Southwestern Electric Power Company

Docket No. FA24-2-000

Audit staff reviewed a sample of completed and suspended projects to determine whether SWEPCo stopped accruing AFUDC on a timely basis. Audit staff found instances when SWEPCo did not cease accruing AFUDC on completed projects until four or more months after the asset was placed in service. In some of these instances AFUDC continued to be accrued on suspended projects until SWEPCo's accounting system identified that the project had no direct charges for six months. The Commission's regulations require that no AFUDC be accrued during periods of interrupted construction. Additionally, according to SWEPCo's policy, the AFUDC accruals should have been manually stopped in the month the project was suspended. SWEPCo did not reverse the AFUDC improperly accrued on the suspended projects.

In addition, SWEPCo improperly recorded electric plant purchased as a component of CWIP and accrued AFUDC as part of the cost of the asset even though the electric plant purchased was ready for use in its utility operation. Audit staff reviewed a sample of AFUDC accruals and found that SWEPCo accrued AFUDC on equipment purchases such as drones, golf carts, handheld radios, fireproof cabinets, and battery chargers. However, SWEPCo did not build or construct the equipment, and the equipment was ready for use in the company's operations. AFUDC only applies during the time of construction and, therefore, is only appropriate for construction projects, not purchases of capital assets that are ready for use in the utility's operation.

As a result of SWEPCo's delay in ceasing AFUDC accruals on completed projects, suspended projects, and purchased assets, SWEPCo over accrued AFUDC included in electric plant in service accounts and overbilled transmission customers.

Accounting for AFUDC ADIT

SWEPCo recorded the state portion of AFUDC debt and equity ADIT in Account 283 instead of Account 282. SWEPCo represented that a limitation in its accounting system caused this ADIT accounting error. The improper accounting resulted in inaccurate deferred tax balances reported in SWEPCo's FERC Form No. 1 filings.

Conclusion

SWEPCo over accrued AFUDC during the audit period causing the overstatement of CWIP and electric plant in service balances. As a result of inputting these overstated balances into its wholesale transmission formula rate calculations, SWEPCo overbilled wholesale transmission customers.

Recommendations

DAA recommends that SWEPCo:

Southwestern Electric Power Company

Docket No. FA24-2-000

17. Revise policies and procedures to ensure that AFUDC is calculated consistent with Electric Plant Instruction No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to ensure that: (1) the long-term debt cost rate is calculated in accordance with 18 C.F.R. § 35.13; (2) the gross long-term debt outstanding is used in the calculation; (3) AFUDC is not accrued on completed or suspended projects, and (4) AFUDC is not accrued on purchased assets that are not under construction and ready for use.
18. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 17, and repeat such trainings as needed.
19. Recalculate accrued AFUDC, in a manner consistent with Electric Plant Instruction No. 3(A)(17) that corrects for the calculation of the long-term debt rates and balances, suspended projects, completed projects, and purchased assets that are not under construction and ready to be used in the utility operations from 2021 through the date of issuance of the audit report and submit to DAA for review within 60 days of this report.
20. Within 60 days of the date of issuance of the audit report, submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over accrual of AFUDC.
21. Revise CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over accrual of AFUDC after receiving DAA's assessment of the proposed accounting entries submitted per Recommendation 20.
22. Submit a refund analysis to DAA for review, within 90 days of the date of issuance of this audit report, that explains and details the following: (1) calculation of refunds that include the amount of excess AFUDC and impacts on related accounts included in customer billings under SWEPCo's transmission formula rate since January 1, 2021, plus interest computed in accordance with section 35.19a of the Commission's regulations; (2) determinative components of the refund; (3) refund method(s); (4) customers to receive refunds; and (5) period(s) for which refunds will be made.
23. File a refund report with the Commission that accords with DAA's assessment of the refund analysis described in the previous recommendation.
24. Refund the amounts disclosed in the refund report to wholesale customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

Southwestern Electric Power Company

Docket No. FA24-2-000

4. Prepayments

SWEPCo improperly recorded certain advance payments that were applicable to future accounting periods in A&G and O&M expense accounts, instead of in Account 165, Prepayments. As a result, SWEPCo did not accurately recognize certain expenses in the period in which they were incurred, leading to the misstatement of A&G, O&M, and other account balances reported in its FERC Form No. 1 filings.

Pertinent Guidance

- 18 C.F.R. Part 101, General Instruction No. 4, Accounting Period, states in part:

Each utility shall keep its books on a monthly basis so that for each month all transactions applicable thereto, as nearly as may be ascertained, shall be entered in the books of the utility....

- 18 C.F.R. Part 101, General Instruction No. 11, Accounting to be on Accrual Basis, states in part:

B. When payments are made in advance for items such as insurance, rents, taxes or interest the amount applicable to future periods shall be charged to account 165, Prepayments, and spread over the periods to which applicable by credits to account 165, and charges to the accounts appropriate for the expenditure.

- 18 C.F.R. Part 101, Account 165, Prepayments, states:

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

Background

Audit staff reviewed SWEPCo's processes, policies, and procedures for recording transactions in Account 165, Prepayments, to determine whether the transactions were accounted for in accordance with the Commission's accounting requirements. Audit staff found that SWEPCo's policies and procedures for recording transactions in Account 165 included a minimum prepayment threshold of \$12,000 for insurance costs and \$100,000 for all other expenses. As a result, certain transactions that represented advance payments of future obligations were not accounted for as prepayments in Account 165 when the amount paid did not meet or exceed SWEPCo's minimum thresholds.

Southwestern Electric Power Company

Docket No. FA24-2-000

SWEPCo instead expensed payments that were applicable to future accounting periods if the payments did not meet SWEPCo's minimum thresholds.

The Commission's accounting regulations do not provide for a dollar threshold for transactions to be recorded in Account 165. General Instruction No. 11, Accounting to be on Accrual Basis, states that "when payments are made in advance for items . . . the amount applicable to future periods shall be charged to Account 165 and spread over the periods to which applicable by credits to Account 165, and charges to the accounts appropriate for the expenditure." Consistent with this instruction, SWEPCo should have accounted for the advance payments in Account 165. SWEPCo's minimum threshold accounting policy for Account 165 is contrary to the Commission's accounting regulations.

Recommendations

DAA recommends that SWEPCo:

25. Revise and implement policies and procedures to ensure that SWEPCo properly records all advance payments that are applicable to future periods in accordance with the Commission's regulations.
26. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 25, and repeat such trainings as needed.

Southwestern Electric Power Company

Docket No. FA24-2-000

5. Accounting Misclassifications

SWEP Co recorded various A&G expenses in a manner contrary to the Commission's accounting regulations. Some of the improper accounting resulted in SWEP Co overstating its ATRR and overbilling its transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 549, Miscellaneous Other Power Generation Expenses (Major Only), states in part:

This account shall include the cost of labor, materials used and expenses incurred in the operation of other power generating stations which are not specifically provided for or are not readily assignable to other generation expense accounts.

- 18 C.F.R. Part 101, Account 566, Miscellaneous Transmission Expenses (Major Only), states in part:

This account shall include the cost of labor, materials used and expenses incurred in transmission map and record work, transmission office expenses, and other transmission expenses not provided for elsewhere.

- 18 C.F.R. Part 101, Account 588, Miscellaneous Distribution Expenses, states in part:

This account shall include the cost of labor, materials used and expenses incurred in distribution system operation not provided for elsewhere.

- 18 C.F.R. Part 101, Account 910, Miscellaneous Customer Service and Informational Expenses (Major Only), states in part:

This account shall include the cost of labor, materials used and expenses incurred in connection with customer service and informational activities which are not includible in other customer information expense accounts.

- 18 C.F.R. Part 101, Account 921, Office Supplies and Expenses, states in part:

A. This account shall include office supplies and expenses incurred

Southwestern Electric Power Company

Docket No. FA24-2-000

in connection with the general administration of the utility's operations which are assignable to specific administrative or general departments and are not specifically provided for in other accounts. This includes the expenses of the various administrative and general departments, the salaries and wages of which are includible in account 920.

- 18 C.F.R. Part 101, Account 923, Outside Services Employed, states in part:

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

Background

Audit staff reviewed A&G expense accounts on a sample basis to determine whether the charges were accounted for in accordance with the Commission's accounting requirements. As part of the review, audit staff examined SWEPCo's invoicing and accounts payable processes, assessed applicable supporting documentation, and interviewed employees who performed relevant accounting functions. Additionally, audit staff reviewed account balance inputs taken from SWEPCo's FERC Form No. 1s and used in SWEPCo's transmission formula rate template for the purpose of computing the ATRR. Audit staff found that SWEPCo misclassified several types of costs, including distribution costs, production costs, and A&G costs.

Legal Costs

During the audit period, SWEPCo incurred legal costs for a variety of services and recorded the costs in Account 923, Outside Services Employed. SWEPCo represented that it treats third-party legal services as A&G expenses *regardless* of the nature of the service - that is, regardless of whether the legal service relates to a particular operating function as opposed to administrative or general operations. During sample testing, audit staff found third-party legal costs relating to SWEPCo's jointly owned North Central Wind (NCW) facility, a wind generation facility, and to Louisiana Public Service Commission (LPSC) filings, recorded in Account 923. The NCW legal services were related to retaining counsel, drafting briefs, and litigating environmental and SPP regulatory matters for the wind generation facility. The LPSC-related legal services pertained to drafting comments to proposed rules related to customer operations in the

Southwestern Electric Power Company

Docket No. FA24-2-000

state and conducting a request for proposal for new generation resources to serve customers in Louisiana. In accordance with the Commission's accounting regulations, SWEPCo should have recorded the costs, including the costs of legal services related to a specific function (i.e., production) in that function's accounts.²² SWEPCo should have recorded the third-party legal services costs in the production and customer accounts, which are not included in SWEPCo's transmission formula rate. SWEPCo's transmission formula rate includes Account 923 balances as an input in the computation of SWEPCo's ATRR. Therefore, portions of the production function and customer operations function legal services costs improperly recorded in Account 923 were included in the calculation of SWEPCo's ATRR and in its billings to transmission customers.

Employee Relocation Costs

During the audit period, the AEP service company, AEPSC, assigned employee relocation costs to SWEPCo. SWEPCo recorded the costs in Account 921, Office Supplies and Expenses. In sample testing, audit staff found that AEPSC used a functional allocator that indicated that all assigned costs were entirely distribution costs or transmission costs depending on the employee. However, SWEPCo recorded these costs as an A&G expense in Account 921. Therefore, as the costs were entirely transmission or distribution, SWEPCo should have recorded the relocation costs in the corresponding functional account. SWEPCo's transmission formula rate includes Account 921 balances as an input in the computation of SWEPCo's ATRR. Therefore, a portion of relocation costs improperly recorded in Account 921 for employees solely working in the distribution function was included in the calculation of the ATRR and in billings to transmission customers.

Customer Costs

During the audit period, SWEPCo incurred customer related costs, and SWEPCo recorded the customer related costs in Account 921, Office Supplies and Expenses. The customer related costs pertained to obtaining data analysis used by SWEPCo's Corporate Communication Group to refresh residential segmentation models, segment customers for marketing campaigns, and better understand customer demographics. These are customer related costs, and SWEPCo should have recorded them in Account 910, Miscellaneous Customer Service and Informational Expenses (Major Only). SWEPCo's transmission formula rate includes Account 921 balances as an input in the computation of SWEPCo's

²² See, e.g., *S.W. Power Pool, Inc. v. Am. Elec. Power Serv. Corp.*, 178 FERC ¶ 61,208, at P 27 (2022) (directing utility to remove certain lease payment expenses from an A&G account and record them in appropriate functional accounts).

Southwestern Electric Power Company

Docket No. FA24-2-000

ATRR, but it does not include Account 910 balances. Therefore, a portion of the customer-related costs improperly recorded in Account 921 were included in the calculation of SWEPCo's ATRR and in billings to transmission customers.

Economic Development Costs

During the audit period, affiliated companies allocated costs incurred in support of state economic development initiatives to SWEPCo, and SWEPCo recorded the costs in Account 930.2. These costs were related to activities, such as conference sponsorships, that allowed SWEPCo to promote its brand and build relationships with current and potential customers. SWEPCo received an allocation of such charges from its affiliates when the activities, according to SWEPCo, benefited SWEPCo customers. Audit staff found that SWEPCo received an allocation charge relating to supporting the economic development work of the Kentucky Association for Economic Development. SWEPCo should not have received and recorded this charge since SWEPCo does not have operations or customers in Kentucky. SWEPCo agreed that the Kentucky economic development costs were incorrectly allocated to SWEPCo. These costs were not included in SWEPCo's ATRR; however, the incorrect allocation led to overstating SWEPCo's Account 930.2 expenses reported in its FERC Form No. 1 filings.

A&G Misclassifications

During the audit period, SWEPCo misclassified several A&G expenses in an improper A&G account. Specifically, SWEPCo recorded automobile and cell phone costs in Account 920, Administrative and General Salaries, an account for salary and other labor-related A&G costs, instead of in the proper account, Account 921, Office Supplies and Expenses. Also, SWEPCo issued face masks out of inventory and recorded the related cost in Account 923, Outside Services Employed, instead of in Account 921. These types of costs are included in the general description, and the list of examples, of the types of costs that should be recorded in Account 921.²³ SWEPCo's misclassifications of A&G costs led to misstatements of A&G account balances reported in its FERC Form No. 1 filings but did not result in overstatement of its ATRR and billings to transmission customers.

Summary

²³ See, e.g., 18 C.F.R. Part 101, Account 921, at Item No. 1 ("Automobile service, including charges through clearing account"); *id.* Item No. 5 ("Communication service expenses"); *id.* Item No. 8 ("Office supplies and expenses").

Southwestern Electric Power Company

Docket No. FA24-2-000

Due to SWEPCo's accounting procedures for recording production, distribution, and certain A&G costs, SWEPCo improperly included portions of these costs in its ATRR and wholesale customer billings. Additionally, SWEPCo's misclassification errors resulted in SWEPCo reporting inaccurate account balances in its FERC Form No. 1 filings.

Recommendations

DAA recommends that SWEPCo:

27. Revise and implement policies and procedures to ensure that SWEPCo properly accounts for operating expenses consistent with the Commission's accounting regulations.
28. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 27, and repeat such trainings as needed.
29. Perform an analysis of A&G expense accounts from 2021 through the date of this audit report to identify costs that were improperly accounted for and included in SWEPCo's ATRR and customer billings. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.
30. Submit a refund analysis to DAA for review, within 90 days of the date of issuance of this audit report, that explains and details the following: (1) calculation of refunds resulting from inappropriate recoveries due to the improper accounting for expenses recorded in A&G accounts from 2021 to the present, plus interest; (2) determinative components of the refund; (3) refund method(s); (4) customers to receive refunds; and (5) the period(s) for which refunds will be made.
31. File a refund report with the Commission that accords with DAA's assessment of the refund analysis described in the previous recommendation.
32. Refund the amounts disclosed in the refund report to transmission customers with interest calculated in accordance with section 35.19a of the Commission's regulations.

Southwestern Electric Power Company

Docket No. FA24-2-000

6. Excess Accumulated Deferred Income Tax

SWEP Co improperly netted the excess and deficient ADIT related to the corporate tax rate change and associated adjustments required due to the Tax Cuts and Jobs Act of 2017 (TCJA) and recorded the amount that resulted from this improper netting in Account 254, Other Regulatory Liabilities. This action affected the transparency and accuracy of the excess and deficient ADIT amounts reported in SWEP Co's FERC Form No. 1 filings.

Pertinent Guidance

- Accounting Interpretation No. 93-5, Accounting for Income Taxes, Question No. 8, Changes in Tax Law or Rates, provides:

Question: How should an entity record the effect of a change in tax law or rates that occurs after the year of initial implementation of [Statement of Financial Accounting Standards No.] 109?

Response: The entity shall adjust its deferred tax liabilities and assets for the effect of the change in tax law or rates in the period that the change is enacted. The adjustment shall be recorded in the proper deferred tax balance sheet accounts (Accounts 190, 281, 282 and 283) based on the nature of the temporary difference and the related classification requirements of the accounts. If as a result of action by a regulator, it is probable that the future increase or decrease in taxes payable due to the change in tax law or rates will be recovered from or returned to customers through future rates, an asset or liability shall be recognized in Account 182.3, Other Regulatory Assets, or Account 254, Other Regulatory Liabilities, as appropriate, for that probable future revenue or reduction in future revenue. That asset or liability is also a temporary difference for which a deferred tax asset or liability shall be recognized in Account 190, Accumulated Deferred Income Taxes or Account 283, Accumulated Deferred Income Taxes – Other, as appropriate.²⁴

²⁴ *Accounting for Income Taxes*, Docket No. AI93-5-000, at 8 (Apr. 23, 1993) (delegated letter order by the Chief Accountant) (Accounting Interpretation No. 93-5), *reh'g denied sub nom. Accounting for Income Taxes Under SFAS 109*, 64 FERC ¶ 61,352 (1993).

Southwestern Electric Power Company

Docket No. FA24-2-000

Background

On December 22, 2017, the TCJA was signed into law, which, in part, reduced the federal corporate income tax rate from 35% to 21%, effective January 1, 2018.²⁵ Accordingly, SWEPCo computed its income taxes owed to the Internal Revenue Service (IRS) based on a 21% tax rate, beginning January 1, 2018. The tax rate reduction resulted in a decrease of ADIT assets and liabilities recorded in Accounts 190, Accumulated Deferred Income Taxes; 282, Accumulated Deferred Income Taxes – Other Property; and 283, Accumulated Deferred Income Taxes – Other, on SWEPCo's books.²⁶ The reduction in ADIT assets and liabilities led to the creation of deficient and excess ADIT, as required by the Commission's accounting guidance.²⁷

SWEPCo revalued its ADIT assets and liabilities recorded in Accounts 190, 282, and 283, using the newly enacted federal corporate income tax rate of 21%. The revaluation resulted in a decrease in ADIT assets of \$38 million and ADIT liabilities of \$602.8 million. SWEPCo combined the excess and deficient ADIT amounts that resulted from the revaluation and recorded the net amount of \$564.8 million as a regulatory liability in Account 254. However, per the Commission's accounting regulations, SWEPCo was required to record the excess and deficient ADIT balances resulting from the tax rate change separately in Accounts 254 and 182.3, respectively.

Recommendations

DAA recommends that SWEPCo:

²⁵ Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

²⁶ ADIT balances are accumulated on the regulated books and records of public utilities based on the requirements of the Uniform System of Accounts. ADIT arises from timing differences between the method of computing taxable income for reporting to the IRS and the method of computing income for regulatory accounting and ratemaking purposes. *See* 18 C.F.R. § 35.24(d)(2) (2023). As a result of the reduction in the federal corporate income tax rate, a portion of an ADIT liability that was collected from customers will no longer be payable from the public utility to the IRS and is considered excess ADIT, which must be returned to customers in a cost-of-service ratemaking context. Additionally, for public utilities that have an ADIT asset, the TCJA resulted in a reduction to that ADIT asset, and the amount of the reduction is considered deficient ADIT.

²⁷ *See* Accounting Interpretation No. 93-5, at Item 8.

Southwestern Electric Power Company

Docket No. FA24-2-000

33. Revise and implement policies and procedures to ensure that SWEPCo properly accounts for and reports the effect of changes in tax laws or tax rates consistent with the Commission's accounting regulations.
34. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 33, and repeat such trainings as needed.
35. Submit correcting journal entries to DAA, within 60 days of issuance of this audit report, with proposed accounting entries and supporting documentation that reflect corrections to recorded excess and deficient ADIT in the appropriate Uniform System of Accounts.

Southwestern Electric Power Company

Docket No. FA24-2-000

7. FERC Form No. 1 Reporting

SWEPCo did not properly follow the FERC Form No. 1 page instructions and, therefore, did not accurately report all required information on certain pages of its FERC Form No. 1 filings. These actions affected the transparency, accuracy, and usefulness of the affected pages of the FERC Form No. 1 filings.

Pertinent Guidance

- 18 C.F.R. § 141.1(b)(2)(iii), which discusses the filing requirements for the FERC Form No. 1, states:

This report must be filed with the Federal Energy Regulatory Commission as prescribed in § 385.2011 of this chapter and as indicated in the General Instructions set out in this form and must be properly completed and verified. Filing on electronic media pursuant to § 385.2011 of this chapter is required.

Background

SWEPCo is required to report financial and operational information on an annual basis in the FERC Form No. 1. During fieldwork, audit staff reviewed SWEPCo's 2021 through 2023 FERC Form No. 1 submissions and evaluated whether SWEPCo properly followed the requirements and instructions for populating and reporting information in the form. The review entailed a detailed analysis of each page.

Audit staff found that amounts reported on Page 429, Transactions with Associated (Affiliated) Companies, did not agree with the supporting documentation SWEPCo provided. SWEPCo stated that the errors were due to internal processes, software design, and workarounds needed to report the data on Page 429. During the audit period, the errors resulted in a total overstatement of \$48,243,142 in Non-power Goods or Services Provided by Affiliated [Companies] and a total understatement of \$14,848,954 in Non-power Goods or Services Provided for Affiliated [Companies] in the 2021 through 2023 FERC Form No. 1 filings.

Additionally, audit staff found several instances when SWEPCo did not report information in its FERC Form No. 1 consistent with the form's instructions or reported incorrect information. These actions affected the transparency and accuracy of the information. The table below presents SWEPCo's reporting errors and their locations in its 2021 through 2023 FERC Form No. 1 filings.

Southwestern Electric Power Company

Docket No. FA24-2-000

Schedule(s)	Page(s)	Reporting Error
List of Schedules	2	"None," "not applicable," or "NA" was not listed for the schedules where no information or amounts were reported in the 2021-2023 filings.
General Information	101	Information regarding the state and date of incorporation was not provided in the 2021-2023 filings.
Information on Formula Rates	106(a)(b)	"No" was checked instead of "yes" in response to "does the respondent have formula rates" in the 2021-2023 filings.
Electric Plant in Service	204-207	ARO adjustments were listed as negative in the additions column, column (c), instead of the adjustments column, column (e), in the 2021 filing.
Other Regulatory Assets	232	The docket numbers were not included for some lines. Additionally, the accounts credited, column (d), were incorrect for some line items in the 2022 and 2023 filings.
Miscellaneous Deferred Debits	233	The accounts charged, column (d), for line 9, Dolet Hills and Sabine Reclamation Advance, were incorrect in the 2023 filing.
Other Regulatory Liabilities	278	The accounts credited, column (c), were incorrect for some line items in the 2023 filing.
Purchased Power	326-327	Statistical Classification, column (b), and FERC Rate Schedule or Tariff Number, column (c), were not completed for all lines in the 2021 and 2022 filings.
Depreciation and Amortization of Electric Plant	336-337	Average Remaining Life, column (g), was not completed in the 2021-2023 filings.
Amounts Included in ISO/RTO Settlement Statements	397	Balance at End of Quarter 1, 2, and 3, columns (b), (c), and (d), were not completed in the 2021 and 2022 filings.
Monthly Transmission System Peak Load	400	Page was not completed in the 2021-2023 filings.
Substations	426-427	Attended or Unattended, column (b-1), was not completed in the 2021-2023 filings.

Southwestern Electric Power Company

Docket No. FA24-2-000

Schedule(s)	Page(s)	Reporting Error
Transactions with Associated (Affiliated) Companies	429	Some of the line-item descriptions, accounts debited/credited, and amounts were not accurate. Some line items were omitted, and the amounts for some line items were incorrect.

Recommendations

DAA recommends that SWEPCo:

36. Revise and implement policies and procedures to ensure that SWEPCo reports correct, accurate, complete information in the FERC Form No. 1 consistent with the page instructions of the form. Include footnotes to the FERC Form No. 1 when software limitations prevent reporting complete information.
37. Provide training to relevant staff on policies and procedures implemented in response to Recommendation 36, and repeat such trainings as needed.

APCo/WPCo Attachment 1
Page 53 of 54

Southwestern Electric Power Company

Docket No. FA24-2-000

V. SWEPCo's Response to the Audit Report



Jessica A. Cano
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March 16, 2026

Kristin Fleet
Director and Chief Accountant
Division of Audits and Accounting
Office of Enforcement and Regulatory Accounting
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Via E-mail: Kristen.fleet@ferc.gov

Re: Docket No. FA24-2-000, Draft Audit Report

Dear Ms. Fleet,

American Electric Power Service Corporation ("AEPSC"), on behalf of Southwestern Electric Power Company ("SWEPCO"), received the Draft Audit Report issued in the above-referenced docket. The Draft Audit Report contains seven findings and 37 recommendations. Pursuant to Section 41.1(b) of the Commission's regulations and consistent with your request, AEPSC is hereby responding to the Draft Audit Report as follows:

1. Capitalization of Vegetation Management Costs

AEPSC accepts this finding and the related recommendations but maintains that its capitalization of the disputed vegetation costs was appropriate from both an accounting and ratemaking perspective. The capitalized vegetation management costs extend the lives and improve the efficiency of the transmission and distribution assets to which they relate. SWEPCO's capitalization of these costs also has resulted in lower historical customer rates than otherwise would have been charged had these costs been expensed. AEPSC clarifies that the statement at pages 2 and 19 that SWEPCO "overbilled transmission customers" is not accurate with respect to its capitalization practices generally; rather, that statement relates only to sub-issue (3), which identified the inadvertent double-counting of certain costs.

Kristen Fleet
March 16, 2026, p. 2

2. Prepaid Pension AFUDC

AEPSC accepts this finding and the related recommendations.

3. Allowance for Funds Used During Construction

AEPSC accepts this finding and the related recommendations.

4. Prepayments

AEPSC accepts this finding and the related recommendations.

5. Accounting Misclassifications

AEPSC accepts this finding and the related recommendations.

6. Excess Accumulated Deferred Income Tax

AEPSC accepts this finding and the related recommendations.

7. FERC Form No. 1 Reporting

AEPSC accepts this finding and the related recommendations.

As requested at page 8 of the Draft Audit Report, AEPSC will submit within 30 days of the issuance of the final audit report a plan for implementing the audit recommendations. AEPSC also will make quarterly reports of its progress in completing each corrective action and provide copies of any written policies and procedures developed in response to the recommendations.

Sincerely,

s/ Jessica A. Cano

Jessica A. Cano
Assoc. General Counsel –
Regulatory East
American Electric Power
Service Corporation

Counsel for SWEPCO

Verification

VERIFICATION

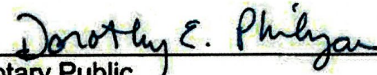
STATE OF WEST VIRGINIA,
COUNTY OF KANAWHA, TO-WIT:)

John J. Scalzo, Vice President – Regulatory Services and Finance for Appalachian Power Company and Wheeling Power Company, after being duly sworn, states upon his information and belief that the facts and allegations contained in the foregoing “Petition” are true and correct.


John J. Scalzo

Taken, subscribed and sworn to before me on the 12th day of June, 2026.

My commission expires: October 2, 2029.


Notary Public

(SEAL)

