



Mailing Address:
139 East Fourth Street
1303 Main / P.O. Box 960
Cincinnati, Ohio 45202
o: 513-287-4320
f: 513-287-4385

VIA OVERNIGHT DELIVERY

RECEIVED

June 3, 2015

JUN 04 2015

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Blvd
Frankfort, Kentucky 40601

PUBLIC SERVICE
COMMISSION

Re: In the Matter of the Joint Application of Duke Energy Corporation, Duke Energy Holding Corp., Deer Acquisition Corp., Cougar Acquisition Corp., Cinergy Corp., The Cincinnati Gas & Electric Company and The Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control,
Case No. 2005-00228

Dear Mr. Derouen:

In the Settlement Agreement in the above-referenced case, Duke Energy Kentucky, Inc. (Duke Energy Kentucky) made several merger commitments. Attached herein is an original and ten copies of the Final Report Affiliate Management Audit of Duke Energy Kentucky in response to Merger Commitment No. 12.

Please file stamp the two copies of this letter and the Final Report enclosed herein and return in the enclosed return-addressed envelope.

Sincerely,

Rocco O. D'Ascenzo

cc: Jennifer Hans (w/o enclosures)

Schumaker & Company



**2013 Affiliate Management Audit
of
Duke Energy Kentucky**

**Case Number: 2005-00228
Final Report**

May 2015

Table of Contents

I. EXECUTIVE SUMMARY	1
A. Background & Perspective.....	1
B. Objectives, Scope, and Methodology	3
Audit Methodology.....	3
Work Plan	3
II. MERGER ORDER REQUIREMENTS.....	7
A. Background & Perspective.....	7
B. Findings & Conclusions	7
Duke Energy Kentucky must continue to offer a full range of cost-effective energy conservation and efficiency programs.	7
The Board of Directors of the combined company must include at least one non-employee member who resides in the company’s service territory in Kentucky, Indiana, or Ohio.....	8
No merger costs may be passed on to Duke Energy Kentucky ratepayers.....	9
C. Recommendations	9
III. AFFILIATE RELATIONSHIPS	11
A. Background & Perspective.....	11
Organization Structure	11
Transactions.....	19
Services.....	19
Convenience Payments.....	21
Personnel Transfers.....	23
Asset Transfers	24
Separation.....	24
Ethics & Compliance Organization.....	26
Other Organizations	26
New Entities Since Last Audit.....	27
Similar Units As Reported in Last Audit	28
Unmentioned This Audit Year.....	30
Competitive or Sensitive Information.....	31

Table of Contents (continued)

Transfer Confidentiality Agreements	33
Training.....	33
Ethics Line	35
B. Findings & Conclusions	35
Affiliate Agreements.....	35
Affiliate Training.....	40
Benchmarking.....	41
2013 Aviation Benchmarking	41
2012 Benchmarking Consortium	41
2012 Security Survey	42
2011 Market Assessment.....	43
2008 Shared Services Cost Allocation and Market Study.....	43
Separations.....	44
Filings	46
C. Recommendations.....	47
IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT ..	49
A. Background & Perspective	49
Methodologies Used.....	50
Description of Transactions	50
Services	50
Asset Transfers.....	53
Cost Accumulation, Assignment, & Allocation.....	56
Billing Mechanisms.....	59
During Year.....	59
True-up Procedures	59
Labor and Overhead Items	59
Late Journal Entries.....	59
B. Findings & Conclusions	60
C. Recommendations.....	67

Table of Contents (continued)

V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE.....	69
A. Background	69
Long-term Debt	69
Long-term Debt Composition.....	69
Credit Ratings.....	71
Short-Term Debt	73
Money Pool	73
A summary of Money Pool funds borrowed by DEK in 2013 is shown in <i>Exhibit V-6</i>	76
Commercial Paper Program.....	76
Credit Facility	76
Capital Structure.....	78
Dividend Payouts	78
Capitalization.....	79
B. Findings & Conclusions	79
C. Recommendations	81
VI. INTERNAL CONTROLS.....	83
A. Background & Perspective.....	83
SOx Controls.....	83
Internal Audits	85
Regulated Utility Operations, Non-Regulated Products and Services Portfolio Review #113010	85
FE&G Non-Utility Operations Accounting Practices Audit #111016	86
FE&G FERC Uniform System of Accounts Audit #310006.....	87
Franchised Electric and Gas (FE&G) State Affiliate Standards – Indiana and Kentucky Audit # 110007	87
Allocations Process Audit #309015.....	88
Risk Assessment/Quality Assurance.....	88
B. Findings & Conclusions	89
C. Recommendations	89



Table of Exhibits

I. EXECUTIVE SUMMARY	1
Exhibit I-1 Summary Duke Energy Corporation Organization as of December 31, 2013...	2
II. MERGER ORDER REQUIREMENTS.....	7
III. AFFILIATE RELATIONSHIPS	11
Exhibit III-1 Detailed Duke Energy Corporation Organization Structure as of December 31, 2013 (Page 1 of 8)	11
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2013 (Page 2 of 8)	12
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2013 (Page 3 of 8)	13
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2013 (Page 4 of 8)	14
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2013 (Page 5 of 8)	15
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2013 (Page 6 of 8)	16
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2013 (Page 7 of 8)	17
Exhibit III-1 Detailed Duke Energy Organization Structure as of December 31, 2013 (Page 8 of 8)	18
Exhibit III-2 Duke Energy Kentucky Parental Structure as of December 31, 2013.....	19
Exhibit III-3 Affiliate Service Charges 2009 to 2013	20
Exhibit III-4 Convenience Payments 2009 to 2013	22
Exhibit III-5 Affiliate Personnel Transfers 2009 to 2013.....	23
Exhibit III-6 Affiliate Asset Transfers 2009 to 2013.....	24
Exhibit III-7 KRS 278.2213 Separate recordkeeping for utility and affiliate -- Prohibited business practices -- Confidentiality of information -- Notice of service available from competitor as of December 31, 2013.....	25
Exhibit III-8 Ethics & Compliance Organization as of December 31, 2013	26
Exhibit III-9 Affiliate Restrictions – Information Disclosure Procedure as of July 31, 2014.	32
Exhibit III-10 Existing Affiliate Agreements (Page 1 of 4) as of December 31, 2013.....	36
Exhibit III-10 Existing Affiliate Agreements (Page 2 of 4) as of December 31, 2013.....	37

Table of Exhibits (continued)

Exhibit III-10	Existing Affiliate Agreements (Page 3 of 4) as of December 31, 2013.....	38
Exhibit III-10	Existing Affiliate Agreements (Page 4 of 4) as of December 31, 2013.....	39
Exhibit III-11	Duke Energy Logos	45
IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT..49		
Exhibit IV-1	Summary Pricing Guide Services as of December 31, 2013.....	52
Exhibit IV-2	Summary Pricing Guide Asset Transfers as of December 31, 2013.....	56
Exhibit IV-3	Allocation Factors as of December 31, 2013	57
Exhibit IV-4	DEBS/PESC Allocation Factors by Function as of December 31, 2013	58
Exhibit IV-5	DEK Dividend Payout 2007 to 2013.....	63
Exhibit IV-6	Direct versus Allocated Affiliate Service Charges 2009 to 2013	64
V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE.....69		
Exhibit V-1	Duke Energy Long-Term Debt as of December 31, 2013	70
Exhibit V-2	Sampled Long-term Debt Instruments as of December 31, 2013.....	71
Exhibit V-3	Duke Energy Credit Ratings as of December 31, 2013.....	72
Exhibit V-4	Duke Energy Money Pool Participants as of December 31, 2013.....	73
Exhibit V-5	Money Pool Funds Lent by DEK as of December 31, 2013	75
Exhibit V-6	Money Pool Funds Borrowed by DEK as of December 31, 2013.....	76
Exhibit V-7	Duke Energy Credit Agreement Participants as of December 31, 2013.....	77
Exhibit V-8	Duke Energy Credit Agreement Pricing Schedule as of December 31, 2013....	78
Exhibit V-9	DEK's Dividend Payout History 2004 to 2013.....	78
Exhibit V-10	DEK's Capital Structure History 2011 to 2013	79
VI. INTERNAL CONTROLS.....83		
Exhibit VI-1	Internal Controls Organization 2013	84
Exhibit VI-2	Internal Audits Associated with Affiliate Relationships / Transactions 2009 to 2013	85
Exhibit VI-3	Risk Assessment/Quality Assurance Documentation	89



Table of Findings

I. EXECUTIVE SUMMARY	1
II. MERGER ORDER REQUIREMENTS.....	7
Finding II-1	Duke Energy Kentucky appears to be responsive to the KPSC’s merger order conditions, but it cannot be determined if any merger costs will be passed on to DEK ratepayers until DEK’s next rate case. 7
III. AFFILIATE RELATIONSHIPS	11
Finding III-1	Affiliate agreements in place for 2013 were all established prior to 2013; however, one of the agreements included in its initial 2014 submittal to the KPSC was a DEO, not a DEK, agreement. 35
Finding III-2	DEK has continued to improve and modify the affiliate training programs. 40
Finding III-3	DEK’s Affiliate Rules training for 2013 indicates indicated only two employees had not completed training within a timely manner. 40
Finding III-4	Duke Energy frequently performs various benchmarking studies as a means to compare costs to market values for services performed. 41
Finding III-5	There was no use of the DEK logo by any non-utility affiliate. 44
Finding III-6	There is no office space shared occupied by DEK and non-regulated affiliated wholesale power marketers. 45
Finding III-7	There are some shared computer systems between by DEK and non-regulated affiliated wholesale power marketers, but they are controlled via passwords and other access permissions. 46
Finding III-8	Filings were made with the KPSC in 2013 as required in the merger commitments approved by the KPSC on November 29, 2005. 46
IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT ..	49
Finding IV-1	The DEK cost allocation manual includes KPSC requirements, but continues to miss key elements of comprehensive CAM documentation used by other utility organizations, such as DEC. 60
Finding IV-2	Appropriate cost allocation factors are being used. 62
Finding IV-3	DEK’s dividend policy is generally reasonable, although in 2011 an extremely high dividend payout ratio occurred, but has since decreased. 62
Finding IV-4	Appropriate levels of direct charging are generally occurring with regard to DEK’s affiliate transactions. 64

Table of Findings (continued)

Finding IV-5	Duke Energy has made changes in having DEK management provide oversight for affiliate charges to DEK.	65
Finding IV-6	Affiliate asset transfer training has improved by incorporating Supply Chain, Accounting, and Rates organizations, unlike 2011.	66
Finding IV-7	Sufficient policy and associated documentation has not been available in past years regarding accounting for asset loans.	67
V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE.....		69
Finding V-1	DEK is not exposed to undue risk because of its long-term indebtedness or that of its affiliates.	79
Finding V-2	DEK is not party to any agreements that obligate it to underwrite the financial viability of any of its affiliates.	80
Finding V-3	During 2012 and 2013 DEK has not issued any security for the purpose of financing the acquisition, ownership, or operation of an affiliate.	80
Finding V-4	DEK has not assumed any obligation or liability as guarantor, endorser, surety, or otherwise in respect of any security of an affiliate.	80
Finding V-5	DEK has not pledged, mortgaged or otherwise used as collateral any of its assets for the benefit of an affiliate.	81
Finding V-6	DEK has maintained a consistent credit rating since mid-2012.	81
Finding V-7	DEK's Money Pool transactions in 2013 have not caused it to incur any material unnecessary expense.	81
VI. INTERNAL CONTROLS.....		83
Finding VI-1	Internal audit reports regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been addressed by DEBS staff in a timely manner.	89



Table of Recommendations

I. EXECUTIVE SUMMARY	1
II. MERGER ORDER REQUIREMENTS.....	7
Recommendation II-1	Provide sufficient documentation during Duke Energy Kentucky's next rate case to ensure that Duke Energy/Progress Energy merger costs are not being passed on to DEK ratepayers. (Refer to Finding II-1.).....
	9
III. AFFILIATE RELATIONSHIPS	11
Recommendation III-1	Aggressively send notifications to employees who have not passed affiliate rules training even before the Day 30 currently used. (Refer to Finding III-3).....
	47
Recommendation III-2	Continue to enhance Affiliate Standards training, plus make sure all Duke Energy employees taking such training using <i>MyTraining</i> by the end of 2014. (Refer to Finding III-2 and Finding III-3.).....
	48
IV. AFFILIATE TRANSACTIONS AND COST ACCUMULATION AND ASSIGNMENT ..	49
Recommendation IV-1	Develop a formal comprehensive cost allocation manual that brings together all required elements of such documentation. (Refer to Finding IV-1).....
	67
Recommendation IV-2	Develop a formal policy and associated documentation regarding asset loans. (Refer to Finding IV-7)
	68
V. FINANCIAL ARRANGEMENT/OBLIGATION COMPLIANCE	69
VI. INTERNAL CONTROLS	83

**2013 Affiliate Management Audit
of
Duke Energy Kentucky
Case Number: 2005-00228
Draft Report**

May 2015



I. Executive Summary

A. Background & Perspective

In 2006, Cinergy Corp. (Cinergy), the parent company of Union Light, Heat and Power Company (ULH&P), subsequently re-named Duke Energy Kentucky (DEK), merged with Duke Energy Corporation (Duke Energy). As part of its approval of the merger, the Kentucky Public Service Commission (KPSC) established forty-six merger commitments in Case No. 2005-00228, of which three (3), specifically Commitments 11, 12, and 13 specifically relate directly to this audit. They apply as follows:

- ◆ DEK is in compliance with its Commitment 11, which requires proper accounting of costs.
- ◆ DEK is in compliance with its Commitment 12, which requires that it maintain appropriate cost allocation procedures and commit to third-party audits.
- ◆ DEK is in compliance with its Commitment 13, which requires that it protect against cross-subsidization.

Also within the scope of this audit is DEK's compliance with KPSC regulations, including:

- ◆ 807 KAR 5:080 SECTION 2 — Annual reports
- ◆ 807 KAR 5:080 SECTION 3 — Filing of cost allocation manual and amendments
- ◆ 807 KAR 5:080 SECTION 4 — Notice of establishment of new non-regulated activity

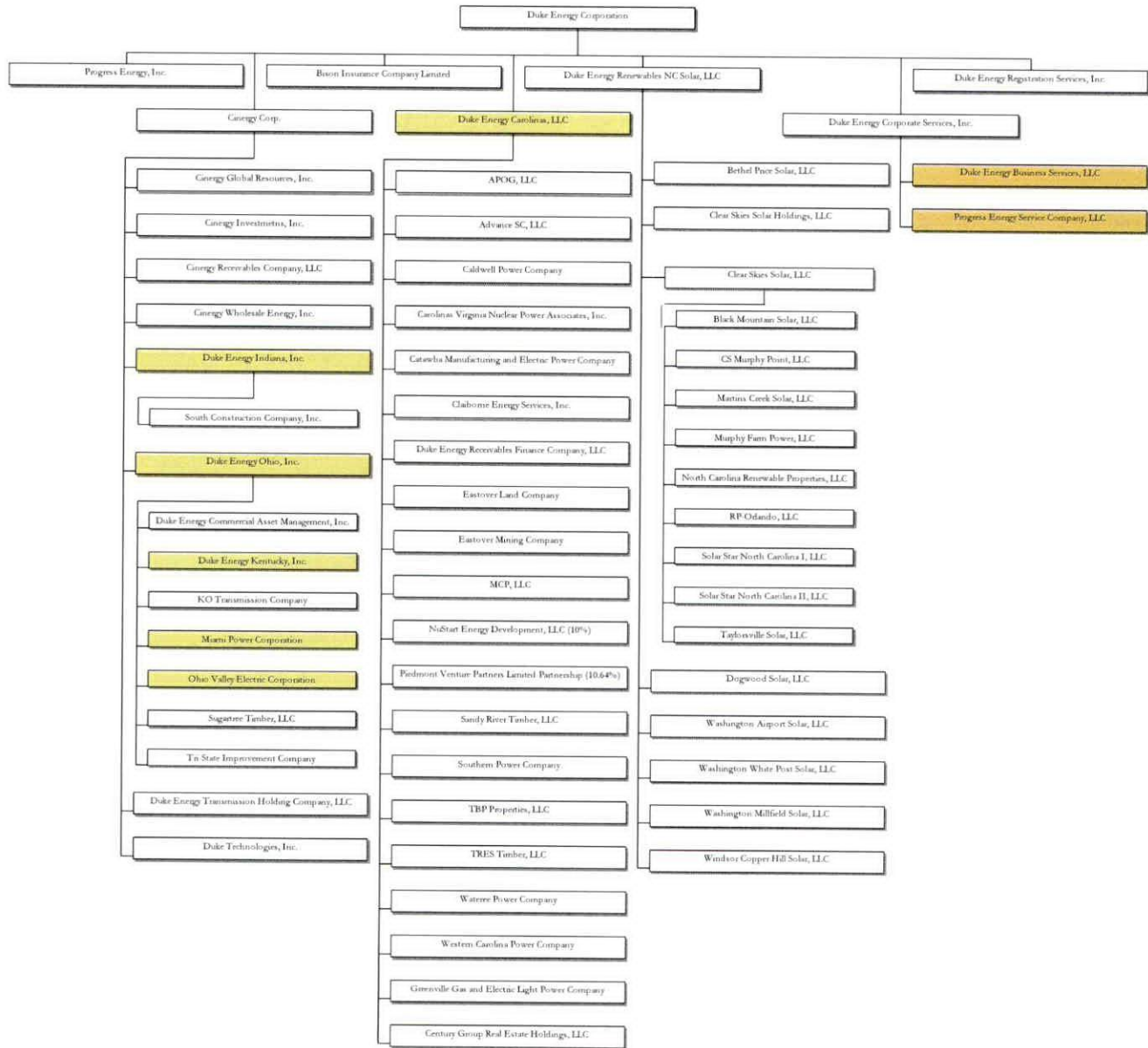
With the approval of the merger of Duke Energy with Progress Energy Corporation (Progress Energy), the KPSC imposed three additional conditions on its approval of the merger, specifically:

- ◆ Duke Energy Kentucky must continue to offer a full range of cost-effective energy conservation and efficiency programs.
- ◆ The Board of Directors of the combined company must include at least one non-employee member who resides in the company's service territory in Kentucky, Indiana, or Ohio.
- ◆ No merger costs may be passed on to Duke Energy Kentucky ratepayers.

Refer to *Chapter II – Merger Order Requirements* for a discussion of Duke Energy's responses.

Duke Energy Kentucky is part of the Duke Energy Corporation organization, in which its summary organization structure, as of December 31, 2013 is depicted on *Exhibit I-1*.¹ It includes Progress Energy entities added when July 2, 2012 merger occurred.

**Exhibit I-1
Summary Duke Energy Corporation Organization
as of December 31, 2013**



Source: Information Response 1 Attachment C (public utilities are highlighted in yellow and the utility service company in orange; all other entities are non-regulated entities.)

B. Objectives, Scope, and Methodology

Audit Methodology

Schumaker & Company followed a three-step process designed to sustain vital, interactive working relationships our project team and DEK. Our approach for achieving the audit objectives was as follows:

- ◆ Step I – Diagnostic Review
- ◆ Step II – Detailed Review and Analysis
- ◆ Step III – Draft and Draft Report Preparation

Work Plan

Each task area in our work plan was designed to allow our team to efficiently gather and analyze information necessary to develop an opinion whether DEK adequately complied with Kentucky's affiliate standards in 2013. The tables on the following pages illustrate a general discussion of the type of work steps typically performed for each task area, as well as the preliminary information that would be required and the key indicators that we would use to assess that specific task area.

Affiliate Relationships		
Typical Work Steps	Information Required	Key Indicators
<p>Review governing regulations, orders, and decisions from the Commission regarding affiliate transactions and determine if these affiliate relations rules have been fully complied with by DEK; identify any situations of non-compliance and determine the actual or potential impact of this non-compliance.</p> <p>Obtain DEK organization charts showing the relationships of DEK with its affiliates.</p> <p>Identify all affiliates that had transactions with DEK during the last three years.</p> <p>Identify all products and services provided from/to regulated and unregulated affiliates of DEK during the last three years.</p> <p>Document the frequency and dollar magnitude of all affiliate goods and services by year and by affiliate for all items received by or provided by DEK.</p> <p>Develop diagrams, graphs, and/or tabulations identifying affiliates, services, dollar magnitude, and other useful information and data. Explain any significant trends or changes.</p> <p>Analyze trends of these allocated amounts compared to the trends of these costs in the parent/affiliate.</p> <p>Separately identify affiliate transactions involving the transfer of employees, property, and/or technology.</p> <p>Identify, by plant category, any capital expenditures made by affiliates but allocated to DEK's operations.</p> <p>Evaluate any transactions that have had a significant effect on depreciation expense.</p> <p>Identify shared facilities, systems, and programs among affiliates including employee training, joint purchasing, information technology, advertising and promotion, and corporate support services.</p> <p>Review internal systems for providing assurance that goals and objectives are accomplished at the lowest possible cost and maximum benefit to ratepayers.</p> <p>Identify internal controls in place to protect against irregular, illegal, and/or improper transactions.</p> <p>Review filings, reports, and communications involving affiliate relationships.</p>	<p>Copies of all governing regulations, orders, and decisions from the Commission regarding affiliate transactions</p> <p>Duke Energy and DEK organization charts showing all affiliate relationships, including regulatory status of affiliates</p> <p>Description of all products and services provided from/to regulated and unregulated affiliates of DEK during the last three years</p> <p>Level and nature of affiliated transactions (actual and budget dollars) from/to DEK's operations and affiliates during the last three years, including a breakdown by:</p> <ul style="list-style-type: none"> ◆ From/to affiliate ◆ Type of transaction ◆ Time period <p>Actual dollars and personnel equivalents, by functional category, for each associated regulated and/or non-regulated DEK affiliate</p> <p>The level and nature of affiliated transactions (actual and budgeted capital expenditure dollars, by plant category) allocated to DEK's operations by affiliates during the last three years – as compared to its parent/affiliates</p> <p>Any cost allocation manual documentation, including formulas and basis</p>	<p>All affiliate transactions of DEK should be in complete compliance with all of the governing regulations, orders, and decisions from the Commission regarding affiliate transactions.</p> <p>The relationships with affiliates are clearly documented.</p> <p>The costs are fairly representative of the value of goods and services provided and of the benefits derived by Kentucky ratepayers.</p> <p>DEK should be able to easily furnish information regarding the products and services provided to/from its affiliates and the corresponding financial transactions that result.</p> <p>DEK should not be negatively impacted by its relationships in the overall corporate organization.</p> <p>Any affiliate costs charged to DEK are reasonable and competitive in the market.</p>

Cost Allocation Methodologies – Affiliate Transactions and Cost Accumulation and Assignment		
Typical Work Steps	Information Required	Key Indicators
<p>Determine procedures specified for identifying, tracking, and posting direct, indirect, and general overhead costs to specific projects or cost pools.</p> <p>Determine how these assignment policies, procedures, and practices have changed over time; assess the rationale for these changes.</p> <p>Assess methodologies (e.g., accounting systems) used to accumulate and assign costs. Examine criteria used to assign costs. Evaluate Duke Energy’s hierarchy for placing emphasis on direct billing versus cost allocation, and for developing causal relationships in formulating allocation methodologies. Evaluate whether direct billing is used whenever possible.</p> <p>Assess whether cost accumulation/assignment bases are reasonable and appropriate (e.g., based on cost causative factors) and whether they have been consistently developed.</p> <p>Review documentation involving policies and guidelines in place to establish the appropriation of resources and costs, including (but not limited to):</p> <ul style="list-style-type: none"> ◆ Finance manuals ◆ Assignment policies ◆ Cost allocation manuals <p>Identify generic direct billing and/or cost allocation methodologies in place within DEK and its affiliates used to calculate the costs for services or products provided.</p> <p>Assess whether cost allocation methodologies, and their associated bases and factors, are reasonable and appropriate, and whether they have been consistently applied. Assess whether these methodologies are regularly reviewed and revised.</p> <p>Determine whether the policies, procedures, and practices governing these transfer pricing methodologies and accounting standards are adequately documented and understood by the personnel involved.</p> <p>Identify the data sources and special studies required to develop allocations factors (if they are used), and evaluate their appropriateness.</p> <p>Determine how allocation policies, procedures, and practices have changed over time; assess the rationale for these changes.</p>	<p>Any cost accounting documentation involving cost accumulation and assignment</p> <p>Copies of DEK’s general ledger and pertinent subsidiary ledgers</p> <p>Any accounting manuals and other documentation describing methodologies, bases, and factors used for direct billing and/or cost allocation, and/or segregating regulated and unregulated costs, including (but not limited to):</p> <ul style="list-style-type: none"> ◆ Finance manuals ◆ Assignment policies ◆ Cost allocation manuals <p>Description of daily accounting standards and recordkeeping methods and procedures that support the daily operations between DEK and its affiliates</p>	<p>DEK and its affiliates should have in place well-defined and consistently applied procedures for accumulating and assigning costs, and should be able to provide timely, current, and accurate information regarding the level, nature, and magnitude of costs incurred.</p> <p>Direct billing and allocation methodologies used by DEK and its affiliates should be founded on reasonable and fair factors and bases that properly reflect the value of products and services received, and should be supported by automated systems and contracts that provide management with the information and data it needs for recording and managing these activities.</p> <p>DEK should not be negatively impacted by its relationships in the overall corporate organization.</p> <p>Any affiliate costs charged to DEK are reasonable and competitive in the market.</p>

Cost Allocation Methodologies – Affiliate Transactions and Cost Accumulation and Assignment		
Typical Work Steps	Information Required	Key Indicators
<p>Determine if contracts are in place and current where appropriate. Determine if the formal contracts define the nature of affiliate services rendered, set forth clearly defined bases for associated charges, and stipulate terms and conditions favorable to DEK's regulated operations in Kentucky.</p> <p>Determine if any contracts with third parties involving more than one affiliate provide DEK's operations with full consideration for performance, taking into account risk premiums or time value of money implicit in the payment or collection terms of such contracts.</p> <p>Assess whether the direct billing and cost allocation processes are adequately automated.</p> <p>Evaluate those mechanisms and procedures in the direct charges/cost allocation guidelines intended to guard against the cross-subsidization of unregulated entities, either through intentional or unintentional means.</p> <p>Identify the extent to which DEK's financial strength is impacted by or insulated from its affiliated (regulated or unregulated) companies.</p>		
<p>Identify the decision-making process used in the determination of services required, and for identifying the most optimum means of providing these services.</p> <p>Identify how DEK determines whether internal or external resources are used; identify instances of comparisons between outside vendors and internal resources for products and services provided to DEK.</p>	<p>Any analyses regarding use of external vendors for the development and delivery of services to DEK and its operations</p> <p>Any cost/benefit analyses performed during the last three years regarding provision of services by DEK or its affiliates</p>	<p>Decisions pertaining to the use of external vendors should be based on analysis that considers cost-benefit, financial, and other factors. These decisions should consider comparisons to provision directly by DEK or its affiliates, as well as the benefits that customers of regulated operations will receive.</p>

II. Merger Order Requirements

A. Background & Perspective

As mentioned initially in *Chapter I – Executive Summary*, with the approval of the merger of Duke Energy Corporation (Duke Energy) with Progress Energy Corporation (Progress Energy), the Kentucky Public Service Commission (KPSC) imposed three additional conditions on its approval of the merger, specifically:

1. Duke Energy Kentucky (DEK) must continue to offer a full range of cost-effective energy conservation and efficiency programs.
2. The Board of Directors of the combined company must include at least one non-employee member who resides in the company's service territory in Kentucky, Indiana, or Ohio.
3. No merger costs may be passed on to DEK ratepayers.

This chapter addresses DEK's response to these conditions.

B. Findings & Conclusions

Finding II-1 **Duke Energy Kentucky appears to be responsive to the KPSC's merger order conditions, but it cannot be determined if any merger costs will be passed on to DEK ratepayers until DEK's next rate case.**

Duke Energy Kentucky must continue to offer a full range of cost-effective energy conservation and efficiency programs.

According to Duke Energy management, DEK continues to offer its customers a robust portfolio of energy efficiency and demand response programs to its customers, including:²

- ◆ Residential Programs
 - Residential Energy Assessments Program
 - Energy Education Programs for Schools Program
 - Residential Smart Saver Efficient Residences Program
 - Residential Smart Saver Energy Efficient Products Program
 - Low Income Neighborhood
 - Low Income Services Program
 - My Home Energy Report
 - Appliance Recycling Program
 - Power Manager Program – *Demand Response Program*

- ◆ Non Residential Programs
 - Smart Saver Prescriptive Program
 - Smart Saver Custom Program
 - Smart Saver Energy Assessments Program
 - PowerShare – *Demand Response Program*

The table below shows the achievement of its portfolio in 2013 and the first six months of 2014:³

	2013		2014 (January-June)	
	Annual KW Savings	Annual KWH Savings	Annual KW Savings	Annual KWH Savings
Residential Programs	17,474	32,632,062	16,174	18,734,673
Non-Residential Programs	22,996	6,060,031	23,195	74,240
Total	40,469	38,692,092	39,369	18,808,913

DEK monitors its program performance as well as market conditions and uses then uses its annual August 15th filing to amend its portfolio of programs. In 2014, DEK proposed the following modifications:⁴

- ◆ Expansion of the scope of the Residential Smart Saver Program and the My Home Energy Report Program by increasing the available measures within each program.
- ◆ The addition of a new program for non-residential customers, the Small Business Energy Saver Program.
- ◆ An update of the measures offered to non-residential customers within the Smart Saver Prescriptive Program and enhancements to the Smart Saver Custom Program.
- ◆ The elimination of the Energy Management and Information Services Pilot due to a lack of customer demand necessary to make the program cost-effective.
- ◆ The flexibility to enhance approved programs in a timelier manner by allowing automatic approval of cost effective measures. The enhancements consist of minor program modifications that will not require a significant increase in costs, \$75,000 or less, and will not fundamentally change the program.

By making annual modifications to its portfolio, DEK management believes that the company increases the relevance of its programs to customers, keeps up with technology advances, and maximizes the effectiveness of its efficiency and demand response programs.⁵

The Board of Directors of the combined company must include at least one non-employee member who resides in the company's service territory in Kentucky, Indiana, or Ohio.

At least one member of Duke Energy (Michael G. Browning) resides in Indiana.⁶

No merger costs may be passed on to Duke Energy Kentucky ratepayers.

According to Duke Energy management, any costs to achieve associated with the merger are charged to the appropriate account pursuant to communicated guidelines provided to Schumaker & Company during this audit. Then, at the time of a rate case, adjustments would be made, if necessary, to remove costs charged to “costs to achieve” from the revenue requirement calculation to be used for establishing new base rates. Duke Energy management believes that such adjustments would ensure that DEK meets its commitment to ensure that “no merger costs are passed on to its retail electric or gas customers.”⁷

C. Recommendations

Recommendation II-1 Provide sufficient documentation during Duke Energy Kentucky’s next rate case to ensure that Duke Energy/Progress Energy merger costs are not being passed on to DEK ratepayers. (Refer to Finding II-1.)

According to documentation provided by Duke Energy management, costs may be treated as costs to achieve (CTA) the merger if they are incremental, non-recurring, and incurred as a direct result of the merger. Also, for operations & maintenance (O&M) purposes, internal labor is not considered incremental; therefore, it is not included by Duke Energy in costs to achieve, although internal labor can be charged to capital CTA projects. External labor (contractors) hired to work on O&M and capital CTA projects are considered incremental and were to be directly charged to CTA projects. Other guidelines, such as those provided for travel/lodging were included in the documentation.⁸

Therefore, during the next Duke Energy Kentucky rate case, Duke Energy must provide rationalization as to why internal labor costs are not charged to merger costs in selected situations, plus it must provide sufficient documentation to ensure that Duke Energy/Progress Energy merger costs are not being passed on to Duke Energy Kentucky ratepayers.

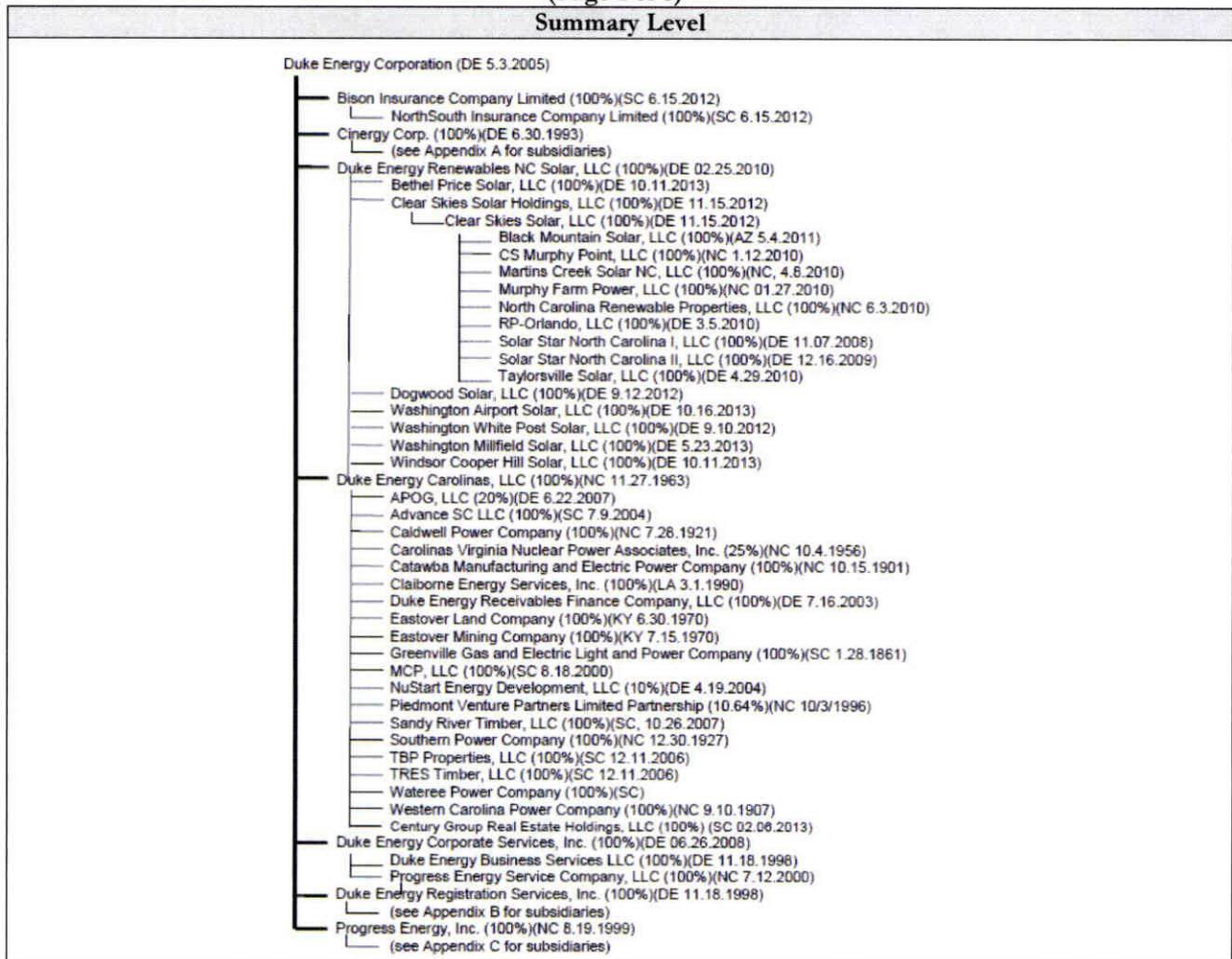
III. Affiliate Relationships

A. Background & Perspective

Organization Structure

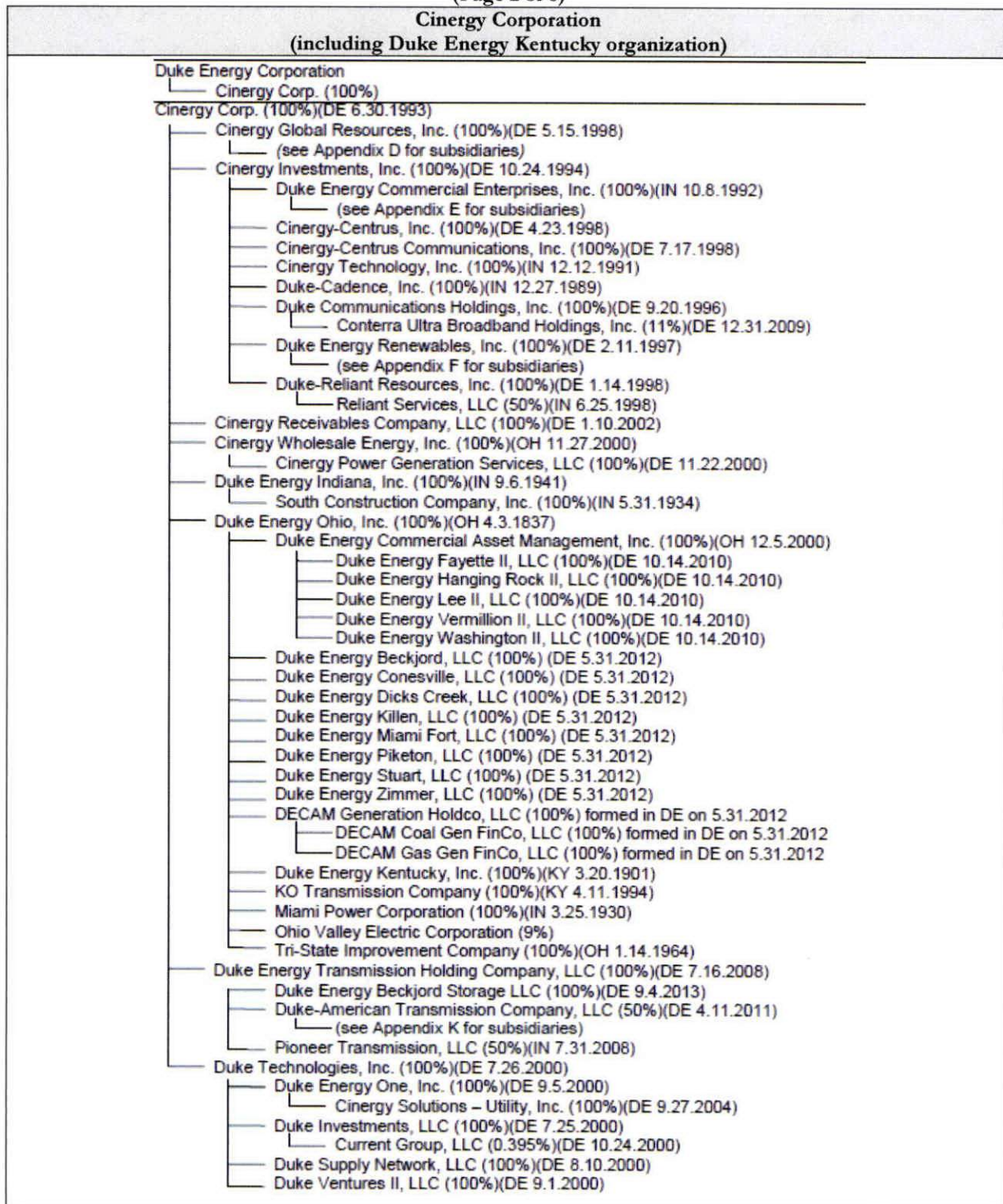
While *Exhibit I-1* displayed in the *Executive Summary* chapter is a summary look at Duke Energy Corporation’s (Duke Energy’s) organization, *Exhibit III-1* is a detailed look, including changes made in September to December of 2013.⁹

Exhibit III-1
Detailed Duke Energy Corporation Organization Structure
as of December 31, 2013
(Page 1 of 8)



Source: Information Response 1 (Item 4)

Exhibit III-1
Detailed Duke Energy Organization Structure
 as of December 31, 2013
 (Page 2 of 8)



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2013
(Page 3 of 8)**

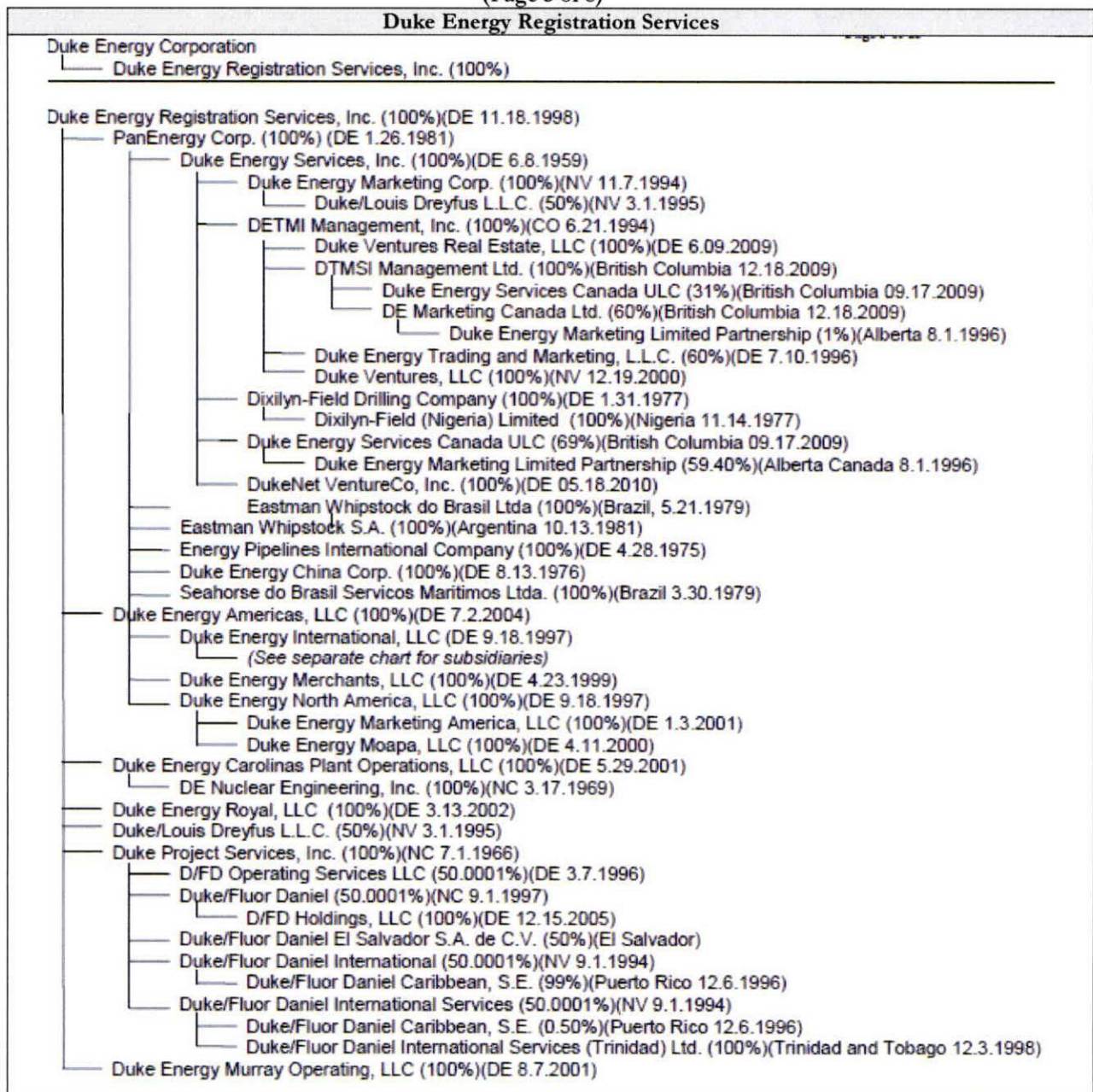
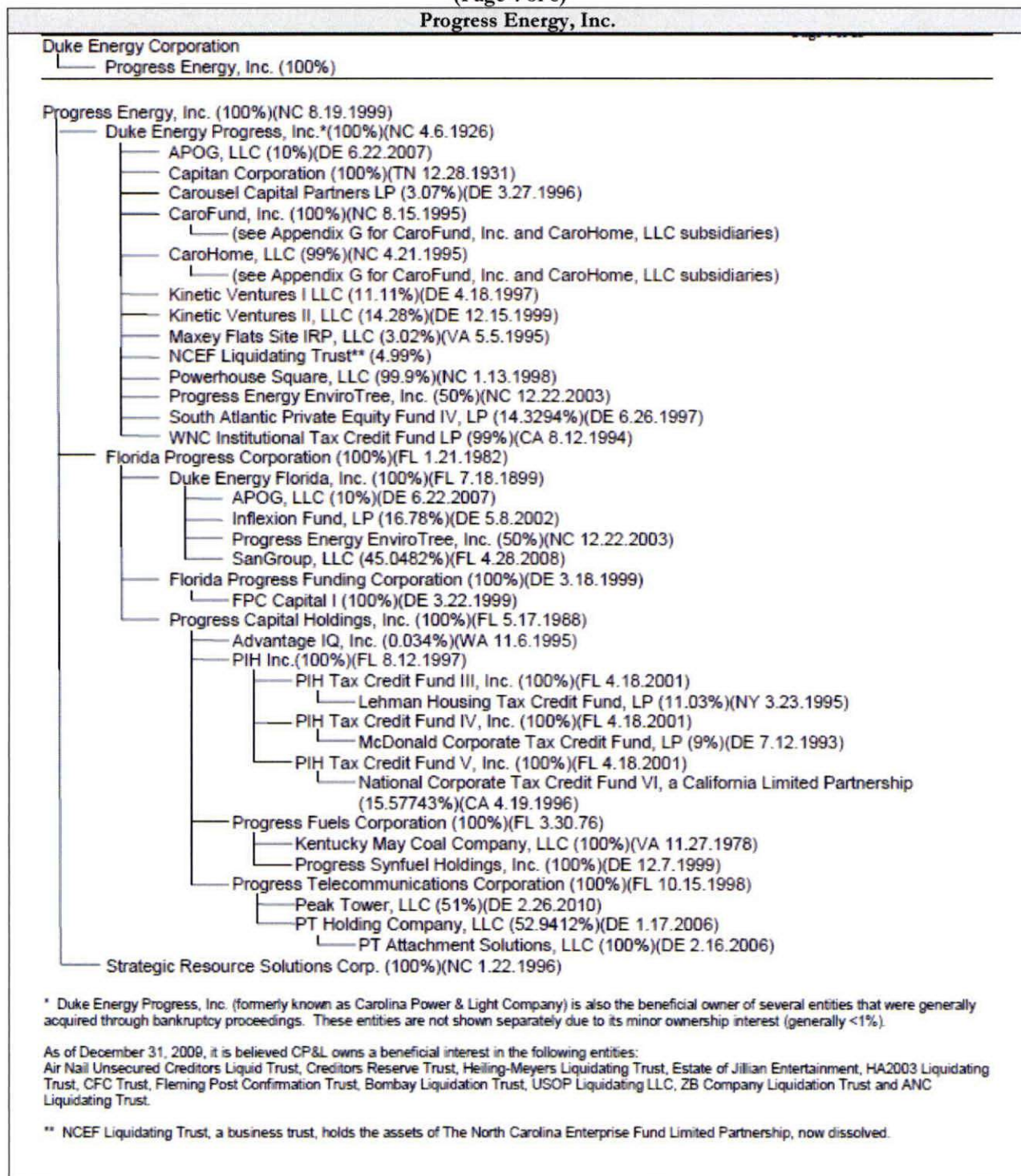
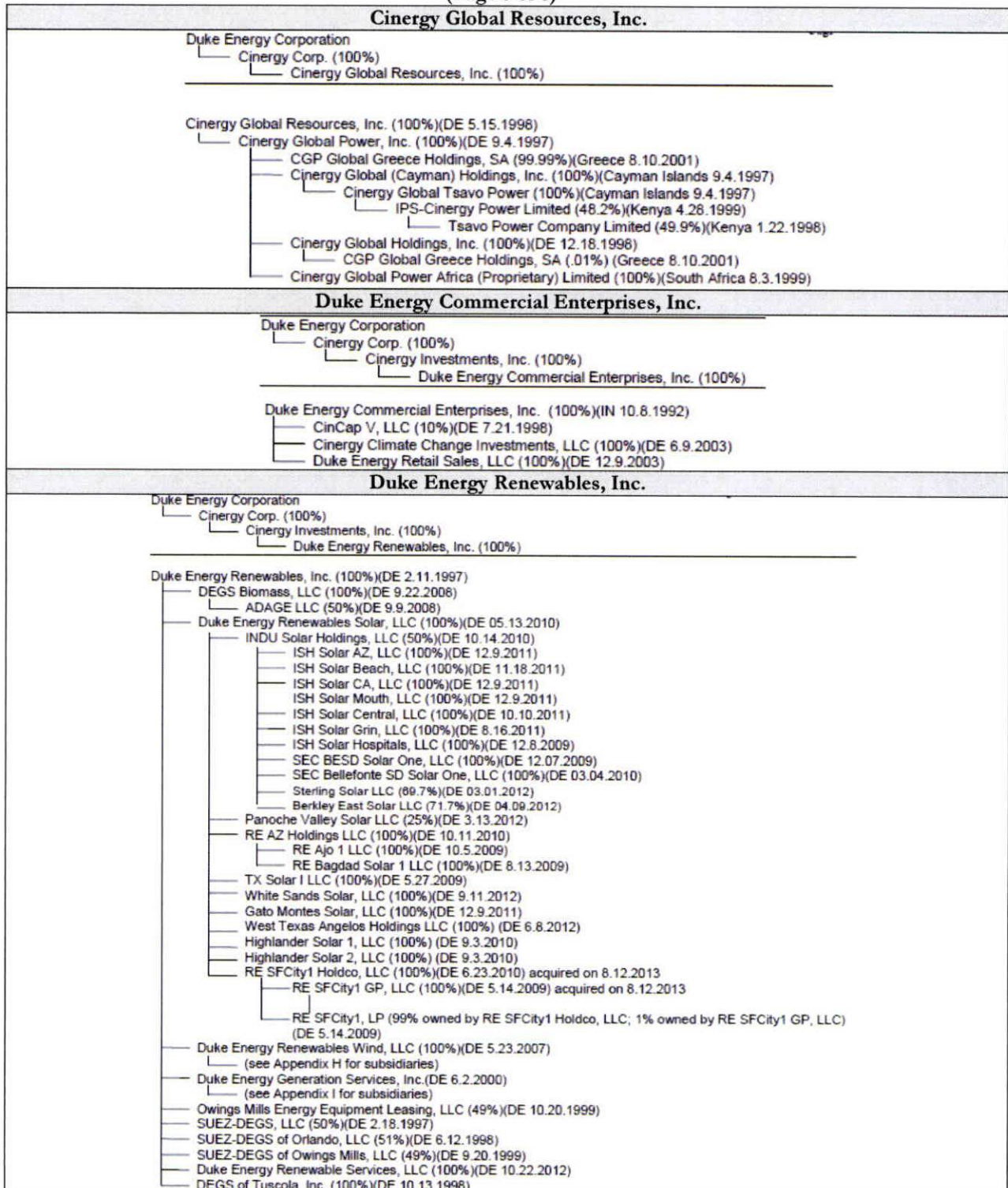


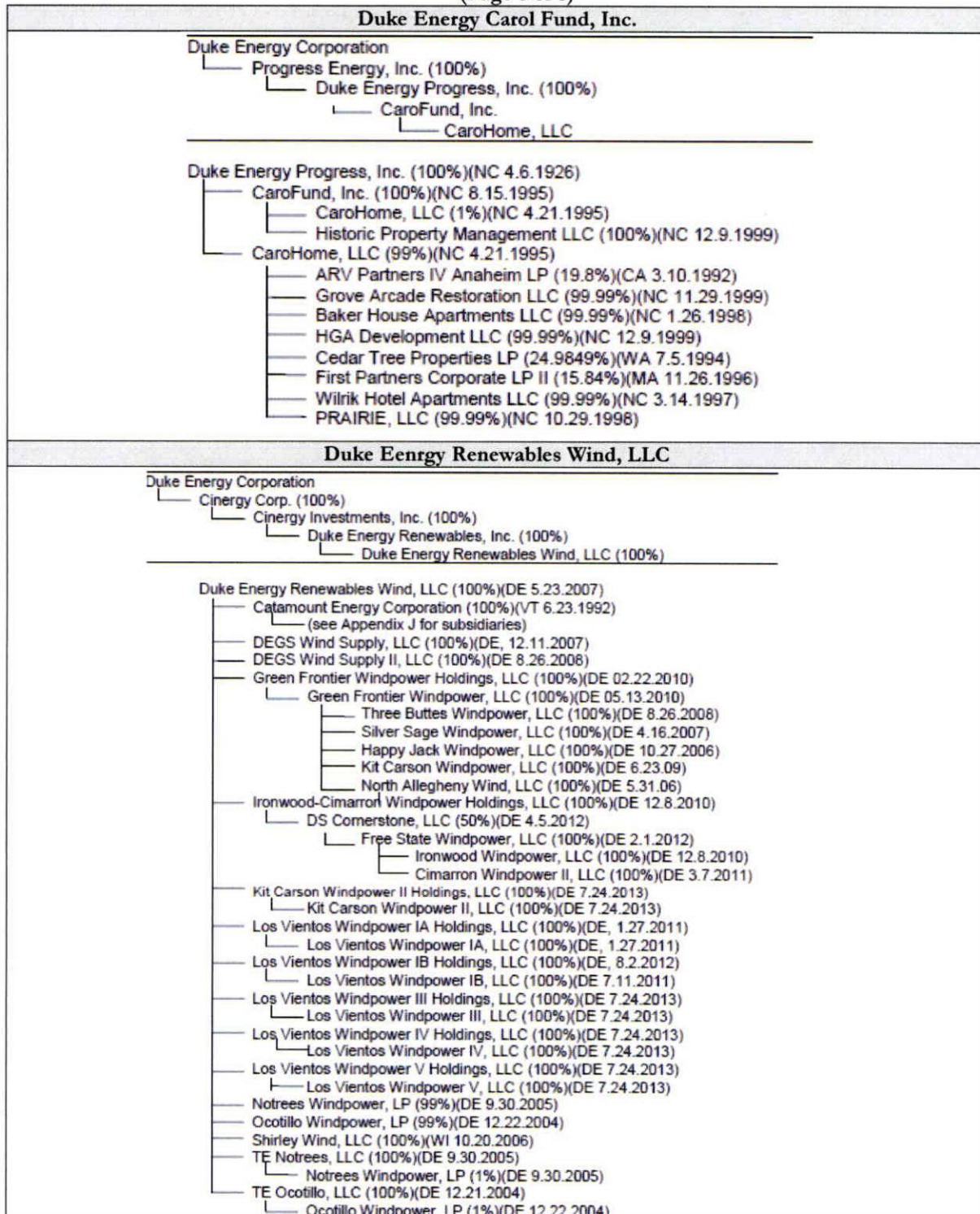
Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2013
(Page 4 of 8)



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2013
(Page 5 of 8)**



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2013
(Page 6 of 8)**



**Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2013
(Page 7 of 8)**

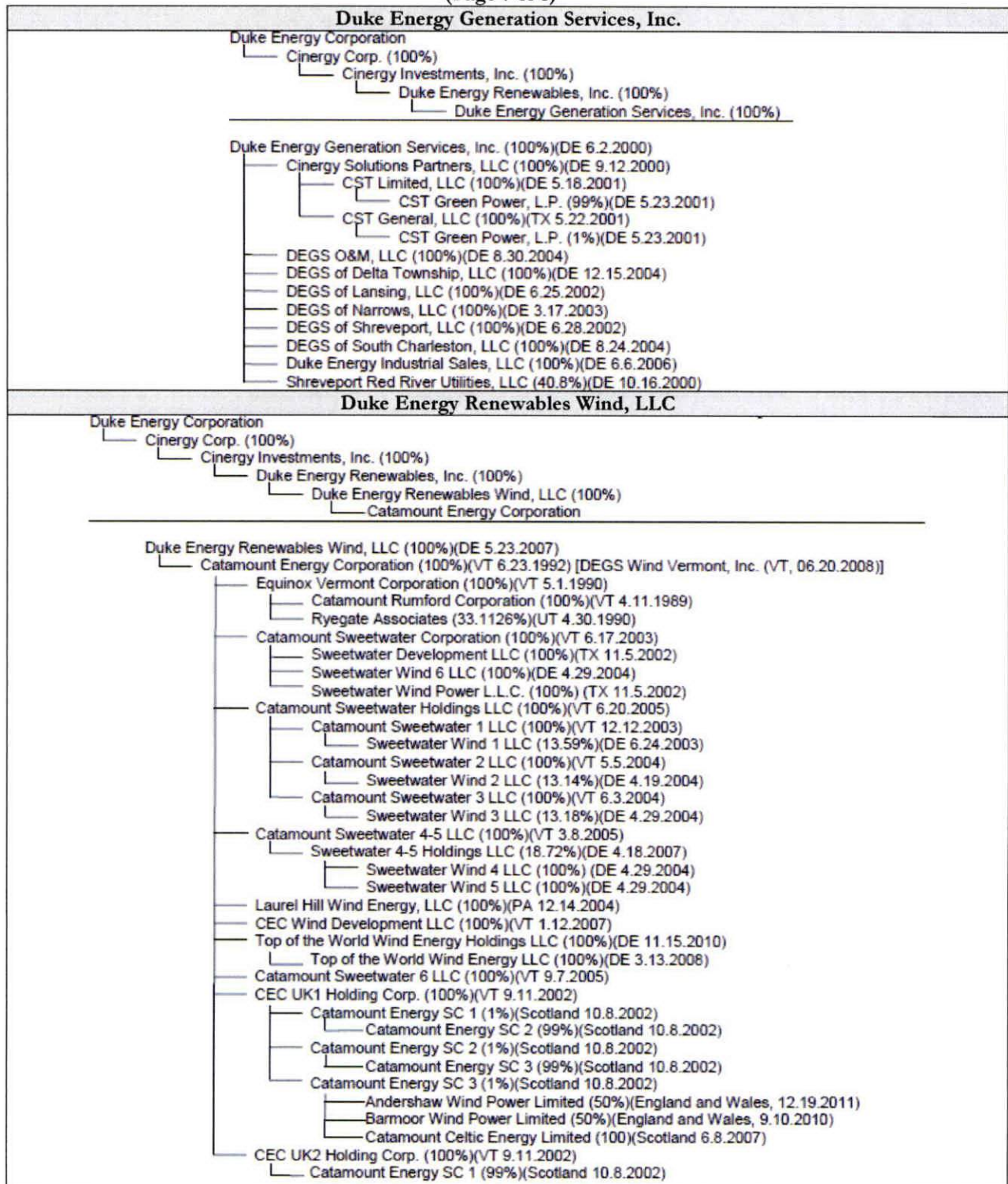
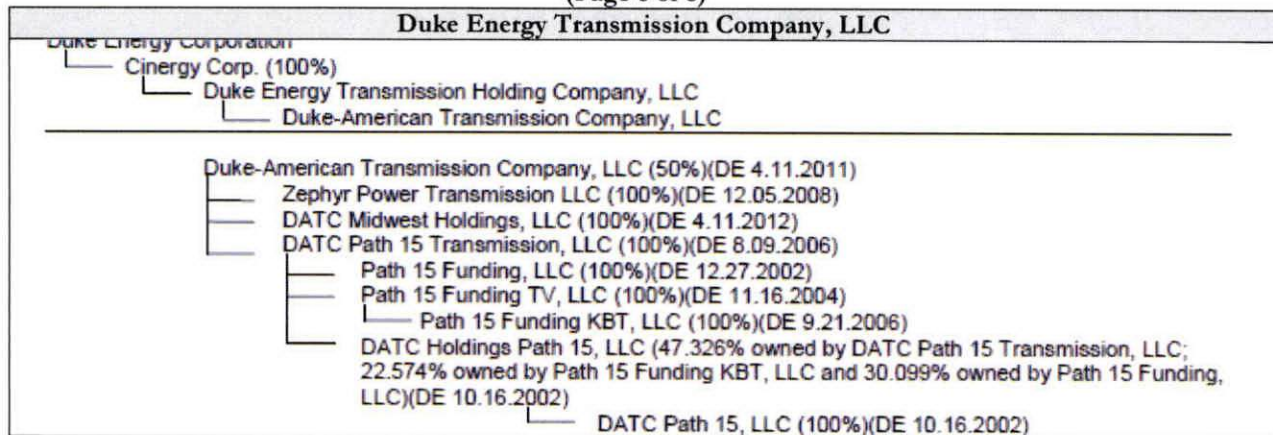


Exhibit III-1
Detailed Duke Energy Organization Structure
as of December 31, 2013
(Page 8 of 8)



Changes to Corporate Structure: September-December 2013

Entities Removed

Ball Hill Windpark, LLC (100%)(DE, 9.29.06) sold on 12.30.2013
 Searchlight Wind Energy LLC (100%)(NV 1.17.2008) sold on 12.30.2013
 Willow Creek Wind Energy LLC (100%)(DE 6.18.2007) sold on 12.30.2013
 Woods Canyon Windpower, LLC (DE 12.20.2013) sold on 12.30.2013
 DukeNet Communications Holdings, LLC (50%)(DE 05.18.2010) sold on 12.31.2013
 DukeNet Communications, LLC (100%)(DE 05.18.2010) sold on 12.31.2013
 DukeNet/TCG LLC (21.6%)(NC 12.12.1997) sold on 12.31.2013

Entities Added

Windsor Cooper Hill Solar, LLC (100%)(DE 10.11.2013)
 Bethel Price Solar, LLC (100%)(DE 10.11.2013)
 Washington Airport Solar, LLC (DE 10.16.2013)
 Woods Canyon Windpower, LLC (DE 12.20.2013)

Entities Restructured

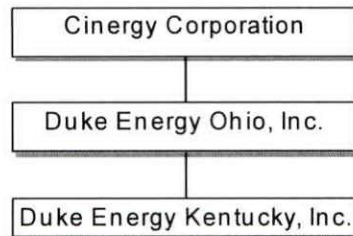
Progress Ventures Holdings, Inc. (100%)(FL 12.31.2009) merged into Duke Energy Corporate Services, Inc. (100%)(DE 06.26.2008) on 1.1.2014
 Progress Ventures, Inc. d/b/a Progress Energy Ventures, Inc. (100%)(NC 3.31.2000) merged into Duke Energy Corporate Services, Inc. (100%)(DE 06.26.2008) on 1.1.2014
 Progress Energy Service Company, LLC (100%)(NC 7.12.2000), as a result of the merger Progress Ventures, Inc. d/b/a Progress Energy Ventures, Inc. into Duke Energy Corporate Services, Inc., became a subsidiary of Duke Energy Corporate Services, Inc. (100%)(DE 06.26.2008) on 1.1.2014

Name Changes

Duke Energy Generation Services Holding Company, Inc. (100%)(DE 2.11.1997) was renamed Duke Energy Renewables, Inc. on 10.16.2013
 DEGS Wind I, LLC (100%)(DE 5.23.2007) was renamed Duke Energy Renewables Wind, LLC on 10.16.2013
 DEGS NC Solar, LLC (100%)(DE 02.25.2010) was renamed Duke Energy Renewables NC Solar, LLC on 10.16.2013
 DEGS Solar, LLC (100%)(DE 05.13.2010) was renamed Duke Energy Renewables Solar, LLC on 10.16.2013

Exhibit III-2 illustrates Duke Energy Kentucky's (DEK's) parent, Duke Energy Ohio (DEO), and Duke Energy Ohio's parent (Cinergy Corporation).¹⁰

Exhibit III-2
Duke Energy Kentucky Parental Structure
as of December 31, 2013



Source: Information Response 1 (Item 3)

DEK is responsible for the transmission, distribution, and sale of electricity energy and the sale and transportation of natural gas in northern Kentucky. Its parent company is Duke Energy Ohio (DEO), which is engaged in the production, transmission, distribution, and sale of electricity and the sale and transportation of natural gas in the southwestern portion of Ohio. Cinergy Corporation is the parent holding company of Duke Energy Indiana, Inc. (DEI), DEO, and Cinergy Investments, Inc.¹¹

The DEK Board is comprised of three directors, who hold officer positions within DEK, DEO, and Cinergy, as follows:¹²

- ◆ DEK Chief Executive Officer, DEO Chief Executive Officer, and Cinergy Chief Executive Officer (Lynn J. Good)
- ◆ DEK Executive VP and DEO Executive VP & Chief Operating Officer, Regulated Utilities (B. Keith Trent)
- ◆ DEK Executive VP, Regulated Utilities; DEO and Executive VP, Regulated Utilities and Executive VP, Customer Operations (Lloyd M. Yates)

Transactions

Services

Exhibit III-3 displays affiliate charges (associated with non-power goods and services) from/to DEK for 2009 to 2013.¹³

**Exhibit III-3
Affiliate Service Charges
2009 to 2013**

From Affiliates to DEK					
	2009	2010	2011	2012	2013
Duke Energy Business Services	\$74,470,263	\$73,366,239	\$81,570,068	\$85,887,612	\$81,420,226 (A)
Progress Energy Service Company	N/A	N/A	N/A	\$1,081,383	\$940,382 (A)
Duke Energy Ohio	\$11,441,842	\$16,177,815	\$14,557,361	\$16,816,430	\$7,143,367 (B1) 2011 (B2) 2012 (B3) 2013
Duke Energy Indiana	(\$11,836)	\$616,933	\$623,628	\$155,159	\$0 (E) 2011 and 2012
Duke Energy Carolinas	\$17,940	\$3,292	\$22,548	\$51,042	\$3,511,396 (C1) 2011 (C2) 2012 and 2013
DEGS	\$17,007	\$0	\$0	\$0	\$0
DE Commercial Enterprises	\$0	\$638,341	\$712,690	\$717,618	\$8,409,949 (D1) 2011 and 2012 (D2) 2013
Duke Energy Progress	N/A	N/A	N/A	\$64,288	\$432,532 (F) 2013
Total	\$85,935,216	\$90,802,620	\$97,486,295	\$104,773,532	\$101,857,852

From DEK to Affiliates					
	2009	2010	2011	2012	2013
Duke Energy Business Services	\$462,705	\$190,463	\$94,507	\$96,075	\$43,896 (F) 2011, 2012, and 2013
Duke Energy Ohio	\$3,064,447	\$2,569,111	\$3,218,494	\$3,894,882	\$3,220,531 (G1) 2011 (G2) 2012 (G3) 2013
Duke Energy Indiana	\$1,485,399	\$1,383,559	\$948,811	\$1,060,673	\$1,240,952 (H1) 2011 (H2) 2012 (H3) 2013
Duke Energy Carolinas	\$44,497	\$57,150	\$4,844	\$11,888	\$0 (I) 2011 and 2012 (J) 2013
Duke Energy One	\$34,527	\$5,544	\$42,982	\$32,978	\$0 (I) 2011 and 2012 (J) 2013
KO Transmission	\$40,983	\$20,066	\$137,653	\$66,426	\$18,026 (I) 2011 and 2012 (J) 2013
Duke Energy Investments	\$0	\$4,094	\$0	\$0	\$0
Total	\$5,132,558	\$4,229,987	\$4,447,291	\$5,162,922	\$4,523,405

From Affiliates to DEK:

(A) Service company transactions to DEK

(B1) DEO employees provide services to DEK for Miami Fort Unit 6 Woodside generating stations, O&M/capital services for electric T&D systems, O&M/capital services for gas distribution system, and other goods or services

(B2) DEO employees provide services to DEK for Miami Fort Unit 6 Woodside generating stations, O&M/capital services for electric T&D systems, O&M/capital services for gas distribution system, and other goods or services

(B3) DEO employees provide generation services, electric T&D services, gas distribution system services, and other goods or services

(C1) Other goods or services

(C2) Customer services, transmission and distribution services, and generation services

(D1) For generating stations

(D2) generation services and other goods or services

(E) DEI employees provides services to DEK for O&M/capital services for generation stations, O&M/capital services for electric T&D systems, and other goods or services

(F) Customer and market services, generation services, and other goods or services

From DEK to Affiliates:

(F) DEK transactions to service company

(G1) DEK employees provide services to DEO for O&M/capital services for the electric T&D systems, O&M/capital services for the gas distribution system, and other goods or services

(G2) DEK employees provide services to DEO for O&M/capital services for the electric T&D systems, O&M/capital services for the gas distribution system, and other goods or services

(G3) Electric T&D services, gas distribution system services, and other goods or services

(H1) DEK employees provide services to DEI for administration, training, and support services at various combustion turbine sites: O&M/capital services for electric T&D systems, and other goods or services

(H2) DEK employees provide services to DEI for administration, training, support services at various combustion turbine sites, and other goods or services

(H3) Administration, training, and support services at various combustion turbine sites and other goods or services

(I) Other goods or services

(J) Gas transmission services

Source: Information Responses 3 and 50

The charges from affiliates to DEK for 2009 to 2011 increased, while the charges from DEK to affiliates decreased. According to Duke Energy management, the primary reasons for increases from affiliates to DEK for 2009 to 2011 were (a) direct expenses from Demand Side Management (DSM) programs, in addition to increased capital costs, and (b) allocated costs attributable to the increasing common Smart Grid costs allocated across participating jurisdictions.¹⁴ From 2011 to 2013, however, the charges from affiliates to DEK increased in 2012 then decreased in 2013, while charges from DEK to affiliates stayed approximately the same with only a slight increase in 2012. Specifically, according to Duke Energy management, the main decrease from 2012 to 2013 was caused by direct expenses for amounts that prior to 2012 were considered a service company cost are now non-affiliate transactions.¹⁵ Specifically, in the past, some A/P invoices were initially designated to Duke Energy Business Services (DEBS), then moved to DEK, especially those processed by DEBS employees. Now, they are directly charged to DEK without being charged to DEBS, even if processed by DEBS employees.¹⁶

Also, according to Duke Energy management, allocated costs from the service companies have decreased in 2013 due to the cost savings from the Progress merger in July 2012.¹⁷

Convenience Payments

Convenience payments (also referred to at Duke Energy as pass through costs) typically include:¹⁸

- ◆ Finance and accounting services
- ◆ Insurance premium expense
- ◆ Advertising expense
- ◆ Community relations projects
- ◆ Donations
- ◆ Employee benefits expense
- ◆ Dues/subscriptions
- ◆ Signage/publications/printing
- ◆ Research and development
- ◆ Miscellaneous lease/rent expense

Exhibit III-4, for example, illustrates convenience payments involving revenues recorded by the Commercial Power segment of DEO for charges to DEK for 2009, 2010, 2011, 2012, and 2013.¹⁹

**Exhibit III-4
Convenience Payments
2009 to 2013**

From DEO to DEK					
Description	2009	2010	2011	2012	2013
Equipment Leases between DEO and DEK	\$444,924	\$1,578,608	\$1,105,356	\$1,059,504	\$256,224
Step-Up Transformers (East Bend, Woodsdale & Miami Fort)	\$1,933,776	\$1,933,776	\$1,933,776	\$701,774	\$0
Transmission Expenses from MISO	\$1,238,783	\$987,938	\$998,177	\$873	\$0
Total	\$3,617,483	\$4,500,322	\$4,037,309	\$1,762,151	\$256,224

Source: Information Response 41

According to Duke Energy management, convenience payments decreased from DEO to DEK for the following reasons:²⁰

- ◆ *Equipment leases:* DEO intent was to sell its non-regulated assets, so assets were moved in 2013 to appropriate books.
- ◆ *Step-up transformers:* These items were moved to DEK's books in the fourth quarter of 2012.
- ◆ *Transmission expenses from MISO:* DEO no longer uses MISO, but is now using PJM.

Personnel Transfers

Exhibit III-5 displays personnel transfers from/to DEK for 2009 to 2013.²¹

Exhibit III-5
Affiliate Personnel Transfers
2009 to 2013

From Affiliates to DEK						
From Company	2009	2010	2011	2012	2013	Total 5 Years
Duke Energy Carolinas	0	0			1	1
DEBS	7	4	10	14	14	49
Duke Energy Commercial	0	0	0	0	2	2
Duke Energy Ohio	11	8	9	7	9	44
Duke Energy Generation Services	0	0	0	1	0	1
Duke Energy Indiana	0	0	0	0	0	0
Total	18	12	19	22	26	97
From DEK to Affiliates						
To Company	2009	2010	2011	2012	2013	Total 5 Years
Duke Energy Carolinas	0	0	0	0	0	0
DEBS	23	13	11	20	14	81
Duke Energy Commercial	0	0	0	0	0	0
Duke Energy Ohio	4	7	3	2	2	18
Duke Energy Generation Services	0	0	0	1	0	1
Duke Energy Indiana	0	0	1	0	0	1
Total	27	20	15	23	16	101

Source: Information Response 4

Asset Transfers

Exhibit III-6 displays asset transfers from/to DEK for 2009 to 2013.²²

Exhibit III-6					
Affiliate Asset Transfers					
2009 to 2013					
From Affiliates to DEK					
	2009	2010	2011	2012	2013
Inventory Stock	\$1,054,674.42	\$4,203,952.66	\$6,360,327.56	\$5,184,694.69	\$9,498,365.01
Meters					
Electric	\$279,149.80	\$191,331.45	\$476,686.70	\$238,473.01	\$411,978.63
Gas	\$63,932.58	\$0.00	\$69,154.36	\$406,769.76	\$105,719.19
Transformers	\$304,522.28	\$591,601.09	\$609,626.56	\$731,570.82	\$533,007.34
Regulators	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Other Miscellaneous Items	\$3,703,167.60	\$218,684.29	\$0.00	\$0.00	\$0.00
Total	\$5,405,446.68	\$5,205,569.49	\$7,515,795.18	\$6,561,508.28	\$10,549,070.17
From DEK to Affiliates					
	2009	2010	2011	2012	2013
Inventory Stock	\$27,833.12	\$271,383.42	\$261,345.21	\$195,063.73	\$1,206,484.35
Meters					
Electric	\$552,387.00	\$171,422.19	\$125,311.31	\$72,603.21	\$104,516.58
Gas	\$219,616.87	\$0.00	\$205,185.81	\$30,351.15	\$65,067.56
Transformers	\$15,289.68	\$99,325.12	\$0.00	\$128,244.39	\$0.00
Regulators	\$8,873.00	\$0.00	\$0.00	\$0.00	\$0.00
Other Miscellaneous Items	\$7,014.50	\$22,928.50	\$0.00	\$0.00	\$0.00
Total	\$831,014.17	\$565,059.23	\$591,842.33	\$426,262.48	\$1,376,068.49

Source: Information Responses 5, 54, 57, and 62

The 2012 and 2013 data includes Issue and Return transactions for a STORELOC labeled ACCTING Storeroom. The 2011 data did not include this type of transaction. An "Accounting Storeroom" is used in the Midwest when materials issued to one project are ultimately used on another project. While the materials are not returned to the warehouse, warehouse personnel administratively "return" and "re-issue" the materials to the project where the materials are used. This eliminates the need for a journal entry in the General Ledger. These are matched pairs that zero out, except for approximately \$30k in 2012, where there was an anomaly with the work order. According to Duke Energy management, this explains the greater number of Inventory Stock \$ in 2012 and 2013, especially 2013, compared to 2011 data.

In the past, according to Duke Energy management, the reason for the continually increasing asset transfers of inventory from affiliates to DEK is primarily due to the location of the Brecon Warehouse in Ohio that serves both Ohio and Kentucky.²³ However, the increases in inventory stock from DEK to affiliates and vice versa increased dramatically, as Duke Energy is now trying to use what the company has.²⁴

Separation

One of the expectations specified in affiliate relationships and transactions rules has to do with the physical separation of regulated and unregulated business and the sharing of information and assets between these entities. In fact, Kentucky regulatory standards provide the following guidelines shown in Exhibit III-7.²⁵

Exhibit III-7
KRS 278.2213 Separate recordkeeping for utility and affiliate -- Prohibited business practices --
Confidentiality of information -- Notice of service available from competitor
as of December 31, 2013

The provisions of this section shall govern a public utility company's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated activities.

4. A utility and its affiliate shall be separate corporate entities and maintain separate books and records. If a utility and nonregulated affiliate have common officers, directors, or employees, the fees, compensation, and expenses of the individuals involved shall be subject to the cost allocation requirements set forth in KRS 278.2203 and 278.2207. Any utility that provides nonregulated activities shall separately account for all investments, revenues, and expenses in accordance with its filed cost allocation manual.
5. A utility shall not provide advertising space in its billing envelope to its affiliates or for its nonregulated activities unless it offers the same to competing service providers on the same terms it provides to its affiliates. This subsection applies to nonregulated activities only.
6. A utility shall not attempt to persuade customers to do business with its affiliates by offering rebates or discounts on tariffed services.
7. All utility company employees engaged in the merchant function shall abide by all standards promulgated by applicable FERC orders and regulations.
8. No utility employee shall share any confidential customer information with the utility's affiliates unless the customer has consented in writing, or the information is publicly available or is simultaneously made publicly available.
9. All dealings between a utility and a nonregulated affiliate shall be at arm's length.
10. Employees transferring from the utility to an affiliate shall not disclose to the affiliate confidential information or take with them any competitively sensitive materials.
11. Neither a utility nor its employees or agents shall solicit business on behalf of an affiliate or for its nonutility services.
12. A utility that carries out any research and development or joint marketing and promotion with its affiliate for its nonregulated activities shall be subject to the cost allocation requirements set forth in KRS 278.2203.
13. Except as provided in subsection (5) of this section, if a utility is engaged in a nonregulated activity, marketing employees for the nonregulated activity shall not have access to the customer information provided to the utility when the customer places an order for regulated service.
14. A utility shall not provide any type of undue preferential treatment to a nonregulated affiliate to the detriment of a competitor.
15. A utility shall notify the customer that competing suppliers of a nonregulated service exist if:
 - a. The utility receives a request for a recommendation from a customer seeking a specific service which is offered by the utility's affiliate or by the utility itself; and
 - b. The utility mentions itself or its affiliate when making the recommendation to the customer.
16. The utility's name, trademark, brand, or logo shall not be used by a nonregulated affiliate in any type of visual or audio media without a disclaimer. The commission shall develop specifications for the disclaimer. The disclaimer shall be approved by the commission prior to use in any advertisement by the utility's affiliate.
17. A utility shall not enter into any arrangements for financing nonregulated activities through an affiliate that would permit a creditor upon default to have recourse to the assets of the utility.
18. A utility shall inform the commission of all new nonregulated activities begun by itself or by the utility's affiliate within a time to be set by the commission.
19. Start-up costs associated with the formation of a nonregulated affiliate shall not be included in the utility's rate base.
20. The commission may require the utility to file annual reports of information related to affiliate transactions when necessary to monitor compliance with these guidelines.

Source: KRS 278.2213

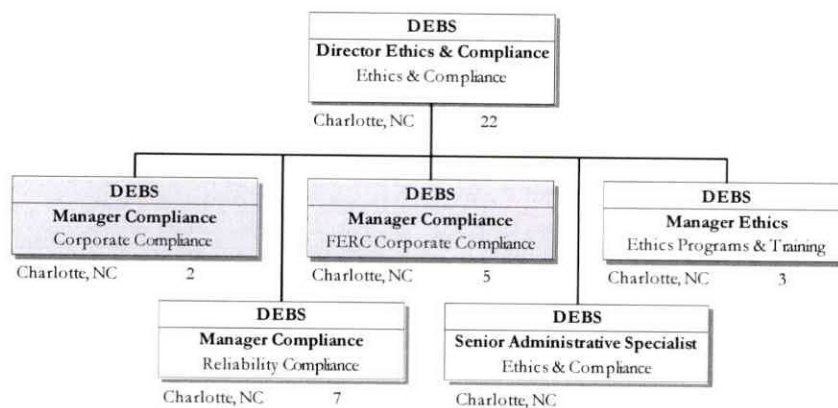
This section discusses Schumaker & Company's findings regarding compliance to the above non-accounting items in the Kentucky standards.

Ethics & Compliance Organization

Exhibit III-8 illustrates the DEBS Ethics & Compliance group, totaling 23 employees in Charlotte (NC), which reports to Audit Services (Internal Audit), and in turn the Chief Legal Officer. The two Corporate Compliance groups (highlighted in gray) are responsible for state and federal regulatory compliance, including:²⁶

- ◆ State and federal regulatory requirements
- ◆ Monitoring regulatory compliance policies and procedures
- ◆ Providing guidance, such as affiliate standards training and advice, to Duke Energy employees in regulatory compliance matters

Exhibit III-8
Ethics & Compliance Organization
as of December 31, 2013



Source: Information Response 37 and Interview 5

The Open Pages system is used to track compliance issues, such as merger conditions, filings, or system access reviews, in which ownership of these issues is also kept. The Regulatory Compliance Manager handles any requests for clarification on Kentucky Affiliate Rules training requirements.²⁷

Other Organizations

Also, Duke Energy currently has two separate organizational groups that are responsible for regulated and unregulated power functions:²⁸

- ◆ The regulated electric business is located in Charlotte (NC). All of the offerings of generation resources into PJM or MISO and the requesting of day-ahead load requirements are handled from the Operations Center located in Charlotte (NC). The individual regulated generation units are dispatched from the Charlotte Operations Center and all trading activities are handled in the Charlotte Operations Center. Regulated wholesale sales are also handled in Charlotte (NC). The Operations Center is split between the Carolinas and Midwest (Kentucky and Indiana) organizations.²⁹ At this time, there is another separate control centers for Duke Energy Progress (DEP) located in Raleigh and another in Florida for the Florida properties.³⁰
- ◆ The unregulated electric business is located in Cincinnati (OH). All of the offerings of generation resources into PJM Interconnection, LLC (PJM) and Midwest Independent System Operator (MISO) and the requesting of day-ahead load requirements are handled from the Operations Center located in Cincinnati (OH). The individual, formerly regulated, generation units (which are in the process of being sold to Dynegy) are dispatched from the Cincinnati Operations Center and all trading activities are handled in the Cincinnati Operations Center. The Operations Center handles the dispatching of the former Duke Energy Ohio generating plants, which are unregulated assets.³¹

DEK power transactions are handled out of Charlotte (NC) by a group of traders and dispatchers that only handle Kentucky and Indiana power transactions. There is a separate group of traders and dispatchers that handle the Carolinas power transactions in Charlotte (NC).³²

All affiliated wholesale power transactions are handled at the organization in Cincinnati (OH). DEK has approximately 24 affiliated wholesale power marketers. DEK's affiliated wholesale power marketers are:³³

New Entities Since Last Audit

1. Cimarron Windpower II, LLC – a Delaware limited liability corporation headquartered in owns a 66 MW (nameplate) wind-powered electric generation facility located in Gray County, Kansas. Cimarron has been granted market-based rate authority and exempt wholesale generator status by the Commission.
2. Ironwood Windpower, LLC – a Delaware limited liability corporation headquartered in owns a 84 MW wind-powered electric generation facility located in Ford County, Kansas. Ironwood has been granted market-based rate authority and exempt wholesale generator status by the Commission.
3. Laurel Hill Wind Energy, LLC; a Pennsylvania limited liability corporation headquartered in owns a 69 MW (nameplate) wind-powered electric generation facility located Lycoming County, Pennsylvania. Laurel Hill has been granted market-based rate authority and exempt wholesale generator status by the Commission.

The following affiliates have been created as a part of the sales of Duke Energy's unregulated generating units. These entities all represent a specific generating unit that is being sold or retired.

4. Duke Energy Beckjord, LLC (Beckjord), a Delaware limited liability company headquartered in Cincinnati, Ohio, owns 893 MW (nameplate) of coal-fired generation, and 212 MW of oil based generation located in New Richmond, Ohio. Beckjord has been granted market-based rate authority and exempt wholesale generator status by the Commission.
5. Duke Energy Conesville, LLC (Conesville), a Delaware limited liability company headquartered in Cincinnati (OH), owns 315 MW (nameplate) of coal-fired generation located in Conesville (OH). Conesville has been granted market-based rate authority and exempt wholesale generator status by the Commission.
6. Duke Energy Dicks Creek, LLC (Dicks Creek), a Delaware limited liability company headquartered in Cincinnati (OH), owns 159 MW (nameplate) of natural gas-fired electric generation located in Middletown (OH). Dicks Creek has been granted market-based rate authority and exempt wholesale generator status by the Commission.
7. Duke Energy Killen, LLC (Killen), a Delaware limited liability company headquartered in Cincinnati (OH), owns 202 MW (nameplate) of coal-fired generation and 6.6 MW of oil based generation located in Wrightsville (OH). Killen has been granted market-based rate authority and exempt wholesale generator status by the Commission.
8. Duke Energy Miami Fort, LLC (Miami Fort), a Delaware limited liability company headquartered in Cincinnati (OH), owns 656 MW (nameplate) of coal-fired generation, and 66 MW of oil based generation located in North Bend (OH). Miami Fort has been granted market-based rate authority and exempt wholesale generator status by the Commission.
9. Duke Energy Piketon, LLC (Piketon), a Delaware limited liability company headquartered in Cincinnati (OH), has a 215 MW share of Ohio Valley Electric Corporation's (OVEC) 2389 MW (nameplate) facility.
10. Duke Energy Stuart, LLC (Stuart), a Delaware limited liability company headquartered in Cincinnati (OH), owns 873 MW (nameplate) of coal-fired generation and 3.9 MW of oil based generation located in Aberdeen (OH). Stuart has been granted market-based rate authority and exempt wholesale generator status by the Commission.
11. Duke Energy Zimmer, LLC (Zimmer), a Delaware limited liability company headquartered in Cincinnati (OH), owns 663 MW (nameplate) of coal-fired generation in Moscow (OH). Zimmer has been granted market-based rate authority and exempt wholesale generator status by the Commission.

Similar Units As Reported in Last Audit

12. CinCap V, LLC (CinCap V), is a Delaware limited liability company (LLC) headquartered in Cincinnati (OH), which markets electricity at wholesale pursuant to market-based rate authority granted by the Federal Energy Regulatory Commission (FERC). CinCap V does not own any generation or transmission facilities.

13. Duke Energy Commercial Asset Management, Inc. (DECAM), is a Delaware corporation headquartered in Cincinnati (OH), which serves as the wholesale merchant agent for a number of generation and marketing businesses within Duke Energy Corporation's commercial business segment. DECAM has been granted authorization to sell power at market-based rates by the FERC. DECAM does not own any generation or transmission facilities, but is parent to entities that own 3120 nominal megawatts (MW) of gas-fired merchant generation.
14. Duke Energy Commercial Enterprises, Inc. (DECE), an Indiana corporation headquartered in Cincinnati (OH), is the parent of Duke Energy Retail Sales, LLC and CinCap V, as well as certain other companies that do not own generation or transmission facilities. DECE has been granted authorization to sell power at market-based rates by the FERC. DECE does not own any generation or transmission facilities.
15. Happy Jack Windpower, LLC (Happy Jack), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 29.4 MW (nameplate) wind-powered electric generation facility located approximately eight miles west of Cheyenne, Wyoming. Happy Jack has been granted market-based rate authority and exempt wholesale generator status by the FERC.
16. North Allegheny Wind, LLC (North Allegheny), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 70 MW (nameplate) wind-powered electric generation facility located in Cambria and Blair Counties (PA). North Allegheny has been granted market-based rate authority and exempt wholesale generator status by the FERC.
17. Three Buttes Windpower, LLC (Three Buttes), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 99 MW (nameplate) wind-powered electric generation facility located in western Converse County (WY). Three Buttes has been granted market-based rate authority and exempt wholesale generator status by the FERC.
18. Silver Sage Windpower, LLC (Silver Sage), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 42 MW (nameplate) wind-powered electric generation facility located approximately eight miles west of Cheyenne, Wyoming. Silver Sage has been granted market-based rate authority and exempt wholesale generator status by the FERC.
19. Kit Carson Windpower, LLC (Kit Carson), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 51 MW (nameplate) wind-powered electric generation facility located in Kit Carson County (CO). Kit Carson has been granted market-based rate authority and exempt wholesale generator status by the FERC.
20. Top of the World Wind Energy, LLC (Top of the World), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 200.2 MW (nameplate) wind-powered electric generation facility located in western Converse County (WY). Top of the World has been granted market-based rate authority and exempt wholesale generator status by the FERC.
21. Duke Energy Lee II, LLC (Lee II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 640 MW (nameplate) natural gas-fired electric generation facility located in Dixon (IL). Lee II is a wholly owned subsidiary of DECAM. Lee II has been granted market-based rate authority and exempt wholesale generator status by the FERC.

22. Duke Energy Hanging Rock II, LLC (Hanging Rock II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 1240 MW (nameplate) natural gas-fired electric generation facility located in Ironton (OH). Hanging Rock II is a wholly owned subsidiary of DECAM. Hanging Rock II has been granted market-based rate authority and exempt wholesale generator status by the FERC.
23. Duke Energy Washington II, LLC (Washington II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 620 MW (nameplate) natural gas-fired electric generation facility located in western Beverly (OH). Washington II is a wholly owned subsidiary of DECAM. Washington II has been granted market-based rate authority and exempt wholesale generator status by the FERC.
24. Duke Energy Fayette II, LLC (Fayette II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 620 MW (nameplate) natural gas-fired electric generation facility located in Masontown (PA). Fayette II is a wholly owned subsidiary of DECAM. Fayette II has been granted market-based rate authority and exempt wholesale generator status by the FERC.

Unmentioned This Audit Year

25. CinCap IV, LLC (CinCap IV) is a Delaware limited liability company headquartered in Cincinnati (OH), which during the test period marketed electricity at wholesale pursuant to market-based rate authority granted by the FERC. On July 20, 2011 the FERC accepted CinCap IV's notice of cancellation requesting that the FERC cancel its market-based rate tariff. CinCap IV did not own any generation or transmission facilities.
26. Duke Energy Retail Sales, LLC (DER), a Delaware limited liability company headquartered in Cincinnati (OH), is a competitive retail electric service (CRES) provider certified by the Public Utilities FERC of Ohio and engages in wholesale power transactions to facilitate its CRES provider business operations. DER owns no generation or transmission facilities. The FERC has granted DER market-based rate authority.
27. Duke Energy Trading and Marketing, L.L.C. (DETM), a Delaware limited liability company headquartered in Cincinnati (OH) during the test period, marketed electricity at wholesale pursuant to market-based rate authority granted by the FERC. On July 20, 2011 the FERC accepted DETM's notice of cancellation requesting that the FERC cancel its market-based rate tariff. DETM did not own any generation or transmission facilities.
28. St. Paul Cogeneration, LLC (St. Paul Cogen), a Minnesota limited liability company headquartered in St. Paul (MN), owns a biomass-fired cogeneration facility with an electric generating capacity of 35 MWs (nameplate) located in St. Paul, Minnesota. St. Paul Cogen has been granted market-based rate authority and qualifying facility status by the FERC.
29. Duke Energy Vermillion II, LLC (Vermillion II), a Delaware limited liability company headquartered in Cincinnati (OH) during the test period, owned an undivided 75% interest in a 640 MW (nameplate) natural gas-fired electric generation facility located in Vermillion County (IN) (also referred to as the facility). Vermillion II is a wholly owned subsidiary of DECAM.

During the test period, Vermillion II had been granted market-based rate authority and exempt wholesale generator status by the FERC. In January 2012, pursuant to FERC authorization, Vermillion II transferred its ownership interest in the Facility to DEI and Wabash Valley Power Association, Inc. (WVPA), with DEI and WVPA subsequently owning 62.5% and 38.5% of the facility, respectively. In March 2012, the FERC accepted Vermillion II's notice of cancellation requesting that the FERC cancel its market-based rate tariff.

The activities of the above wholesale affiliates are coordinated out of DECAM in Cincinnati (OH). The employees of the affiliated wholesale power marketer(s) (located in Cincinnati) operate independently of the employees responsible for DEK's wholesale merchant and generation functions (located in Charlotte).³⁴

There is also no space occupied by DEK and non-regulated affiliated wholesale power marketers as defined. These two organizations operate independently. Schumaker & Company confirmed these statements by physical observations during our interviews.³⁵

Competitive or Sensitive Information

When asked to provide any formal policies or procedures documentation regarding access by DEK and any affiliate to competitive or sensitive information, a copy of Duke Energy's *Affiliate Restrictions – Information Disclosure Procedures* was provided, as shown in *Exhibit III-9*.³⁶ Its purpose is to provide a process for handling the disclosure of regulated market information to market regulated power sales affiliates.

Exhibit III-9
Affiliate Restrictions – Information Disclosure Procedure
as of July 31, 2014



Regulatory Compliance
FERC Operations Manual

Affiliate Restrictions – Information Disclosure Procedure

Purpose: Document the process for handling the disclosure of regulated market information to market regulated power sales affiliates.

FERC Program Chapter:

Chapter 4 – Affiliate Restrictions & Standards of Conduct

Record Retention Rule:

Five years

Procedure:

- Legal shall be notified if regulated market information is shared with power sales affiliate employees, or if there are deviations from separation of functions, including during emergency situations.
- Legal will determine whether to make a posting of such information on its web site or a filing with the Commission, using procedures similar to those used for Standards of Conduct disclosures (see “Duke Energy FERC Page”).
- Legal or Regulatory Compliance will meet with the business unit involved in the inappropriate disclosure to discuss and offer recommendations to mitigate future occurrences. This information (which may include compliance measures) will be maintained by Regulatory Compliance.

Periodic Review of Procedures:

Automatic reminders are forwarded annually through OpenPages (compliance tool).

Source: Information Response 25

Training materials used by Duke Energy’s or DEK’s employees on sharing of competitive or sensitive information and/or sharing of office space, computers, or any other assets includes the following:³⁷

- ◆ Midwest (Kentucky, Indiana, and Ohio) State Regulatory Requirements for Non-regulated Products and Services *MyTraining*, including but not limited to:
 - The affiliate must be fully separated.
 - The affiliate must have separate accounting treatment.
 - The affiliate must not be given an unfair competitive advantage or be extended any undue preference by the utility (meeting guidelines, proprietary customer information/customer consent, customer leads/referrals, appropriate/inappropriate responses, etc.)
 - A code of conduct should be established that satisfies the commission rules.
- ◆ DEK Expectations for Customer Care guidelines
- ◆ Quick Reference Guide – State Regulatory Requirements – Non-regulated Products & Services comparison chart of Indiana, Kentucky, Ohio, and Carolinas.

Transfer Confidentiality Agreements

The Regulatory Compliance group manages and facilitates the employee transfer process from DEK to an affiliate. Identified individuals (and their managers) who transfer from the utility to an affiliate are required to complete and confirm that they have reviewed system access, physical access, and email distribution lists. Also, automated emails are forwarded to impacted managers with required actions items.³⁸

Training

The affiliate standards training has been developed across Duke Energy and modified slightly for each state based on the specific requirements of that state. The content of training differs due to slightly different Affiliate Rules in Kentucky, although they are very similar to Ohio rules. One difference is that DEK is required to specifically report asset transfers \$1 million or more to the KPSC, but no similar differences regarding service charges involving Kentucky.³⁹

Affiliate Rules compliance training is combined for OH/KY, not just because DEO owns DEK, but also due to the amount of overlap among participants for OH/KY requirements. The Ohio Corporate Separation-Kentucky Affiliate Rules training, which was developed in-house, is conducted annually for any Duke Energy employees deemed to be impacted by Affiliate Standards requirements. Starting in 2010, it was deployed electronically. Previously it was classroom-based training.⁴⁰

At the end of 2013, approximately 796 of Duke Energy's employees were required to participate in Kentucky Affiliate Rules training, although approximately 52 were removed from the list due to various reasons. The annual training titled *Ohio Corporate Separation – Kentucky Affiliate Rules EC30113* was deployed on November 4, 2013. Recipients were to complete the training by January 3, 2014. Notifications were made on November 4, 2013 via email message with follow-up messages and calls to employees and their supervisors to remind those who did not yet complete the training. The first reminder email message was sent December 16, 2013 (40 days not 30 days), if appropriate, and a first

overdue notice email message was sent on January 7, 2014, if appropriate, to Duke Energy employees who had not completed the training sessions by these dates. Any individuals (approximately two employees) who still did not complete the training were escalated to management by email message, which was sent February 6, 2014, approximately 30 days after training completion was due.⁴¹

To identify the employees required to participate in training, Duke Energy identifies a deployment list, which is reviewed annually. It will also be updated throughout the year, if necessary. Those identified are not just Service Company employees but anyone within the Duke Energy organization whose function is likely to be impacted by Affiliate Rules requirements.⁴²

The focus of this training is threefold, as follows:⁴³

- ◆ Discuss why guidance regarding affiliate relationships is important, including risks if not followed.
- ◆ A direct description of what that means.
- ◆ A reminder that, if employees have questions, who they should contact for further guidance.

Other relevant training provided in 2013 was (a) affiliate asset transfer training, including compliance with federal and state pricing rules, (b) FERC affiliate restrictions and standards of conduct, and (c) large business training, which includes discussions about affiliate interactions.⁴⁴

- ◆ The focus of the affiliate asset transfer training is primarily employees in the supply chain/plant inventory functions and includes an overview of the following:
 - Understand federal and state rules that govern affiliate asset transfers
 - Affiliate asset transfer agreements for regulated affiliates
 - Affiliate asset transfer process & eForm requirements
 - Understand consequences of non-compliance
 - Understand employee's role to ensure compliance
- ◆ The focus of the FERC affiliate restrictions and standards of conduct training and case study is fairly broad (involving approximately 8,500 employees) and includes an key FERC requirements, such as:
 - Market information from the regulated utility should not be shared with non-regulated employees (employees who work on behalf of the non-regulated affiliates).
 - Non-regulated employees and regulated employees should operate separately.
 - Regulated and non-regulated utility affiliates cannot sell energy or capacity to each other without FERC approval.
 - FERC asymmetrical pricing rules apply to goods and service transactions between the regulated utility and the non-regulated utility/non-utility affiliates, unless there is an exception.

This training is administered annually to individuals who are either *directly or indirectly* impacted by the Affiliate Restriction or Standards of Conduct requirements administered by FERC. In support of this training session is a comprehensive 96-page FERC compliance manual.

- ◆ Also, in 2011, 94 participants received training regarding sharing of competitive or sensitive information and/or sharing of office space, computers, or any other assets.

Ethics Line

Additionally, Duke Energy has an ethics line that allows employees to call in, anonymously if they like, any concerns that they have, although the company has also added a compliance reporting mailbox (compliancereporting@duke-energy.com), which is focused on compliance issues. Duke Energy encourages employees to use the mailbox for any questions or concerns that employees have with regarding to compliance issues, but they can use either the ethics line or the mailbox. Advertisements for the ethics line and mailbox include posters in buildings and mention in code of business and affiliate training sessions.⁴⁵

B. Findings & Conclusions

Affiliate Agreements

Finding III-1 **Affiliate agreements in place for 2013 were all established prior to 2013; however, one of the agreements included in its initial 2014 submittal to the KPSC was a DEO, not a DEK, agreement.**

Exhibit III-10 summarizes existing affiliate agreements impacting DEK.⁴⁶ All of these agreements were effective prior to 2013. Of these, the following changed agreements were filed with the KPSC as part of the cost allocation manual on March 28, 2013 (and again on March 28, 2014), as they were changed in 2012 (effective July 2, 2012) due to the merger of Duke Energy and Progress Energy:⁴⁷

- ◆ Intercompany Asset Transfer Agreement
- ◆ Operating Companies Service Agreement
- ◆ Service Company Utility Service Agreement
- ◆ Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liabilities and Benefits
- ◆ Utility Money Pool Agreement

However, the Operating Company/Non-Utility Companies Service Agreement provided to the KPSC on March 28, 2014 incorrectly included the Operating Company/Non-Utility Companies Service Agreement for DEO, not DEK. Therefore, on April 24, 2014, a revised cost allocation manual was re-submitted to the KPSC. The revised submittal referred to the Amended and Restated Operating Company/Nonutility Companies Service Agreement; however, the Asymmetrically-Priced DEK Non-Utility Companies Service Agreement was provided to Schumaker & Company, not the DEK Amended and Restated Operating Company/Nonutility Companies Service Agreement. Then, on July 2, 2014, the DEK Amended and Restated Operating Company/Nonutility Companies Service Agreement was submitted to the KPSC and a copy provided to Schumaker & Company.⁴⁸

Exhibit III-10
Existing Affiliate Agreements (Page 1 of 4)
as of December 31, 2013

Merger-Related Service Agreements			
Agreement	Agreement Description	Effective	Compensation
Service Company Utility Agreement	Duke Energy Corporation, Cinergy Corp, Duke Energy Business Services, LLC (DEBS), Progress Energy Service Company (PESC), and other various utility (Duke Energy Carolinas (DEC), DEI, DEK, DEO, and Miami Power Corporation, Progress Energy Carolinas (PEC), Progress Energy Florida) companies involving DEBS and PESC functions: information systems; meters; transportation; system maintenance; marketing/ customer relations; T&D engineering/construction; power engineering/ construction; human resources; materials management; facilities; accounting; power and gas planning and operations; public affairs; legal; finance; rates; rights of way; internal audit; environmental, health, and safety; fuels procurement; investor relations; planning; and executive.	July 2, 2012 (third amendment)	Cost except otherwise required by IRS 482
Operating Companies Service Agreement	DEC, DEI, DEK, DEO, Miami Power Corporation, PEC, and Progress Energy Florida involving services (including loans of employees), such as engineering/construction; operation/maintenance; installation services; equipment testing; generation technical support; environmental, health, and safety; and procurement services; plus use of assets, equipment, and facilities. It specifically excludes affiliate transactions involving sales or other transfers of assets, goods, energy commodities (electricity, natural gas, coal, and other combustible fuels), or thermal energy products.	July 2, 2012 (fourth amendment)	Cost based only; with DEC and PEC and DEO exceptions
Operating Company/Non-Utility Companies Service Agreement	DEK/various Duke Non-Utility companies involving services (including loans of employees), such as: <ul style="list-style-type: none"> ◆ <i>DEK to Non-Utility</i>: engineering/construction; operation/maintenance; installation services; equipment testing; generation technical support; environmental, health/safety; and procurement services; plus use of assets, equipment, and facilities. ◆ <i>Non-Utility to DEK</i>: Technology services; monitoring, surveying, inspecting, constructing, locating, and marking of overhead and underground utility facilities; meter reading materials management; vegetation management; and marketing/customer relations. 	September 1, 2008 (amended and restated) prior audit	Cost based only

Source: Information Responses 2, 8, 23, and 52

Exhibit III-10
Existing Affiliate Agreements (Page 2 of 4)
as of December 31, 2013

Generation Acquisition Service Agreements			
Agreement	Agreement Description	Effective	Compensation
Facilities Operation Agreement	Permits DEK to utilize DEO-owned transmission facilities and equipment to provide service from DEK's generating stations	September 27, 2004 (as amended) DEK is in the process of acquiring ownership of transformers covered by the generation step-up (GS) agreement between DEO and DEK; agreement was scheduled for cancellation on or about May 8, 2012 once the GSU transfer took place. It was no longer in effect for 2013.	N/A, as no longer in effect for 2013.
Miami Fort 6 Operations Agreement	Permits DEO to operate the Miami Fort 6 generating station, including procurement of fuel, on behalf of DEK.	January 1, 2006	Described in other agreement.
Gas & Propane Services Agreement	Permits DEO to provide certain operations and maintenance support to DEK related to the natural gas and propane facilities at the Woodsdale generating station.	January 24, 2009 (first amendment)	Described in other agreement.
Other Service Agreements			
Agreement for Gypsum Waste Material Disposal Services	DEO pays DEK a market price for generator waste disposal services; because it follows Kentucky's affiliate pricing rules, Commission approval was not necessary.	April 24, 2007	\$21.95/ton

Source: Information Responses 2, 8, 23, and 53



Exhibit III-10
Existing Affiliate Agreements (Page 3 of 4)
as of December 31, 2013

Other Affiliate Agreements			
Agreement	Agreement Description	Effective	Compensation
Intercompany Asset Transfer Agreement	DEC, DEI, DEK, DEO, PEC, and Progress Energy Florida asset transfers, in which "assets" means parts inventory, capital spares, equipment and other goods except for commodities, such as the following: coal; natural gas; fuel oil used for electric power generation; emission allowances; electric power; and environmental control reagents.	July 2, 2012	Except to the extent otherwise required by Section 482 of the Internal Revenue Code or analogous state tax law, Recipient Operating Company shall compensate Transferor Operating Company for any assets transferred at cost; provided however that any transfers of electric generation-related assets between DEO, on the one hand, and DEI or DEK on the other hand, will be priced in accordance with FERC affiliate transaction pricing requirements. *
Utility-Non-Utility Asset Transfer Agreement	DEK/Non-Utility asset transfers, in which "assets" means parts inventory, capital spares, equipment and other goods except for commodities, such as the following: coal; natural gas; fuel oil used for electric power generation; emission allowances; electric power; and environmental control reagents.	January 1, 2009	Except to the extent otherwise required by Section 482 of the Internal Revenue Code or analogous state tax law, a Recipient party under this Agreement shall compensate the Transferor for any assets transferred in accordance with the FERC affiliate transaction pricing requirements. Accordingly, assets transferred from DEK to a Non-Utility Company shall be priced at the greater of cost or market, and assets transferred from a Non-Utility Company to DEK shall be priced at no more than market. Alternatively, to the extent that an asset may be transferred under this Agreement, the Transferor and Recipient may agree that the asset transferred to the Recipient be replaced in kind.

Source: Information Responses 2, 8, 23, and 52

- * Accordingly, generation-related assets transferred from DEI or DEK to DEO shall be priced at the greater of cost or market, and generation-related assets transferred from DEO to DEI or DEK shall be priced at no more than market. Alternatively, to the extent that an asset may be transferred under this Agreement, the Transferor and Recipient may agree that the asset transferred to the recipient be replaced in kind.

Exhibit III-10
Existing Affiliate Agreements (Page 4 of 4)
as of December 31, 2013

Agreement Title	Agreement Description	Effective	Compensation
Asymmetrically-Priced DEK/Non-Utility Companies Service Agreement	DEK/ various Duke Non-Utility companies involving services (including loans of employees), such as: <ul style="list-style-type: none"> ◆ <i>DEK to Non-Utility</i> – engineering/ construction; operation and maintenance; installation services; equipment testing; generation technical support; environmental, health, and safety; and procurement services; plus use of assets, equipment, and facilities. ◆ <i>Non-Utility to DEK</i> – information technology services; monitoring, surveying, inspecting, constructing, locating, and marking of overhead and underground utility facilities; meter reading materials management; vegetation management; and marketing and customer relations. 	October 1, 2009	FERC pricing mechanism
Utility Money Pool Agreement	A money pool arrangement to manage cash and working capital requirements in which those companies with surplus short-term funds provide short-term loans to affiliates (other than Duke Energy, Progress Energy, and Cinergy) participating under this arrangement.	July 2, 2012	Depends on if internal and/or external fund used.
Amended and Restated Purchase & Sale Agreement with Cinergy Receivables	Allows the operating companies (DEI, DEO, and DEK) to sell their retail accounts receivables to this affiliate.	October 27, 2010	Fair market value of receivable on initial funding date
Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liability and Benefits	Tax liability is allocated to Duke Energy subsidiaries on the basis of the percentage of the total tax which the tax of such an entity, if computed on a separate return, would bear to the total amount of the taxes for all entities.	July 2, 2012 (second amendment)	

Source: Information Responses 2, 8, 23, and 52

None of these agreements became effective in 2013, but all were in effect during the year. As the Duke Energy/ Progress Energy merger became effective in 2012, those agreements that changed were required to be submitted to the Kentucky Public Service Commission.



Affiliate Training

Finding III-2 DEK has continued to improve and modify the affiliate training programs.

The training programs described above have been modified over the last several years as new needs are identified. All impacted employees are required to annually repeat the online training. Individuals that have not completed the training in a timely manner are sent action emails and personally called to ensure completion. These ongoing modifications have addressed Schumaker & Company's prior audit report recommendations (*Recommendation II-2* and *Recommendation III-4*) completed in January 2013.

Finding III-3 DEK's Affiliate Rules training for 2013 indicates indicated only two employees had not completed training within a timely manner.

Beginning in 2011, all impacted employees involving Ohio, Kentucky, and Indiana operations were required to attend Affiliate Standards training sessions via Duke's online Learning Management System(s) (*MyTraining* for legacy Duke Energy employees and *PlantView* for legacy Progress Energy employees). During 2013, approximately 796 employees and contractors were scheduled for Ohio/Kentucky-related training course. They were typically notified on November 2013 (November 4, 2013) and were expected to complete training within 60 days (by January 3, 2014). The day when the employees/contractors are notified is considered *Day 1*. Approximately 30 days later (*Day 30*), a reminder is sent. On *Day 50*, if someone has not viewed the eLearning slides and passed the exam, then another reminder is sent to the individual and to his/her manager, plus a report is sent to the HR VP and SVP. Not participating in training (and passing the exam) within 60 days is considered non-compliance. On approximately *Day 61* (January 7, 2014), an overdue notification is sent to the individual and his/her manager. An escalation email message to senior management was sent on February 6, 2014. These notifications and reports continue until all employees and contractors supposed to take the training have completed it.⁴⁹ DEBS management also indicated that additional past due notices are being used and manual escalations to management began earlier than in the past.⁵⁰

- ◆ Day 1 – first past due notice
- ◆ Day 7 – second past due notice
- ◆ Day 14 – third past due notice
- ◆ Day 21 – fourth past due notice
- ◆ Day 28 – manual escalation begins to management

Of these 796 participants, all had completed training, although two employees had a completion date after January 4, 2014.⁵¹ Also, Duke Energy management indicated that legacy Progress Energy employees often took longer than legacy Duke Energy employees to complete training, because *PlantView* requires a manual review, notification, and escalation, unlike *MyTraining*, which can be automatically done.⁵²

Benchmarking

Finding III-4 Duke Energy frequently performs various benchmarking studies as a means to compare costs to market values for services performed.

Duke Energy's last full benchmarking exercise results were produced in 2010 based on 2009 costs and services. The company typically likes to benchmark in alternate years to allow improvement initiatives to manifest in the results; however, it did not conduct a benchmark of the 2011 to 2012 time period due to the amount of effort focused on merger analysis. Duke Energy management indicates that is currently benchmarking 2013 costs, which includes multiple data centers and service companies, as transition from merger was in progress when interviews with Duke Energy management occurred during this audit. The final report was expected in September 2014, which Duke Energy management expects to show good results, although Duke Energy is likely to show more "widgets" as the company is still in transition due to the merger with Progress Energy.⁵³

Other benchmark studies performed by Duke Energy include the following described on the following pages:⁵⁴

- ◆ 2013 Aviation Benchmarking
- ◆ 2012 Benchmarking Consortium
- ◆ 2012 Security Survey
- ◆ 2011 Market Assessment
- ◆ 2008 Shared Services Cost Allocation & Market Study

2013 Aviation Benchmarking

Duke Energy participated in a 2013 corporate aviation benchmarking report prepared by VanAllen. The objective was to collect benchmark data focused on the areas of operational, organizational, safety and security, and policies and practices.⁵⁵

Within the Duke Energy organization, aviation usage is based on executive need, either themselves directly or someone else with executive approval, as opposed to having a regular routing schedule. The study performed an overall review of the aviation fleet, with a deep dive in administrative services. As a result of the benchmarking study, Duke Energy is in the process of resizing the fleet through changing the number and types of airplanes, as management believes that Duke Energy is fairly consistent with its peer group; however, some opportunities for change exist.

2012 Benchmarking Consortium

Duke Energy is a member of a benchmarking consortium called the *Electric Utilities – HR Metrics Group* (EU-HRMG).⁵⁶ The EU-HRMG was formed in May, 2003 through the collaborative efforts of Entergy, Aquila, Dominion Resources, JEA, Southern Company, Tennessee Valley Authority and Westar Energy. The Electric Utility – Talent Acquisition Group (EU-TAG) added their benchmarks and data points in



2010. Both groups were formed under an Electric Utility Community of Practice Group Charter in 2010 to provide overall direction for ownership of data and management of the budget (to keep the costs reasonable for participation of all electric utilities no matter the size).⁵⁷

Each year, the study is done with an objective of developing HR metrics and sharing best practices, including:⁵⁸

- ◆ Operating efficiency – key metrics
- ◆ Operating metrics – span and pay
- ◆ Operating metrics – HR and other
- ◆ Talent acquisition
- ◆ Talent development
- ◆ Attrition
- ◆ Other

The member companies submit benchmark data to a third-party vendor (Vemo, Inc.) who compiles the data and produces a confidential annual report for the consortium. For 2012, there were 35 contributors to benchmarking data used for high-level, not deep dive, study broken down into:⁵⁹

- ◆ Small
- ◆ Medium
- ◆ Large
- ◆ Very large, of which Duke Energy was one

The 2012 report contains information that is farther reaching than costs and service competitiveness, as it also measures other HR criteria that may not fit that description. The report provides aggregate data grouped together based on the participant organization size, but does not compare Duke Energy individually to the overall consortium. In 2012 the study include prior metrics, plus:⁶⁰

- ◆ Span
- ◆ IT as % per employee
- ◆ Finance as % per employee
- ◆ Peak co-op/full-year intern
- ◆ Peak summer intern
- ◆ Retirement rate versus eligibility
- ◆ Promotion rate

Information provided is not necessarily a conclusion, but data is provided to each company, so they can evaluate their information against study results.⁶¹

2012 Security Survey

Duke Energy's security officer average cost is within the median cost of officers (\$30,000 and \$39,999) based upon a 2012 Entergy security survey of over 40 participating companies.⁶²

2011 Market Assessment

There was a market assessment created by KPMG of Aon Hewitt services performed for the Duke Energy Human Resources department. It was completed in May 2011 using 2010 data prior to the merger with Progress Energy.⁶³ Major sections discussed in the assessment included:⁶⁴

- ◆ Pricing
- ◆ Service levels
- ◆ Aon concerns

Although potentially 39 companies were available to Aon Hewitt, six comparators were generally used, as they were closer to Duke Energy in size and type. It was a deeper dive study to allow apples-to-apples comparison of Duke Energy to low, average, and high results of its comparatives.⁶⁵

2008 Shared Services Cost Allocation and Market Study

A Shared Services Cost Allocation & Market Study, as described below, is typically done every five years. The next one is schedule to be done in 2015, based on 2014 data.⁶⁶

Ernst & Young LLP (EY) performed a Market and Cost Allocation study of the services provided by DEBS and Duke Energy Shared Services to DEC for the period ending December 31, 2008, which was completed in September 2009. Of the 23 services provided by the Service Company, one was largely outsourced (4%), one was immaterial (4%), four were strategic in nature (18%), eight had no comparable market data (35%), and nine (39%) were evaluated using benchmarking data. The benchmarking data indicated that only one service, Information Systems, was above the median benchmark for some portions. It should be noted that benchmarks cannot be considered alone or without context as circumstances of peer organizations differ. Therefore, Duke Energy management believes that benchmark results should be viewed as a point of reference and significant variances should be considered based on the facts and circumstances of the organizations being benchmarked. Due to the inherent limitations of benchmarking data, it cannot be used as the sole basis for making an assessment on market value.⁶⁷

The procedures included conducting a series of structured interviews with key business personnel as well as Service Company employees. To analyze costs, EY obtained Duke Energy detailed data files and supporting documentation for costs charged to DEC. At the request of DEC, EY co-developed a cost allocation framework to calculate the fully distributed costs of each service. For market comparables, EY identified vendors who, based on Duke Energy's input, could provide services currently performed by Service Company employees. EY analyzed publicly available information for these vendors to analyze market pricing. Based upon the procedures performed, EY documented if reasonable market comparables could not be found for certain services or if a service had been excluded from analysis of market comparables due to business or strategic reasons. For the majority of services, EY noted that the level of activities provided by the Service Company for each service could not be easily replicated by one vendor, as part of the standard services offered by the vendor. Additionally, without obtaining

detailed pricing information from vendors that aligned to the services provided by the Service Company, market comparables were not readily available. The consensus of the project team, which consisted of staff from Service Company, EY, and subject matter resources in an advisory capacity, was that this sort of solicitation for information from third parties would not be appropriate for a number of reasons, as outlined in the report.⁶⁸

In conjunction with the Cinergy merger integration project, the majority of Services performed an analysis to assess which functions could be outsourced to a third party provider. Each of these assessments considered a number of function specific factors, but cost was always considered as part of this analysis. Subsequent to the integration project, services were challenged to review costs annually and consider any cost-savings of outsourcing. As of December 31, 2008, approximately 50% of non-Executive Services were either outsourced or directly purchased.⁶⁹

EY's research also indicated that no utility in Duke Energy's or DEC's peer group had outsourced, in totality, as much as Duke Energy. Actual cost comparisons to peers utilities by service for 2008 were not possible as this level of information was no longer required to be filed on FERC Form 60. As such, comparability of costs between utilities using available 2007 FERC Form 60 information was not possible.⁷⁰

Where benchmarking information was available from qualified independent sources, it was utilized to compare the cost of services provided by the Service Company to the cost of comparable services incurred by other organizations. The results of benchmarking analysis were used to help organizations set the direction to develop its strategy in specific process areas. Similar to the constraints noted above in using FERC Form 60 information, benchmarking information did not provide details on the actual functions provided within each service. Benchmarking data was also impacted by many company specific factors including the complexity of the organization, competencies and skill sets of personnel, use of technology, etc.⁷¹

Also, the external benchmarking EY used was based on all industries and was not specific to the utility industry. It was recognized that the utility industry has a number of specific regulatory and operating requirements which impact its comparability with other industries. Additionally, DEC operates in a regulated environment, where revenues were based on a cost plus model. The analysis indicated that on average, DEC rates were 33% less on average than its peers.⁷²

Separations

Finding III-5 There was no use of the DEK logo by any non-utility affiliate.

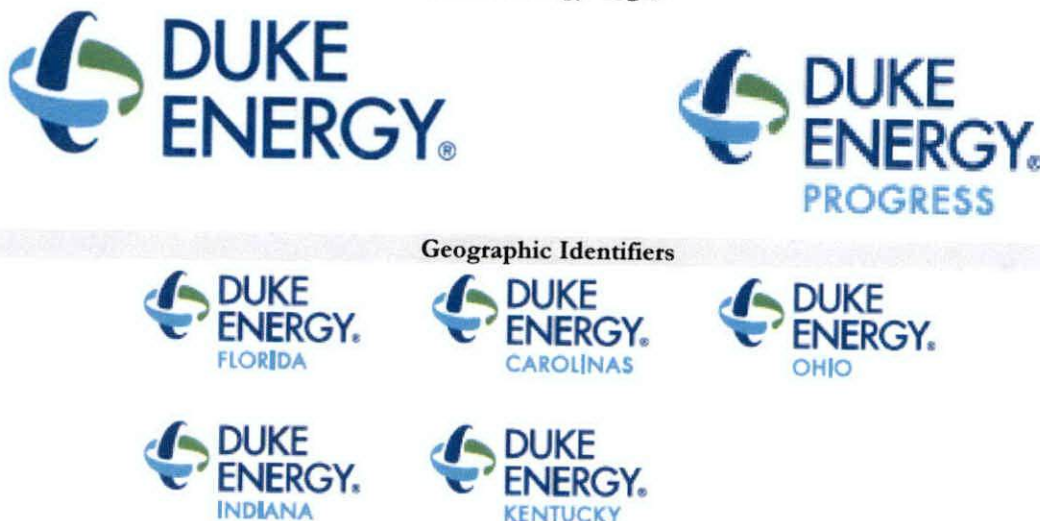
The Duke Energy Logo is shown in *Exhibit III-11*.⁷³ In the past, most Duke Energy entities used an older Duke Energy logo with a geographic identifier for the utility companies. However, now only the Duke Energy logo is used to identify the company, regardless of application or media. Other logos may not be created or used for offices, generating stations, facilities, departments or events. Only DEP (previously Progress Energy Carolinas) has "Progress" following the Duke Energy logo, also shown in

*Exhibit III-11.*⁷⁴ The geographic identifiers shown in *Exhibit III-11* are to be used only in the following applications:⁷⁵

- ◆ Regulatory filings in the franchised jurisdictions and other public documents (press releases, fact sheets, etc.) referring to those filings
- ◆ Utility-specific reports presented to regulators
- ◆ Limited internal uses (financial reports, customer data, etc.)
- ◆ Business cards and stationery for large customer/regulator/legislator-facing employees in the respective utility organizations (this applies to all employees in the organizations reporting to the utility presidents)

Any non-regulatory communications, print or electronic, should refer to Duke Energy only and use the Duke Energy logo; geographic identifiers should not be used. Regional operations can be described in terms of “doing business in the Carolinas” or “the company’s Kentucky operations.” Geographic identifier logos should never be used on hard hats, apparel, vehicles, signage or company-branded merchandise.⁷⁶

Exhibit III-11
Duke Energy Logos



Source: Information Response 59

Finding III-6 **There is no office space shared occupied by DEK and non-regulated affiliated wholesale power marketers.**⁷⁷

Duke Energy management has attested that there is no space occupied by DEK and non-regulated affiliated wholesale power marketers, nor any sharing of assets except computer systems.⁷⁸ There are

systems that are shared between DEK and the non-regulated affiliated wholesale power marketers, but there are controls in place to prevent information and data sharing, as these two organizations operate independently.⁷⁹ Examples of such controls include:

- ◆ Compliance tracking of system access for employees having state and federal affiliate implications, in which business unit (BU) owners are identified, access level is verified, and attestations are required – each on an annual basis.
- ◆ Training sessions as previously discussed in interview session.
- ◆ Physical access limitations; especially with regard to Kentucky no shared access exists.

In addition, in the corporate physical access guidelines, personnel are also required to sign a visitor log for FERC restricted areas. As per the procedure, a visitor log is made for all individuals that are escorted into the secured areas.⁸⁰

Finding III-7 **There are some shared computer systems between by DEK and non-regulated affiliated wholesale power marketers, but they are controlled via passwords and other access permissions.⁸¹**

There are systems that are shared between the non-regulated affiliated wholesale power marketers and the regulated wholesale power marketers. These systems have all been identified and access to each is controlled via passwords and other access permissions. Information systems used by DEK have been included in a System Inventory Access Review process. The review of access and associated processes is accomplished via a compliance tool, Open Pages, which has the capability of reminding and documenting that the owners/administrators of the various systems complete a review of system access on an annual basis (sometimes more frequently).⁸²

In response to information requests and interviews, DEK provided a listing of shared information systems and the security measures used to assure the confidentiality of customer and other information. The systems that are shared by regulated and non-regulated users have firewall separation and/or separate passwords for regulated and non-regulated users. Employees requesting system access are required to submit an eForm and/or email to the system administrator through the employee's manager. Both the manager and administrator must approve prior to granting access to the system.⁸³

Filings

Finding III-8 **Filings were made with the KPSC in 2013 as required in the merger commitments approved by the KPSC on November 29, 2005.**

DEK is required to give the KPSC 30 days advance notice of any changes in cost allocation methodologies and justifications in the amount and methodology. Cost allocation methodologies are noted to be established in several DEK documents in the merger commitments agreed to in 2005.

These are the 1) Service Company Utility Service Agreement, 2) Operating Company / Nonutility Companies Services Agreements, 3) Operating Company Service Agreements.⁸⁴

On March 29, 2013, DEK filed the following affiliate contracts with the KPSC in compliance with the above commitment. Note that only new or amended service agreements are required to be filed with the annual report, after the annual report.⁸⁵

- ◆ Intercompany Asset Transfer Agreement
- ◆ Operating Companies Service Agreement
- ◆ Service Company Utility Service Agreement
- ◆ Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liabilities and Benefits
- ◆ Utility Money Pool Agreement

The Operating Company / Nonutility Companies Services Agreements is not listed above as a contract filed with the KPSC, as it was not changed since the last annual report was filed. DEK is only required to file for any changes in cost allocation methodologies and, therefore, this agreement was not included in that group of contracts filed in 2013.⁸⁶

C. Recommendations

Recommendation III-1 Aggressively send notifications to employees who have not passed affiliate rules training even before the Day 30 currently used. (Refer to Finding III-3)

For 2013, Duke Energy anticipated implementing a more aggressive, proactive reminder schedule for its Ohio/Kentucky affiliate rules training program. For example, Duke Energy management indicated that individuals who are required to participate in the training program:⁸⁷

- ◆ Receive reminders at 30 days, 20 days, and 10 days prior to the deadline.
- ◆ Be sent four past due notices will be sent on a weekly basis to employees who fail to complete the training program by the deadline.

However, in 2013, Duke Energy only sent reminders at 30 days and 10 days prior to the deadline (*Day 30* and *Day 50*), not 20 days (*Day 40*), although four past due notices were sent and an escalation notification sent to management following the past due notices.⁸⁸

So as many employees as possible who are required to participate in affiliate rules training do so by the deadline, Duke Energy should ensure that it implements these plans to accelerate its reminders (*Day 20*, *Day 30*, *Day 40*, and *Day 50*), and increase usage of past due notices, especially escalation notices to management, which should begin prior to *Day 60*, not just 28 days after *Day 60* deadline date.

Recommendation III-2 Continue to enhance Affiliate Standards training, plus make sure all Duke Energy employees taking such training using *MyTraining* by the end of 2014. (Refer to Finding III-2 and Finding III-3.)

The training is essentially the same as in 2011. A few scenarios have been added, but no major overhaul has been made. Starting in 2014 major enhancements are expected, such as whiteboard and videos to be more engaging (as done with other HR training through newly created service functions), are expected to be made. As such, the FERC training has been delayed until November 2014.

Also For 2013, legacy DEBS employee information was captured in the *MyTraining* system, while legacy PESC employees were captured in the *PlantView* system for regulatory compliance purposes, although the same content was used in each. Eventually all employee information is expected to be captured in *MyTraining*; however, not yet, but hopefully by the end of 2014.

Despite substantial improvements to Affiliate Standards training since the prior audit, further enhancements, such as those expected, would be helpful to enliven the training with better examples and a more interactive presentation of the standards.

IV. Affiliate Transactions and Cost Accumulation and Assignment

A. Background & Perspective

The primary Duke Energy Corporation (Duke Energy) accounting system is Financial Management Information System (FMIS), a PeopleSoft system with general ledger, accounts receivable, accounts payable, asset management, project costing (i.e., Power Plant), contract, and billing applications, plus feeder systems that also pass information to the general ledger. The FMIS processes charges to/from Duke Energy Business Service (DEBS) and Duke Energy Kentucky (DEK) affiliates.⁸⁹ Legacy Progress Energy companies use Oracle; however, Duke Energy is in the process of moving legacy Progress Energy companies to PeopleSoft.⁹⁰

According to Duke Energy management, the only major change in direct billing/allocation in 2013 was that starting July 2, 2012, Progress Energy added new entities to the process. Progress Energy Service Company (PESC) continued to have employees until 2014 when they became DEBS employees.⁹¹ Another change was the shift of some service company employees to utility allocation factor (roughly 1,000 employees), particularly those involving Duke Energy Carolinas (DEC). Also, both PE Carolinas and PE Florida used the utility allocation factor unless direct billing used.⁹²

The system has a terminology and method of operation, and each uses a code block/chart field that comprises a set of elements that classify financial information. The code block/chart field contains multiple elements that describe five aspects of a financial transaction as follows:⁹³

- ◆ When – defines the timing of the work performed
- ◆ Who – identifies who performed the work on whose behalf
- ◆ What – defines the nature of the work performed
- ◆ How – defines the resource used to perform the work
- ◆ Where – identifies the location the work was performed or performed for

The corporate organization is broken down into thousands of responsibility centers, which roll up into other higher level responsibility centers based on reporting responsibility. FMIS uses responsibility center (RC) codes to designate parties to a transaction. FMIS records an accounting entry for a direct charge transaction by designating an RC code that represents the work group performing the service and an Operating Unit (OU) code that represents the group for which the work was performed. The OU To code can be specific or not; for example, it can designate a particular plant or just fossil/hydro plants in general. The business unit receiving the charge designates the OU code to which the amount should be charged. The accounting entry also includes an account, process, project number, resource type (e.g., labor, materials, outside contractor), and amount; the FERC account number is usually embedded in the accounting code block numbering. For allocated charges, the OU code represents an allocation pool,

such as governance or enterprise accounting. The FMIS system processes allocation pools at month-end, distributing the charges according to the appropriate allocation pool percentages.⁹⁴

Methodologies Used

Description of Transactions

Services

For all cross affiliate services provided (except those with Progress Energy), an eForm, which is the same form throughout Duke Energy, is required. This process has been in place for approximately eight years.⁹⁵

Among the duties of the Allocations & Reporting group is the responsibility for developing and maintaining a basis data binder used to allocate Service Company costs and tracking and reporting Service Company allocations to receiving departments, as well as answering requests from individual departments. The basis data used for developing allocation factors for a calendar year is updated annually based on the 12 months of actual results ending the prior June 30th of each year. The only exception is for basis data involving capital expenditures (Electric T&D Engineering & Construction and Power Engineering & Construction), which the capital budget data for the upcoming year. June 30 data is available and used to update the basis data in the July through September time frame, so this data can be used to complete the budget for the upcoming year.⁹⁶

As shown later in *Exhibit IV-3*, Duke Energy uses approximately 20 factors for allocating Service Company costs. The allocation factors used do not change often because the methodologies have been agreed to and included in the various Service Company agreements. Adding a methodology/factor would require modifying the agreement documents and getting buy-in from the various states and regulatory bodies. A major change in business operations, such as the merger with Cinergy or Progress Energy, causes the methodologies (and the service agreements) to be modified. The real test of the methodologies used rests with the owners of the function. They have a vested interest in how the allocations are calculated and how much is allocated to affiliates in an area. A good example of different charge allocations using the same factor ratio is the Human Resources function based on number of employees ratio in which (a) governance activities are charged to all entities, including small portion to the international affiliates); (b) enterprise HR only is charged to all affiliates, except international ones, and (c) Utilities HR is charged only to the regulated industries.⁹⁷

DEBS is basically a net \$ entity, in which most costs are charged to Duke Energy subsidiaries; exceptions include DEBS income tax, which is not allocated, and selected interest charges that remain with the service company entity. Also, return on DEBS assets area also excluded from DEBS charges to affiliates.⁹⁸ Also, prior to the merger, PESC was a net \$ entity; however, following the merger, income taxes were kept at PESC. As PESC has no assets, therefore, there's no return on PESC assets to be charged to affiliates.⁹⁹

Departmental employees are directed to direct charge if they can and only include their costs in the allocation pools if they cannot direct charge. Duke Energy's time reporting system, *MyTime*, which has been used approximately three years, was fully implemented on an enterprise basis in April 2011. The time reporting system has a default for employees' time and it is charged unless changed. According to DEBS management, employees were trained to use the new system when it was implemented, so all employees should know how to change their time from the default.¹⁰⁰ However, legacy Progress Energy employees did not use *MyTime* in 2013, but their own system, referred to as the *Corporate Time Entry* (CTE) system. Therefore, starting July 2, 2012 (when merger was effective), all legal Progress Energy employees had to submit timesheets. By the end of 2013 (employees converted over by group during 2013), all legacy Duke Energy employees (even exempt) also had to submit timesheets; however, in the beginning of 2013, exception time reporting was still used.¹⁰¹ All DEBS employees, including legacy Progress Energy employees, use *MyTime* in 2014.¹⁰²

Timekeepers enter time into *MyTime* from approved employee timesheets, or in some areas the employee enters time into *MyTime* and the data is approved by the manager or delegate. The time data is extracted and exported to Aon Hewitt for biweekly pay processing through a series of programs, which loads the time data to the individual employee pay sheets in its HRMS system. Once the time data from *MyTime* has been processed to the individual employee pay sheets, a series of pay calculations occur in the payroll system to finalize the check process. Following the pay confirmation process, files are generated from the payroll system for processing through the Labor Distribution System (LDS). Aon Hewitt balances the labor files before sending the files and control totals to Duke Energy for labor distribution processing to the general ledger. All exempt employees are required to enter their vacation taken into *MyTime* and each business unit determines other time reporting requirements for their area. Some employees enter actual time data, while other employees have their time data generated based on their standard schedule and their default labor allocation. The time data, both entered and generated, is extracted and exported to LDS for processing to the general ledger.¹⁰³

For allocated charges, one of the following three methodologies is used for recording intercompany transactions:¹⁰⁴

- ◆ *Auto-generating*: Intercompany transactions required for recording loans, cash sweeps, or that generate the booking of revenue and generation of a receivable where both affiliates are on the enterprise PeopleSoft ledger may be recorded using the auto-generating methodology. It only handles US\$ transactions; therefore, any non US\$ transactions are exempt from using this methodology. This methodology automatically generates the *purchaser/receiver* transaction based on the *seller/sender* transaction and is available to all Duke Energy business units using the enterprise PeopleSoft general ledger.
- ◆ *Automated Crossbill*: Intercompany transactions that are required for recording allocations or expense/revenue transfers between corporate/business units are to be recorded using the automated crossbill methodology. Allocations or expense/revenue transactions recorded using this methodology may be recorded to third-party accounts rather than designated intercompany accounts as long as individuals responsible for the transaction ensure the propriety of the effect

to the consolidated financial statement line items. The PeopleSoft system automatically generates the related receivable or payable to intercompany accounts.

- ◆ **Manual Balancing:** Although manual balancing is not the preferred methodology for recording inter-business unit transactions, manual balancing can be used when deemed necessary. Examples include: intercompany transactions that are required for recording investment/equity, intercompany derivatives, non-US\$ transactions or, in the case where the transaction is with an affiliate who is not on the enterprise-wide PeopleSoft general ledger. Prior to recording inter-business unit transactions using the manual balancing methodology, both the *seller/sender* and *purchaser/receiver* must submit a request for approval (including the reason for using this methodology and documentation of the mitigating controls in place to ensure compliance with policy) to the Enterprise Intercompany Process Owner (IPO), defined as the person who is in the role of IPO for all of Duke Energy Corporation and its consolidated subsidiaries.

Exhibit IV-1 illustrates a summary pricing guide for affiliate service charges.¹⁰⁵

**Exhibit IV-1
Summary Pricing Guide
Services
as of December 31, 2013**

		TRANSFER TO										
		DE Carolinas	DE Indiana	DE Kentucky	DE Ohio (T&D)	Miami Power	PE Carolinas	PE Florida	DE Ohio (Gen)	other non-reg utility ²	non-utility ⁴ (excl. Svc. Co.)	Service Company
TRANSFER FROM	DE Carolinas	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Indiana	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost	At Cost
	DE Kentucky	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost	At Cost
	DE Ohio (T&D)	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	At Cost	At Cost
	Miami Power	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost	At Cost
	DE Progress	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Florida	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Ohio (Gen)	Cost / Mkt	Cost / Mkt ¹	Cost ³	Cost	Cost / Mkt	Cost / Mkt	Cost / Mkt	Negotiated Rates	Negotiated Rates	At Cost	At Cost
	other non-reg utility ²	Cost / Mkt	Cost / Mkt ¹	Cost / Mkt	Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Negotiated Rates	Negotiated Rates	Negotiated Rates	Negotiated Rates
	non-utility ⁴ (excl. Svc. Co.)	Lower Cost / Mkt	At Cost ¹	At Cost ³	At Cost ³	At Cost ³	At Cost ³	At Cost ³	At Cost	Negotiated Rates	Negotiated Rates	Negotiated Rates
	Service Company	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost

Footnotes:

- The IRUC requires DE Indiana to follow FERC's asymmetrical pricing rules. However, since several of the Duke regulated utilities must follow more restrictive state pricing rules, it has been recommended that DEI affiliate transfers be priced at the more restrictive pricing.
- Non-Regulated Utility Affiliates currently include: DEO-Generation, St. Paul Cogeneration, DE Trading & Marketing, Duke Energy Commercial Asset Management, Inc, CinCap IV, CinCap V, Duke Energy Commercial Enterprises, Inc., Happy Jack Windpower, North Allegheny Wind, Silver Sage Wind, Three Buttes Windpower, LLC., Kit Carson Windpower, LLC., Top of the World Windpower, LLC., Duke Energy Retail Sales, LLC., Duke Energy Lee, II, LLC, Duke Energy Hanging Rock II, LLC and Duke Energy Fayette II, LLC, Cimarron Windpower II, LLC, Laurel Hill Windpower and Ironwood Windpower II, LLC.
- Non-Utility Affiliates are all other affiliates not identified in footnote 3 or the regulated utilities: DE Carolinas, DE Progress, DE Florida, DE Indiana, DE Kentucky, DE Ohio (T&D) and Miami Power.
- If the affiliate is NOT party to the service agreement in place prior to 3/30/08, services provided must be at the Higher of Cost / Mkt. Be certain a subsequent agreement is in place authorizing the services even at asymmetrical pricing. Per Order No. 707, services provided to counterparties under service agreements in effect prior to 3/30/08 can be provided at cost pricing as provided in those service agreements.
- FERC No Action Letter allows DEO Gen to provide services to DEK Plants (Woodlawn, EastBend, and Miami Fort Unit 6) at cost.
- If the affiliate is NOT party to the service agreement in place prior to 3/30/08, services received must be at the Lower of Cost / Mkt. Be certain a subsequent agreement is in place authorizing the services even at asymmetrical pricing. Per Order No. 707, services provided to counterparties under service agreements in effect prior to 3/30/08 can be provided at cost pricing as provided in those service agreements.

Source: Information Response 42

Asset Transfers

The FERC accounts in which asset transfers (e.g. utility, emission allowances, materials and supplies) between DEK and its affiliates are recorded as follows:¹⁰⁶

- ◆ *Utility Plant in Service:* 300 level electric plan accounts
- ◆ *Emission Allowances:* 158 emission allowance inventory account
- ◆ *Materials and Supplies:* Although transactions of materials and supplies could be recorded in capital accounts and O&M accounts, the following accounts were used in recording materials and supplies asset transfers between DEK and its affiliates in 2011:
 - 107000 Construction Work in Process
 - 154100 Plant Materials and Operating Supplies

The asset transfer rules for DEK and other Duke Energy utilities in the Midwest are different from the rules that govern asset transfers in the Carolinas. Transfers in the Carolinas require the use of eForms (a burdensome form that is needed to comply with specific regulations in the Carolinas). Because of the number of transfers within the Midwest, Duke Energy put in a process that did not require the use of eForms in these states. Duke Energy uses an IBM Maximo system, called eMax, to track inventory stock-to-stock transfers between entities, although Progress Energy didn't start using eMax until 2014. DEK generally carries a smaller amount of inventory stock on its books than the other Midwest entities. Transfers of in-service assets are tracked in other systems, typically PowerPlant, which DEK uses. Asset transfers typically occur fossil plant to fossil plant or nuclear plant to nuclear plant as the part needs are similar. Typical transfers are low cost items, such as pumps or valves, although (as shown in *Exhibit III-6*) transfers may also include meters, transformers, regulators, and other miscellaneous items, which are not considered inventory stock transfers.¹⁰⁷

According to Duke Energy management, the biggest change in asset transfers due to the Duke Energy/Progress Energy merger is in the Carolinas with regard to e-Forms caused by the nuclear service agreement. Currently Progress Energy's nuclear organization uses Passport software, but is expected to be converting to eMax in the next two years.¹⁰⁸

Additionally, any individual asset transfers involving DEK that are \$1 million or higher must be reported to the KPSC for approval, as follows:¹⁰⁹

- ◆ In KRS 278.218 (approval of commission for change in ownership or control of assets owned by utility) indicates the following:
 - 1) No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars (\$1,000,000) or more and:
 - a) The assets are to be transferred by the utility for reasons other than obsolescence; or

- b) The assets will continue to be used to provide the same or similar service to the utility or its customers.
- 2) The commission shall grant its approval if the transaction is for a proper purpose and is consistent with public interest.
- ◆ Also, regarding the KPSC Order in Case No. 2008-122 DEK agreed to be bound by KRS 278.218 for transactions involving its gas utility assets.

eMax is used for inventory stock transfers (Account # 154-Plant Materials and Operating Supplies in the sending entity to Account # 154 in the receiving entity); at the end of the month an automatic charge from Account # 163 (Storage, Freight, and Handling) of the sending entity is also transferred to Account # 163 in the receiving entity.¹¹⁰

On a monthly basis, in the Midwest, Duke Energy generates a report from eMax and uses it to determine if fair market value is to be calculated and, where appropriate, book the differential between fair market value and cost to comply with asset transfer standards. The asset valuation of fair market value for the transfers is done in one of three ways:¹¹¹

- ◆ If goods were acquired using a blanket purchase order, the value is the blanket average unit price (AVP).
- ◆ If not acquired using a blanket purchase order, Duke Energy uses a recent purchase order (typically less than six months old but no longer than a year) cost for the item.
- ◆ If there is no purchase order, Duke Energy will get quotes; there is no prescribed number of quotes that must be received.

Transfers of assets not in inventory, such as capital spares, are performed in PowerPlant by the Asset Accounting organization. Similarly, on a quarterly basis, Duke Energy generates a report from PowerPlant, and uses it to if fair market value is to be calculated and, where appropriate, book the differential between fair market value and cost (original cost minus depreciation reserve equals net book value cost) to comply with asset transfer standards.

Cost is handled automatically in the systems; market rate differentials must be handled via a journal entry. The reports for transfers, both inventory stock and in-service assets, go to the Manager, Asset Accounting and a General Ledger journal entry (multiple lines) is created, if necessary. For transfers of in-service assets between regulated and non-regulated entities, rather than simply make a transfer, Asset Accounting retires the asset from the sending entity and adds it formally to the receiving entity, creating a salvage amount to reflect the market differential amount.

Following the Duke Energy/Progress Energy merger, according to DEBS management, there's been more opportunity for transferring capital assets. Both Duke Energy and Progress Energy use PowerPlant for non-inventory assets; however, they were on different versions. Therefore, manual

entry was needed for transferring assets between versions. Then in 2014, both began using the same version, resulting in more system generated transfers.¹¹²

Affiliate transfers of assets are governed by Federal Energy Regulatory Commission (FERC) 707 and asset transfer agreements. FERC 707 requires that transfers between regulated and non-regulated affiliates be priced using asymmetrical pricing. This requires that transfers from DEK to a non-regulated affiliate must be valued at the higher of cost or market, and transfers from non-regulated affiliates to DEK be valued at the lower of cost or market price, referred to as asymmetrical pricing. Therefore, if a transfer is regulated to non-regulated and a market value adjustment is needed, then a gain is added via a journal entry. Conversely if a transfer is non-regulated to regulated, an adjustment via a journal entry is made, if needed. For regulated-to-regulated transfers, asymmetrical pricing is not required, but is done at cost.

There's a No Action letter in Kentucky. In 2006 Duke Energy made a request to FERC, when it transferred Miami Fort Unit 6 from DEO (then CG&E) to DEK (then ULH&P), to allow inventory stock transfers at "at cost" rather than "asymmetrical pricing," even though they would be transferred from a non-regulated entity (DEO Miami Fort 7/8) to a regulated entity (DEK). If any inventory stock transfers go from DEK to DEO, however, "asymmetrical pricing" is required.¹¹³

Exhibit IV-2 illustrates a summary pricing guide for affiliate asset transfers.¹¹⁴

**Exhibit IV-2
Summary Pricing Guide
Asset Transfers
as of December 31, 2013**

TRANSFER FROM	TRANSFER TO								
	DE Carolinas ^{1A, 1B}	DE Indiana	DE Kentucky	DE Ohio (T&D)	PE Carolinas	PE Florida	DE Ohio (Gen)	other non-reg utility ⁷	non-utility ⁴
DE Carolinas ⁵	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}
DE Indiana	At Cost ^{1A}	At Cost	At Cost	At Cost	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
DE Kentucky ⁶	At Cost ^{1A}	At Cost	At Cost	At Cost	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
DE Ohio (T&D)	At Cost ^{1A}	At Cost	At Cost	At Cost	At Cost ^{1A}	At Cost ^{1A}	At Cost	Higher Cost / Mkt	Higher Cost / Mkt
DE Progress	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}
DE Florida	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	At Cost ^{1A}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}	Higher Cost / Mkt ^{1B}
DE Ohio (Gen)	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ²	At Cost ²	At Cost	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ^{1B}	Negotiated Rates	Negotiated Rates	Higher Cost / Mkt
other non-reg utility ⁷	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ²	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ^{1B}	Negotiated Rates	Negotiated Rates	Negotiated Rates
non-utility ⁴ (excl. Svc. Co.)	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ²	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt ^{1B}	Lower Cost / Mkt	Negotiated Rates	Negotiated Rates

Footnotes:

1A. Goods may be transferred "At Cost" with regulated utility affiliates. LEGAL MUST BE CONTACTED when a transfer is >\$100K so that a separate legal agreement can be developed and filed. All Goods Transfers >\$ 1mm require SC Commission Approval.

1B. Prior to transferring goods at the Higher of Cost / Mkt or receiving goods at the Lower of Cost / Mkt, DE Carolinas must file an agreement, CONTACT LEGAL.

2. The IRUC requires DE Indiana to follow FERC's asymmetrical pricing rules. However, since several of the Duke regulated utilities must follow more restrictive state pricing rules, it has been recommended that DEI affiliate transfers be priced at the more restrictive pricing.

3. Non-Regulated Utility Affiliates currently include: DEO-Generation, St. Paul Cogeneration, DE Trading & Marketing, Duke Energy Commercial Asset Management, Inc., CnCap IV, CnCap V, Duke Energy Commercial Enterprises, Inc., Happy Jack Windpower, North Allegheny Wind, Silver Sage Wind, Three Buttes Windpower, LLC., Kit Carson Windpower, LLC., Top of the World Windpower, LLC., Duke Energy Retail Sales, Duke Energy Lee, II, LLC, Duke Energy Hanging Rock II, LLC and Duke Energy Fayette II, LLC, Cimarron Windpower II, LLC, Laurel Hill Windpower and Ironwood Windpower II, LLC.

4. Non-Utility Affiliates are all other affiliates not identified in footnote 3 or the regulated utilities: DE Carolinas, DE Progress, DE Florida, DE Indiana, DE Kentucky, DE Ohio (T&D) and Miami Power. Confirmation must be made that they are party to the existing agreements, if not, CONTACT LEGAL.

5. Transfers from DE Carolinas Involving an asset over \$1 million must be approved by the SCPSC.

6. DE Kentucky cannot transfer assets valued at \$1 million or more without prior approval of the KYPSC.

7. FERC No Action Letter allows DEO Gen to provide services to DEK Plants at cost.

Source: Information Response 42

Cost Accumulation, Assignment, & Allocation

When a DEBS or PESC employee of performs services for a client company, costs are to be directly assigned or allocated. Duke Energy uses 20 factors, as shown in *Exhibit IV-3*, for allocating Service Company costs. The allocation factors used do not change often because the methodologies have been agreed to and included in the various Service Company agreements. Adding a methodology/factor would require modifying the agreement documents and getting buy-in from the various states and regulatory bodies. A major change in business operations, such as the merger with Cinergy, causes the methodologies (and the service agreements) to be modified. The real test of the methodologies used rests with the owners of the function. They have a vested interest in how the allocations are calculated and how much is allocated to affiliates in an area. A good example of different charge allocations using the same factor ratio is the Human Resources function based on number of employees ratio in which (a) governance activities are charged to all entities, including small portion to the international affiliates); (b) enterprise HR only is charged to all affiliates, except international ones, and (c) Utilities HR is charged only to the regulated industries.¹¹⁵

**Exhibit IV-3
Allocation Factors
as of December 31, 2013**

Factor	Utility	Non-Utility
Circuit miles of electric transmission lines	Yes	No
Construction expenditures	Yes	Yes
Electric peak load	Yes	Yes
Generating unit MW capability	Yes	Yes
Gross margin	Yes	Yes
Inventory	Yes	Yes
Labor dollars	Yes	Yes
Miles of distribution lines	Yes	No
Number of central processing unit (CPU) seconds	Yes	Yes
Number of customers	Yes	Yes
Number of employees	Yes	Yes
Number of information systems servers	Yes	Yes
Number of meters	Yes	No
Number of personal computer (PC) work stations	Yes	Yes
O&M expenditures	No	Yes*
Procurement spending	Yes	Yes
Revenues	Yes	Yes
Sales	Yes	Yes
Square footage	Yes	Yes
Total property, plant, and equipment	Yes	Yes

Source: Information Responses 2 and 8 and Interview 6

* *Although a valid factor for charging service company costs to utility companies, it is not used by Duke Energy.

For allocated services, the Service Company Utility Service Agreement prescribes 23 functions with their associated allocation methodologies, as follows¹¹⁶

Exhibit IV-4
DEBS/PESC Allocation Factors by Function
as of December 31, 2013

Information Systems	<ul style="list-style-type: none"> ◆ Number of Central Processing Unit Seconds Ratio ◆ Number of Personal Computer Workstations Ratio ◆ Number of Information Systems Servers Ratio ◆ Number of Employees Ratio ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Meters	<ul style="list-style-type: none"> ◆ Number of Customers Ratio
Transportation	<ul style="list-style-type: none"> ◆ Number of Employees Ratio ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
System Maintenance	<ul style="list-style-type: none"> ◆ Circuit Miles of Electric Transmission Lines Ratio ◆ Circuit Miles of Electric Distribution Lines Ratio ◆ Labor Dollars Ratio (Gas Distribution) (Kentucky)
Marketing and Customer Relations	<ul style="list-style-type: none"> ◆ Number of Customers Ratio
T&D Engineering & Construction	<ul style="list-style-type: none"> ◆ Electric Transmission Plant Construction - Expenditures Ratio ◆ Electric Distribution Plant Construction - Expenditures Ratio
Power Engineering & Construction	<ul style="list-style-type: none"> ◆ Electric Production Plant Construction - Expenditures Ratio
Human Resources	<ul style="list-style-type: none"> ◆ Number of Employees Ratio
Materials Management	<ul style="list-style-type: none"> ◆ Procurement Spending Ratio ◆ Inventory Ratio
Facilities	<ul style="list-style-type: none"> ◆ Square Footage Ratio ◆ Number of Employees Ratio (used in 2013 as square footage not available in selected locations due to merger)
Power Planning Operations	<ul style="list-style-type: none"> ◆ Electric Peak Load Ratio ◆ Weighted Average of the Circuit Miles of Electric Distribution Lines Ratio and the Electric Peak Load Ratio ◆ Construction-Expenditures Ratio (Gas Distribution Operations (Kentucky)) ◆ Weighted Average of the Circuit Miles of Electric Transmission Line Ratio and the Electric Peak Load Ratio ◆ Generating Unit MW Capability Ratio ◆ Sales Ratio
Accounting	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E) ◆ Generating Unit MW Capability Ratio (Carolinas for splitting among plants)
Public Affairs	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E) ◆ Weighted Average of the Number of Customers Ratio and Number of Employees Ratio
Legal	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Rates	<ul style="list-style-type: none"> ◆ Sales Ratio
Finance	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Rights of Way	<ul style="list-style-type: none"> ◆ Circuit Miles of Electric Transmission Lines Ratio ◆ Circuit Miles of Electric Distribution Lines Ratio (new, but not used) ◆ Electric Peak Load Ratio (new, but not used)
Internal Auditing	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Environmental, Health and Safety	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E) ◆ Sales Ratio
Fuels	<ul style="list-style-type: none"> ◆ Sales Ratio
Investor Relations	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Planning	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)
Executive	<ul style="list-style-type: none"> ◆ Three Factor Formula (Gross Margin, Labor Dollars, PP&E)

Source: Information Responses 2, 3, and 8 and Interview 6

Billing Mechanisms

During Year

Most affiliate billing mechanisms (those using FMIS/PeopleSoft) are automatically performed at month-end (based on direct charges and allocations) with offsetting entries to the charging entity (A/R) and receiving entity (A/P). This information is rolled up and summarized, then sent to Treasury, who in turn moves monies between the associated bank accounts. If a Duke Energy entity is not using FMIS (such as Progress Energy using Oracle), then a check or wire transfer is typically made. For regulated entities, settlement is required monthly. For non-regulated entities, it is not done until a capital infusion is required.¹¹⁷

True-up Procedures

Labor and Overhead Items

The Duke Energy Financial Management Information System (FMIS) automatically applies labor loaders for fringe benefits, payroll taxes, unproductive time, incentives, and Service Company overhead (O/H) allocations, if charges from DEBS to an affiliate; Service Company O/H allocations, but other entity O/H allocations are used if a different entity (such as Progress Energy post July 2, 2012 merger). Accounting personnel enter into FMIS the percentage for each labor loader item each month. These rates typically remain constant for most of the year. Accounting personnel record actual costs for the four labor-related costs in separate accounts that they monitor to make sure that the rates it has been applying are staying in line with actual costs. They typically adjust loader rates in the fourth quarter to clear any residuals compared to actual costs. Any journal entries recorded after monthly allocations run are either manually allocated in the current month or recorded in the following month.¹¹⁸

Late Journal Entries

Any journal entries recorded after the monthly allocations run are either manually allocated in the current month or recorded in the following month.¹¹⁹ As Duke Energy employees can only enter JEs until the second business day following month-end, large items after the second business day are manually allocated, while small items may be delayed to the next month. At year-end, however, any missing items, regardless of size, must be manually allocated.¹²⁰

B. Findings & Conclusions

Finding IV-1 The DEK cost allocation manual includes KPSC requirements, but continues to miss key elements of comprehensive CAM documentation used by other utility organizations, such as DEC.

Kentucky Revised Statutes (KRS) 278.22054 provides that any Kentucky utility engaged in non-regulated activities, which produce aggregate revenue exceeding the lesser of two percent (2%) of the utility's total revenue or one million dollars (\$1,000,000) annually, shall develop and file a cost allocation manual (CAM) with the KPSC. The DEK CAM is based solely on KPSC requirements; it does not include various elements, which would make it more useful, such as those discussed in the recommendation associated with this finding.¹²¹

DEK's 2013 CAM was developed during the first quarter of 2013 and the affidavit for the 2013 CAM is dated March 22, 2013. Subsequently Duke Energy Kentucky's 2014 CAM was developed during the first quarter of 2014 and the affidavit for the 2014 CAM is dated March 27, 2014. Consistent with KRS 278.2205, DEK revises its CAM periodically for material changes. DEK also conducts an annual comprehensive review during the first quarter of each year to determine if there are any changes (both material and non-material) that need to be reflected. DEK conducts this CAM review along with its preparation of various annual financial and statistical reports that are filed with the KPSC on or about March 31st of each year. These additional annual reports include, but are not limited to, vegetation and reliability, resource planning updates, non-regulated revenues, and other reports required pursuant to various KPSC Administrative proceedings.¹²² The 2013 changes primarily account for changes (mostly name changes and adding new companies) as a result of the Duke Energy and Progress Energy merger that was consummated on July 2, 2012.¹²³ One of the major CAM changes was the addition of Progress Energy entities to various agreements. The 2013 and 2014 changes also reflect updates to the various reporting requirements of non-regulated activities and changes in the percentage for cost allocation details, not new steps.¹²⁴

DEK's CAM includes the following segments:¹²⁵

- ◆ Description of Duke Energy and DEK
- ◆ CAM requirements, including:
 - KRS 278.2205 (2) (a): A listing of regulated and non-regulated divisions within the utility (not applicable, as DEK does not have any non-regulated divisions).
 - KRS 278.2205 (2) (b): A listing of all regulated and non-regulated affiliates of the utility to which the utility provides services or products and where the affiliates provide non-regulated activities, as defined in KRS 278.010 (21) (CAM Appendix A, with further description in agreements)
 - KRS 278.2205 (2) (c): A listing of services and products provided by the utility, and

identification of each as regulated or non-regulated, and the cost allocation methodology generally applicable to each category

- KRS 278.2205 (2) (d): A listing of incidental, non-regulated activities that are subject to the provisions of KRS 278.2203 (4)
- KRS 278.2205 (2) (e): A description of the nature of transactions between the utility and its affiliates
- KRS 278.2205 (2) (f): For each Uniform System of Accounts (USofA) account and subaccount, a report that identifies whether the account contains costs attributable to regulated operations and non-regulated operations, including an identification of whether the costs are joint costs that cannot be directly identified; if allocated a description of the methodology used, which are subject to the provisions of KRS 278.2203

◆ Appendices

- Listing of DEK affiliates
- Incidental non-regulated revenue (2012)
- Kentucky revised statutes
- Affiliate agreements, including:
 - Utility/non-utility asset transfer agreement
 - Amended and restated operating company/non-utility companies service agreement
 - Asymmetrically priced DEK/non-utility companies service agreement
 - Operating companies service agreement
 - Service company/utility service agreement, including shared service cost distribution detail
 - Utility money pool agreement
 - Second amended and restated purchase and sale agreement of receivables
 - Agreement for filing consolidated income tax returns and for allocation of consolidated income tax liabilities and benefits
 - Intercompany asset transfer agreement, including a report of 2012 inventory transfers
- Operations agreements
 - Facilities operation agreement between Cincinnati Gas & Electric Company (CG&E) and Union Light Heat and Power Company (ULH&P) (no longer applicable)
 - Miami Fort 6 operation agreement
 - Gas and propane services agreement with respect to Woodsdale generating station
 - Agreement for gypsum disposal services

- Report of 2012 inventory transfers
- FERC affiliate transactions report
- FERC uniform system of accounts

Several key elements of a comprehensive CAM are missing from DEK's CAM, including (but not limited to) elements such as:¹²⁶

- ◆ Description of cost accumulation, assignment, and allocation (direct and allocated charges)
- ◆ Description of allocation methodologies and factors, including how calculated
- ◆ Policies, guidelines, and procedures
- ◆ Description of processes and systems used for affiliate charges; etc.

Duke Energy management indicates that it is currently evaluating transferring the maintenance of the CAM to the Rates Department for revision consistent with how the North Carolina CAM is maintained.¹²⁷

Finding IV-2 Appropriate cost allocation factors are being used.

Three primary categories of cost allocations affect DEK and its affiliates, including:¹²⁸

- ◆ Cost allocations from DEBS and PESC to DEK
- ◆ Cost allocations between DEK and DEO for common costs shared by both utility organizations
- ◆ Administrative and general (A&G) cost allocations between its gas and electric operations for both capital and expense accounts

Additionally DEK also provides various services and goods to and receives various services and goods from other regulated and non-regulated affiliates, as shown previously in *Exhibit III-3*. The allocation factors used at Duke Energy are illustrated in *Exhibit IV-3*, with those identified by function are illustrated in *Exhibit IV-4*. Schumaker & Company's review of factors used by function indicate that appropriate allocation factors are being used.

Finding IV-3 DEK's dividend policy is generally reasonable, although in 2011 an extremely high dividend payout ratio occurred, but has since decreased.

Duke Energy (parent company) targets a long-term payout to shareholders of approximately 65% to 70% of adjusted diluted earnings per share, subject to the approval of its Board of Directors. The operating subsidiaries, including DEK, are expected to mirror this policy over time, but have flexibility to vary their dividends to the parent company depending on capital structure requirements and capital spending needs. DEK's historical dividends are displayed in *Exhibit IV-5*.¹²⁹

**Exhibit IV-5
DEK Dividend Payout
2007 to 2013**

	2007	2008	2009	2010	2011	2012	2013
Dividend/(Infusion)	(\$3.1)	\$30.0	\$0.0	\$0.0	\$135.0	\$10.0	\$40.0
Net Income	\$33.5	\$37.5	\$28.1	\$43.3	\$24.3	\$28.2	\$45.1
Payout Ratio	N/A	80.0%	0.0%	0.0%	555.6%	35.5%	88.7%

Source: Information Response 12

In 2011, as DEK had not paid a dividend to its parent since 2008, the dividend in 2011 reflects several years of earnings and cash flow. Duke Energy believed that DEK's capital structure had also become too heavily weighted on equity (approximately 59% equity prior to the dividend versus an approved regulatory capital structure comprised of 51% equity).¹³⁰ Then in 2012 the dividend payout ratio declined to 35.5% followed by 88.7% in 2013.¹³¹

Also, management indicates that since 2006 DEK's payout ratio has been approximately 88%; however, Duke Energy management indicates that this figure would be decreased substantially if the company were to undertake a significant capital expenditures program to meet new resource requirements or comply with environmental regulations.¹³²

DEK has no royalty policy nor has it historically paid any royalties to the parent company or its affiliates.¹³³

Finding IV-4 **Appropriate levels of direct charging are generally occurring with regard to DEK's affiliate transactions.**

For 2013, as well as the prior four years, the percentage of direct charges shown in *Exhibit IV-6* illustrate that generally a large portion of charges were directly charged, not allocated charges.¹³⁴

Exhibit IV-6
Direct versus Allocated Affiliate Service Charges
2009 to 2013

From Affiliates to DEK					
Duke Energy Service Company					
	2009	2010	2011	2012	2013
Total Affiliate Charges (\$)	\$90,101,377	\$100,872,862	\$99,923,766	\$86,968,994	\$82,360,608
Direct %	62.6%	65.1%	62.0%	58.7%	63.7%
Allocated %	37.4%	34.9%	38.0%	41.3%	36.3%
	100.0%	100.0%	100.0%	100.0%	100.0%
Other Affiliates					
	2009	2010	2011	2012	2013
Total Affiliate Charges (\$)	\$11,464,953	\$17,436,381	\$15,916,227	\$17,804,537	\$19,497,244
Direct %	66.1%	76.8%	69.2%	73.5%	66.9%
Allocated %	33.9%	23.2%	30.8%	26.5%	33.1%
	100.0%	100.0%	100.0%	100.0%	100.0%
From DEK to Affiliates					
Duke Energy Service Company (DEBS Only)					
	2009	2010	2011	2012	2013
Total Affiliate Charges (\$)	\$462,705	\$190,463	\$94,507	\$96,075	\$43,896
Direct	23.9%	28.0%	60.5%	62.5%	100.0%
Allocated	76.1%	72.0%	39.5%	37.5%	0.0%
	100.0%	100.0%	100.0%	100.0%	100.0%
Other Affiliates					
	2009	2010	2011	2012	2013
Total Affiliate Charges (\$)	\$4,669,853	\$4,039,524	\$4,352,784	\$5,066,847	\$4,479,509
Direct %	64.9%	61.7%	71.2%	66.7%	65.8%
Allocated %	35.1%	38.3%	28.8%	33.3%	34.2%
	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Information Responses 3, 6, and 51

In *Exhibit IV-6*, regarding 2009 to 2011, FERC Form 1 and FERC Form 60 figures were used for all but DEBS to DEK affiliate charges, which was based solely on FERC Form 60 figures, as FERC Form 1 and FERC Form 60 figures did not agree. In Schumaker & Company's prior audit report, *Finding III-5* further explained these differences, and *Recommendation III-2* suggested that Duke Energy have one DEBS group perform both FERC Form 1 and FERC Form 60 reporting so as to eliminate discrepancies in reporting results.¹³⁵ Following Schumaker & Company's 2011 audit report, the Allocations & Reporting group is responsible for developing both.¹³⁶

In *Exhibit IV-6*, regarding 2012 and 2013, several items on FERC Form 60 were not included on FERC Form 1, because FERC Form 1 excluded categories of transactions that were below \$250,000. Based on follow-up to the original response, additional detail was provided by Duke Energy and incorporated into *Exhibit IV-6*.¹³⁷

Finding IV-5 Duke Energy has made changes in having DEK management provide oversight for affiliate charges to DEK.

According to the DEBS USFE&G group, it not responsible for “auditing” charges from affiliates to DEK (or other regulated entities) or DEK to affiliates. This group only looks at monthly variances against budget. Additionally, no DEK management is responsible for oversight of DEBS or other affiliate charges to Kentucky; only the DEK functions will be looking at charges, but it was not clear that they question affiliate charges. Therefore, in Schumaker & Company’s prior audit report, we recommended that a key person within the DEK management group should be identified and be responsible for oversight of all charges from affiliates to DEK and vice versa. They should not only obtain input from the various DEK groups impacted by these charges, but also question any figures that do not appear appropriate, thereby requiring DEBS Accounting groups to investigate and change, if necessary.¹³⁸

Subsequently, during the 2013 audit report of affiliate charges, Duke Energy management indicated that the following activities occur to support the prior recommendation:¹³⁹

- ◆ All Service Request forms (services to/from DEK) are reviewed by the Utility Planning and Strategy Department prior to being signed by the DEK President.
- ◆ Affiliate transactions are reviewed on a monthly basis by the Regulatory Utility Financial Planning & Analysis (RUFPA) Department. This review process is coordinated by the Financial Planning & Analysis (FP&A) Department, as described in the *Affiliate Transaction Playbook* documentation.
- ◆ Service Company allocation factors are reviewed and updated annually, or as significant events warrant.
- ◆ Periodic training is provided (charging guidance, affiliate code of conduct, etc.)
- ◆ Monthly O&M and capital variance analysis is conducted by the FP&A and RUFPA departments.
- ◆ Monthly financial statements are prepared by the Regulated Utilities Accounting Department.
- ◆ Monthly financial meetings are held with DEK management team, which includes its President and other senior management designates. Meetings include a discussion of:
 - Actual results by major income statement line item
 - Significant variance drivers between actual and budget
 - Summary of O&M and capital
 - Return on equity
 - Annual projection updates

- ◆ Questions/discrepancies raised are reviewed/analyzed and follow up reporting is provided to the DEK management team.

Finding IV-6 Affiliate asset transfer training has improved by incorporating Supply Chain, Accounting, and Rates organizations, unlike 2011.

In the past, the asset transfer training had fewer participants than the FERC training, because only focused on selected employees in supply chain/plant inventory areas, as accountants participate only in general overview training; in future possibly have accountants participate in both.¹⁴⁰

In 2011, 29 Duke Energy employees completed affiliate asset transfer training, mostly from Engineering and Operations groups. The training list only included one Supply Chain employee and no Accounting or Rates employees. In our interviews regarding asset transfers, we spoke with Supply Chain, Accounting, and Rates representatives, who told us asset transfer training for inventory stock-to-stock transfers was informally done. Instead, the responsibility for the Supply Chain, Accounting, and Rates employees to see that this is done correctly resided with the Director, Sourcing, who trained these employees on such tasks.¹⁴¹ There's more employees in 2013 who are taking asset transfer training sessions than in 2011. For example, now training regarding asset transfers includes Supply Chain, Accounting, and Rates organizations, unlike 2011.¹⁴² For 2013, approximately 67 employees attended LD324 coursework sessions and approximately 1,579 attended the new EC30713 coursework sessions.¹⁴³

In 2013, the Regulatory Compliance Department has developed and annual deploys affiliate asset transfer training, which includes.¹⁴⁴

- ◆ Safety
- ◆ Regulatory Governance
- ◆ Regulatory Conditions
- ◆ Code of Conduct
- ◆ Compliance Monitoring
- ◆ Merger Conditions Management
- ◆ Intercompany Asset Transfer Agreement
- ◆ Capital to Capital
- ◆ Capital to Inventory
- ◆ Inventory to Inventory

Finding IV-7 Sufficient policy and associated documentation has not been available in past years regarding accounting for asset loans.

Regarding asset loans, Duke Energy started (in 2012) considering putting a value on asset loans, but did not value them in 2011. The thought by DEBS management was to use the Storage, Freight, and Handling cost (Account # 163) as the value of an asset loan. Duke Energy also considered the use of the service eForm for services as management considers this more like a service (rental) than an asset transfer, especially for loans lasting less than three to four months. If it is longer than three to four months, then Duke Energy was considering selling the asset and buying it back on the associated entity's books. In 2012 during Schumaker & Company's prior audit, DEBS did not have a formal policy regarding asset loans nor sufficient documentation describing the proper accounting for such transactions.¹⁴⁵ Although no such loans occurred in 2013 involving asset loans from/to DEK, other Duke Energy entities, such as DEI, did have such loans.¹⁴⁶ In 2014 during the Schumaker & Company 2013 audit, Duke Energy management indicated that DEK does not have a formal policy regarding asset loans;¹⁴⁷ however, a slide discussing asset loans was incorporated into asset transfer training courses, but is not sufficient documentation describing the proper accounting for such transactions.¹⁴⁸ However, Duke Energy management indicated that it is currently the company's practice not to loan assets.¹⁴⁹

C. Recommendations

Recommendation IV-1 Develop a formal comprehensive cost allocation manual that brings together all required elements of such documentation. (Refer to Finding IV-1)

DEK is in need of formal documentation, such as that used by DEC, which in one package with any associated appendices comprehensively describes its affiliate relationships/organization structure; affiliate standards to which it is subject; affiliate agreements; description of cost accumulation, assignment, and allocation (direct and allocated charges); allocation methodologies and factors; policies, guidelines, and procedures; description of processes and systems used for affiliate charges; etc. According to Duke Energy management, DEK is currently evaluating transferring the maintenance of the Duke Energy CAM to the Rates Department for revision consistent with how the DEC CAM is maintained.¹⁵⁰

If that is done, Duke Energy should continue to include KPSC requirements, but also incorporate recommended changes.

Recommendation IV-2 Develop a formal policy and associated documentation regarding asset loans. (Refer to Finding IV-7)

Even though asset loans have been incorporated in summary form into training materials, Duke Energy should also develop a formal policy and associated written documentation describing how and why it handles asset loans among affiliates, as it has performed such activities in the past, although it indicated that it is currently not done. Nevertheless, Duke Energy should ensure that it develops a formal policy and create such procedural documentation, so that they exist going forward in situations where asset loans are actually done.

V. Financial Arrangement/Obligation Compliance

This chapter addresses financial arrangement/obligation between Duke Energy Kentucky (DEK) and its affiliates, including its parent organizations – Duke Energy Ohio (DEO), Cinergy Corporation (Cinergy), and Duke Energy Corporation (Duke Energy).

A. Background

The specific governing regulatory section that is addressed in this chapter is KRS # 278.2207 - Transactions between utility and affiliate – Pricing requirements – Request for deviation, as follows:

1. The terms for transactions between a utility and its affiliates shall be in accordance with the following
 - a. Services and products provided to an affiliate by the utility pursuant to a tariff be at the tariffed rate, with nontariffed items priced at the utility's fully distributed cost but in no event less than market, or in compliance with the utility's existing (United States Department of Agriculture) USDA, Securities & Exchange Commission (SEC), or Federal Energy Regulatory Commission (FERC) approved cost allocation methodology.
 - b. Additionally, services and products provided to the utility by an affiliate are to be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.
2. A utility may file an application with the commission requesting a deviation from the requirements of this section for a particular transaction or class of transactions, but the utility has the burden of demonstrating that the requested pricing is reasonable. The commission may grant the deviation if it determines the deviation is in the public interest.
3. Nothing in this section should be construed to interfere with the commission's requirement to ensure fair, just, and reasonable rates for utility services.

Financial services and products provided to DEK by affiliates and provided by DEK to its affiliates consist of long-term and short-term debt and investments.

Long-term Debt

Long-term Debt Composition

DEK's long-term debt at the end of calendar year 2013 consisted of capital leases, first mortgage bonds, pollution control bonds, and unsecured debt totaling approximately \$339 million. At the end of the same period DEK's affiliates, including its parents, DEO and Duke Energy, had similar types of long-

term debt totaling approximately \$40.3 billion. Details of the long-term debt for DEK and its affiliates at the end of 2013 are shown in *Exhibit V-1*.¹⁵¹

Exhibit V-1
Duke Energy Long-Term Debt
as of December 31, 2013

Entity	Balance (\$000)
Duke Energy Kentucky	339,053
Duke Energy Business Services	130,992
Duke Energy Carolina	8,436,056
Duke Energy Indiana	3,796,182
Duke Energy Ohio	1,848,656
Duke Energy Corporation	6,154,810
Duke Energy International	1,041,761
Duke Energy Generation Services	1,021,033
Duke Energy Progress	5,235,007
Duke Energy Florida	4,885,942
Progress Energy, Inc.	3,993,360
Cinergy Receivables	325,000
Purchase Accounting Adjustments	3,048,273
Total	40,256,125

Source: Duke Energy Web Site, Fixed Income Investors, LT Debt Detail

Schumaker & Company auditors reviewed the documentation from a sample of Duke Energy's long-term debt instruments, including capital leases, as of the end of 2013. Documentation from 18 of Duke's long-term debt instruments were reviewed. This review included all of the debt instruments issued by Duke Energy and its subordinates in 2012 and 2013. DEK did not issue any debt in either 2012 or 2013. This review was made to determine if the debt documentation contained clauses or covenants that could possibly expose DEK to financial damage or risk. This review was made to determine if the debt documentation contained clauses or covenants that could possibly expose DEK to financial damage or risk. The long-term debt instruments reviewed are shown in *Exhibit V-2*.¹⁵²

Exhibit V-2
Sampled Long-term Debt Instruments
as of December 31, 2013

No.	Entity	Description	Balance (\$000)	Rate	Type	Settlement	Maturity
2013 Issuances							
1	Duke Energy Corporation	Senior Notes	\$400,000	3.950%	Fixed	10/11/13	10/15/23
2	Duke Energy Corporation	Senior Notes	\$500,000	2.100%	Fixed	06/10/13	06/15/18
3	Duke Energy Corporation	Junior Subordinated Debentures	\$500,000	5.125%	Fixed	01/09/13	01/15/73
4	Duke Energy Indiana	First Mortgage Bonds	\$150,000	LIBOR plus 0.35%	Floating	07/11/13	09/11/16
5	Duke Energy Indiana	First Mortgage Bonds	\$350,000	4.900%	Fixed	07/11/13	07/15/43
6	Duke Energy Ohio	First Mortgage Bonds	\$150,000	LIBOR plus 0.14%	Floating	09/06/13	03/06/15
7	Duke Energy Ohio	First Mortgage Bonds	\$300,000	3.800%	Fixed	09/06/13	09/01/23
8	Duke Energy Progress	Pollution Control Revenue Refunding Bonds	\$48,485	4.000%	Fixed	06/06/13	06/01/41
9	Progress Energy Carolinas	First Mortgage Bonds	\$500,000	4.100%	Fixed	03/12/13	03/15/43
Total 2013 Issuances			\$2,898,485				
2012 Issuances							
10	Duke Energy Carolina	First Mortgage Bonds	\$650,000	4.00%	Fixed	09/21/12	09/30/42
11	Duke Energy Corporation	Senior Notes	\$700,000	1.62%	Fixed	08/16/12	08/15/17
12	Duke Energy Corporation	Senior Notes	\$500,000	3.05%	Fixed	08/16/12	08/15/22
13	Duke Energy Indiana	First Mortgage Bonds	\$250,000	4.20%	Fixed	03/15/12	03/15/42
14	Progress Energy	Senior Notes	\$450,000	3.15%	Fixed	03/08/12	04/01/22
15	Progress Energy Carolinas	First Mortgage Bonds	\$500,000	2.80%	Fixed	05/18/12	05/15/22
16	Progress Energy Carolinas	First Mortgage Bonds	\$500,000	4.10%	Fixed	05/18/12	05/15/42
17	Progress Energy Florida	First Mortgage Bonds	\$250,000	0.650%	Fixed	11/20/12	11/15/15
18	Progress Energy Florida	First Mortgage Bonds	\$400,000	3.85%	Fixed	11/20/12	11/15/42
Total 2012 Issuances			\$4,200,000				
TOTAL ISSUANCES			\$7,098,485				

Source: Duke Energy Web Site, Long-Term Debt Information, Recent Issuances & Prospectuses, and Pre-Merger Issuances & Prospectuses

Credit Ratings

DEK's credit ratings for its senior unsecured debt at the end of 2013 was listed as Stable, with ratings of BBB+ by Standard & Poor's (S&P), Baa1 by Moody's Investor Service (Moody's), and A- by Fitch Ratings, Inc. (Fitch). These ratings were comparable to its Duke Energy affiliates. The S&P ratings for DEK were based on the consolidated credit profile of Duke Energy and reflected the consolidated credit profiles of all of the Duke Energy domestic operating subsidiaries – Duke Energy Carolinas (DEC), Duke Energy Florida (DEF), DEO, Duke Energy Indiana (DEI), Progress Energy, Inc., Duke Energy Progress (DEP), and DEK – and contributions from Duke Energy's Latin American operations and existing and planned renewable generation investments. The credit rating agencies listed DEK's low business risk profile and credit supportive regulatory environment, partially offset by expected declines in DEK's financial metrics as rationale for the current rating and outlook.¹⁵³

In July 2012, S&P lowered DEK's credit rating from A- to BBB+, along with the corporate credit rating for Duke Energy and the other utility affiliates. Additionally, the senior unsecured debt of Duke Energy was lowered from BBB+ to BBB. S&P takes the view that there are no meaningful measures that can

prevent the free flow of cash throughout the Duke Energy companies and therefore views all of the companies as a single economic entity.¹⁵⁴

Ratings for all of the Duke Energy operating companies at December 31, 2013 are shown in *Exhibit V-3*.¹⁵⁵

Exhibit V-3
Duke Energy Credit Ratings
as of December 31, 2013

ENTITY	DECEMBER 31, 2013		
	S&P	MOODY'S	FITCH
Duke Energy Kentucky			
Outlook	Stable	Stable	Stable
Senior Unsecured	BBB+	Baa1	A-
Duke Energy Corporation			
Outlook	Stable	Stable	Stable
Senior Unsecured	BBB+	A3	BBB+
Junior Subordinate Debt	BBB	A3	BBB+
Commercial Paper	A-2	P-2	G-2
Duke Energy Carolinas			
Outlook	Stable	Stable	Stable
Senior Secured	A	Aa2	A+
Senior Unsecured	BBB+	A1	A
Duke Energy Florida			
Outlook	Stable	Stable	Stable
Senior Secured	A	A1	A
Senior Unsecured	BBB+	A3	A-
Duke Energy Indiana			
Outlook	Stable	Stable	Stable
Senior Secured	A	Aa3	A
Senior Unsecured	BBB+	A2	A-
Duke Energy Ohio			
Outlook	Stable	Stable	Stable
Senior Secured	A	A2	A
Senior Unsecured	BBB+	Baa1	A-
Progress Energy, Inc.			
Outlook	Stable	Stable	Stable
Senior Unsecured	BBB	Baa1	BBB
Duke Energy Progress			
Outlook	Stable	Stable	Stable
Senior Secured	A	Aa2	A+
Senior Unsecured	BBB+	A1	A

Source: Information Response 24 and Duke Energy Website

Short-Term Debt

DEK's short-term debt requirements are managed by Duke Energy's Treasury Department in a consolidated manner for all of Duke Energy's utility industry companies. Short-term cash requirements for the Duke Energy companies are fulfilled through use of a consolidated money pool arrangement whereby short-term funds are lent and borrowed amongst participating Duke Energy affiliated companies. Outside source of funds for the money pool is a Duke Energy commercial paper program. An additional source of funds is from a consolidated credit facility.¹⁵⁶

Money Pool

The Utility Money Pool Agreement was amended on July 2, 2012, reflecting organizational changes brought about by the merger of Duke Energy and Progress Energy. This agreement authorizes DEK and a number of its affiliates to participate in a short-term borrowing and lending arrangement to better manage cash and working capital requirements. Under this arrangement, those companies with surplus short-term funds provide short-term loans to affiliates participating under this arrangement. Short-term funds borrowed may be from either internal or external sources. The participants in the Duke Energy Money Pool Agreement are shown in *Exhibit V-4*.¹⁵⁷

Exhibit V-4
Duke Energy Money Pool Participants
as of December 31, 2013

No.	Participant	State of Registration	Description	Money Pool Rights	
				Lend	Borrow
1	Cinergy Corporation	Delaware	Holding company - sub of Duke Energy Corp.	X	
2	Duke Energy Business Services	Delaware	Service company - sub of Duke Energy Corp.	X	X
3	Duke Energy Corporation	Delaware	Parent Company	X	
4	Duke Energy Indiana	Indiana	Public utility - sub of Cinergy Corp.	X	X
5	Duke Energy Kentucky	Kentucky	Public utility - sub of Duke Energy Ohio	X	X
6	Duke Energy Ohio	Ohio	Public utility - sub of Cinergy Corp.	X	X
7	Duke Energy Carolinas	North Carolina	Public utility - sub of Duke Energy Corp.	X	X
8	KO Transmission Company	Kentucky	Non-utility - sub of Duke Energy Ohio	X	X
9	Miami Power Corporation	Indiana	Public utility - sub of Duke Energy Ohio	X	X
10	Progress Energy	North Carolina	Holding company - sub of Duke Energy Corp.	X	
11	Progress Energy Carolinas	North Carolina	Public utility - sub of Progress Energy Corp.	X	X
12	Progress Energy Florida ¹	Florida	Public utility - sub of Progress Energy Corp.	X	X
			Service company - sub of Duke Energy Corp.		
13	Progress Energy Service Company	North Carolina	Services	X	X

¹ Previously titled "Progress Energy Florida"

Source: Information Response 23

Each Duke entity in the Money Pool can contribute funds to the Money Pool. Each participant determines daily, “on the basis of cash flow projections and other relevant factors” and at each party’s “sole discretion,” the amount of excess cash that they have available to contribute to the Money Pool. The decision to lend funds to the Money Pool is made by each participant’s Chief Financial Officer or Treasurer, or their designee. Any participant may withdraw their funds from the Money Pool at any time with notice given to Duke Energy Business Services (DEBS) as administrative agent of the Money Pool.¹⁵⁸

Each of the Money Pool participants, with the exception of Duke Energy, Progress Energy, and Cinergy, are authorized to borrow cash on a short-term basis from the Money Pool, subject to the availability of funds. The decision to borrow from the Money Pool is at the sole discretion of the borrowing company and can only be made by the borrower’s chief financial officer or treasurer, or their designee. No participant can be required to borrow from the Money Pool if it is determined that money can be borrowed at a lower cost from other sources (such as banks or the sale of its own commercial paper), and the participant is authorized to effect such a borrowing.¹⁵⁹

The source of funds available in the Money Pool to be borrowed comes from the following sources:¹⁶⁰

- ◆ *Surplus funds* – from the treasuries of Money Pool participants. Borrowers borrow their funds from each Money Pool lending party in proportion to the amount loaned to the Money Pool by each lender in relation to the total amount loaned at any one time.
- ◆ *External funds* – proceeds from borrowings by participants, including the sale of commercial paper by Duke Energy, Progress Energy, Cinergy, DEC, DEI, DEO, DEK, and Progress Energy Carolina (PEC), and Progress Energy Florida. These funds will be made available in a manner to result in the lowest possible cost of borrowing, consistent with individual borrowing needs and financial standing of the parties providing funds, as determined by DEBS, as administrator of the Money Pool.

Interest accrues monthly on all borrowings from the Money Pool. If the source of the borrowed funds are internal, i.e., come from other participating Money Pool companies, the interest rate is the CD yield equivalent of the 30-day Federal Reserve AA industrial commercial paper composite rate. If the composite rate is not available, then the composite rate from the previous day for which a composite rate was established is used. If the source of funds is external, the interest rate is to be equal to the lending party’s cost of acquiring the funds. This can be a composite rate (weighted average of cost incurred by all parties involved) if the funds come from several lending sources. If the borrowed funds come from a combination of internal and external sources, the interest rate charged is also a composite or blended rate. In all cases, the rate charged is to be the Money Pool’s cost of the money borrowed and is expected to result in a lower cost of borrowing. There is no fee added to the rate charged.¹⁶¹

In 2013 DEK borrowed short-term funds from affiliates and lent short-term funds to affiliates through the Money Pool. The terms of each loan were usually one day with the exception of weekends and holidays, when terms were three to four days.¹⁶²

DEK lent funds to affiliates and received \$23,142 in interest for a weighted average annual interest rate of 0.1221% in 2013. DEK borrowed funds from affiliates during 2013 and paid \$829 in interest for a weighted average annual interest rate of 0.2514%.¹⁶³

A summary of funds lent by DEK through the Money Pool are shown in *Exhibit V-5*.¹⁶⁴

Exhibit V-5
Money Pool Funds Lent by DEK
as of December 31, 2013

Borrower	Period	Average Amount Lent (\$)	Weighted Par Value (\$)	Interest Received (\$)	Weighted Average Annual Interest Rate
Duke Energy Business Services	12/31/2012 - 1/2/2014	12,787,835.37	4,194,410,000	14,290	0.1227%
Duke Energy Progress	1/2/2013 - 1/2/2014	3,816,180.33	1,163,935,000	3,750	0.1160%
Duke Energy Florida	3/4/2013 - 1/2/2014	1,637,558.44	126,092,000	466	0.1332%
Progress Energy Service Company	3/15/2013 - 3/26/2013	584,181.82	6,426,000	25	0.1401%
Duke Energy Ohio	12/31/2012 - 12/16/2013	4,360,567.11	1,299,449,000	4,494	0.1245%
Duke Energy Indiana	12/31/2012 - 7/11/2013	296,225.49	30,215,000	117	0.1389%
Totals/Weighted Average			6,820,527,000	23,142	0.1221%

Source: Information Response 23

A summary of Money Pool funds borrowed by DEK in 2013 is shown in *Exhibit V-6*.¹⁶⁵

Exhibit V-6
Money Pool Funds Borrowed by DEK
as of December 31, 2013

Lender	Period	Average Amount Borrowed (\$)	Weighted Par Value (\$)	Interest Paid (\$)	Weighted Average Annual Interest Rate
Duke Energy Carolinas	1/30/2013 - 10/4/2013	871,135	32,232,000	111	0.1244%
Duke Energy Florida	1/30/2013 - 10/4/2013	401,941	13,666,000	52	0.1361%
Duke Energy Indiana	8/22/2013 - 10/4/2013	380,435	8,750,000	28	0.1144%
Duke Energy Corporation	1/30/2013 - 10/4/2013	1,506,973	55,758,000	610	0.3937%
Progress Energy Service Company	1/30/2013 - 10/4/2013	228,432	8,452,000	29	0.1248%
Totals			118,858,000	830	0.2514%

Source: Information Response 23

Commercial Paper Program

Duke Energy has only one consolidated commercial paper program, which can be used for short-term needs for all of the affiliates, including DEK. Commercial paper issued by Duke Energy is available to be loaned to DEK and the other affiliates through the Money Pool. In 2013, commercial paper with a par value of \$13.6 billion at interest rates that ranged from 0.22% to 0.45% was issued through SunTrust, Morgan Stanley, Citibank, and JP Morgan commercial paper dealers. Period terms for the commercial paper issued ranged from one day to 183 days. The weighted average interest rate for Duke Energy's Commercial Paper program was 0.35972%.¹⁶⁶

Credit Facility

There is a \$6 billion master Credit Agreement (amended on December 18, 2013) between Duke Energy, DEC, DEO, DEI, DEK, DEP, and DEF as borrowers and approximately 30 international banks as lenders. The participating banks involved are shown in *Exhibit V-7*.¹⁶⁷

Exhibit V-7
Duke Energy Credit Agreement Participants
as of December 31, 2013

Bank	Participation	
	Position in Agreement	Commitments (\$)
Wells Fargo Bank, National Association	Administrative Agent and Swingline Lender	315,000,000
Bank of America, N.A.	Issuing Lender	315,000,000
Royal Bank of Scotland PLC	Issuing Lender	315,000,000
Bank of China, New York Branch	Issuing Lender	315,000,000
Bardays Bank PLC	Issuing Lender	315,000,000
Citibank, N.A.	Issuing Lender	315,000,000
Credit Suisse AG, Cayman Islands Branch	Issuing Lender	315,000,000
JPMorgan Chase Bank, N.A.	Issuing Lender	315,000,000
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	Issuing Lender	315,000,000
UBS AG, Stamford Branch	Issuing Lender	315,000,000
BNP Paribas	Lender	247,000,000
Goldman Sachs Bank USA	Lender	247,000,000
Mizuho Bank, Ltd.	Lender	247,000,000
Morgan Stanley Bank, N.A.	Lender	247,000,000
Royal Bank of Canada	Lender	247,000,000
Sun Trust Bank	Lender	247,000,000
The Bank of Nova Scotia	Lender	247,000,000
Banco Bilbao Vizcaya Argentaria, SA, New York Branch	Lender	135,000,000
Industrial and Commercial Bank of China, Limited, New York Branch	Lender	135,000,000
KeyBank National Association	Lender	135,000,000
The Bank of New York Mellon	Lender	135,000,000
U.S. Bank National Association	Lender	135,000,000
The Northern Trust Company	Lender	101,000,000
Fifth Third Bank	Lender	85,000,000
Credit Agricole Corporate & Investment Bank	Lender	65,000,000
PNC Bank, National Association	Lender	65,000,000
Santander Bank, N.A.	Lender	65,000,000
TD Bank, N.A.	Lender	65,000,000
TOTAL COMMITMENTS		6,000,000,000

Source: Information Response DEI 123

Of the total \$6 billion facility, DEK has a maximum limit of \$150 million. This is less than the limits assigned to DEO and DEI (\$750 million each), DEF and DEP (\$1 billion each), DEC (\$1.5 billion) and Duke Energy (\$3 billion).¹⁶⁸ The interest rate that applies to each loan from the Credit Facility is dependent on the type of loan and the credit rating of the borrower. Each borrowing entity must obtain

a credit rating on its outstanding senior unsecured long-term debt from two credit rating agencies, one of which must be either Standard & Poor's (S&P) or Moody's. The interest and facility fee rates that apply to borrowings based on the borrower's credit rating are shown in *Exhibit V-8*.¹⁶⁹

Exhibit V-8
Duke Energy Credit Agreement Pricing Schedule
as of December 31, 2013

Borrower's Credit Rating	S&P	Moody's	S&P	Moody's	S&P	Moody's	S&P	Moody's	S&P	Moody's	S&P	Moody's
	≥ A+	≥ A1	≥ A	≥ A2	≥ A-	≥ A3	≥ BBB+	≥ Baa1	≥ BBB	≥ Baa2	< BBB	< Baa2
Facility Fee Rate	7.5		10.0		12.5		17.5		22.5		27.5	
Applicable Margin												
Euro-Dollar Loans	80.0		90.0		100.0		107.5		127.5		147.5	
Base Rate Loans	0.0		0.0		0.0		7.5		27.5		47.5	

Source: Information Response DEI 123-002

Capital Structure

Dividend Payouts

Duke Energy dividend policy, subject to approval of the Board of Directors, is a long-term payout to shareholders of approximately 65% to 70% of adjusted diluted earnings. DEK and the other utility subsidiaries are also expected to follow this policy over time, with some additional flexibility that allows them to vary their payouts to their parent based on their capital structure and capital spending requirements. Maintaining what Duke Energy and their credit rating agencies believe to be an appropriate capital structure (52% to 45% debt and 48% to 55% equity) is a higher priority than compliance with the dividend payout target. A schedule displaying DEK's dividend payouts to Duke Energy over the past ten years is shown in *Exhibit V-9*.¹⁷⁰

Exhibit V-9
DEK's Dividend Payout History
2004 to 2013

Financial Data	Years									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Dividend (\$ Millions)	15	10	0	0	30	0	0	135	10	40
Net Income (\$ Millions)	19	15	11	34	38	28	43	24	28	45
Payout Ratio	79%	67%	N/A	N/A	79%	N/A	N/A	555%	36%	89%

Source: Information Response DEI 143

Capitalization

DEK's capital structure over the past three years is shown in *Exhibit V-10*.¹⁷¹

Exhibit V-10
DEK's Capital Structure History
2011 to 2013

Financial Data	For Years Ended December 31					
	2011		2012		2013	
	\$ Millions	%	\$ Millions	%	\$ Millions	%
Debt ¹	343	49.1%	341	47.8%	339	47.3%
Equity ¹	355	50.9%	373	52.2%	378	52.7%
Total Capitalization	698	100.0%	714	100.0%	717	100.0%

¹ US GAAP reporting

Source: Information Response DEI 143

B. Findings & Conclusions

Finding V-1 **DEK is not exposed to undue risk because of its long-term indebtedness or that of its affiliates.**

To determine if there was any recourse to DEK for any indebtedness incurred by an affiliate, Schumaker & Company interviewed Duke Energy personnel, whose responsibilities in 2013 included the establishment of treasury/capitalization policies for the corporation; research/execution of corporate financing transactions (including credit facilities) for Duke Energy, DEC, DEF, DEO, DEI, DEP, and DEK; and interest rate risk management. This interview revealed that no indebtedness has been incurred by any affiliate of DEK that included any recourse to DEK. Additionally, Schumaker & Company sampled the long-term debt instruments of DEK's affiliates to verify that there was no indication of any recourse to DEK.

At December 31, 2013, eleven Duke Energy entities had a total of 222 long-term debt instruments with a balance of \$40.3 billion listed on the Duke Energy web site. All of the debt instruments issued by DEK's affiliates in 2012 and 2013 were selected for review. None of the debt issued in 2012 and 2013 was from DEK or DEK's non-utility affiliates. The value of the debt instruments reviewed represented over 17% of the value of the long-term debt issues for all of the Duke Energy entities, and the number

of debt instruments reviewed was in excess of 8% of the total number of Duke debt instruments outstanding at December 31, 2013.

Documentation for each of these long-term debt obligations was reviewed to identify any clauses or codicils that might affect DEK or could possibly require DEK to assume some future obligation as a result of an action or inaction by one of its affiliates. Specific sections that seemed to denote risk were reviewed in detail. For the long-term debt obligations of DEK, documentation was reviewed for the presence of any risky situations or circumstances that could adversely affect DEK's rate payers.

There was no indication DEK or its ratepayers were at greater risk due to its long-term debt obligations or those held by its affiliates.

Finding V-2 **DEK is not party to any agreements that obligate it to underwrite the financial viability of any of its affiliates.**

Reviews of the Duke Energy Utility Money Pool Agreement, the \$6 billion Credit Agreement, and the long-term debt obligations referred to in *Finding V-1* revealed no obligations on the part of DEK to assist any of its affiliates. The obligations of DEK's affiliates were specific to the Duke Energy affiliate noted as the borrower and did not contain language including other Duke affiliates. There was no terminology to indicate that any affiliates of the borrower in question would be at greater risk due to the long-term debt obligation.

Finding V-3 **During 2012 and 2013 DEK has not issued any security for the purpose of financing the acquisition, ownership, or operation of an affiliate.**

Securities issued by DEK consist of capital leases, first mortgage bonds, pollution control bonds, and unsecured debt. In 2012 and 2013 DEK did not issue any debt instruments, therefore, there was nothing to indicate that DEK was financing the acquisition, ownership, or operation of an affiliate.

Finding V-4 **DEK has not assumed any obligation or liability as guarantor, endorser, surety, or otherwise in respect of any security of an affiliate.**

Reviews of funding agreements and sampled debt obligation documentation did not reveal any instance in which DEK had assumed, or was to assume, obligations or liabilities as guarantor, endorser, surety, or otherwise for one of its affiliates. An attestation from Duke Energy's Director of Corporate Finance and Assistant Treasurer, responsible for the establishment of treasury/capitalization policies for the corporation and research/execution of corporate financing transactions (including credit facilities for DEK and its affiliates), verified that DEK does not have any financial instruments that include credit-rating triggers or provisions leading to collateral calls.

Finding V-5 **DEK has not pledged, mortgaged or otherwise used as collateral any of its assets for the benefit of an affiliate.**

A review of Duke's funding agreements (Utility Money Pool and Credit Facility), sampled debt obligation documents, and DEK's financial statements did not reveal any indication that DEK had pledged, mortgaged, or otherwise used as collateral any of its assets for the benefit of an affiliate. An attestation from Duke Energy's Director of Corporate Finance and Assistant Treasurer, responsible for the establishment of treasury/capitalization policies for the corporation and research/execution of corporate financing transactions (including credit facilities for DEK and its affiliates), verified that DEK does not have any financial instruments that include credit-rating triggers or provisions leading to collateral calls.

Finding V-6 **DEK has maintained a consistent credit rating since mid-2012.**

DEK's credit ratings for its senior unsecured debt at the end of 2013 was listed as Stable, with ratings of BBB+ by Standard & Poor's (S&P), Baa1 by Moody's Investor Service (Moody's), and A- by Fitch Ratings, Inc. (Fitch). S&P downgraded DEK's credit rating from A- to BBB+ with a Negative outlook in July, 2012. S&P's rating has not changed then, but the outlook has been improved to Stable. Moody's rating and outlook has remained unchanged since 2009 and Fitch has maintained the same rating since it started rating DEK in mid-2012.

Finding V-7 **DEK's Money Pool transactions in 2013 have not caused it to incur any material unnecessary expense.**

DEK both lent money to affiliates and borrowed money from affiliates through the Money Pool in 2013. Although the interest rate that DEK paid for the funds borrowed from affiliates (weighted average annual interest rate of 0.2514%) was higher than the rate paid to DEK for funds lent to affiliates (weighted average annual interest rate of 0.1221%), the amount of interest paid by DEK was minimal (\$823) and far less than the interest received for funds lent to affiliates (\$23,142). Additionally, the average daily amount borrowed from Duke Energy Corporation, which carried the more expensive interest rates (0.3937%) amounted to approximately 25% of the average daily amount lent to affiliates, indicating that most of the funds lent to affiliates came from DEK's excess operating funds.

C. Recommendations

None

VI. Internal Controls

A. Background & Perspective

As part of the Kentucky Public Service Commission's (KPSC's) approval of the Cinergy / Union Light, Heat and Power Company (ULH&P) merger in 2006, the KPSC established 46 merger commitments, which were stated in Case No. 2005-00228. Three of these merger commitments are directly applicable to this audit. These three commitments are:

- ◆ Commitment 11 requiring proper accounting of costs.
- ◆ Commitment 12 requiring Duke Energy Kentucky (DEK) maintain appropriate cost allocation procedures and commit to third party audits.
- ◆ Commitment 13 requiring DEK protect against cross subsidization.

Adhering to these three merger commitments is partially achieved through the existence and functionality of appropriate processes/procedures and effective internal controls at DEK. Internal controls are subject to specific monitoring through the Sarbanes Oxley (SOx) rules. Procedures, processes, and internal controls are monitored on an ongoing basis by the Audit Services organization. Compliance with the SOx rules and the ongoing audit function helps in maintaining the merger commitments made in Case No. 2005-00228. Both SOx and audit activities impacting DEK or affiliate transactions are discussed in the following sections.

SOx Controls

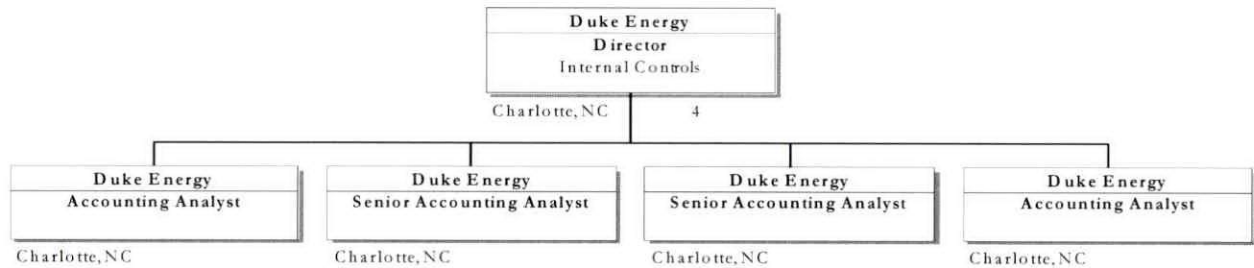
SOx controls were the ultimate result of an act passed by U.S. Congress in 2002 to protect investors from the possibility of fraudulent accounting activities by corporations. The Sarbanes-Oxley Act mandated strict reforms to improve financial disclosures from corporations and prevent accounting fraud. As a part of this Act, year-end financial reports were mandated to contain an assessment of the effectiveness of the internal controls and the company's auditing firm would be required to attest to that assessment. This has resulted in public companies registered with the SEC to list specific controls and test them regularly and determine that the controls are operating effectively and as intended. These listed controls are referred to as SOx controls.

The Duke Energy organization has approximately 1,745 SOx controls. Of these controls, approximately 10 are directly applicable to the USF&G OH/KY group and two of these were tested in 2013. The controls tested were both considered "effective," none were "ineffective" or "undetermined." Also, the SOx controls regarding accounting for services and asset transfers, such as inventory stock transfers, are generic and not specifically focused on affiliate charges, as affiliate charges do not impact Duke Energy's consolidated financial statements, since affiliate charges are eliminated during consolidation.¹⁷²

SOx Testing

SOx testing occurs at random and specific times during the year. When the Director of Accounting, Internal Controls, notifies the SOx representatives, each SOx representative verifies that the SOx control owners for which they are responsible are still valid. Once validity is confirmed, the SOx representative directs the control owners to begin the SOx testing. The testing results are documented ultimately in the Open Pages system with a narrative and any back up needed to confirm that the control is working. When the documentation is complete in Open Pages, the SOx representative reviews the information provided. The Internal Controls group, shown in Exhibit VI-1 also monitors this activity and documentation on an ongoing basis.¹⁷³

Exhibit VI-1
Internal Controls Organization
2013



Source: DEI Audit Interviews and Information Request 112-10

- ◆ Duke Energy has approximately ten SOx controls that apply to the affiliate relations and charges, and the USFE&G Ohio / Kentucky group. The controls have been relabeled between 2011 and 2013. The newly labeled controls are:
 - ◆ Corporate allocation calculation review
 - ◆ Corporate allocations posted properly
 - ◆ Service company allocations posted properly
 - ◆ Composite rates are entered correctly in FMIS
 - ◆ Affiliate Allocations Phire Form
 - ◆ Affiliate Overhead Run Control Report
 - ◆ Intercompany Elimination Review
 - ◆ Intercompany Balances Review
 - ◆ Subregistrant Balance Sheet Review
 - ◆ Subregistrant Financial Results Summary (FRS)

Subregistrant Financial Results Summary and Corporate Allocation Review were the two controls selected for testing and determined to be operating effectively during 2013.¹⁷⁴

Internal Audits

Five internal audits regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been conducted in the last five years. The Corporate Audit Services group did not specifically perform any audits regarding the Kentucky/Ohio Accounting & Reporting group in 2009 through 2013; however, routine internal control reviews have been performed during this time period, and five audits were conducted that pertained to affiliated relationships or transactions. These audits are briefly described in *Exhibit VI-2*.¹⁷⁵

Exhibit VI-2
Internal Audits Associated with Affiliate Relationships / Transactions
2009 to 2013

Audit #	Audit Title	Date Completed
113010	Regulated Utilities Operations, Non-Regulated Products and Services Portfolio Review	September 9, 2013
111016	Non-Utility Operations Accounting Practices	July 25, 2011
310006	FE&G FERC Uniform System of Accounts	June 30, 2010
110007	Franchised Electric and Gas (FE&G) State Affiliate Standards Indiana and Kentucky	March 24, 2010
309015	Allocations Process	October 30, 2009

Source: Information Response 15

According to the Director, Corporate Audit Services, the actions required to address each of these recommendations from these audits have been completed.¹⁷⁶

Regulated Utility Operations, Non-Regulated Products and Services Portfolio Review #113010

The scope of this audit was to review controls, processes, and management of the residential non-regulated portfolio of products and services. The targeted objectives were:¹⁷⁷

- ◆ Marketing programs were conducted in accordance with applicable regulatory guidelines
- ◆ Processes, including roles and responsibilities, were fully defined and communicated
- ◆ Processes associated with program management as well as contract and claims administration were appropriate and performed in accordance with applicable corporate policies and contractual terms and conditions
- ◆ Program results were reported timely and sufficient detail is maintained for effective management oversight
- ◆ Methodology for allocating shared costs was appropriate and processes and controls related to allocations were sufficient

- ◆ Customer data was adequately safeguarded and protected from unauthorized access by both internal and external parties

A summary of the audit report indicated that the portfolio was being handled as expected and as required by state regulatory guidelines. The review of key business processes included cost allocations of shared employees and contract administration. No compliance issues were noted during the work performed.¹⁷⁸

One observation was made during the audit work. Opportunities currently exist to make the management of the products and services offered by the legacy companies more consistent. Management is aware of the opportunity and is aligning processes as the legacy companies are integrated.¹⁷⁹

Management has implemented the proposed action plan in advance of the September 30, 2014 target implementation date.¹⁸⁰

FE&G Non-Utility Operations Accounting Practices Audit #111016

The scope of this audit was to evaluate the processes and controls governing the designation and accounting for non-utility operations, which primarily consist of residential and non-residential customer products and services, excluding accounting for products and services associated with Duke Energy One. Its objectives were to evaluate whether:¹⁸¹

- ◆ Accounting practices were in accordance with FERC guidelines and Duke Energy procedures
- ◆ Products and services were appropriately designated as non-utility operations
- ◆ Associated revenues and expenses, including allocations, were fully charged to non-utility operations
- ◆ Communication and monitoring practices were in place and operating effectively

A summary of the audit report indicates that the overall process of designating and accounting for non-regulated products and services in accordance with FERC guidelines is generally working effectively; however, opportunities exist to enhance account coding practices to ensure appropriate classification of non-utility operations, although miscoding errors noted were not considered material. One “low” item was discussed, as follows:¹⁸²

- ◆ The product code list used to assist in identifying proper account coding includes inaccurate product code classifications and inactive products.
- ◆ Immaterial errors were noted in the recording of non-regulated and regulated operations in the general ledger.
- ◆ Certain miscodings were not identified and corrected in the review performed by Project Accounting.

In its management response, three specific actions to address these items included: (a) the Retail Customer Products and Services (RCPS) Business Management Services group is to work with Project Accounting on a routine basis to identify miscoding trends to target for reinforcement and to reinforce the proper account coding for all residential and non-residential customer products and services through

the current training process, (b) the Project Accounting is to review the miscodings identified during the audit, including system generated miscodings, and record corrections for those that exceed a reasonable materiality threshold, and to document and enhance the current accounting review process to include a review for accurate classification of all nonregulated products and services for all jurisdictions, and (c) the RCPS Business Management Services is to work with Project Accounting to review and update the product code list for inaccuracies and inactive products, and also to implement a process to periodically review the product code list for accuracy. All of these actions were to be implemented by August 31, 2011.¹⁸³

FE&G FERC Uniform System of Accounts Audit #310006

The scope of this audit was a review of Duke Energy Carolinas' compliance with the FERC Uniform System of Accounts, especially in regard to recording costs to the proper accounts, which was a requirement of the Amended and Restated Agreement and Stipulation of Settlement related to the 2009 North Carolina rate case filings. Its objectives were to evaluate whether:¹⁸⁴

- ◆ Processes, including monitoring activities, were in place to ensure compliance with the FERC Uniform System of Accounts
- ◆ Cost coding guidelines were clearly defined, communicated, and consistently applied
- ◆ Findings related to improper cost coding identified by the Public Staff were addressed

A summary of the audit report indicates that the Controller's group and Financial Planning and Analysis group were to perform monitoring processes to ensure costs are recorded to the proper accounts in compliance with the FERC Uniform System of Accounts, with the processes performed by the Controller's group designed to detect the items noted during this internal audit, but the processes had not yet been performed during 2010. Although issues were identified with labor in two accounts reviewed, there were no other issues related to the inappropriate recording of costs, including classification of recoverable and non-recoverable costs; however, the implementation of systematic controls and formal training to supplement current communications could improve the efficiency of the manual monitoring processes.¹⁸⁵

In its management response, two actions were noted to address these issues, including, (a) perform enhanced training to reinforce the importance of coding costs to proper accounts and (b) work with the Finance Information Technology group to assess the feasibility of implementing key systematic controls to prevent certain account coding errors as a supplement to the current monitoring processes. All actions were to be implemented by August 31, 2010.¹⁸⁶

Franchised Electric and Gas (FE&G) State Affiliate Standards – Indiana and Kentucky Audit # 110007

This audit addressed FE&G State Affiliate Standards- Indiana and Kentucky. The scope of this audit, which was to assess compliance with Indiana and Kentucky Affiliate Standards, focused on systems

access, and controls and processes governing transactions between Duke Energy Indiana (DEI), DEK, and respective affiliates. The objectives of the audit were to determine whether processes effectively ensure.¹⁸⁷

- ◆ Systems with market or confidential information had appropriate access
- ◆ Invoices for IT services were appropriately charged
- ◆ Company guidelines regarding charges covered by service requests were consistently applied
- ◆ Labor loader calculations were accurate

The conclusion of this moderate finding by Audit Services was that opportunities existed to enhance access reviews of regulated and non-regulated application data and improve the timeliness of corrections identified in the affiliate transaction review process. Also implementation would require changes to the GenWeb and MicroGads Gold system's user access and the FERC System Access Review system, whose completion was expected in 2010. In its management response, DEBS management accepted these recommendations and agreed to completion by the scheduled due date.¹⁸⁸

Allocations Process Audit #309015

This audit addressed the allocations process by evaluating the process and procedures for Service Company and departmental allocations across enterprise transactions for the period of July 1, 2008 to June 30, 2009. The objectives of the audit were to determine whether:¹⁸⁹

- ◆ Processes and procedures were fully defined and roles and responsibilities were understood
- ◆ Allocations were consistently applied in compliance with applicable requirements
- ◆ Cost pools were clearly defined and monitored

The overall conclusion by Audit Services was that the process effectively administers allocations for the enterprise; however, the process is complex and was not fully understood by key business areas. There are opportunities for process enhancements, which impacts the roles and responsibilities of process owners at the Service Company and departmental levels. Enhancements recommended included defining and communicating roles and responsibilities, implementing consistent documentation and monitoring practices, and providing training. This moderate priority recommendation was scheduled for completion by August 31, 2010. In its management response, the Duke Energy Business Services (DEBS) management accepted these recommendations and agreed to completion by the scheduled due date.¹⁹⁰

Risk Assessment/Quality Assurance

Based on the July 2, 2012 Duke Energy/Progress Energy merger, Duke Energy has implemented risk assessment/QA processes that is followed for 2012 merger conditions in Kentucky. It includes a risk assessment methodology and quality assurance monitoring procedure that was documented and provided to Schumaker & Company consultants during this audit, as illustrated in overview fashion in *Exhibit VI-3*.¹⁹¹

Exhibit VI-3
Risk Assessment/Quality Assurance Documentation

❖ The purpose of this document is to provide scope and documentation regarding OpenPages Task Management:

- I. Assess and Document the 'risk'
- II. Monitoring and QA Methodology for 'Completed Tasks'
- III. QA Tracking and Issue Escalation processes for 'Completed Tasks'



Source: Information Response 56

B. Findings & Conclusions

Finding VI-1 **Internal audit reports regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been addressed by DEBS staff in a timely manner.**

For each of the audits identified previously in *Exhibit VI-2*, Schumaker & Company investigated if the resulting audit recommendations were addressed by DEBS staff in a timely manner. The Director of Audit Services confirmed during this audit that all corrective actions were completed and implemented by the agreed upon completion dates.

C. Recommendations

None

-
- ¹ / Information Response 1 (Item 4-Attachment C)
 - ² / Information Response 65
 - ³ / Information Response 65
 - ⁴ / Information Response 65
 - ⁵ / Information Response 65
 - ⁶ / Information Response 63 and Browning Investments website
 - ⁷ / Information Response 64
 - ⁸ / Information Response 64
 - ⁹ / Information Response 1 (Item 4-Attachment C)
 - ¹⁰ / Information Response 1 (Item 3-Attachment B)
 - ¹¹ / Information Response 1 (Item 2-Attachment A)
 - ¹² / Information Response 1 (Item 2-Attachment A)
 - ¹³ / Information Response 3
 - ¹⁴ / Schumaker & Company Prior Audit Report
 - ¹⁵ / Information Response 38 and Interview 6
 - ¹⁶ / Interview 6
 - ¹⁷ / Information Response 38 and Interview 6
 - ¹⁸ / Page 41 2011 NC CAM and Interview 6
 - ¹⁹ / Schumaker & Company prior audit report and Information Response 41
 - ²⁰ / Interview 2
 - ²¹ / Schumaker & Company prior audit report and Information Response 4
 - ²² / Information Responses 5 and 54
 - ²³ / Prior Schumaker & Company audit report and Draft Report Company Comments
 - ²⁴ / Interview 4
 - ²⁵ / KRS 278.2213
 - ²⁶ / Information Response 37 and Interview 5
 - ²⁷ / Information Response 37 and Interview 5
 - ²⁸ / Interview 7
 - ²⁹ / Interview 7
 - ³⁰ / Interview 7
 - ³¹ / Interview 7
 - ³² / Interview 7
 - ³³ / DEI Information Response 111
 - ³⁴ / Interview 7
 - ³⁵ / Interview 7
 - ³⁶ / Information Response 25
 - ³⁷ / Interview 5
 - ³⁸ / Interview 5
 - ³⁹ / Interview 5 and Information Response 18
 - ⁴⁰ / Interview 5 and Information Response 18
 - ⁴¹ / Interview 5 and Information Response 19
 - ⁴² / Interview 5 and Information Response 18
 - ⁴³ / Prior Schumaker & Company audit report and Interview 5
 - ⁴⁴ / Prior Schumaker & Company audit report and Interview 5
 - ⁴⁵ / Prior Schumaker & Company audit report and Interview 5

-
- ⁴⁶ / Information Responses 2, 8, 23, and 52
⁴⁷ / Information Response 50
⁴⁸ / Information Response 52
⁴⁹ / Information Responses 19 and 50 and Interview 5
⁵⁰ / Information Response 50
⁵¹ / Information Response 19 and Interview 5
⁵² / Interview 5
⁵³ / Information Response 16 and Interview 8
⁵⁴ / Information Response 16 and Interview 8
⁵⁵ / Information Response 16
⁵⁶ / Information Response 16 and Interview 8
⁵⁷ / <http://euhrcp.vemoplanning.com/>
⁵⁸ / Information Response 16 and Interview 8
⁵⁹ / Information Response 16 and Interview 8
⁶⁰ / Information Response 16 and Interview 8
⁶¹ / Interview 8
⁶² / Information Responses 16 and 58 and Interview 8
⁶³ / Information Response 16 and Interview 8
⁶⁴ / Interview 8
⁶⁵ / Interview 8
⁶⁶ / Interview 8
⁶⁷ / Information Response 16 Attachment A
⁶⁸ / Information Response 16 Attachment A
⁶⁹ / Information Response 16 Attachment A
⁷⁰ / Information Response 16 Attachment A
⁷¹ / Information Response 16 Attachment A
⁷² / Information Response 16 Attachment A
⁷³ / Duke Energy website
⁷⁴ / Interview 5 and Information Response 59
⁷⁵ / Information Response 59
⁷⁶ / Information Response 59
⁷⁷ / Information Response 26
⁷⁸ / Information Response 26
⁷⁹ / Information Response 26
⁸⁰ / Interview 7
⁸¹ / Information Response 26
⁸² / Information Response 26
⁸³ / Interview 7
⁸⁴ / KPSC Case No. 2005-00228 Order, Approved 11/29/05, Merger Agreement 12
⁸⁵ / Information Responses 21 and 22
⁸⁶ / Information Responses 21
⁸⁷ / Schumaker & Company prior audit report
⁸⁸ / Information Response 50
⁸⁹ / Information Response 10
⁹⁰ / Interview 2
⁹¹ / Interview 6
⁹² / Interview 6
⁹³ / Information Response 10

-
- 94 / Information Response 10
 - 95 / Prior Schumaker & Company audit report Interviews 2, 5, and 6
 - 96 / Interview 6
 - 97 / Prior Schumaker & Company audit report and Interview 6
 - 98 / Interview 6
 - 99 / Interview 6
 - 100 / Prior Schumaker & Company audit report and Interview 6
 - 101 / Interview 6
 - 102 / Interview 6
 - 103 / Prior Schumaker & Company audit report and Interview 6
 - 104 / Accounting for Intercompany Transactions Policy (DEI Information Response 6)
 - 105 / Information Response 42
 - 106 / Prior Schumaker & Company audit report and Interview 4
 - 107 / Interview 4
 - 108 / Interview 4
 - 109 / Information Response 43
 - 110 / Information Response 45 and Interview 4
 - 111 / Information Response 45 and Interview 4
 - 112 / Interview 4
 - 113 / Information Response 44
 - 114 / Information Response 42
 - 115 / Interview 6 and Information Responses 2 and 8 (also DEI Information Response 146)
 - 116 / Information Responses 2, 3, and 8 and Interview 6
 - 117 / Interview 6
 - 118 / Information Response 9 and Interview 6
 - 119 / Information Response 9
 - 120 / Interview 6
 - 121 / Information Responses 2 and 8
 - 122 / Schumaker & Company prior audit report and Information Responses 2, 8, and 20 and Interview 6
 - 123 / Information Response 21
 - 124 / Schumaker & Company prior audit report and Information Responses 2, 8, and 20 and Interview 6
 - 125 / Information Responses 2 and 8
 - 126 / Information Responses 2 and 8
 - 127 / Information Response 50
 - 128 / Interview 6 and Various Information Responses
 - 129 / Information Response 12
 - 130 / Schumaker & Company prior audit report
 - 131 / Information Response 12
 - 132 / Schumaker & Company prior audit report, Information Response 12 Analysis, and Interview 1
 - 133 / Information Response 13
 - 134 / Information Responses 3, 6, and 51
 - 135 / Schumaker & Company prior audit report and Information Response 51
 - 136 / Information Response 50
 - 137 / Information Response 51
 - 138 / Schumaker & Company prior audit report and Interview 6
 - 139 / Information Response 50 and Interview 6
 - 140 / Schumaker & Company prior audit report
 - 141 / Schumaker & Company prior audit report

142	/ Interviews 4 and 5
143	/ Information Response 55
144	/ Information Response 50
145	/ Schumaker & Company prior audit report
146	/ Information Response 47
147	/ Information Response 50 Response to Schumaker & Company Prior Audit Recommendations
148	/ Information Response 50 SCH-DR-0105B Attachment Page 23
149	/ Information Response 61
150	/ Information Response 50
151	/ Duke Energy Web Site, Fixed Income Investors, LT Debt Details
152	/ Duke Energy Web Site, Long-Term Debt Information, Recent Issuances & Prospectuses, and Pre-Merger Issuances & Prospectuses
153	/ Information Response 24 and Duke Energy Web Site
154	/ Information Response 24
155	/ Information Response 24 and Duke Energy Web Site
156	/ Interview 1
157	/ Information Response 23
158	/ Information Response 23
159	/ Information Response 23
160	/ Information Response 23
161	/ Information Response 23
162	/ Information Response 23
163	/ Information Response 23
164	/ Information Response 23
165	/ Information Response 23
166	/ Information Response DEI 121
167	/ Information Response DEI 123
168	/ Information Response DEI 123-002
169	/ Information Response DEI 123-002
170	/ Information Response DEI 143
171	/ Information Response DEI 143
172	/ Information Response DEI 36 and Interview 5
173	/ DEI Audit Interviews and Information Request 112-10
174	/ Information Response DEI 36 and Interview 5
175	/ Information Response DEI 36
176	/ Information Response 60
177	/ Information Response 15
178	/ Information Response 15
179	/ Information Response 15
180	/ Information Response 60
181	/ Information Response 15
182	/ Information Response 15
183	/ Information Response 15
184	/ Information Response 15, Schumaker & Company prior audit report
185	/ Information Response 15, Schumaker & Company prior audit report
186	/ Information Response 15, Schumaker & Company prior audit report
187	/ Information Response 15, Schumaker & Company prior audit report
188	/ Information Response 15, Schumaker & Company prior audit report
189	/ Information Response 15, Schumaker & Company prior audit report

¹⁹⁰ / Information Response 15, Schumaker & Company prior audit report

¹⁹¹ / Information Response 56 and Interview 5