FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA19-7-000
July 2, 2020

Amy M. Perlman
Vice President and Controller
Michigan Electric Transmission Company, LLC
27175 Energy Way
Novi, MI 48377

Dear Ms. Perlman:

1. The Division of Audits and Accounting (DAA) within the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (Commission) has completed an audit of Michigan Electric Transmission Company, LLC (METC). The audit covered the period from January 1, 2015 through December 31, 2018.

2. The audit evaluated METC's compliance with: (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment O of the Midcontinent Independent System Operator, Inc. (MISO) Open Access Transmission, Energy and Operating Reserve Markets Tariff, and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; and (4) requirements in Preservation of Records of Public Utilities and Licensees, 18 C.F.R. Part 125. The enclosed audit report contains 6findings and 18 recommendations that require METC to take corrective action.

3. On June 22, 2020, you notified DAA that METC does not contest the 6 findings and agrees to implement the 18 recommendations. A copy of your verbatim response is included as an appendix to this report. I hereby approve the audit report.

4. METC should submit its implementation plan to comply with the recommendations within 30 days of this letter order. METC should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed by the audit report, these submissions should be made no later than 30 days after the end of each calendar

quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

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

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

7. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Steven D. Hunt, Acting Director and Chief Accountant, Division of Audits and Accounting at (202) 502-6084.

Sincerely,

Larry R. Parkinson
Director
Office of Enforcement

Enclosure

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

DRAFT AUDIT REPORT*

Audit of Michigan Electric Transmission Company, LLC's Compliance with:

- **The Transmission Formula Rate Mechanism in Attachment O of the MISO Open Access Transmission Tariff;**

- **Commission Accounting Requirements under the Uniform System of Accounts for Public Utilities and Licensees under 18 C.F.R. Part 101;**

- **Reporting Requirements of the FERC Form No. 1 and Supplemental Form 3-Q under 18 C.F.R. Part 141; and**

- **Requirements in Preservation of Records of Public Utilities and Licensees, 18 C.F.R. Part 125.**

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I. Executive Summary

A. Overview

The Division of Audits and Accounting (DAA) within the Office of Enforcement of the Federal Energy Regulatory Commission (Commission or FERC) has completed an audit of Michigan Electric Transmission Company, LLC (METC) to evaluate compliance with: (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment O of the Midcontinent Independent System Operator, Inc. (MISO) Open Access Transmission, Energy and Operating Reserve Markets Tariff, and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts for Public Utilities and Licensees (USofA) under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others, and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. §141.1; and (4) requirements in Preservation of Records of Public Utilities and Licensees, 18 C.F.R. Part 125. The audit covered the period from January 1, 2015 to December 31, 2018.

B. Summary of Compliance Findings

Audit staff's compliance findings are summarized below. Section IV of this report explains our findings in detail. Audit staff found 6 areas of noncompliance:

- *Accounting for Lobbying Costs* – METC recorded lobbying costs associated with pensions in Account 926, Employee Pensions and Benefits, instead of in Account 426.4, Expenditures for Certain Civic, Political and Related Activities. Account 926 is included in METC's formula rate while Account 426.4 is not. As a result, METC overstated its wholesale transmission revenue requirement used to bill transmission customers by approximately $57,673 from 2015 through 2018.

- *Accounting for Compromised Settlements* – METC incorrectly recorded $287,435 of allocated costs related to the settlement of employment discrimination claims from ITC Holdings Corp. (ITC Holdings), its parent holding company, in its operating expense accounts. The operating expense accounts were included in METC's wholesale transmission formula rate mechanism. As a result, METC overstated its wholesale transmission revenue requirement used to bill transmission customers.

- *Accounting for Abandoned Transmission Projects* – METC did not assign any engineering and supervision (E&S) costs to abandoned transmission construction projects; instead, it reallocated the associated E&S costs to ongoing transmission projects and improperly accrued AFUDC on the reallocated amounts. As a result, METC improperly accrued and recovered AFUDC on E&S costs related to abandoned transmission projects capitalized to plant in service and understated the cost of abandoned projects recorded to expense.

- *Accounting for Donations* – METC inappropriately accounted for a donation as an operating expense. This accounting misclassification led to improper amounts being included in the inputs to METC's wholesale transmission formula rate mechanism which resulted in METC overbilling its wholesale transmission customers.

- *Accounting for Asset Retirement Obligations* – METC failed to use the income statement and used only balance sheet accounts to record Asset Retirement Obligations (AROs) related to its utility plant assets.

- *FERC Form No. 1 Reporting* – METC did not properly follow the instructions of the FERC Form No. 1 in some cases and therefore did not report all the required information in its FERC Form No. 1 filings.

C. Summary of Recommendations and Corrective Actions Taken

Audit staff's recommendations to remedy the findings are summarized below. Detailed recommendations are in section IV. All refunds are to be for the audit period unless otherwise stated. To address the areas of noncompliance, audit staff recommends that METC:

Accounting for Lobbying Costs

1. Strengthen processes and procedures to ensure that employees record lobbying expenses in the correct accounts.

2. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculations of the refunds relating to the inclusion of lobbying costs in Account 926 and the resulting impact on charges to METC's transmission customers, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

3. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

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

Accounting for Settlements of Employment Discrimination Claims

5. Strengthen processes and procedures and provide training to staff to ensure that METC properly records settlement amounts related to employment discrimination claims in accordance with Accounting Release AR-12.

6. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculations of the refunds resulting from correcting the inclusion of settlement amounts related to employment discrimination claims in the billing rates of METC, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

7. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

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

Accounting for Abandoned Transmission Projects

9. Going forward, record necessary journal entries to reclassify abandoned E&S costs and related expenditures to the appropriate expense accounts.

10. Enhance its existing policies, procedures, and practices to assign an applicable portion of E&S costs to abandoned transmission construction projects going forward, and to account for such abandoned project E&S costs by recording them in the correct account.

Accounting for Donations

11. Record necessary journal entries to reclassify donations from operating or other accounts to Account 426.1.

12. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) the calculation of refunds that resulted from correcting its improper classification of donations, including interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

13. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

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

Accounting for Asset Retirement Obligations

15. Strengthen processes and procedures to ensure that METC accounts for asset retirement obligations in accordance with Commission accounting rules and regulations, including Order No. 631. Similarly, the recovery of the asset retirement obligation should also follow Order 631.

16. Provide training on the updated processes and procedures to employees performing accounting functions for assets retirement obligations.

FERC Form No. 1 Reporting

17. Revise and strengthen documented policies, procedures, and practices to help ensure information in the FERC Form No. 1 is correct, accurate, and consistent with the instructions of the form. Notify and seek guidance from the Commission regarding any instructions of the form that METC finds unclear, if necessary.

18. Provide training to staff on the revised FERC Form No. 1 policies, procedures, and practices. Also, develop a training program that supports the provision of periodic training in this area, as needed.

D. Other Matter

METC's accounting practice for the use of preliminary survey and investigation (PSI) expenses is to record charges to Account 568, Maintenance Supervision and Engineering (Major Only), and Account 920, Administrative and General Salaries, instead of booking these costs in Account 183, Preliminary Survey and Investigation Charges (Major Only). As a result, METC recovered costs as an expense in current rates that could have been capitalized and recovered through depreciation of the capitalized asset or expensed in a different reporting period.

E. Compliance and Implementation of Recommendations

Audit staff further recommends that METC submit for audit staff's review:

- A plan for implementing audit staff's recommendations. METC should submit this plan to audit staff within 30 days after this final audit report is issued.

- Quarterly reports to DAA describing METC's progress in implementing each corrective action recommended in this final audit report. METC should make these nonpublic quarterly submissions no later than 30 days after the end of each calendar quarter, beginning with the first full quarter after submission of the implementation plan, and continuing until it completes all recommended corrective actions.

- Copies of any written policies and procedures developed in response to audit recommendations. These products should be submitted for audit staff's review in the first quarterly filing after METC completes them.

II. Background Information

A. Overview and Corporate Structure

ITC Holdings Corp.

ITC Holdings is a large independent electricity transmission company that provides delivery and interconnection services. ITC Holdings operates directly or through its subsidiaries in Michigan's Lower Peninsula and portions of Iowa, Minnesota, Illinois, Missouri, Kansas, and Oklahoma. ITC Holdings also focuses on new areas where significant transmission system improvements are needed through the work of its subsidiary ITC Grid Development and that entity's subsidiaries.

Michigan Electric Transmission Company, LLC

METC is a wholly owned subsidiary of ITC Holdings. METC is a transmission company responsible for operating its system that serves 4.9 million people throughout Michigan's Lower Peninsula. METC's operating assets consist primarily of approximately 5,600 circuit miles of transmission lines; approximately 38,000 transmission towers and poles; and 80 stations, which connect METC's transmission lines to generation resources, distribution facilities, and neighboring transmission systems.

METC incorporated in 2002, in response to an act of the Michigan Legislature requiring the divestiture of transmission assets from Michigan's then vertically structured utilities. The transmission assets acquired by METC upon incorporation had been previously owned and operated by Consumers Energy Company. In 2006, METC was acquired by ITC Holdings. In 2016, ITC Holdings was acquired by Fortis Inc. (Fortis).

METC's rates are regulated by the Commission and established through a formula rate mechanism conditionally accepted, subject to refund, by the Commission in 2005, effective January 1, 2006, and accepted, as resolved by an uncontested settlement, in 2007.[1] METC's service area covers approximately two-thirds of Michigan's Lower Peninsula and is contiguous with that of METC's affiliate, ITC Transmission Company. MISO bills and collects revenue from METC's customers. METC has no employees; all functions of METC are performed by employees of ITC Holdings, the parent company.

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[1] *Michigan Electric Transmission Company, LLC,* 113 FERC ¶ 61,343 (2005) (Docket No. ER06-56-000) (conditionally accepting revised tariff sheets), *reh'g granted in part, denied in part*, 116 FERC ¶ 61,164 (2006); 120 FERC ¶ 61,194 (2007) (accepting uncontested settlement).

Consumers Energy Company

Consumers Energy Company (Consumers Energy) operates the electric distribution system to which METC's transmission system connects. METC typically receives a majority of its billed revenue from Consumers Energy.[2] In addition, METC is a party to a number of operating contracts with Consumers Energy that impact the operations and maintenance of its transmission system. These contracts include the following:

- *Amended and Restated Easement Agreement* (*Easement Agreement*) – Under the Easement Agreement, Consumers Energy provides METC with an easement to the land on which a majority of METC's transmission towers, poles, lines, and other transmission facilities used to transmit electricity for Consumers Energy and others are located. METC pays Consumers Energy an annual rent for the easement and also pays any rental fees, property taxes, and other fees related to the property covered by the Easement Agreement.

- *Amended and Restated Operating Agreement* (*Operating Agreement*) – Under the Operating Agreement, METC is responsible for maintaining and operating its transmission system in accordance with particular provisions of the Operating Agreement, including providing Consumers Energy with information and access to METC's transmission system and related books and records, administering and performing the duties of control area operator (that is, the entity exercising operational control over the transmission system), and, if requested by Consumers Energy, building connection facilities necessary to permit interaction with new distribution facilities built by Consumers Energy.

- *Amended and Restated Purchase and Sale Agreement for Ancillary Services* (*Ancillary Services Agreement*) – Because METC does not own any generating facilities, it must procure ancillary services from third party suppliers, such as Consumers Energy. Currently, under the Ancillary Services Agreement, METC pays Consumers Energy for providing certain generation-based services necessary to support the reliable operation of the bulk power grid, such as voltage support and generation capability and capacity to balance loads and generation.

- *Amended and Restated Distribution-Transmission Interconnection Agreement* (*DT Interconnection Agreement*) – The DT Interconnection Agreement provides for the interconnection of Consumers Energy's distribution system with METC's

[2] For example, Consumers Energy provided 77.5 percent of METC's billed revenue in 2017, as reported on page 123.23 of METC's 2017 FERC Form No. 1.

transmission system and defines the continuing rights, responsibilities, and obligations of the parties with respect to the use of their own and the other party's properties, assets, and facilities.

B. Fortis Merger

On February 9, 2016, ITC Holdings entered into a merger agreement (Merger Agreement) with Fortis, pursuant to which Fortis would acquire ITC Holdings and its subsidiaries, including METC, for cash and equity consideration (the Merger). Upon the completion of the Merger, ITC Holdings would become a subsidiary of Fortis. On April 20, 2016, Fortis reached a definitive agreement with GIC Private Ltd. (GIC), Singapore's sovereign wealth fund, pursuant to which GIC would acquire a 19.9 percent equity interest in ITC Holdings for cash consideration upon completion of the Merger.

ITC Holdings became a wholly owned subsidiary of ITC Investment Holdings Inc., which is owned by Fortis and GIC, upon the closing of the Merger. ITC Investment Holdings Inc. indicated that it would not record its merger-related costs to its subsidiaries' books, including METC's books. As a result, these costs should not have been included as components of METC's revenue requirement.

C. Transmission Formula Rate

METC's annual transmission revenue requirement (ATRR) is determined using METC's Commission-approved formula rate, which is applied to cost inputs supplied each year by METC to produce METC's ATRR and related billing rates to be used to calculate customer charges for a one-year period. These inputs are primarily derived from the FERC Form No. 1 filings submitted by METC each year. METC's cost-based formula rate includes a true-up mechanism that compares METC's actual revenue requirements to its billed revenues for the prior year, to determine any over- or under-collection of revenue. Revenue is recognized for services provided during each reporting period based on trued-up, actual revenue requirements calculated using the formula. METC accrues or defers revenues in Account 456.1 to the extent that the trued-up, actual revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. The amount of accrued or deferred revenue is reflected in future revenue requirements and thus flows through to customer bills within two years under the provisions of METC's formula rate.

III. Introduction

A. Objectives

The audit evaluated METC's compliance with: (1) approved terms, rates, and conditions of its transmission formula rate mechanism as provided in Attachment O of the Midcontinent Independent System Operator, Inc.'s Open Access Transmission, Energy and Operating Reserve Markets Tariff, and other jurisdictional rates on file with the Commission; (2) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; (3) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1; and (4) requirements in Preservation of Records of Public Utilities and Licensees, 18 C.F.R. Part 125. The audit covered the period from January 1, 2015 to December 31, 2018.

B. Scope and Methodology

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

- *Review of Public Information* – Reviewed publicly available information relating to METC's operations, structure, history, regulatory oversight, tariff, and other pertinent business and regulatory aspects before commencing the audit on February 6, 2019. Materials reviewed included METC's FERC Form No. 1 filings, other filings, and relevant Commission orders; METC's corporate website; trade and industry press; and news articles.

- *Conferring with Commission Staff* – Conferred with Commission staff in the Office of Energy Market Regulation and the Office of General Counsel to ensure audit report findings were consistent with Commission precedent and policy.

- *Regulatory Standards and Criteria* – Identified regulatory requirements and criteria to evaluate METC's compliance with audit objectives. These requirements and criteria included the rates, terms, and conditions in METC's transmission tariff, Commission accounting and reporting requirements in 18 C.F.R. Parts 101 and 141, and Commission rules, regulations, letter orders, and other requirements for jurisdictional public utilities. This review also included

METC's rate and accounting filings to understand the nuances of METC's rates and jurisdictional operations.

- *Data Requests* – Issued formal data requests to obtain information and audit evidence. Information requested included METC's internal policies and procedures, financial accounting data, information supporting amounts and disclosures in METC's FERC and MISO filings, internal and external audit reports, Board of Directors and Audit Committee meeting minutes, corporate compliance program documents, and other pertinent information not publicly available.

- *Site Visits to METC Headquarters* – Conducted two site visits to METC's corporate headquarters to discuss, observe, and evaluate METC's procedures, practices, and controls intended to ensure compliance with Commission regulations. The visits enabled audit staff to:

    - Discuss METC's corporate structure, departmental functions, and employee responsibilities, and meet with key company officials;

    - Learn about METC's transmission system and operations – in particular, the assets, departments, activities, functions, systems, and processes used in its operations;

    - Interview executives, managers, and staff responsible for accounting, financial reporting, transmission operations, and corporate compliance;

    - Review Board of Directors and Audit Committee meeting minutes and internal and external audit reports;

    - Discuss management and operation of METC's corporate compliance program;

    - Discuss and observe internal accounting and reporting procedures, processes, and controls relevant to the audit's scope; and

    - Discuss METC's preservation of records policies, procedures, and practices.

- *Interviews and Meetings* – Held an opening conference with METC to discuss audit objectives, scope, and process. Likewise, held a closing conference about fieldwork completion and the extent of audit findings and recommendations. Conducted regular phone conferences and interviews with

METC employees to discuss technical and administrative matters relevant to the audit.

- *Audit Testing* – Evaluated METC's compliance with the Commission's accounting and financial reporting requirements, and METC's wholesale transmission formula rate tariff by evaluating, on a test basis, evidence supporting the amounts used in the determination of rates billed to wholesale transmission customers and METC's operational processes for implementing the requirements of the formula rate.

<u>Accounting, Recordkeeping, and Financial Reporting</u>

- *Accounting Processes and Procedures* – Evaluated METC's accounting processes, procedures, and internal controls used to comply with Commission accounting regulations under 18 C.F.R Part 101. Held discussions with and interviewed METC employees regarding accounting practices, adherence to METC accounting policies and procedures, system processes used for FERC accounting, and internal controls intended to achieve compliance with FERC accounting regulations.

- *Accounting Systems* – Reviewed METC's accounting systems used to capture, manage, and retain financial information, including the general ledger, work order systems, expenses and billing systems, and other key processes. Examined the systems' ability to capture transactions consistently to ensure information reported in financial statements and other reports was accurate and complete.

- *Significant Accounting Matters* – Tested select balance sheet and income statement accounts to determine whether the nature of the costs recorded in those accounts complied with the USofA under 18 C.F.R. Part 101. Below are examples of significant accounting matters examined:

  - *Construction Work in Progress* (*CWIP*) – Reviewed capital work orders to understand the nature of each project, the inclusion or exclusion of each project in rate base and in MISO's Transmission Expansion Plan, and METC's controls for ensuring that AFUDC is not accrued on CWIP for projects once they are included in rate base. Examined select work orders to determine the types of costs included in construction project work orders.

  - *Allowance for Funds Used During Construction* (*AFUDC*) – Reviewed METC's AFUDC calculations for compliance with Commission requirements.

  - *Taxes* – Reviewed and tested the current and deferred tax computations to ensure that the correct amounts were recorded in the appropriate accounts. Tested the functionalization of the various items driving the deferred tax balances and evaluated their impact on the formula rate. In addition, reviewed and ensured that the impacts of the 2017 Tax Cuts and Jobs Act were properly implemented and factored into METC's ratemaking procedures.

- *Variance Analysis* – Performed variance analyses for accounts reported in the FERC Form No. 1 by investigating accounts with large balances, unusual activity, and/or significant year-to-year fluctuations. Followed up with METC on each account fluctuation to understand the nature of the fluctuation and, where necessary, obtain additional information and support.

- *Review of Notes to Financial Statements* – Reviewed the Notes to Financial Statements beginning on page 123.1 of the FERC Form No. 1 for significant accounting matters and followed up with METC on these matters to understand financial statements and transmission formula rate implications, if any.

Transmission Formula Rate

To evaluate METC's compliance with the terms and conditions of its FERC formula rate mechanism, audit staff:

- Evaluated METC's compliance with its transmission cost-of-service formula rate in Attachment O and the related Protocols set forth in Attachment O to MISO's OATT, including METC's filings containing inputs to the formula rate.

- Reviewed initial and all subsequent Commission orders relating to the formula rate, including METC filings and orders approving related settlements.

- Determined the level of functionalization, derivation of allocation factors, return on equity, rate base, accumulated depreciation, and other expenses. Reviewed background information about specific cost treatment, deferrals, cost caps, disallowances, and other matters disclosed as part of approving the derivation of the formula rate.

- Evaluated processes, procedures, and controls used to prepare and review the formula rate and annual updates, true-ups, or informational filings associated with the formula rate.

- Reviewed formula rate mechanics (forward-looking, historical, true-up, and informational filings), including a comprehensive overview of the formula rate mechanism that the company provided.

- Evaluated the FERC Form No. 1 reporting processes and procedures to test the accuracy and completeness of METC's reporting. As part of this evaluation, audit staff reconciled FERC Form No. 1 data with formula rate calculations and reviewed all discrepancies.

- Reviewed METC's FERC Form Nos. 1 and 3-Q filings, including related notes to financial statements, to identify major accounting matters. Audit staff highlighted significant notes to understand financial statement and formula rate implications and identified underlying accounting entries for these significant accounting matters.

- Reviewed the allocation factors used by METC to derive customers' billing rates from its annual ATRRs to test whether correct factors had been applied. As part of this review, audit staff verified a sample of components from allocation factors by reconciling balances back to the FERC Form No. 1. Specifically, audit staff tested the impact of the disposition of assets on the general plant allocator by ensuring that removal of the asset changed the allocator percentage in the way asserted. Audit staff also compared allocation factors before and after disposition of the assets.

- Evaluated whether METC applied formula rate inputs in compliance with rate approval orders.

- Reconciled formula rate inputs derived from the FERC Form No. 1 to METC's books and records. Evaluated compliance with the USofA for the inputs under review, including all related guidance, accounting releases, and accounting treatment of input items.

- Evaluated various METC accounts incorporated into the formula rate mechanism for compliance with relevant accounting regulations in the USofA.

IV. Findings and Recommendations

1. Accounting for Lobbying Costs

METC recorded lobbying costs associated with pensions in Account 926, Employee Pensions and Benefits, instead of in Account 426.4, Expenditures for Certain Civic, Political and Related Activities. Account 926 is included in METC's formula rate while Account 426.4 is not. As a result, METC overstated its wholesale transmission revenue requirement used to bill transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 426.4, Expenditures for Certain Civic, Political and Related Activities, states in part:

> This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing referenda, legislation or ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

- 18 C.F.R. Part 101, Account 926, Employee Pensions and Benefits, states in part:

> A. This account shall include pensions paid to or on behalf of retired employees, or accruals to provide for pensions, or payments for the purchase of annuities for this purpose, when the utility has definitely, by contract, committed itself to a pension plan under which the pension funds are irrevocably devoted to pension purposes, and payments for employee accident, sickness, hospital, and death benefits, or insurance therefor. Include, also, expenses incurred in medical, educational or recreational activities for the benefit of employees, and administrative expenses in connection with employee pensions and benefits.…

ITEMS

1. Payment of pensions under a nonaccrual or nonfunded basis.

2. Accruals for or payments to pension funds or to insurance companies for pension purposes.

3. Group and life insurance premiums (credit dividends received).

4. Payments for medical and hospital services and expenses of employees when not the result of occupational injuries.

5. Payments for accident, sickness, hospital, and death benefits or insurance.

6. Payments to employees incapacitated for service or on leave of absence beyond periods normally allowed, when not the result of occupational injuries, or in excess of statutory awards.

7. Expenses in connection with educational and recreational activities for the benefit of employees.

NOTE A: The cost of labor and related supplies and expenses of administrative and general employees who are only incidentally engaged in employee pension and benefit activities may be included in accounts 920 and 921, as appropriate.

NOTE B: Salaries paid to employees during periods of nonoccupational sickness may be charged to the appropriate labor account rather than to employee benefits.

Background

METC incorrectly charged lobbying costs to Account 926 due to a systemic issue noted among all ITC Holdings' public utility subsidiaries. ITC Holdings records lobbying costs associated with pensions in Account 926, Employee Pensions and Benefits, instead of Account 426.4, Expenditures for Certain Civic, Political, and Related Activities. When allocated a portion of the lobbying costs by ITC Holdings, METC employed this same accounting practice. Audit staff found that the great majority of METC's lobbying costs pertained to services provided by external parties, while a small amount was incurred internally. As a result, METC inappropriately included approximately $57,673 in its wholesale transmission rate determination from 2015 through 2018.

Once these misclassified costs were identified, METC began building and testing a new monthly system allocation to move current month pension costs associated with lobbying to Account 426.4 based on internal labor hours recorded to the lobbying work order. METC implemented this new system during the third quarter of 2019. For the lobbying costs recorded in Account 926 for the first 9 months of 2019, manual journal entries were recorded to reclassify $14,604 to Account 426.4. While METC has addressed this issue going forward, this error affected the rate making process for prior years. METC should conduct a study to evaluate the impact to ratepayers and make the appropriate refunds if necessary.

In addition, audit staff was informed that all of the ITC Holdings subsidiaries use one uniform approach to accounting for similar items. ITC Holdings should conduct a study to ensure that the ratepayers at the other entities were not negatively impacted.

Recommendations

We recommend that METC:

1. Strengthen processes and procedures to ensure that employees record lobbying expenses in the correct accounts.

2. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculations of the refunds relating to the inclusion of lobbying costs in Account 926 and the resulting impact on charges to METC's transmission customers, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

3. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

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

2. Accounting for Settlements Related to Employment Discrimination Claims

METC incorrectly recorded $287,435 of allocated settlement costs related to employment discrimination claims from ITC Holdings, its parent holding company, in its operating expense accounts. The operating expense accounts were included in the METC's wholesale transmission formula rate mechanism. As a result, METC overstated its wholesale transmission revenue requirement used to bill transmission customers.

Pertinent Guidance

- Accounting Release AR-12,[3] effective February 1, 1980, discusses expenses "resulting from employment practices that were found to be discriminatory by a judicial or administrative decree or that were the result of a compromise settlement or consent decree,"[4] stating:

> The Uniform System of Accounts provides that all charges to utility operating expense accounts must be just and reasonable. Expenditures of the nature mentioned above [i.e., relating to employment practices found to be discriminatory] that can be readily identified and quantified should not be considered as just and reasonable charges to utility operations and should be classified to the appropriate nonoperating expense accounts.
>
> Types of expenditures usually related to discriminatory employment practices may include, but are not limited to, the following:
>
> 1. fines or penalties related to judicial or administrative decree imposed by governmental authorities,

[3] Accounting releases are informal interpretations of the USofA to be followed in the absence of specific reference to prescribed accounting regulations and other Commission decisions. These interpretations express the views of the Chief Accountant as to the correct application of the provision of the USofA that the Commission has prescribed. As provided for in General Instruction No. 5 in the USofA, these interpretations do not preclude any company from submitting questions of doubtful interpretations to the Commission on matters dealt with in accounting releases.

[4] Accounting Release AR-12, Discriminatory Employment Practices (Feb. 1, 1980), *available at* www.ferc.gov/enforcement/acct-matts/docs/ar-12.asp (Accounting Release AR-12).

2. legal fees reimbursed to the plaintiffs,
3. in-house and outside legal costs in unsuccessful defense against charges of discriminatory practices,
4. damage awards to plaintiffs,
5. duplicate labor cost such as back pay, bonus or other pay awards to plaintiffs where other employees have already been paid by the utility for prior services, and
6. costs of reporting, training and recruiting undertaken as a result of a court order, administrative decree or settlement which are in addition to those which otherwise would be incurred to assure continuing equal employment opportunity.
7. Fines or penalties are to be recorded in Account 426.3, Penalties, and all other costs are to be recorded in Account 426.5, Other deductions.[5]

Background

ITC Holdings incurred and recorded the costs associated with settlements related to employment discrimination claims in Accounts 561.2, Load Dispatch – Monitor and Operate Transmission System; 920, Administrative and General Salaries; 923, Outside Services Employed; and 925, Injuries and Damages. During our review of the accounting for settlements related to employment discrimination claims, audit staff found that ITC Holdings did not track any internal labor costs related to defenses of discriminatory practice claims and settlements in the company's accounting and time tracking system. Consequently, when METC was allocated a portion of these costs, it recorded them in the same accounts without specific identification of labor costs related to unsuccessful defenses. As a result of this audit, METC performed a study to determine internal labor costs associated with this matter. Associated costs estimated by ITC Holdings and METC were as follows:

Type of Expenditure	Amount Charged to ITC Holdings	Amount Allocated to METC
In-house Employee Costs	$113,752	$34,074
Outside Legal Costs	340,794	101,906
Settlement Payments	511,186	151,455
Total	$965,732	$287,435

Consequently, METC recorded these costs in operating expense accounts, including Accounts 561.2, 920, 923, and 925.

[5] Accounting Release AR-12.

METC's accounting for these expenditures was not consistent with the Commission's accounting requirements. Accounting Release AR-12 states that companies should classify in Account 426.5 expenses "resulting from employment practices that were found to be discriminatory by a judicial or administrative decree or that were the result of a compromise settlement or consent decree." METC improperly classified these expenditures in operation and maintenance, and general and administrative accounts. The improper accounting resulted in the improper recovery of these expenditures from METC's wholesale transmission customers.

Furthermore, ITC Holdings' other regulated utilities appear to have applied the same improper accounting. This could have resulted in improper amounts being recovered from customers by other FERC jurisdictional entities that reside in the ITC corporate structure.

Recommendations

We recommend that METC:

5. Strengthen processes and procedures and provide training to staff to ensure that METC properly records settlements related to employment discrimination claims amounts in accordance with Accounting Release AR-12.

6. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) calculations of the refunds resulting from correcting the inclusion of settlement amounts related to employment discrimination claims in the billing rates of METC, plus interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

7. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

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

3. Accounting for Abandoned Transmission Projects

METC did not assign any engineering and supervision (E&S) costs to abandoned transmission construction projects; instead, it reallocated the associated E&S costs to ongoing transmission projects and improperly accrued AFUDC on the reallocated amounts. As a result, METC improperly accrued and recovered AFUDC on E&S costs related to abandoned transmission projects capitalized to plant in service and understated the cost of abandoned projects recorded to expense.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 107, Construction Work in Progress–Electric, states in part:

  > A. This account shall include the total of the balances of work orders for electric plant in process of construction.

- 18 C.F.R. Part 101, Electric Plant Instruction No. 4(A), Overhead Construction Costs, states:

  > A. All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.

- 18 C.F.R. Part 101, Electric Plant Instruction No. 3(A)(11), Engineering and Supervision, states:

  > Engineering and supervision includes the portion of the pay and expenses of engineers, surveyors, draftsmen, inspectors, superintendents and their assistants applicable to construction work.

Background

During fieldwork, audit staff discovered that METC did not track the E&S costs by specific project, but instead created an E&S pool and allocated these costs proportionally on a monthly basis to the materials, labor, and labor overhead costs of each ongoing construction project. When projects were canceled, METC would reassign the E&S costs that were assigned to the canceled projects back to the pool to be reallocated to ongoing projects. This practice led to E&S costs of abandoned projects being incorrectly added to the cost of other viable construction projects and an understatement of operating expenses.

METC accounted for all of its E&S costs associated with wholesale transmission projects in Account 107. Audit staff found that, from 2016 through 2018, METC's abandoned transmission project costs totaled $0.5 million. Audit staff discovered that METC did not assign any of the E&S costs to abandoned transmission projects. Instead, METC reallocated E&S costs that should have been assigned to the abandoned transmission projects to other ongoing transmission projects.

METC's internal policies permit the accumulation of AFUDC on all incurred costs recorded in CWIP, including the reallocated E&S costs, based on the average monthly value of all construction projects. As a result, audit staff determined that METC improperly accumulated AFUDC on the E&S costs reallocated to ongoing transmission projects. METC then recorded these E&S costs previously allocated to abandoned transmission projects and the related AFUDC in Account 101, Electric Plant in Service, on the completion of ongoing construction projects throughout the year, leading to an improper overstatement of METC's transmission rate base. METC should not have reassigned the E&S costs associated with abandoned projects. Instead, METC should have treated all abandoned project costs, including the associated E&S costs, the same.

Recommendations

We recommend that METC:

9. Going forward, record necessary journal entries to reclassify abandoned project E&S costs and related expenditures to the appropriate expense accounts.

10. Enhance its existing policies, procedures, and practices to assign an applicable portion of E&S costs to abandoned transmission construction projects going forward, and to account for such abandoned project E&S costs by recording them in the correct account.

4. Accounting for Donations

METC inappropriately accounted for a donation as an operating expense. This accounting misclassification led to improper amounts being included in the inputs to METC's wholesale transmission formula rate mechanism which resulted in METC overbilling its wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 426.1, Donations, states:

  This account shall include all payments or donations for charitable, social or community welfare purposes.

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

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

  B. This account may be subdivided in accordance with a classification appropriate to the departmental or other functional organization of the utility.

  NOTE: Office expenses which are clearly applicable to any group of operating expenses other than the administrative and general group shall be included in the appropriate account in such group. Further, general expenses which apply to the utility as a whole rather than to a particular administrative function shall be included in account 930.2, Miscellaneous General Expenses.

  ITEMS

  1. Automobile service, including charges through clearing account.
  2. Bank messenger and service charges.

3. Books, periodicals, bulletins and subscriptions to newspapers, newsletters, tax services, etc.
4. Building service expenses for customer accounts, sales, and administrative and general purposes.
5. Communication service expenses.
6. Cost of individual items of office equipment used by general departments which are of small value or short life.
7. Membership fees and dues in trade, technical, and professional associations paid by a utility for employees. (Company memberships are includible in account 930.2.)
8. Office supplies and expenses.
9. Payment of court costs, witness fees and other expenses of legal department.
10. Postage, printing and stationery.
11. Meals, traveling and incidental expenses.

Background

In 2017, METC inappropriately recorded a donation to an economic development organization to Account 921, Office Supplies and Expenses. These costs related to meals and entertainment, and ITC Holdings' name and logo being placed at an annual charitable golf outing event.

According to the Commission's accounting regulations, Account 921 should be used to record office supplies and expenses incurred in connection with the general administration of the utility's operations. Based on the nature of the costs in relation to the charitable event, they did not meet this definition. Accordingly, these expenses are nonoperating in nature, and METC should have recorded them in Account 426.1, Donations. Audit staff's testing of select general ledger transactions covered the period from January 2016 to December 2017. Therefore, donation expenses recorded during other months of the audit period also might have been misclassified. Moreover, this accounting misclassification led to improper amounts being included in the inputs to METC's wholesale transmission formula rate and to METC overbilling its wholesale transmission customers.

METC changed its accounting methodology for this golf charity event from Account 426.1 to Account 921. METC stated that it believes this is a cost of doing business; however, audit staff respectfully disagrees. The appropriate accounting treatment for such a donation is to record it in Account 426.1, Donations, not in an account for office supplies and expenses.[6] METC should review its accounting procedures to ensure that all procedures and/or changes to those procedures conform with the Commission's USofA in 18 C.F.R. Part 101, and particularly the directive to record donations in Account 426.1.

Recommendations

We recommend that METC:

11. Record necessary journal entries to reclassify donations from operating or other accounts to Account 426.1.

12. Submit a refund analysis, within 60 days of receiving the final audit report, to DAA for review that explains and details the following: (1) the calculation of refunds that resulted from correcting its improper classification of donations,

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[6] *See, e.g., Trunkline Gas Co.,* Opinion No. 441, 90 FERC ¶ 61,017, at 61,064 (2000) ("[t]he financial burden of charitable contributions should be borne by the stockholders for whom such contributions are intended to retain customer good will and employee loyalty. Charitable contributions are not operating expenses and bear no relationship to the necessary costs of providing utility service."); *EPGT Texas Pipeline, L.P.*, 99 FERC ¶ 61,295, at 62,249-250 (2002) (charitable contributions excluded from cost of service in determining interstate rates regardless of what state utility commission permits for intrastate rates); *Williston Basin Interstate Pipeline Co.,* 95 FERC ¶ 63,008, at 65,095 (2001) (rejecting inclusion of civic and charitable donations in cost of service even where the donations were made to local charities benefiting communities served by the utility and "represent[ed] a minimal amount of the overall cost of service"), *aff'd in relevant part, and rev. in part,* 104 FERC ¶ 61,036, at P 65 (2003) (even if ratepayers chose charities to which utility made contributions "and there was such a demonstrable connection between the charities and the ratepayers," this does not "overcome[] the conclusion that such costs are not operating expenses and bear no relationship to the necessary costs of providing utility service."); *id.* at P 65 n. 89 stating:

> Because our policy of denying inclusion of charitable contributions in a pipeline's cost of service is premised upon such contributions being primarily for the benefit of a company's shareholders, and that they are not operating expenses and bear no relationship to the necessary costs of providing utility service, a pipeline has a heavy burden indeed in including any amounts for charitable contributions in its cost of service.

including interest; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) in which refunds will be made.

13. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

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

5. Accounting for Asset Retirement Obligations

METC failed to use the income statement and used only balance sheet accounts to record Asset Retirement Obligations (AROs) related to its utility plant assets.

Pertinent Guidance

- 18 C.F.R. Part 101, General Instruction No. 25(B)(1), Accounting for Asset Retirement Obligations, states in part:

> The utility shall record the accretion of the liability by debiting account 411.10, Accretion expense, for electric utility plant…and crediting account 230, Asset retirement obligations.

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

> A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies.

- 18 C.F.R. Part 101, Account 230, Asset Retirement Obligations, states in part:

> B. The utility shall charge the accretion expense to account 411.10, Accretion expense for electric utility plant … and credit account 230, Asset retirement obligations.

- 18 C.F.R. Part 101, Account 403.1, Depreciation Expense for Asset Retirement Costs, states:

> This account shall include the depreciation expense for asset retirement costs included in electric utility plant in service.

Background

METC recorded AROs on its books and records. These AROs represented liabilities for future costs associated with the final removal of certain utility plant assets. METC adjusted the ARO liability over time to account for the time value of money by recording accretion expense, and METC will settle these AROs when the actual removal work is performed. METC defers the ARO accretion expense and the depreciation of the associated asset retirement cost due to the cost being recovered in the cost of removal component of its FERC approved depreciation rates.

METC accounted for AROs by debiting Account 101, Electric Plant in Service, for the asset retirement cost, and crediting Account 230, Asset Retirement Obligation Liability. These AROs were associated with the estimated cost to dispose of plant contaminated with asbestos and polychlorinated biphenyls (PCBs).

METC improperly recorded depreciation expense for asset retirement costs by debiting Account 182.3 and crediting Account 108, Accumulated Provision for Depreciation of Electric Utility Plant. METC should have debited Account 403.1, Depreciation Expense for Asset Retirement Costs, and credited Account 108. METC also improperly recorded accretion expense by debiting Account 182.3 and crediting Account 230. METC should have debited Account 411.10, Accretion Expense, and credited Account 230. After properly recording asset retirement cost depreciation expense and accretion expense to Accounts 403.1 and 411.10, METC should then have reclassified the appropriate amounts to Account 182.3.

Recommendations

We recommend that METC:

15. Strengthen processes and procedures to ensure that METC accounts for asset retirement obligations in accordance with Commission accounting rules and regulations, including Order No. 631. Similarly, the recovery of the asset retirement obligation should also follow Order No. 631.

16. Provide training on the updated processes and procedures to employees performing accounting functions for assets retirement obligations.

6. FERC Form No. 1 Reporting

METC did not properly follow the instructions of the FERC Form No. 1 and therefore in some cases did not report all the required information in its FERC Form No. 1 filings.

Pertinent Guidance

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

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

Background

METC is required to report financial and operational information on an annual basis in the FERC Form No. 1. During fieldwork, audit staff performed a detailed review of METC's 2015-2017 FERC Form No. 1 filings and evaluated whether METC properly followed the requirements and instructions for populating and reporting the form. This review entailed a detailed analysis of each page in the 2015-2017 FERC Form No. 1 filings, focused on ensuring METC reported the correct information on the appropriate pages. During this review, audit staff found several instances where METC did not accurately report the required information in its 2015-2017 FERC Form No. 1 filings, as follows:

Reporting Year	Schedule	Page(s)	Reporting Error
2015-2017	Statement of Retained Earnings for the Year	118-119	No data reported in Column (b) for "Contra Primary Account Affected."
2017	Transmission Service and Generation Interconnection Study Costs	231	METC, which is a transmission-only company, reported all study costs under "Generation Studies."
2015-2017	Transmission of Electricity for	328-330	No data reported in Column (h) for "Billing Demand (MW)."

	Others		
2015-2017	Depreciation and Amortization of Electric Plant	336-337	No data reported in Column (g) for “Average Remaining Life.”
2017	Purchase and Sale of Ancillary Services	398	No data reported in Column (e) for “Number of Units” and Column (f) for “Unit of Measure” on Line 1.
2015, 2016	Purchase and Sale of Ancillary Services	398	No data in Columns (b), (c), (e), and (f) on Lines 1 and 7. No footnote was provided for the amount reported on Line 7.
2015-2017	Monthly Transmission System Peak Load	400	No data reported in Columns (e) through (j).
2015, 2016	Transmission Line Statistics Pages	422-423	No data reported in Columns (m) through (p) for “Expenses, except Depreciation and Taxes.”

METC indicated to audit staff that on occasion it is uncertain of how the reader of its FERC Form No. 1 will interpret its reporting. Audit staff concluded that when there may be areas of ambiguity, METC should make notes within the form to explain to the reader how its reporting meets the FERC Form No.1 reporting requirements.

Recommendations

We recommend that METC:

17. Revise and strengthen documented policies, procedures, and practices to help ensure information in the FERC Form No. 1 is correct, accurate, and consistent with the instructions of the form. Notify and seek guidance from the Commission regarding any instructions of the form that METC finds unclear, if necessary.

18. Provide training to staff on the revised FERC Form No. 1 policies, procedures, and practices. Also, develop a training program that supports the provision of periodic training in this area, as needed.

V. Other Matter

1. Accounting for Preliminary Survey and Investigation Expenses

METC's accounting practice for capital construction projects did not record any preliminary survey and investigation (PS&I) costs in Account 183, Preliminary Survey and Investigation Charges (Major Only). METC's accounting practices for PS&I expenses may lead to incorrect accounting and ratemaking results.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 107, Construction Work in Progress–Electric, states in part:

  A. This account shall include the balances of work orders for electric plant in process of construction.

- 18 C.F.R. Part 101, Electric Plant Instruction No. 4(A), Overhead Construction Costs, states:

  All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.

- 18 C.F.R. Part 101, Electric Plant Instruction No. 3(A)(11), Engineering and Supervision, states:

  Engineering and supervision includes the portion of the pay and expenses of engineers, surveyors, draftsmen, inspectors, superintendents and their assistants applicable to construction work.

- 18 C.F.R. Part 101, Account 183, Preliminary Survey and Investigation Charges (Majority Only), states in part:

> This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc., made for the purpose of determining the feasibility of utility projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged. If the work is abandoned, the charge shall be made to account 426.5, Other Deductions, or to the appropriate operating expense account.

- Accounting Release No. 5 (Revised), Capitalization of Allowance for Funds Used During Construction, states in part:

> **Question:** What is the proper period for capitalization of Allowance for Funds Used During Construction (AFUDC)?
>
> **Answer:** The capitalization period for AFUDC shall begin when two conditions are present: (1) capital expenditures for the project have been incurred; and (2) activities that are necessary to get the construction project ready for its intended use are in progress. AFUDC capitalization shall continue as long as these two conditions are present.
>
> The term "activities" is to be construed broadly and includes all the actions required to prepare the construction project for its intended use, including activities prior to physical construction, such as the development of plans or the process of obtaining permits from governmental authorities. However, the term "activities" does not include preliminary survey and investigation activities. Activities occurring prior to the above two conditions being met would be considered preliminary in nature for the purpose of determining feasibility of projects under contemplation and would be included in Accounts 183, Preliminary Survey and Investigation Charges, or 183.2, Other Preliminary Survey and Investigation Charges, as appropriate. These preliminary activities would not be subject to AFUDC accruals until such a time as the two conditions are met and the amounts included in Account 183 or Account 183.2 are transferred to Account 107, Construction Work in Progress.[7]

[7] Accounting Release No. 5 (Revised), Capitalization of Allowance for Funds Used During Construction, issued February 16, 2011 in Docket No. AI11-1-000 (with an effective date of March 18, 2010), available at www.ferc.gov/enforcement/acct-matts/docs/ar-5.asp (Accounting Release AR-5 (Revised)).

Background

During fieldwork, audit staff discovered that METC expensed all costs incurred in consideration of capital projects until it determines the need to pursue a particular project, and at that point will begin recording additional project costs as CWIP in Account 107. Under this approach, the costs of proposed construction projects in the PS&I stage of development are not recorded in the Account 183.

Under the Commission's accounting requirements, assessments of current and future operations are performed to determine if and what type of improvements are needed to the utility's operating system. The costs for these assessments are recorded in the appropriate O&M and A&G expense accounts. Once the utility begins to evaluate the feasibility of potential construction projects, the Commission's accounting regulations provide that Account 183 be used to record the cost of PS&I work. Once feasibility is reached, the utility may transfer the PS&I costs associated with the identified construction project to Account 107.

For METC to comply with the Commission's accounting requirements for construction-related activities, it should record costs in Account 183 incurred to evaluate the feasibility of a proposed construction project. However, during the audit period, METC did not record any PS&I costs in Account 183. Audit staff believes METC should identify the relevant stages of construction projects and establish procedures to capture its costs consistent with the Commission's accounting regulations. Absent these procedures, METC may misstate the original cost of constructed assets, record PS&I costs to expense in the incorrect accounting period, and as a result, shift the timing of rate recovery of PS&I costs and include incorrect amounts in the determination of transmission formula rates.

VI. METC's Response to the Draft Audit Report

June 22, 2020

Steven D. Hunt
Director and Chief Accountant
Division of Audits and Accounting
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street, N.E., Room 5K-13
Washington, D.C. 20426

Re: Michigan Electric Transmission Company, LLC
Docket No. FA19-7-000

Dear Mr. Hunt:

Michigan Electric Transmission Company, LLC (METC) submits this response to the draft audit report dated June 5, 2020. METC does not contest the six findings and agrees to implement the eighteen recommendations, many of which METC has already begun to address. While accepting the report's findings, METC respectfully requests that the Federal Energy Regulatory Commission revisit its policy, as set forth in Accounting Release 12, which prohibits the recovery of settlement costs related to the resolution of employment discrimination claims. METC believes this policy undermines the public interest because it incentivizes utilities to engage in protracted litigation when settlement of claims may be more beneficial for utilities, claimants, and ratepayers.

Within 30 days after the final report is issued, METC will submit an implementation plan addressing each of the 18 recommendations. This plan will include a timeline for completing each open recommendation. Further, METC will submit quarterly reports describing its progress in implementing each recommendation no later than 30 days after the end of each calendar quarter, beginning with the first full quarter after submission of the implementation plan, and continuing until it completes all recommended corrective actions.

I would like to take this opportunity to thank the Division of Audits and Accounting staff for their professionalism and assistance throughout the audit process.

Respectfully submitted,

/s/ Amy M. Perlman
Vice President and Controller
Michigan Electric Transmission Company, LLC
27175 Energy Way
Novi, MI 48377

Cc: Nkosi Brooks
Daniel Birkam