Office of the Ohio Consumers' Counsel

February 4, 2022

Mr. Gregory Price, Attorney Examiner
Public Utilities Commission of Ohio
180 E. Broad Street, 12th Floor
Columbus, Ohio 43215

Re: PUCO Case No. 20-1502-EL-UNC (Investigation of FirstEnergy)

Dear Attorney Examiner Price:

At an August 31, 2021 prehearing conference, you denied OCC's motion to compel discovery to obtain information from FirstEnergy regarding a FERC audit of FirstEnergy Corp. and its subsidiaries. You said OCC's motion could be "revisited" when FERC files its public report.[1] FERC filed its audit report today. Please revisit your ruling and order FirstEnergy to provide the information to OCC that we requested. (*See* OCC RPD 5-001, INT 6-03.) FERC's audit report is attached.

FirstEnergy Corp. is notable for being the owner of three Ohio utilities that serve two million Ohio consumers and for being charged with a federal crime related to corruption. While OCC is still reviewing FERC's Audit Report, we note issues of FERC's concern in the audit that affect Ohio consumers and that bolster our need for the discovery that we are owed from FirstEnergy. Those issues include the following:

> the existence of significant shortcomings in FirstEnergy and its subsidiaries' internal controls over financial reporting, including controls over accounting for expenses relating to civic, political, and related activities, such as lobbying activities performed by and on behalf of FirstEnergy and its subsidiaries. **Even more concerning, several factual assertions agreed to by FirstEnergy in DPA and the remedies FirstEnergy agreed to undertake, point towards internal controls having been possibly obfuscated or circumvented to conceal or mislead as to the actual amounts, nature, and purpose of the lobbying expenditures made, and as a result, the improper inclusion of lobbying and other nonutility costs in wholesale transmission billing rates.[2]**

OCC submitted discovery requests in PUCO Case 20-1502 for all information related to the FERC audit. The pertinent requests are RPD-05-001 and INT-06-003:

[1] Transcript of August 31, 2021 Prehearing Conference at 18 (Sept. 13, 2021).

[2] *In re FirstEnergy Audit,* Docket No. FA19-1-000 at 47-48 (Feb. 4, 2022) (emphasis added).

> **RPD-05-001.** On February 16, 2021, FirstEnergy filed a Form 8-K with the SEC disclosing an investigation by FERC's Division of Audits and Accounting that includes activities relating to HB 6 lobbying and governmental affairs activities. Please produce all documents reflecting (i) communications from FERC's Division of Audits and Accounting relating to the investigation; (ii) communications from FirstEnergy to FERC's Division of Audits and Accounting relating to this investigation.[3]
>
> **INT-06-003.** With respect to the financial audit of FirstEnergy Corp. including its service companies and other associated companies, undertaken by FERC, Division of Audits and Accounting, Office of Enforcement, Docket No. FA 19-1-000, please identify:
>
> a. The employees that have met with the FERC Staff either in person or via a virtual meeting;
> b. The employees interviewed by FERC Staff; and
> c. The employees that have communicated with the FERC Staff.

Again, you made the following ruling:

> EXAMINER PRICE: Okay. We are going to go ahead and deny the motion to compel. We will let FERC proceed with their investigation in a confidential matter. If and when a public audit is released by FERC, we can revisit this issue at that time.

Now that FERC has completed its audit and publicly released its report, any need for confidentiality has ended (not that OCC accepts it was confidential). Accordingly, please "revisit" OCC's motion to compel discovery, per your earlier ruling, and compel FirstEnergy to *immediately* respond to OCC's discovery requests. FirstEnergy Corp. is bound to cooperate with government investigations, under the U.S. Deferred Prosecution Agreement.

Thank you.

Respectfully yours,

/s/ Maureen R. Willis

Maureen R. Willis (0020847)
Counsel of Record

cc: All Parties of Record

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[3] Motion to Compel Responses to Fifth and Seventh Sets of Discovery and Request for Expedited Ruling, Attachment 1 at p. 11 of 22 (June 29, 2021).

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA19-1-000
February 4, 2022

Jason Lisowski
Vice President, Controller and Chief Accounting Officer
FirstEnergy Corporation
76 South Main Street
Akron, OH 44308

Dear Mr. Lisowski:

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 FirstEnergy Corporation and its subsidiaries (collectively, FirstEnergy). The audit covered the period January 1, 2015 to September 30, 2021.

2. The audit evaluated FirstEnergy's compliance with: (1) cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35; (2) service company accounting, recordkeeping, and FERC Form No. 60 reporting requirements under 18 C.F.R. Parts 366, 367, and 369; (3) accounting and reporting requirements prescribed for public utilities pertaining to transactions with affiliated companies under 18 C.F.R. Parts 101 and 141; and (4) preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368. The enclosed audit report contains seven findings of noncompliance and 38 recommendations that require FirstEnergy and its subsidiaries to take corrective action.

3. On January 24, 2022, FirstEnergy notified DAA that it largely accepts the findings and recommendations. FirstEnergy also proposed that Finding No. 1, Allocation of Overhead Costs to CWIP, and its associated Recommendation Nos. 1, and 7 through 11 be revised consistent with FirstEnergy's response to the audit report. A verbatim copy of FirstEnergy's response is included as Section V to the accompanying audit report. I hereby approve the uncontested findings and recommendations.

4. FirstEnergy should submit its implementation plan to comply with the uncontested recommendations within 30 days of issuance of this letter order. FirstEnergy should make quarterly submissions to DAA describing the progress made to comply with the

uncontested 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. Pursuant to Part 41 of the Commission's regulations, this serves as notice that within 30 days of the issuance of this order, FirstEnergy may notify the Commission in writing as to whether it requests Commission review of Finding No. 1 and its associated Recommendation Nos. 1, and 7 through 11 by means of a shortened procedure or, if FirstEnergy contends that there are material facts in dispute which require cross-examination, a trial-type hearing. 18 C.F.R. § 41.2 (2021). If FirstEnergy does not timely respond to this order, it will be deemed to acquiesce in the finding and recommendations.

6. The Commission delegated 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 with respect to all uncontested findings and recommendations. FirstEnergy may file a request for rehearing of this letter order with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713. This letter order does not constitute final agency action with respect to Finding No. 1 and its associated Recommendation Nos. 1, and 7 through 11 so long as FirstEnergy timely responds to this letter order as set forth in Paragraph 5 above.

7. 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.

8. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Gerald Williams, Director and Chief Accountant, Division of Audits and Accounting at (202) 502-8277.

Sincerely,

JANEL BURDICK Digitally signed by JANEL BURDICK Date: 2022.02.01 14:54:26 -05'00'

Janel Burdick
Director
Office of Enforcement

Enclosure

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

AUDIT REPORT

Audit of FirstEnergy Corporation's and its subsidiaries' compliance with:

- Cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35;
- Service company accounting, recordkeeping, and FERC Form No. 60 reporting requirements under 18 C.F.R. Parts 366, 367, and 369;
- Accounting and reporting requirements prescribed for public utilities pertaining to transactions with affiliated companies under 18 C.F.R. Parts 101 and 141; and
- Preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368.

Docket No. FA19-1-000
February 4, 2022

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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) has completed an audit of FirstEnergy Corporation (FirstEnergy) and its subsidiaries. The audit evaluated FirstEnergy's and its subsidiaries' compliance with: (1) cross-subsidization restrictions on affiliate transactions under 18 C.F.R. Part 35; (2) service company accounting, recordkeeping, and FERC Form No. 60 reporting requirements under 18 C.F.R. Parts 366, 367, and 369; (3) accounting and reporting requirements prescribed for public utilities pertaining to transactions with affiliated companies under 18 C.F.R. Parts 101 and 141; and (4) preservation of records requirements for holding companies and service companies under 18 C.F.R. Part 368. The audit covered the period January 1, 2015 to September 30, 2021.

B. FirstEnergy Corporation and its Subsidiaries

FirstEnergy, headquartered in Akron, OH, was incorporated under Ohio law in 1996 as a public utility holding company. FirstEnergy and its subsidiaries are engaged in the generation, transmission, distribution, and sale of energy in the Midwest and Mid-Atlantic regions. FirstEnergy has 63 subsidiaries that it owns directly or indirectly, which include ten wholly owned franchised public utilities (FPU)[1] and three transmission-lines-only public utilities.[2]

FirstEnergy FPUs and Transmission-Lines-Only Companies

During the audit period, FirstEnergy's FPUs provided distribution and wholesale transmission services and made wholesale sales of power for resale under Commission

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[1] FirstEnergy's FPU subsidiaries are: The Cleveland Electric Illuminating Company, Jersey Central Power and Light Company (JCP&L), Metropolitan Edison Company, Monongahela Power Company, Ohio Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, The Potomac Edison Company, The Toledo Edison Company, and West Penn Power Company.

[2] FirstEnergy's transmission-lines-only subsidiaries are: American Transmission Systems, Incorporated (ATSI), Mid-Atlantic Interstate Transmission, LLC (MAIT), and Trans-Allegheny Interstate Line Company (TrAILCo) (collectively, Transmission Companies).

market-based rate tariffs.[3] Three of the FPUs – Monongahela Power Company, The Potomac Edison Company, and West Penn Power Company – recovered their wholesale transmission service costs pursuant to stated, cost-based wholesale transmission Open Access Transmission Tariff (OATT) rates as transmission owner members of the PJM Interconnection, L.L.C. (PJM).[4] Effective January 1, 2021, these companies implemented a forward-looking formula rate, which was accepted by the Commission, subject to refund, pending further hearing and settlement procedures.[5] JCP&L began recovering its wholesale transmission service costs pursuant to a formula rate tariff in PJM that became effective January 1, 2020,[6] and the remaining six FPUs either did not have transmission assets, or transferred their transmission assets to affiliates, during the audit period.

The Transmission Companies are transmission owner members of PJM. The companies recover their transmission service costs pursuant to their respective individual

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[3] *See* The Cleveland Electric Illuminating Company, Market-Based Rate Power Sales Tariff, Second Revised Market-Based Rate Power Sales Tariff, 5.0.0; The Ohio Edison Company, Market-Based Rate Power Sales Tariff, Second Revised Ohio MBR, FE Ohio Revised MBR Tariff, 5.0.0; The Toledo Edison Company, Market-Based Rate Power Sales Tariff, Second Revised Toledo MBR Tariff, 5.0.0; Pennsylvania Power Company, Market-Based Rate Power Sales Tariff, Revised PennPower MBR Power Sales Tariff, 5.0.0; The Metropolitan Edison Company, Market-Based Power Sales Tariff, Revised MetEd Tariff, 5.0.0; Pennsylvania Electric Company, Market-Based Rate Power Sales Tariff, 10 Revised, Revised Ancillary Services, 2.0.0; Jersey Central Power & Light Company, Market-Based Rate Power Sales Tariff, Section 1, Market Based Rates, 5.0.0; Monongahela Power Company, Allegheny Power Market Rate Tariff, Revised Allegheny Power Market Based Rate Tariff 4.0.0; The Potomac Edison Company, Allegheny Power MBR Tariff, Cert. of Concurrence, Allegheny Power Market Tariff (Potomac Edison) 0.1.0; and West Penn Power Company, Allegheny Power Market Tariff (West Penn), Cert. of Concurrence, Allegheny Power Market Tariff (West Penn) 0.1.0.

[4] *See* PJM Interconnection, L.L.C., FERC FPA Electric Tariff, Intra-PJM Tariffs, Schedule 12, Appendix A-14 Monongahela Power Company, The Potomac Edison Company, and West Penn Power Company, all doing business as Allegheny Power, 19.0.0.

[5] *Monongahela Power Co*., 173 FERC ¶ 61,290 (2020), *reh'g denied by operation of law*, 174 FERC ¶ 62,136 (2021).

[6] *Jersey Central Power & Light Co*., 169 FERC ¶ 61,205 (2019).

wholesale transmission formula rate mechanisms found in the PJM OATT.[7] The FPUs and Transmission Companies collectively serve approximately 6 million customers and have over 24,000 miles of transmission lines and over 272,000 miles of distribution lines.

FirstEnergy Special Purpose Entities

During the audit period, FirstEnergy had two special purpose entity subsidiaries – FirstEnergy Service Company (FESC) and Allegheny Energy Service Corporation. FESC was FirstEnergy's centralized service company. It provided administrative, management, support, and external affairs services during the audit period, including political and regulatory advocacy services on behalf of FirstEnergy and its subsidiaries under a shared services agreement. Allegheny Energy Service Corporation owned aircraft and leased them to FESC.

Competitive Power Generation Entities

FirstEnergy owned FirstEnergy Solutions Corp. (FES) and FirstEnergy Nuclear Operating Company (FENOC), which provided energy related products and services. FES, through its subsidiaries, and FENOC owned and operated two coal-fired generating plants, a dual fuel gas/oil plant, a petroleum coke-fired plant, and three nuclear power plants.[8] On March 31, 2018, FES and FENOC, together with FES's subsidiaries, filed voluntary petitions for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code in connection with the implementation of a proposed plan of reorganization.[9] Under the reorganization plan ultimately approved by the bankruptcy court, upon emergence from bankruptcy, a new privately-held holding company, Energy Harbor was formed and became the parent of the companies. Energy Harbor is neither a subsidiary

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[7] *See* PJM Interconnection L.L.C., FERC FPA Electric Tariff, Intra-PJM Tariffs, OATT Attachment H-21A - ATSI, 4.0.0; PJM Interconnection L.L.C., FERC FPA Electric Tariff, Intra-PJM Tariffs, OATT Attachment H-28A - MAIT Formula Rate Template, 1.0.0; and PJM Interconnection L.L.C., FERC FPA Electric Tariff, Intra-PJM Tariffs, OATT Attachment H-18A - Trans-Allegheny, 4.0.0.

[8] FES and its wholly owned subsidiaries – FirstEnergy Generation, LLC, and FirstEnergy Nuclear Generation, LLC – had market-based rate tariffs on file with the Commission.

[9] Due to the bankruptcy proceeding, which was ongoing during this audit, and FirstEnergy's representation that FES and FENOC ceased to be under its control upon completion of the reorganization, there were limited audit procedures performed that were directed at FES's and FENOC's operations.

nor an affiliate of FirstEnergy. The market-based rate tariffs previously held by FES and its subsidiaries were succeeded by market-based rate tariffs of Energy Harbor's subsidiaries – Energy Harbor LLC, Energy Harbor Generation LLC, and Energy Harbor Nuclear Generation LLC.[10]

C. Summary of Compliance Findings

Audit staff's compliance findings are summarized below. Details of these findings are in Section IV. Audit staff found the following seven areas of noncompliance:

- *Allocation of Overhead Costs to CWIP* – FirstEnergy's subsidiaries capitalized overhead costs to Account 107, Construction Work in Progress-Electric, using an allocation method that was not based on actual time employees were engaged in construction activities based on timecard reports or on a representative time study. This may have led to FirstEnergy's subsidiaries capitalizing costs to Account 107 that did not have a definite relationship to construction. As a result, the companies may have overstated construction costs recorded in Account 107 and electric plant in service, as well as accumulated depreciation, depreciation expenses, and accumulated deferred income tax (ADIT) balances, and understated operating expenses. Moreover, accumulated overstatement of electric plant in service and the related depreciation due to this accounting practice during and prior to the audit period may have resulted in the FirstEnergy subsidiaries with wholesale transmission formula rate service cost recovery mechanisms, overstating their respective wholesale annual transmission revenue requirements and overcharging wholesale transmission customers.

- *Accounting for Vegetation Management Costs* – The FirstEnergy FPUs improperly accounted for maintenance expenses incurred to remove vegetation surrounding in service distribution powerlines. Specifically, the FPUs inappropriately capitalized the cost to electric plant in service. This accounting practice caused the companies to overstate electric plant in service, accumulated depreciation, ADIT,

[10] *See Energy Harbor LLC*, Docket Nos. ER20-1436-000, ER20-1437-000, and ER20-1438-000 (May 21, 2020) (delegated order on succession and related tariff changes); *see also* Energy Harbor LLC, FERC FPA Electric Tariff and Market-Based Rate Power Sales Tariff; Energy Harbor Generation LLC, FERC FPA Electric Tariff and Market-Based Power Sales Tariff; Energy Harbor Nuclear Generation LLC, FERC FPA Electric Tariff and Market-Based Rate Power Sales Tariff.

depreciation expenses, and other account balances, and understate operating expenses incurred.

- *Accounting for Amortization of Regulatory Assets* – FirstEnergy's subsidiaries deferred certain maintenance expenses, associated with costs incurred to remove vegetation in transmission corridors, and recorded the deferred expenses as regulatory assets in Account 182.3, Other Regulatory Assets, for Commission accounting and reporting purposes. Certain subsidiaries then improperly amortized $3.8 million of the deferred costs as expenses in subsequent periods without obtaining Commission approval to recover these regulatory assets in rates. Moreover, two of the Transmission Companies, ATSI and TrAILCo, included these expenses representing amortization of the regulatory assets in their annual transmission revenue requirements calculated pursuant to their wholesale transmission formula rates without the required Commission approval to recover such regulatory assets. Also, certain FirstEnergy subsidiaries recovered overstated depreciation expense through transmission formula rates.

  As a result of the above deficiencies, the Transmission Companies inappropriately included approximately $2.7 million of regulatory asset amortization and depreciation expense in their annual transmission revenue requirements and overbilled their wholesale transmission customers by this amount.

- *Accounting for Lobbying Costs, Donations, and Costs that Lacked Proper Supporting Documentation* – FESC improperly accounted for and improperly reported lobbying expenses, donations, and other costs that lacked proper supporting documentation or were misclassified (unsupported costs). Moreover, FESC allocated and charged the improperly accounted for lobbying, donation, and unsupported costs to FirstEnergy and its subsidiaries. This led the FirstEnergy subsidiaries to improperly account for and report the lobbying expenses, donations, and unsupported costs in their respective books and records, and FERC Form No. 1. The errors resulted in the Transmission Companies including the lobbying expenses, donations, and unsupported costs in their annual wholesale transmission revenue requirements and billing rates, and overbilling wholesale transmission customers.

- *Allowance for Funds Used During Construction* – FirstEnergy's FPUs improperly included undistributed subsidiary earnings and accumulated other comprehensive income in equity balances used for the purpose of computing AFUDC rates. As a result, the companies over-accrued AFUDC during the audit period, which led them to overstate CWIP and plant-in-service balances.

- *Service Company Billing Procedures* – Billing information that FESC provided to FirstEnergy's subsidiaries pertaining to charges for services provided to them was insufficient. Specifically, FESC did not provide detailed information to reflect the services provided and showing the charges classified as direct costs, indirect costs, or compensation for use of capital, with the details of service company accounts by service provided, as required. As a result, the FirstEnergy subsidiaries misclassified costs charged by FESC.

- *Accounting for Fuel – Coal Supply and Other Consulting Services* – The FirstEnergy FPU, Monongahela Power Company, improperly accounted for fixed monthly consultation fees paid in Account 501, Fuel, as a component cost of coal used in operations without first being accounted for as inventoried fuel stock in Account 151, as required. The accounting led to costs being included in fuel used in operations that may not have been directly assignable and likewise not properly allocable to the cost of coal purchased and used. As a result, Monongahela Power Company may have overcharged wholesale customers, through operation of the fuel cost adjustment formula in its tariff, for the cost of fuel included as a component cost of generating electricity.

D. List of Recommendations

Audit staff's recommendations to remedy the audit findings are listed below. Details are in Section IV. Audit staff recommends that FirstEnergy:

Allocation of Overhead Costs to CWIP

1. Retain an independent third-party entity, subject to approval by DAA, to conduct a representative labor time study for allocation of overhead costs incurred in 2021 to CWIP, and to assist with the development of procedures FirstEnergy subsidiaries shall use to periodically determine the allocation of overhead labor and labor-related costs capitalized by each FirstEnergy subsidiary into the cost of construction after 2021. The independent consultant should have expertise and experience independently performing time studies used in the determination of overhead capitalization rates of U.S. based utilities subject to the accounting requirements prescribed for public utilities and licensees or for natural gas companies under 18 C.F.R. Part 101 or Part 201, respectively. The time study should involve a representative sample of study participants (employees) that provides for extrapolation of the study results to the full population of FirstEnergy employees, and should include processes for application of the study results from

the audit period to the issue date of this audit report, and processes for applying the capitalization rate(s) the study finds for 2021 back to the period January 1, 2015 through December 31, 2020, either with no change to the capitalization rates found in the study or with such modifications to the capitalization rate(s) the independent consultant finds reasonable and supported by evidence. The independent consultant should use its expertise and all relevant information available to it to make recommendations as to what the capitalization rate(s) should be for prior years for each FirstEnergy subsidiary, should set forth the basis for its recommendations, and provide both the recommendations and the basis therefore to FirstEnergy and DAA. If there is no recommendation by the independent consultant for any year or other period between January 1, 2015 and December 31, 2020 for any specific capitalizable cost center, then FirstEnergy should base its capitalization rate and the amount to be capitalized for such year or period on the rates and costs of such specific cost centers for which FirstEnergy can provide to DAA reasonable evidence as to the time employees in such cost centers spent having a definite relation to construction, and exclude from consideration those cost centers for which FirstEnergy cannot provide such evidence, per, for example, 18 C.F.R. Part 101, General Instruction No. 2 and § 41.8.

The progress of the study should be reported within 120 days and the time study results provided to DAA for review and consideration within 180 days of the date of issuance of this audit report, and the developed allocation procedures should be submitted when complete, but no later than 60 days after completion of DAA's review of the labor time study. At a minimum, the developed allocation procedures should provide a method for overhead cost allocation and capitalization to construction based on actual timecard distributions or where this procedure is impractical, based on periodic time studies.

2. Revise written policies, practices, procedures, and controls governing the methods used to account for, track, report, and review overhead labor and related costs, and all other costs allocated to construction projects to be consistent with Commission accounting requirements. In addition, adopt procedures to retain formal documentation supporting the amount of overhead costs allocated to electric plant accounts.

3. Revise accounting processes and procedures to account for and report capitalized A&G amounts recorded in Accounts 920, Administrative and General Salaries, and 921, Office Supplies and Expenses, using Account 922, Administrative Expenses Transferred – Credit, consistent with Commission regulations.

4. Train relevant staff on the revised overhead allocation, control, and A&G accounting procedures and documentation, and provide periodic training in this area, as needed.

5. Train staff on the time reporting guidelines and establish a periodic training program in this area.

6. Within 30 days of the completion of Recommendation No. 1, submit an estimate to DAA, including the calculations and determinative components, of overhead costs that would have been allocated to CWIP from 2015 through the present consistent with the requirements of Electric Plant Instruction No. 4 and General Instruction No. 9. The estimate should be based on a recalculation of 2015's and subsequent years' overhead costs allocated to construction with labor and related costs removed from the cost of plant that were not associated with construction activities based on the methodology developed in response to Recommendation No. 1.

7. With the response to Recommendation No. 6, submit proposed accounting entries to DAA that remove the overhead costs that were allocated to CWIP and electric plant in service from 2015 through the present that exceed the amount of costs that would have been allocated to the accounts based on the methodology developed in response to Recommendation No. 1. Also, provide proposed accounting entries to remove associated amounts from other accounts and balances affected by the inappropriately allocated cost such as the accumulated depreciation and ADIT accounts, and AFUDC balances capitalized into CWIP and electric plant in service. If the adjusting entries result in a significant impact to income for the current year, FirstEnergy subsidiaries may account for the transaction as a correction of a prior period error in Account 439, Adjustments to Retained Earnings. Such adjustments to retained earnings with the proposed accounting entries should be submitted to DAA.

8. Revise account balances for FirstEnergy subsidiaries' utility plant, accumulated depreciation, ADIT, and other account balances impacted by the inappropriate allocation of unsupported overhead costs after receiving DAA's approval of proposed accounting entries submitted per Recommendation No. 7, and restate and footnote the balances reported in the next-filed FERC Form No. 1 reports of the FirstEnergy subsidiaries for both the current and comparative years presented in each subsidiary's next-filed report, as necessary to reflect and disclose the revisions.

9. Submit a refund analysis to DAA that explains and details the following: (1) calculation of refunds that result from correcting the overstatement of

transmission plant due to the improperly capitalized labor costs, as determined by the labor time study, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

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

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

Accounting for Vegetation Management Costs

12. Revise accounting policies and procedures for vegetation management activities in distribution corridors to be consistent with Commission accounting requirements.

13. Train relevant staff on the revised vegetation management accounting policy and procedures and provide periodic training.

14. Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the FirstEnergy FPU's CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by the capitalization of vegetation management expenses for the period from October 1, 2021 through the present within 60 days of issuance of this audit report.

15. Revise the FirstEnergy FPUs' CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC after receiving DAA's approval of the proposed accounting entries per Recommendation No. 14 and restate and footnote the FERC Form No. 1 reports for current and comparative years as necessary.

Accounting for Amortization of Regulatory Assets

16. Revise policies, practices, and procedures to amortize or write off the regulatory assets consistent with Commission accounting requirements.

17. Train relevant staff on the revised methods, and provide periodic training in this area, as needed.

18. Submit a refund analysis, within 60 days of issuance of this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that result from the correction of ATSI's and TrAILCo's improper and unauthorized,

respective, depreciation and amortization of plant and regulatory assets to the depreciation expense account and inclusion of the expenses in service rate determinations, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

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

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

Accounting for Lobbying Expenses, Donations, and Unsupported Costs

21. Critically review and strengthen internal controls in FirstEnergy and its subsidiaries. Establish and implement procedures governing methods to be used to appropriately identify, account for, track, report, and review all lobbying costs, donations, and any unsupported expenses, including, but not limited to, expenses of external lobbyists, monies paid to external corporate entities to be used for lobbying, and other external lobbying costs and internal lobbying costs, including employee lobbying time and other internal lobbying costs.

22. Train relevant staff on the internal control enhancements and procedures established, including internal controls over vendor creation in the accounts payable system, payments, accounting, and reporting violations; and provide periodic training in this area, as needed.

23. Perform an analysis of costs that FirstEnergy and its subsidiaries incurred associated with internal and external lobbying activities, including payments of FirstEnergy funds to outside entities for purposes of those entities using those funds for lobbying, and provide support to identify lobbying-related expenses improperly charged to utility operating accounts, for the audit period and, with respect to the specific issues discussed in this finding, for the entire period affected by or relevant to each such specific issue. Within 60 days of the issuance of this audit report and on a rolling basis within 60 days of conclusion of each internal or external investigation discussed in the finding or any new internal or external investigation arising directly from Ohio House Bill 6 (HB 6) or lobbying activities occurring prior to 2021, provide the results of the investigation, proposed correcting journal entries, and FirstEnergy's analysis of the findings from each investigation and the related impact on prior and future accounting and rate development to audit staff.

24. Submit a refund analysis, within 60 days of issuance of this audit report and on a rolling basis within 60 days of conclusion of each investigation discussed in the finding or any new investigation arising directly from HB 6 or lobbying activities occurring prior to 2021, for DAA's review, that explains and details the following: (1) calculation of refunds resulting from correcting the improper accounting for external lobbying costs, donations, and unsupported costs in utility operating and plant accounts; and internal lobbying costs as identified pursuant to the analysis performed in response to Recommendation No. 23, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

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

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

Allowance for Funds Used During Construction

27. Revise and implement the FPUs' processes and procedures to calculate their respective AFUDC rates consistent with EPI No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to prevent the inclusion of balances in Accounts 216.1 and 219 in the AFUDC rate calculations.

28. Train relevant staff on the revised AFUDC calculation method, and provide periodic training, as needed.

Service Company Billing Procedures

29. Revise FESC policies, procedures, and accounting systems so as to provide sufficient billing information to FirstEnergy's subsidiaries in accordance with the Commission's regulations.

30. Train relevant staff on the revised policies, procedures, and accounting systems and provide periodic training in this area, as needed.

Accounting for Fuel – Coal Supply and Other Consulting Services

31. Revise accounting policies and procedures for cost of fuel by the FPUs to ensure compliance with the Commission's accounting regulations.

32. Train relevant staff on the revised policies and procedures and provide periodic training.

33. Perform an analysis of all monthly payments made to consultants, including BCG Resources, LLC, that were included in the cost of fuel used in operations during the audit period and submit the analysis to DAA with supporting documents within 60 days of issuance of this audit report. Based on the analysis, submit proposed adjusting accounting entries to record the consultation costs in the appropriate accounts for DAA's review and approval.

34. Revise the FirstEnergy FPUs' fuel inventory and other account balances impacted by the improper accounting after receiving DAA's approval of the proposed accounting entries per Recommendation No. 33 and restate and footnote the FERC Form No. 1 reports for current and comparative years as necessary.

35. Review collections received, including but not limited to uplift payments, during the audit period based, in part, on the cost of fuel and submit an analysis to DAA for review of retail and wholesale overcollections due to improper recording of costs in Account 501.

36. Submit a refund analysis if there were overcollections from wholesale customers, within 60 days of issuance of this audit report, for DAA's review, that explains and details the following: (1) calculation of refunds resulting from the improper accounting for fuel costs, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale customers to receive refunds; and (5) period(s) refunds will be made.

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

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

E. Implementation of Recommendations

Audit staff further recommends that FirstEnergy submit the following:

- A plan for implementing the audit recommendations within 30 days after the audit report is issued;

- Quarterly reports describing progress in completing each corrective action recommended. Quarterly nonpublic submissions should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the audit report is issued, and continuing until all recommended corrective actions are completed; and

- Copies of any written policies and procedures developed in response to the recommendations. These documents should be submitted in the first quarterly filing after development of a written policy or procedures.

II. Background

A. FirstEnergy Service Company

FESC is a centralized service company that provides certain accounting, administrative, management, utility operation, and other services to FirstEnergy and its subsidiary companies, including through June 2020 to FirstEnergy's former subsidiaries FES and FENOC, which ceased to be FirstEnergy's subsidiaries after emerging from bankruptcy in February 2020. FESC recovers its cost of providing services through monthly billings to associate companies. The associate companies are either directly assigned or allocated a portion of the costs. Direct assignment takes place when a service provided by FESC benefits a specific company. When the cost of a service provided by FESC benefits multiple companies, the costs are billed to the benefiting companies using an allocation method intended to consider cost causation. Shared service agreements between FESC and the associate companies describe the services provided and the cost allocation methodologies.

B. Service Company Accounting System

FESC's accounting system primarily consists of an SAP SE (SAP) general ledger system and related modules. It is a system with several modules that process transactions for accounting, cost allocation, and financial reporting. Additionally, FESC uses other business systems that interface with the SAP system, including, for example, PowerPlan, which processes fixed assets and taxes. FESC maintains the accounting records for the FPUs and Transmission Companies, as well as for FirstEnergy's other subsidiaries, in its integrated SAP general ledger system. Transactions recorded in the system are designated with individual company codes.

FESC uses its own internal account numbers to account for revenue and expenses, and it converts the balances in those general ledger accounts to the Commission's prescribed accounts for public utilities and service companies for regulatory reporting purposes. The SAP general ledger balance sheet account numbers used by FESC are the same as those provided in the Commission's Uniform System of Accounts Prescribed for Public Utilities and Licensees, 18 C.F.R. Part 101, and Uniform System of Accounts for Centralized Service Companies, 18 C.F.R. Part 367 (collectively, USofA).

C. Cost Accumulation and Allocation

FESC's cost accumulation and allocation procedures are performed within its SAP system. Costs are accumulated using several cost collectors in addition to the internal account numbers. The cost collectors are accounting devices used to plan and track detailed costs of different categories or types of work. Cost collectors used by FESC are cost centers, work breakdown structure elements (WBS), and internal orders. The cost centers collect routine costs for employees providing services for particular functions. Internal orders are used to collect costs for projects of a certain dollar amount that are not capital investments. The internal orders are company specific and are numbered by the SAP system sequentially. WBS are used for projects exceeding certain dollar amounts or durations that involve capital investments.

Cost collectors accumulate costs from payroll and employee time sheets, expense reports, overhead distributions, vendor invoices, journal entries, allocations, etc. for later billing to the associate company (or companies) benefiting from the work performed. The SAP system records the entity providing a service and the corresponding entity or entities benefiting from the service based on whether the service cost is directly charged or, alternatively, allocated pursuant to allocation rates input into the system. FESC has 18 allocators, as reported in its FERC Form No. 60, Annual Report of Centralized Service Companies, that result in distribution percentages for charging the cost of specific activities performed to associate companies that benefit. Approximately 65 percent of the total costs incurred by FESC during the audit period were indirect costs assigned to associate companies using the allocators.

D. Department of Justice Complaint and Subsequent Investigations

On July 17, 2020, the U.S. Department of Justice (DOJ) filed a criminal complaint in the U.S. District Court for the Southern District of Ohio alleging that then-Speaker of the State of Ohio House of Representatives, four other individuals, and a 501(c)(4) nonprofit entity named Generation Now, organized under the laws of the State of Delaware, engaged in conducting the affairs of an enterprise through a pattern of racketeering activity in violation of federal law, and committed multiple acts of bribery chargeable under Ohio law.[11] The complaint alleged that the defendants facilitated and participated in actions to funnel almost $61 million received from an Ohio public utility, referred to as Company A in the complaint, and its affiliates through the nonprofit entity to various Ohio political figures to support election of the lead defendant as Speaker of the House, then secure the passage of Ohio Bill 6, which, among other things, would provide over a billion dollars in subsidies, to be paid for by Ohio ratepayers, to the Ohio-based coal-fired and nuclear power plants owned by Company A's affiliates, and then defeat a ballot initiative effort calling for the repeal of the Ohio Bill 6 legislation.

[11] *United States v. Larry Householder*, *et al.*, Case No. 1:20-MJ-00526 (S.D. Ohio), Complaint (July 17, 2020).

On July 21, 2020, FirstEnergy disclosed in a public statement that it had received subpoenas from the DOJ in connection with the investigation surrounding Ohio House Bill 6.[12] In October 2020, two of the five individual defendants named in the DOJ complaint entered guilty pleas.[13] On October 29, 2020, FirstEnergy issued a press release, which stated that the Independent Review Committee of the Board of Directors of FirstEnergy had terminated FirstEnergy's Chief Executive Officer, effective immediately, and had also terminated FirstEnergy's Senior Vice President of Product Development, Marketing, and Branding and its Senior Vice President of External Affairs, also effective immediately.[14]

The DOJ complaint and audit staff's discussions on internal controls during onsite interviews of FESC employees raised audit staff's concerns about the existence of significant shortcomings in FirstEnergy and its subsidiary companies' controls over financial reporting, including controls over accounting for the costs of civic, political, and related activities, such as lobbying activities, performed by and on behalf of FirstEnergy and its subsidiaries. Moreover, these controls may have been circumvented in ways designed to conceal the nature and purpose of expenditures made and, as a result, that led to the improper inclusion of lobbying and other nonutility costs in wholesale rate determinations.

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[12] *See* [An Act that] Creates Ohio Clean Air Program, 2019 Am. Sub. HB 6 ("HB 6"), *repealed in part by* [An Act to] Revise electric utility service law; repeal portions of HB 6, 2021 Am. Sub. HB 128 ("HB 128"). HB 6 passed the Ohio House on May 29, 2019. The bill passed the Ohio Senate and was signed into law by the Governor of Ohio in July 2019, with an effective date of October 22, 2019. A referendum effort to repeal HB 6 in its entirety was waged from July 24, 2019 to the Act's effective date in October 2019, but was not successful. However, in March 2021, HB 128 was signed into law, which repealed the provisions of HB 6 that provided approximately $1 billion to two Ohio nuclear plants, and repealed certain other provisions, but left in place assistance provided to coal-fired generation plants. *See also* "FirstEnergy Corp. Statement on HB 6 Investigation," FirstEnergy Newsroom, at https://www.firstenergycorp.com/content/fecorp/newsroom/news_articles/firstenergy-corp--statement-on-hb-6-investigation.html.

[13] *See United States v. Jeff Longstreth*, Case No. 1:20-CR-77 (S.D. Ohio), Plea Agreement (filed Oct. 29, 2020); and *United States v. Juan Cespedes*, Case No. 1:20-CR-77 (S.D. Ohio), Plea Agreement (filed Oct. 29, 2020).

[14] *See* "FirstEnergy Announces Leadership Transition," FirstEnergy Newsroom, at https://www.firstenergycorp.com/content/fecorp/newsroom/news_articles/firstenergy-announces-leadership-transition.html.

Following the filing of the DOJ complaint, the U.S. Securities and Exchange Commission, the U.S. Internal Revenue Service, the Public Utilities Commission of Ohio, the Ohio Attorney General, and the Commission commenced investigations of FirstEnergy's operations.[15] In addition, FirstEnergy initiated its own internal investigation to be overseen by the Independent Review Committee of FirstEnergy's Board of Directors. As of the date of this report, these investigations have either not been completed, or the findings of these investigations were not available to audit staff during performance of this audit.

On November 12, 2020, FirstEnergy informed audit staff that, as part of its internal investigation, it had determined that responses provided to audit staff's data requests relating to lobbying activities were incomplete and omitted several payments. FirstEnergy proposed to provide several supplemental updates to its lobbying-related data responses over the next several months. Included in FirstEnergy's supplemental data responses and its further responses to audit staff's follow up data requests were the following:

a) *Payments to certain corporate entities, including U.S. Internal Revenue Code Section 501(c)(4) entities*:

FirstEnergy identified eight lobbying payments, made between March 2017 and October 2019, amounting to a total of $26.5 million, paid to Generation Now ($1 million) and Partners for Progress, Inc. ($25 million), which were U.S. Internal Revenue Code Section 501(c)(4) entities, and to Hardworking Ohioans, Inc. ($0.5 million), a for-profit corporation. Audit staff determined that the payments to Generation Now and Hardworking Ohioans, Inc. were allocated to the ten FPUs of FirstEnergy and improperly accounted for as General and Administrative expenses ($0.65 million) and costs of electric plant in service ($0.85 million). Those expenses were then used to develop service rates charged. The $25 million paid to Partners for Progress, Inc. was allocated to FirstEnergy Corporation.

In a supplemental data request response, FirstEnergy produced a schedule of lobbying payments, prepared by Energy Harbor, which identified additional lobbying payments made between October 2018 and October 2019, totaling around $43.1 million that were paid to Generation Now. Those

[15] On February 18, 2021, FirstEnergy disclosed in its 2020 SEC Form 10-K, under Item 1A, Risk Factors, Risks Associated with the Ongoing Investigations, that staff of the Commission's Division of Investigations in its Office of Enforcement had initiated an investigation.

payments were made by FESC on behalf of FES under a service agreement.[16] FirstEnergy also disclosed payments to two additional entities – 614 Solutions LLC and The Oxley Group – totaling $1 million and around $0.3 million, respectively. FirstEnergy represented to audit staff that these additional payments totaling $44.4 million were made with funds provided to FESC by FES and that the payments had no impact on the operations of the FPUs and Transmission Companies.

In summary, the total payments to 501(c)(4) entities and Hardworking Ohioans, Inc. and others disclosed by FirstEnergy, including those made by FES, amounted to approximately $70.9 million. Audit staff notes that FirstEnergy did not disclose that these payments were made until after the DOJ investigation was made public. At which point, FirstEnergy informed audit staff that it would supplement its prior data request responses to correct inaccurate information previously provided regarding its and its subsidiaries' lobbying activities and costs incurred.

According to FirstEnergy, out of the $70.9 million of payments, $44.4 million was recorded in the accounts of FES and $25 million was recorded in FirstEnergy's own books.[17] Out of the $1.5 million that FirstEnergy identified as being charged to the FPUs and the Transmission Companies, $0.65 million were recorded as General and Administrative expenses, while around $0.85 million were ultimately recorded as the cost of electric plant in service.

[16] The payments totaling around $43.1 million were made prior to FES's emergence from bankruptcy and becoming an Energy Harbor subsidiary.

[17] Audit staff evaluated FESC's accounts and other records and determined that the payments FESC made were charged to FES and to FirstEnergy. Audit staff's evaluation did not include the accounts and records of FirstEnergy, which does not allocate costs to its Commission-jurisdictional subsidiaries, and did not include the accounts and records of FES and FENOC, which were under independent management and bankruptcy court supervision, and also did not allocate costs to FirstEnergy's FPUs and Transmission Companies. Audit staff did obtain information pertaining to FirstEnergy and FES, however, confirming their receipt of the $25 million and $44.4 million charges, respectively.

b) *Payments made to Sustainability Funding Alliance of Ohio, Inc. and IEU-Ohio Administration Company, LLC – entities associated with an appointed Ohio government official*:

On November 19, 2020, FirstEnergy disclosed, in its SEC Form 10-Q filing for the quarter ended September 30, 2020, that a payment of approximately $4 million had been made in early 2019, in connection with the termination of a purported consulting agreement that had been in place since 2013. The counterparty to the consulting agreement, Sustainability Funding Alliance of Ohio, Inc., was associated with a person who was later appointed to be the Chairman of the Public Utility Commission of Ohio (PUCO) in February 2019. This person was identified as Public Official B in a FirstEnergy deferred prosecution agreement with the United States Attorney's Office for the Southern District of Ohio wherein the person was determined by the DOJ to have operated in an official capacity as the PUCO Chairman to assist with the passage of legislation and regulatory orders that benefited FirstEnergy in return for monetary payments.[18]

Audit staff followed up on the SEC Form 10-Q disclosure. In response, FirstEnergy identified approximately $13.8 million, including the approximately $4 million disclosed in its SEC Form 10-Q, paid between 2013 and 2018 to Sustainability Funding Alliance of Ohio, Inc. FirstEnergy's FPUs and Transmission Companies were allocated $11.9 million of the costs which were accounted for as General and Administrative expenses initially and then a $6.7 million portion was capitalized as electric plant in service and the balance of $5.2 million continued to be accounted for as General and Administrative expenses. FirstEnergy's improper capitalization of General and Administrative expenses is discussed in Finding No. 1, Allocation of Overhead Costs to CWIP, in Section IV of this report.

FirstEnergy disclosed to audit staff additional payments to Sustainability Funding Alliance of Ohio, Inc., established under a different vendor number in FirstEnergy's Accounts Payable system, and IEU-Ohio Administration Company, LLC, another entity associated with the former PUCO Chairman. Those payments, made from 2010 to 2015, in $1 million annual installments to Sustainability Funding Alliance of Ohio, Inc. and $0.5 million annual installments to IEU-Ohio Administration Company, LLC, totaled $9 million. In summary, the two entities received around $22.8 million

[18] *United States v. FirstEnergy Corp.*, Case No. 1:21-CR-00086-TSB (S.D. Ohio), Deferred Prosecution Agreement (filed Jul. 22, 2021). The deferred prosecution agreement notes that Public Official B resigned from the PUCO in November 2020.

in payments and $20.9 million of this amount was charged to certain FirstEnergy FPUs and Transmission Companies. Some of the costs were used in customer rate development for those regulated entities and a portion was recovered from customers. However, FirstEnergy acknowledged that certain transactions were either improperly classified, misallocated to certain of the FPUs and Transmission Companies, or lacked proper supporting documentation and resulted in amounts collected from customers.

FirstEnergy represented to audit staff that it will make refunds of around $185,000 to retail and transmission customers and has already made the related accounting entries to correct charges of $6.7 million allocated to electric plant in service of the FPUs and Transmission Companies and to prevent those expenses from impacting future rates.

c) *Payments to sixteen entities associated with an individual under investigation by FirstEnergy*:

In coordination with its filing of SEC Form 10-K for 2020, FirstEnergy revealed to audit staff in February 2021 that it was investigating payments totaling around $28.8 million made between 2003 and 2020 to sixteen entities associated with an individual identified by FirstEnergy. FirstEnergy's FPUs were allocated around $19.7 million of these payments, the Transmission Companies $1.1 million, FES $2.2 million, and $5.8 million was allocated to FirstEnergy and its nonregulated subsidiaries.

The FPUs and Transmission Companies included $1.4 million of the cost in electric plant in service balances, including capital lease balances, and $19.4 million in Operating Expense balances that were used in the development of customer rates charged. FirstEnergy acknowledged that certain transactions were either improperly classified, misallocated to certain of the FPUs and Transmission Companies, or lacked proper supporting documentation and resulted in amounts collected from customers. FirstEnergy committed to remove the cost from electric plant in service balances and provide an estimated $9.6 million in customer refunds.

d) *Deferred Prosecution Agreement*

On July 20, 2021, FirstEnergy and the United States Attorney's Office for the Southern District of Ohio entered into a deferred prosecution agreement

(DPA).[19] As set forth in the DPA, FirstEnergy acknowledged that it, "through the acts of its officers, employees, and agents conspired with public officials and other individuals and entities to pay millions of dollars to and for the benefit of public officials in exchange for specific official action for FirstEnergy's benefit."[20] Per the DPA, among other things, FirstEnergy agreed to pay a penalty of $230 million, accept a single charge of conspiracy to commit honest services wire fraud, and undertake substantial compliance-related and other obligations going forward.

In addition, FirstEnergy committed to address any deficiencies in its internal controls, which includes its policies, and procedures.[21] Specifically, FirstEnergy committed to "ensure that it has a system of financial and accounting procedures, including a system of internal controls, reasonably designed to ensure the maintenance of fair and accurate books, records, and accounts."[22] Pursuant to the DPA, this system "should be designed to provide reasonable assurances that [FirstEnergy's] transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets."[23] Such system should also provide reasonable assurances that FirstEnergy's transactions are recorded as necessary to permit preparation of financial statements for Commission reporting purposes in conformity with the definitions, instructions, and accounts of the Uniform System of Accounts and FERC Form Nos. 1 and 3-Q, and to maintain accountability for assets.[24]

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[19] *United States v. FirstEnergy Corp.*, Case No. 1:21-CR-00086-TSB (S.D. Ohio), Deferred Prosecution Agreement (filed Jul. 22, 2021).

[20] *Id*. P 17.

[21] *Id*. P 5(F), Remediation, Corporate Compliance Program, and Reporting. (In order to address any deficiencies in its internal controls, policies, and procedures, FirstEnergy Corp. represents that it will continue to undertake in the future, in a manner consistent with all of its obligations under this Agreement, a review of its internal controls, policies, and procedures regarding compliance with U.S. law.)

[22] *Id*. at Attachment B: Corporate Compliance Program.

[23] *Id*.

[24] *Id*.

III. Introduction

A. Objectives

The audit evaluated FirstEnergy's and its subsidiaries' compliance with cross-subsidization restrictions on affiliate transactions; service company and public utility accounting, recordkeeping, and reporting requirements pertaining to transactions with associate companies; and preservation of records requirements for holding companies and service companies. The audit covered the period January 1, 2015 to September 30, 2021.

B. Scope and Methodology

Audit staff observed during the audit planning that FirstEnergy and several affiliated companies were operating in a financially stressed environment. Significant impairment losses were recognized under Generally Accepted Accounting Principles and the ability of certain affiliated generation companies to operate as a going concern became questionable. Audit staff also observed media reports on major efforts by FirstEnergy to lobby at the federal and state level to gain support for its failing nuclear and coal generating plants. This financially stressed operating environment combined with audit staff's discovery of deficient internal controls led to increased testing by audit staff.

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

- *Review of Public Information* – Reviewed publicly available information before commencing the audit. The review provided information on FirstEnergy's operations and finances, reorganization, significant contracts, and other key regulatory and business activities. Examples of materials reviewed include FirstEnergy's annual reports and SEC Forms 10-K and 10-Q, FERC Form Nos. 1 and 60 of the FirstEnergy subsidiaries, prior Commission audit reports, company-related websites, and other relevant regulatory and media sources.

- *Audit Criteria* – Identified audit criteria including the Commission's rules, regulations, and other requirements necessary to evaluating compliance with the audit objectives.

- *Data Requests* – Issued data requests to collect audit evidence and information. The information related to internal policies; service company and operating company operations, procedures, and controls; business practices; risk management; corporate structure; contractual agreements; financial accounting, cost allocation and reporting activities; corporate compliance; regulatory filings; and other pertinent information, including internal and external audit reports, Board of Directors and Audit Committee meeting minutes, corporate compliance program procedures, and other items not publicly available. The evidence and information were used to test and evaluate compliance with Commission requirements relevant to audit objectives.

- *Teleconferences* – Held multiple teleconferences with FirstEnergy and FESC staff to discuss audit objectives, testing, data request responses, technical and administrative matters, and compliance concerns.

- *Site Visits* – Participated in three site visits to FirstEnergy's headquarters in Akron, OH to discuss and observe controls and procedures related to audit objectives. The visits enabled audit staff to:

  - Discuss FirstEnergy's and its subsidiaries' organizational and corporate structures, departmental functions, and employee responsibilities, and meet with key company officials;

  - Learn about FirstEnergy's and its subsidiaries' cost allocation and capitalization program, processes and operations, in particular the cost of departments, activities, functions, and systems attributed to plant construction;

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

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

  - Discuss the management and operation of the corporate compliance program; and

  - Discuss and observe accounting and reporting procedures, processes, and controls relevant to audit objectives.

- *Internal Commission Collaboration* – Conferred with other Commission staff on compliance issues to ensure audit findings were consistent with Commission precedent and policy.

Accounting, Recordkeeping, and Financial Reporting

To evaluate FirstEnergy's and its subsidiaries' compliance with accounting, recordkeeping, and financial reporting requirements of the FERC Form Nos. 1 and 60, audit staff reviewed the following:

- *Application of USofA* – Analyzed the companies' interpretations and applications of select accounts for consistency with Commission accounting instructions. For example, reviewed balances in regulatory asset and liability accounts to assess whether the companies had the proper regulatory basis to record each item in these accounts and amortized these costs to the proper expense accounts and accounting periods as required. Analyzed costs recorded in operating accounts that have historically been found during Commission audits to be misclassified, such as lobbying expenses. Also, sampled 900 series accounts to determine whether the companies recorded salaries, office supplies, outside services, and other administrative and general expenses in a manner consistent with Commission accounting instructions.

- *Associate Company Transactions* – Reviewed corporate and associate company transactions to assess whether FirstEnergy's subsidiaries recorded revenues and costs for goods and services received and provided at the appropriate price and in the correct accounts, taking into consideration cross-subsidization restrictions and the nature of the transactions. As part of this review, audit staff evaluated policies, procedures, and practices relating to the sale of non-power goods and services to understand (1) the types of services provided by and between FirstEnergy subsidiaries, (2) the contract terms for the pricing of the non-power goods and services provided, and (3) invoice, work order, and other price and cost support documentation. Further, audit staff interviewed FESC accounting staff; reviewed transactions reported in FERC Form Nos. 1 and 60; tested a sample of FESC charges for non-power goods and services; and assessed billings by and between associate companies to verify proper classification of the amounts and compliance with the "at cost" standard.[25]

- *Reconciliation of Reported Information* – Reconciled a sample of information reported in the FERC Form No. 1 at page 429 to information reported in

[25] 18 C.F.R. § 35.44(b)(3) (2021) provides that a franchised public utility that has captive customers, or that owns or provides transmission service over jurisdictional transmission facilities, may only purchase or receive non-power goods and services from a centralized service company at cost.

FESC's FERC Form No. 60 to determine whether information was reported accurately and consistently. Also, evaluated compliance with the USofA for the information under review, including related guidance, accounting releases, and Commission orders.

- *Reporting Processes and Procedures* – Evaluated the FERC Form Nos. 1 and 60 reporting processes and procedures to determine whether there was accurate, complete and timely reporting consistent with Commission reporting requirements and the instructions of the forms.

- *Annual FERC Filings* – Reviewed the FERC Form Nos. 1 and 60, including related notes to the financial statements, to identify major accounting matters. Highlighted significant notes to understand financial statement and cost allocation implications and identified underlying accounting entries for these matters.

- *Variance Analysis* – Performed variance analyses of a sample of balance sheet and income statement accounts reported in 2013-2017 FERC Form No. 60 filings. Analyzed unusual variances to understand their basis and identify potential accounting and reporting concerns.

- *Audit Sampling* – Evaluated various account balances that were reported as associate company transaction charges for compliance with relevant accounting and cost charging requirements.

- *Accounting Processes and Procedures* – Reviewed FirstEnergy's subsidiaries' accounting and financial reporting processes, procedures, and internal controls for compliance with the Commission's regulations. Specifically, reviewed reporting controls, procedures, and practices to test the accuracy and completeness of the reported account data, and interviewed employees that worked directly on daily reporting and with management responsibility for ensuring that costs were charged in accordance with the requirements of the USofA under 18 C.F.R. Parts 101 and 367.

- *Capitalization of Administrative and General Costs* – Evaluated the methods used to allocate overhead labor and labor-related costs to the cost of construction projects. Audit procedures were performed to determine whether the overhead costs charged to Account 107, Construction Work in Progress, had a definite relation to construction. The audit procedures included, among other things, interviews of a randomized sample of FirstEnergy's and its subsidiaries' employees whose labor costs were allocated to construction projects during the audit period and a review of a sample of timesheets associated with the employees. Audit staff covered the following topics during its interviews: (i) responsibilities and day-to-day duties of each employee; (ii) associate companies that FESC's employees performed work on behalf of; (iii) the organizational structure and function of employees' business units; (iv) work performed by employees related to construction, and the estimated amount of time spent on construction-related activities; (v) availability of documentation to support time spent engaged on construction-related activities, such as calendar appointments or work products; (vi) policies, processes, and procedures related to the submission and approval of employees' timesheets, including the specific code(s) each employee used to charge time and any guidance received on how to charge time; (vii) employee awareness of methods used to allocate a portion of labor costs to construction projects; and (viii) internal communications about decisions on the allocation methods used to charge overhead costs to construction projects.

- *Capital Project Life Cycle* – Reviewed accounting and cost tracking procedures used during capital projects' life cycles. This included an assessment of procurement methods, cost allocator selections, confirmation of billings to companies, and accounting system work orders generated.

- *Allowance for Funds Used During Construction* (*AFUDC*) – Reviewed the procedures that FirstEnergy's subsidiaries followed to calculate individual components of the AFUDC rates reported in their FERC Form No. 1 filings, including balances and cost rates for short-term debt, long-term debt, common stock, preferred stock, and CWIP. Verified the actual values of balances and cost rates for short-term debt, long-term debt, common stock, preferred stock, and CWIP to determine whether the AFUDC rates calculated were consistent with Commission accounting requirements. Identified major projects placed in service during the audit period and analyzed whether AFUDC accrual ceased when the projects were placed in service.

- *External Accountants' Working Papers* – Reviewed FirstEnergy's external accountants' working papers to better understand certain accounting practices, and to identify accounting practice changes and material or unusual transactions.

- *Chart of Accounts* – Reviewed each of FirstEnergy's subsidiaries' chart of accounts to determine whether the conversion from internal accounts to the Commission's USofA resulted in proper mapping of costs to specific balance sheet and income statement accounts.

- *Cost Allocation* – Reviewed cost allocation methods and tested supporting details by recalculating a sample of allocation percentages used. Also, analyzed a sample of billings from FESC to associate companies and related accounting to test compliance with established cost allocation methods reported in FESC's FERC Form No. 60 filings.

- *Preservation of Records* – Reviewed the retention schedules that were included in the record retention program. Interviewed employees responsible for record retention to understand processes, procedures, and controls for administration and maintenance of records. Sampled selected records to ascertain whether their retention period aligned with the Commission's preservation of records regulations, and whether any records prematurely destroyed or lost were reported to the Commission.

IV. Findings and Recommendations

1. Allocation of Overhead Costs to CWIP

FirstEnergy's subsidiaries capitalized overhead costs to Account 107, Construction Work in Progress-Electric, using an allocation method that was not based on actual time employees were engaged in construction activities based on timecard reports or on a representative time study. This may have led to FirstEnergy's subsidiaries capitalizing costs to Account 107 that did not have a definite relationship to construction. As a result, the companies may have overstated construction costs recorded in Account 107 and electric plant in service, as well as accumulated depreciation, depreciation expenses, and ADIT balances, and understated operating expenses. Moreover, accumulated overstatement of electric plant in service and the related depreciation due to this accounting practice during and prior to the audit period may have resulted in the FirstEnergy subsidiaries, with wholesale transmission formula rate service cost recovery mechanisms, overstating their respective wholesale annual transmission revenue requirements and overcharging wholesale transmission customers.[26]

Pertinent Guidance

- 18 C.F.R. Part 101, General Instruction No. 2, Records, states in part:

> A. Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto.
>
> B. The books and records referred to herein include not only accounting records in a limited technical sense, but all other records, such as minute books, stock books, reports, correspondence, memoranda, etc., which

[26] The FirstEnergy subsidiaries with wholesale transmission formula rate mechanisms during the audit period were: The Cleveland Electric Illuminating Company, Metropolitan Edison Company, Ohio Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, The Toledo Edison Company, ATSI, MAIT, TrAILCo, and JCP&L. During the audit period, JCP&L transferred from a stated rate to a wholesale transmission formula rate mechanism effective January 1, 2020. *See Jersey Central Power & Light Co.*, 169 FERC ¶ 61,205 (2019).

> may be useful in developing the history of or facts regarding any transaction.
>
> C. No utility shall destroy any such books or records unless the destruction thereof is permitted by rules and regulations of the Commission.

- 18 C.F.R. Part 101, General Instruction No. 9, Distribution of Pay and Expenses of Employees, states:

> The charges to electric plant, operating expense and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance, and operations, shall be based upon the actual time engaged in the respective classes of work, or in case that method is impracticable, upon the basis of a study of the time actually engaged during a representative period.

- 18 C.F.R. Part 101, Electric Plant Instruction No. 4, Overhead Construction Costs, states in part:

> B. As far as practicable, the determination of payroll charges includible in construction overheads shall be based on timecard distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.

- 18 C.F.R. Part 101, Account 922, Administrative Expenses Transferred – Credit, states:

> This account shall be credited with administrative expenses recorded in accounts 920 and 921 which are transferred to construction costs or to nonutility accounts. (See electric plant instruction 4.)

Background

FESC employed shared services personnel that performed legal, finance, accounting, information technology, human resources, utility and non-utility operations, and other functions on behalf of FirstEnergy and its subsidiaries. Pursuant to multiple service agreements by and between FESC and the companies, labor and related costs of FESC employees were directly charged by FESC to the specific company that benefitted from a service provided, or when multiple companies benefited from a service provided, FESC charged the cost of the service to the multiple benefitting companies using a cost allocation procedure. Audit staff evaluated the FirstEnergy subsidiaries' accounting for administrative and general (A&G) expenses directly incurred by the companies and those incurred on their behalf for services provided and charged by FESC through direct and allocated charges. The evaluation included an assessment of labor, related A&G, and other costs that were accounted for as capitalized overhead construction cost on the FirstEnergy subsidiaries' books. Labor, related A&G, and other costs capitalized included employees' base salaries, overtime wages, pension and other benefit expense, payroll taxes, annual incentive plan payments, employee expenses, materials and supplies, outside contractor costs, advertising expenses, donations, dues and subscription costs, lease/rental payments, and insurance expenses.[27]

During the evaluation, audit staff: (1) analyzed methods used by the companies to determine the pool of capitalizable costs, which included overhead labor and related A&G costs that were directly incurred by the FirstEnergy subsidiaries and those charged to the companies by FESC; (2) examined the development and application of overhead capitalization rates used to allocate costs in the overhead cost pool to construction projects; (3) assessed the accounting used to charge costs in the overhead cost pool to construction projects; and (4) interviewed FESC staff and an employee of FES, who transferred from FESC, about labor and related A&G costs included in the overhead cost pool. Audit staff discovered that many employees were not aware of FirstEnergy's corporate time reporting guidelines or were coached when hired but did not receive formal training on time reporting.

Audit staff found that all A&G costs incurred by FESC that were not directly charged to specific FirstEnergy subsidiaries were included in the overhead cost pool. These residual expense amounts, i.e., indirect costs, were charged to the FirstEnergy subsidiaries based on various cost allocation methodologies that were applied to each FESC business department. The FirstEnergy subsidiaries then applied calculated capitalization rates to the allocated cost and accounted for a portion of the cost as CWIP in Account 107. Additionally, the FirstEnergy subsidiaries applied the calculated

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[27] FirstEnergy subsidiaries' A&G capitalization included other costs such as lobbying expenses and donations which were improperly classified as A&G expenses.

capitalization rates to their directly incurred A&G expenses and similarly accounted for a portion of the cost as construction related in Account 107.

To assess the applicability, relevance and accuracy of the capitalization rates used to determine cost capitalized to the FirstEnergy subsidiaries' construction operations, audit staff evaluated the nature of the operations of the respective FESC business departments and interviewed a sample of employees in the departments to determine whether a nexus existed between activities performed by the employees and the FirstEnergy subsidiaries' construction operations. There were 90 FESC business departments that were represented as performing activities that supported the FirstEnergy subsidiaries' construction operations. These 90 business departments had a total of 553 employees. Audit staff interviewed a randomly selected, statistically representative sample of 80 employees, plus 11 additional employees, selected based on Audit staff's judgment, for a total of 91 interviews of employees that worked in the departments that had cost capitalized to construction projects. The selection resulted in a representative sample of employees from 56 of the 90 business departments.

Audit staff found that most of the employees interviewed performed work in business departments that did not support the capitalization rates used to charge labor and related cost to the FirstEnergy subsidiaries' construction operations. Instead, these business departments and the employees working therein performed activities that supported transmission, generation and/or distribution operations, as applicable, on FirstEnergy's existing in-service infrastructure or provided less construction support than represented by the capitalization rate applied. First, there were employees with labor and related costs capitalized to CWIP who did not support construction operation, and instead only supported the existing in-service infrastructure doing work such as information technology and physical security, analyzing plant operations, internal controls and risk assessment, and customer service.

Second, there were employees that spent less of their time supporting the FirstEnergy subsidiaries' construction operations than represented by the capitalization rates used to charge their time to the performance of construction related activities. For example, audit staff found that some employees spent five percent or less of their time performing work that supported the FirstEnergy subsidiaries' construction operations, but had more than 90 percent of their labor and related costs capitalized as a cost of construction. Consequently, the calculated capitalization rates applied to the A&G cost allocated to and directly incurred by the FirstEnergy subsidiaries were not determined with consideration of whether the activities of the employees involved or supported construction operations. As such, the capitalization rates used were not applicable or relevant to the FirstEnergy subsidiaries' construction operations.

Although the interviews revealed that the employees in the FESC business departments either: (1) spent no time supporting the FirstEnergy subsidiaries' construction operations; or (2) spent a lower percentage of their time supporting construction operations than represented by the capitalization rates, audit staff found that these employees had a significant portion of their labor and related costs charged to CWIP in Account 107. However, in accordance with the accounting requirements of Electric Plant Instruction No. 4, Overhead Construction Costs, and General Instruction No. 9, Distribution of Pay and Expenses of Employees, labor costs capitalized to plant must have a definite relation to construction, and must be based on time card distributions or be allocated based on a study of the time actually engaged in construction related activities during a representative period. FirstEnergy acknowledged that there was not a representative labor-time study performed. Further, some interviewed employees admitted to not receiving formal training on time reporting, thus there was a lack of awareness about the time reporting guidelines. Consequently, since the labor and related costs charged to construction were neither based on the time that employees actually engaged in construction activities nor on a representative time study of such engagement, the charged costs did not have a definite relation to construction.

Upon finding that the method used to determine overhead labor and related A&G costs capitalizable to construction was not consistent with Commission accounting requirements, audit procedures were performed to evaluate the accuracy of the capitalization rates used and to develop an estimate of the amount of costs appropriately capitalizable to construction. Audit staff found that the FirstEnergy companies historically developed overhead capitalization rate formulas that were used to determine the amount of A&G costs charged to construction projects. The overhead capitalization rate formula used by FirstEnergy's FPUs during the audit period was comprised of a ratio of total direct internal labor costs charged to FPU capital projects over total direct and indirect internal labor costs incurred by the FPUs. The formula used by FirstEnergy's Transmission Companies in 2016 and subsequent years was comprised of a ratio of total direct internal labor costs plus construction contractors' labor costs charged to the Transmission Companies capital projects over total direct and indirect internal labor costs plus construction contractors' labor costs incurred by the Transmission Companies. In 2015, the Transmission Companies' capitalization rate formula excluded construction contractors' labor costs from the ratio.

The capitalization practices resulted in the Transmission Companies using a capitalization rate of 56.7 percent in 2015 and 92 percent in 2016 and subsequent years, and the FPUs using a 56.7 percent capitalization rate in 2015 and subsequent years.[28]

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[28] The FPUs also capitalized a portion of customer service costs using varying capitalization rates for several business departments.

From 2015 through 2019, the First Energy subsidiaries capitalized $575.5 million of overhead labor and related A&G costs to construction projects.[29] This total includes $26.2 million of customer service costs that were capitalized. However, the customer service activities of which the costs were borne generally involved employee interaction with the public and customers with regard to the operation of FirstEnergy's existing in-service infrastructure. FirstEnergy acknowledged that it did not have evidence to support the customer service capitalization rates that were used. Consequently, the customer service activities lacked a definite relation to construction and thus the associated costs were not appropriately capitalizable as a cost of construction.[30]

Based on an evaluation of the nature of the work performed by the FESC employees and a former FES employee interviewed that had overhead labor and related A&G costs charged to construction, audit staff developed an estimate of the average percentage of time employees throughout the corporation spent engaged in activities that supported construction operations. Audit staff estimated, based on the sampling and interviews it conducted, that the average of all administrative and general employees' time spent performing activities that supported construction operations was significantly below the A&G capitalization rates used by FirstEnergy's subsidiaries.[31]

During discussions with FESC employees with oversight responsibility for capitalization of A&G costs, the employees stated a belief that FESC's primary activities involved support of the FirstEnergy subsidiaries' construction operations. This belief, while not supported by the actual activities performed by a majority of FESC's staff who primarily supported operation of FirstEnergy's existing in service infrastructure, may have been factored into decisions that resulted in the use of inaccurate capitalization rates, which led to inappropriate A&G costs capitalized to CWIP in Account 107 and eventually plant in service. Moreover, audit staff discovered that FirstEnergy implemented an annual procedure to review the accuracy of the capitalization rates used and the company found on several occasions that the rates used could have been lower. Despite the findings of these reviews, FirstEnergy decided against lowering the capitalization rates or adjusting plant balances in response to the results of the reviews due, FirstEnergy asserts, to a lack of materiality.

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[29] The FirstEnergy subsidiaries continued the capitalization practices in 2020 and 2021 adding additional amounts of A&G expenses to capital construction projects.

[30] *See* 18 C.F.R. Part 101, Electric Plant Instruction No. 4 (2021).

[31] This average was derived from a random sample taken from all administrative and general employees, including those who spent no time, as well as those who spent some time, performing construction related activities.

The FirstEnergy subsidiaries' improper capitalization practices impacted plant balances in Account 107 and electric plant in service, as well as accumulated depreciation, depreciation expenses, and ADIT balances, and understated certain operating expenses. Amounts recorded in these accounts were included in the determination of service rates of FirstEnergy subsidiaries with wholesale transmission formula rates. The accumulated impact of excess A&G capitalized during the audit period and prior years on electric plant in service that was included in rate determinations and resulting excess depreciation expense may have led the companies to overcharge wholesale transmission customers subject to the rates.

Finally, audit staff found that FirstEnergy's subsidiaries did not use Account 922, Administrative Expenses Transferred – Credit, as required, after 2015. The Commission's regulations require administrative expenses recorded in Accounts 920, Administrative and General Salaries, and 921, Office Supplies and Expenses, that are transferred to construction costs or to nonutility accounts be credited to Account 922. The companies' improper accounting impacted the uniformity and comparability of their capitalization activities to those reported by other utilities.

Recommendations

DAA recommends that FirstEnergy:

1. Retain an independent third-party entity, subject to approval by DAA, to conduct a representative labor time study for allocation of overhead costs incurred in 2021 to CWIP, and to assist with the development of procedures FirstEnergy subsidiaries shall use to periodically determine the allocation of overhead labor and labor-related costs capitalized by each FirstEnergy subsidiary into the cost of construction after 2021. The independent consultant should have expertise and experience independently performing time studies used in the determination of overhead capitalization rates of U.S. based utilities subject to the accounting requirements prescribed for public utilities and licensees or for natural gas companies under 18 C.F.R. Part 101 or Part 201, respectively. The time study should involve a representative sample of study participants (employees) that provides for extrapolation of the study results to the full population of FirstEnergy employees, and should include processes for application of the study results from the audit period to the issue date of this audit report, and processes for applying the capitalization rate(s) the study finds for 2021 back to the period January 1, 2015 through December 31, 2020, either with no change to the capitalization rates found in the study or with such modifications to the capitalization rate(s) the independent consultant finds reasonable and supported by evidence. The independent consultant should use its expertise and all relevant information available to it to make recommendations as to what the capitalization rate(s)

should be for prior years for each FirstEnergy subsidiary, should set forth the basis for its recommendations, and provide both the recommendations and the basis therefore to FirstEnergy and DAA. If there is no recommendation by the independent consultant for any year or other period between January 1, 2015 and December 31, 2020 for any specific capitalizable cost center, then FirstEnergy should base its capitalization rate and the amount to be capitalized for such year or period on the rates and costs of such specific cost centers for which FirstEnergy can provide to DAA reasonable evidence as to the time employees in such cost centers spent having a definite relation to construction, and exclude from consideration those cost centers for which FirstEnergy cannot provide such evidence, per, for example, 18 C.F.R. Part 101, General Instruction No. 2 and § 41.8.

The progress of the study should be reported within 120 days and the time study results provided to DAA for review and consideration within 180 days of the date of issuance of this audit report, and the developed allocation procedures should be submitted when complete, but no later than 60 days after completion of DAA's review of the labor time study. At a minimum, the developed allocation procedures should provide a method for overhead cost allocation and capitalization to construction based on actual timecard distributions or where this procedure is impractical, based on periodic time studies.

2. Revise written policies, practices, procedures, and controls governing the methods used to account for, track, report, and review overhead labor and related costs, and all other costs allocated to construction projects to be consistent with Commission accounting requirements. In addition, adopt procedures to retain formal documentation supporting the amount of overhead costs allocated to electric plant accounts.

3. Revise accounting processes and procedures to account for and report capitalized A&G amounts recorded in Accounts 920 and 921 using Account 922 consistent with Commission regulations.

4. Train relevant staff on the revised overhead allocation, control, and A&G accounting procedures and documentation, and provide periodic training in this area, as needed.

5. Train staff on the time reporting guidelines and establish a periodic training program in this area.

6. Within 30 days of the completion of Recommendation No. 1, submit an estimate to DAA, including the calculations and determinative components, of overhead

costs that would have been allocated to CWIP from 2015 through the present consistent with the requirements of Electric Plant Instruction No. 4 and General Instruction No. 9. The estimate should be based on a recalculation of 2015's and subsequent years' overhead costs allocated to construction with labor and related costs removed from the cost of plant that were not associated with construction activities based on the methodology developed in response to Recommendation No. 1.

7. With the response to Recommendation No. 6, submit proposed accounting entries to DAA that remove the overhead costs that were allocated to CWIP and electric plant in service from 2015 through the present that exceed the amount of costs that would have been allocated to the accounts based on the methodology developed in response to Recommendation No. 1. Also, provide proposed accounting entries to remove associated amounts from other accounts and balances affected by the inappropriately allocated cost such as the accumulated depreciation and ADIT accounts, and AFUDC balances capitalized into CWIP and electric plant in service. If the adjusting entries result in a significant impact to income for the current year, FirstEnergy subsidiaries may account for the transaction as a correction of a prior period error in Account 439, Adjustments to Retained Earnings. Such adjustments to retained earnings with the proposed accounting entries should be submitted to DAA.

8. Revise account balances for FirstEnergy subsidiaries' utility plant, accumulated depreciation, ADIT, and other account balances impacted by the inappropriate allocation of unsupported overhead costs after receiving DAA's approval of the proposed accounting entries submitted per Recommendation No. 7, and restate and footnote the balances reported in the next-filed FERC Form No. 1 reports of the FirstEnergy subsidiaries for both the current and comparative years presented in each subsidiary's next-filed report, as necessary to reflect and disclose the revisions.

9. Submit a refund analysis to DAA that explains and details the following: (1) calculation of refunds that result from correcting the overstatement of transmission plant due to the improperly capitalized labor costs, as determined by the labor time study, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

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

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

2. Accounting for Vegetation Management Costs

The FirstEnergy FPUs improperly accounted for maintenance expenses incurred to remove vegetation surrounding in service distribution powerlines. Specifically, the FPUs inappropriately capitalized the cost to electric plant in service. This accounting practice caused the companies to overstate electric plant in service, accumulated depreciation, ADIT, depreciation expenses, and other account balances, and understate operating expenses incurred.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 593, Maintenance of Overhead Lines (Major Only), states in part:

> This account shall include the cost of labor, materials used and expenses incurred in the maintenance of overhead distribution line facilities, the book cost of which is includable in account 364, Poles, Towers and Fixtures, account 365, Overhead Conductors and Devices, and account 369, Services. . . .
>
> ITEMS
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> . . . . .
>
> 2. Work of the following character on overhead conductors and devices:
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> . . . . .
>
> k. Trimming trees and clearing brush.

Background

An audit report was issued on April 24, 2013, for an audit conducted of FirstEnergy subsidiary ATSI under Docket No. FA11-8-000 (the 2013 Audit).[32] During the 2013 Audit, ATSI's policy for accounting for vegetation management expenses for the clearing of transmission and distribution corridors was assessed and found to be inconsistent with Commission accounting requirements. As a result of that audit, ATSI revised its policy so as to cease capitalizing vegetation management costs and to instead

[32] *American Transmission Systems, Inc.,* Docket No. FA11-8-000 (Apr. 24, 2013) (delegated order).

account for the costs as maintenance expenses, consistent with Commission accounting requirements.

Audit staff evaluated ATSI's and the other FirstEnergy subsidiaries' policies for accounting for vegetation management expenses during the current audit and found that the FirstEnergy subsidiaries' policy for accounting for the vegetation management costs associated with the clearing of *transmission* corridors was consistent with Commission accounting requirements, but was not for the clearing of *distribution* corridors. Specifically, audit staff found that the FirstEnergy subsidiaries with distribution assets (i.e., the FPUs) capitalized maintenance costs incurred to remove vegetation surrounding in service distribution powerlines and were corrected and will be refunded to customers.

FirstEnergy acknowledged that, in response to the 2013 Audit of ATSI, the corporate-wide vegetation management accounting policy was changed for transmission corridors, but was not changed for distribution corridors. FirstEnergy reasoned that the results of the 2013 Audit were not applicable to vegetation management in distribution corridors because ATSI did not have distribution assets during the audit. However, although ATSI did not have distribution assets during the 2013 Audit (and had none during the current audit), the vegetation management accounting policy that was evaluated during the 2013 Audit applied to the clearing of transmission and *distribution* corridors. The 2013 Audit's report states that "ATSI provided audit staff with its vegetation management policy for accounting for the clearing of transmission and distribution corridors."[33] Consequently, the results of the audit were applicable to the vegetation management accounting policy for distribution, as well as transmission, corridors. Further, the same factors that make the vegetation management accounting policy applicable to transmission corridors logically also apply to distribution corridors. There is no reasonable basis to distinguish between transmission and distribution corridor vegetation management with respect to this subject.

In the 2013 Audit, it was determined that ATSI's capitalization of vegetation management expenses into in service plant was inappropriate because vegetation management activities performed after the initial clearing associated with construction of an asset do not result in a substantial addition to the corresponding in service transmission lines or system. The Commission has previously clarified that to qualify as a substantial addition, an item added to the cost of an in service asset must make the asset more useful, more efficient, of a greater durability, or of a greater capacity.[34] Vegetation

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[33] *Id*. at 15.

[34] *See*, *e.g*., *National Fuel Gas Supply Corp.*, Docket No. AC98-11-000, at 1 (Jun. 17, 1998) (delegated order) (must be "a substantial betterment" the purpose of which "is

management activities do not directly make distribution or transmission assets or systems more useful, more efficient, of a greater durability, or of a greater capacity. Consequently, vegetation management activities do not result in a substantial addition to in service distribution or transmission plant.

The FirstEnergy FPUs should have properly accounted for vegetation management activities performed in distribution corridors as maintenance expenses. Account 593, Maintenance of Overhead Lines (Major Only), provides for the accounting of costs to remove vegetation surrounding in service distribution powerlines. Since FirstEnergy only revised its vegetation management accounting policy for transmission corridors in response to the 2013 Audit, it continued improperly to account for vegetation management activities performed in distribution corridors, both prior to and during the current audit period. This led the FPUs to inflate distribution plant balances from 2013 through the audit period. This also impacted accumulated depreciation, ADIT, and other associated accounts, and resulted in the understatement of operating expenses prior to and during the audit period.

Consistency of accounting policies used for transmission and distribution plant is essential for accurate development of service rates, in particular where service rates are determined using a formula that includes a portion of certain costs in rate determinations based on a ratio of balances in accounts such as functional plant accounts. As such, FirstEnergy should be consistent in the determination and application of its accounting policy for vegetation management activities in distribution and transmission corridors.

Recommendations

DAA recommends that FirstEnergy:

12. Revise accounting policies and procedures for vegetation management activities in distribution corridors to be consistent with Commission accounting requirements.

13. Train relevant staff on the revised vegetation management accounting policy and procedures and provide periodic training.

14. Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the FirstEnergy FPU's CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by the capitalization of vegetation management expenses for the period from October 1, 2021 through the present within 60 days of issuance of this audit report.

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to make property more useful, more efficient, of a greater durability, or of a greater capacity").

15. Revise the FirstEnergy FPUs' CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC after receiving the DAA's approval of proposed accounting entries per Recommendation No. 14 and restate and footnote the FERC Form No. 1 reports for current and comparative years as necessary.

3. Accounting for Amortization of Regulatory Assets

FirstEnergy's subsidiaries deferred certain maintenance expenses, associated with costs incurred to remove vegetation in transmission corridors, and recorded the deferred expenses as regulatory assets in Account 182.3, Other Regulatory Assets, for Commission accounting and reporting purposes. Certain subsidiaries then improperly amortized \$3.8 million of the deferred costs as expenses in subsequent periods without obtaining Commission approval to recover these regulatory assets in rates. Moreover, two of the Transmission Companies, ATSI and TrAILCo, included these expenses representing amortization of the regulatory assets in their annual transmission revenue requirements calculated pursuant to their wholesale transmission formula rates without the required Commission approval to recover such regulatory assets. Also, certain FirstEnergy subsidiaries recovered overstated depreciation expense through transmission formula rates.

As a result of the above deficiencies, the Transmission Companies inappropriately included approximately \$2.7 million of regulatory asset amortization and depreciation expense in their annual transmission revenue requirements and overbilled their wholesale transmission customers by this amount.

Pertinent Guidance

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

> A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies. (*See* Definition No. 30.)
>
> B. The amounts included in this account are to be established by those charges which would have been included in net income, or accumulated other comprehensive income, determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services. When specific identification of the particular source of a regulatory asset cannot be made, such as in plant phase-ins, rate moderation plans, or rate levelization plans, account 407.4, regulatory credits, shall be credited. The amounts recorded in this account are generally to be charged, concurrently with the recovery of the amounts in rates, to the same account that would

> have been charged if included in income when incurred, except all regulatory assets established through the use of account 407.4 shall be charged to account 407.3, regulatory debits, concurrent with the recovery in rates.
>
> C. If rate recovery of all or part of an amount included in this account is disallowed, the disallowed amount shall be charged to Account 426.5, Other Deductions, or Account 435, Extraordinary Deductions, in the year of the disallowance.

Background

Pursuant to the 2013 Audit of ATSI, FirstEnergy revised its corporate-wide accounting policy for vegetation management expenses at transmission corridors to cease capitalizing the cost. During the compliance phase of the ATSI audit, the company informed the Commission that it would account for the costs of vegetation management activities as maintenance expenses consistent with Commission accounting requirements.[35] During the current audit, audit staff found that ATSI and the other FirstEnergy subsidiaries, as directed by the 2013 Audit report, had ceased the practice of capitalizing in plant accounts the vegetation management-related maintenance expenses incurred in transmission corridors for Commission accounting and reporting purposes, but had begun deferring the costs as regulatory assets. These entities continued to account for and report the cost in plant accounts for other non-Commission related purposes. Certain FirstEnergy subsidiaries sought and received approval from the Commission to recover a portion of the deferred costs through service rates charged, and certain of them did not.[36]

In accordance with the instructions of Account 182.3, Other Regulatory Assets, expenses not includible in other accounts for recovery in current period, that probably

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[35] The compliance phase of an audit commences after issuance of the audit report. During this phase, an audited entity submits information to audit staff that responds to the recommendations of the audit report that the entity will implement. This information includes discussion of activities that an audited entity has initiated as of the submittal or that it plans to initiate in a subsequent period to become compliant with Commission requirements and/or controls to help maintain compliance.

[36] *See Mid-Atlantic Interstate Transmission, LLC*, 158 FERC ¶ 62,185 (2017), *order on settlement*, 163 FERC ¶ 61,131 (2018) (MAIT received approval to include deferred vegetation management costs of $4.18 million in wholesale transmission formula rate determinations); *Jersey Central Power & Light Co.,* 158 FERC ¶ 62,186

will be recovered in subsequent rates resulting from the ratemaking actions of regulatory agencies, may be deferred and accounted for as regulatory assets. To establish a regulatory asset, it must be probable that the Commission will permit the company to recover these costs in future rates. Further, amounts accounted for as regulatory assets are generally required to be amortized concurrent with recovery of the deferred expenses in rates and amounts for which recovery is disallowed must be charged to nonoperating expense accounts. Audit staff found that certain FirstEnergy subsidiaries improperly amortized the regulatory assets to Account 407.3, Regulatory Debits, without concurrent recovery in rates, and others amortized the cost to Account 403, Depreciation Expenses, and included the costs in rates without regulatory approval.[37] However, when expenses deferred as regulatory assets are appropriately amortized consistent with the instructions of Account 182.3, the cost must be amortized pursuant to, and concurrent with, authorized recovery in rates, and recorded in the same account that would have been charged if the costs were included in deriving the operating income when incurred.

Account 571, Maintenance of Overhead Lines, provides for the recording of the costs of vegetation management-related maintenance activities performed at transmission corridors when incurred. As such, the costs should be amortized to Account 571 after the companies receive regulatory approval for recovery. However, since the companies did not have approval for recovery, amortization of the costs was inappropriate, and the companies' use of Accounts 403 and 407.3 to account for the amortization of the regulatory assets was incorrect. In addition, certain of the subsidiaries that continued to account for and report the vegetation maintenance cost in plant accounts for non-Commission related purposes erroneously recorded depreciation of the cost to Account 403. Balances recorded in Account 403 were used to populate the Transmission Companies' wholesale transmission formula rates. Consequently, plant and regulatory

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(2017), *order on settlement,* 162 FERC ¶ 61,140 (2018) (JCP&L was denied recovery of deferred vegetation management costs in wholesale transmission formula rate determinations); *American Transmission Systems, Inc*., 171 FERC ¶ 61,273 (2020) (ATSI sought Commission approval to, among other things, recover regulatory assets related to deferred vegetation management costs. The Commission accepted the filing and set the matter for hearing and settlement judge procedures. The case is currently going through settlement procedures); *see Monongahela Power Co*., 173 FERC ¶ 61,290 (2020), *reh'g denied by operation of law*, 174 FERC ¶ 62,136 (2021) (The Potomac Edison Company and West Penn Power Company sought Commission approval to, among other things, recover regulatory assets related to deferred vegetation management costs. The Commission accepted the filing and set the matter for hearing and settlement judge procedures. The case is currently going through settlement procedures).

[37] The Potomac Edison Company and West Penn Power Company amortized the regulatory assets to Account 407.3, and the Transmission Companies amortized the regulatory assets to Account 403.

asset amounts improperly depreciated and amortized, respectively, to Account 403 were included in the Transmission Companies' wholesale transmission rates, which led to their customers being charged for unapproved amounts of approximately $2.7 million. If rate recovery is disallowed, regulatory assets should be charged to Account 426.5, Other Deductions, or Account 435, Extraordinary Deductions, in the year of the disallowance instead of annual amortization to other accounts.

Recommendations

DAA recommends that FirstEnergy:

16. Revise policies, practices, and procedures to amortize or write off the regulatory assets consistent with Commission accounting requirements.

17. Train relevant staff on the revised methods, and provide periodic training in this area, as needed.

18. Submit a refund analysis, within 60 days of issuance of this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that result from the correction of ATSI's and TrAILCo's improper and unauthorized, respective, depreciation and amortization of plant and regulatory assets to the depreciation expense account and inclusion of the expenses in service rate determinations, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

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

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

4. Accounting for Lobbying Expenses, Donations, and Costs that Lacked Proper Supporting Documentation

FESC improperly accounted for and improperly reported lobbying expenses, donations, and other costs that lacked proper supporting documentation or were misclassified (unsupported costs). Moreover, FESC allocated and charged the improperly accounted for lobbying, donation, and unsupported costs to FirstEnergy and its subsidiaries. This led the FirstEnergy subsidiaries to improperly account for and report the lobbying expenses, donations, and unsupported costs in their respective books and records, and FERC Form No. 1. The errors resulted in the Transmission Companies including the lobbying expenses, donations, and unsupported costs in their annual wholesale transmission revenue requirements and billing rates, and overbilling wholesale transmission customers.

Pertinent Guidance

- 18 C.F.R. § 367.3, Records, states in part:

> (a) Each service company must keep its books of account, and all other books, records, and memoranda that support the entries in the books of account, so as to be able to furnish full information on any item included in any account. Each entry must be supported by sufficient detailed information that will permit ready identification, analysis, and verification of all facts relevant and related to the records.
>
> (b) The books and records referred to in this part include not only accounting records in a limited technical sense, but all other records, such as minutes books, stock books, reports, correspondence, and memoranda, that may be useful in developing the history of or facts regarding any transaction.

- 18 C.F.R. § 367.14, Transactions with associate companies, states:

> Each service company must keep its accounts and records so as to be able to furnish accurately and expeditiously statements of all transactions with associate companies. The statements may be required to show the general nature of the transactions, the amounts involved in the transactions and the amounts included in each account prescribed in this part with respect to such transactions. Transactions with associate companies must be recorded in the appropriate accounts for transactions of the same

> nature. Nothing contained in this part, however, must be construed as restraining the service company from subdividing accounts for the purpose of recording separately transactions with associate companies.

- 18 C.F.R. § 367.4261, Account 426.1, Donations, states:

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

- 18 C.F.R. § 367.4264, Account 426.4, Expenditures for Certain Civic, Political and Related Activities, states in part:

> (a) This account must 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.

- 18 C.F.R. Part 101, General Instructions, E states:

> All amounts included in the accounts prescribed herein for electric plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5, Other Deductions.

Background

In the fall of 2020, FirstEnergy acknowledged the existence of the DOJ initiated investigation into its activities.[38] The investigation assessed FirstEnergy's activities involving payment of over $61 million from FirstEnergy to 501(c)(4) entities and others, that allegedly were made to influence public opinion, state legislation, and a state ballot initiative using means employed by a 501(c)(4) entity and other individuals that the

[38] *See* FirstEnergy statement accessed Oct. 30, 2020, https://www.prnewswire.com/news-releases/firstenergy-corp-statement-on-hb-6-investigation-301097421.html.

federal government has alleged to be unlawful.[39] Audit staff interviews of FESC employees, reviews of internal emails and messages, and Attachment A – Statement of Facts included in DPA and agreed to by FirstEnergy indicate the existence of significant shortcomings in FirstEnergy and its subsidiaries' internal controls over financial reporting, including controls over accounting for expenses relating to civic, political, and related activities, such as lobbying activities performed by and on behalf of FirstEnergy and its subsidiaries. Even more concerning, several factual assertions agreed to by FirstEnergy in DPA and the remedies FirstEnergy agreed to undertake, point towards internal controls having been possibly obfuscated or circumvented to conceal or mislead as to the actual amounts, nature, and purpose of the lobbying expenditures made, and as a result, the improper inclusion of lobbying and other nonutility costs in wholesale transmission billing rates.

FESC performed lobbying activities during the audit period that it represented were intended to influence public opinion and federal and state legislatures. One of its lobbying initiatives involved garnering legislative support for FirstEnergy's former subsidiaries, FES and FENOC, which owned fossil fuel and nuclear power generation assets that operated in competitive markets. Audit staff evaluated costs incurred associated with this initiative and with others undertaken by FESC – i.e., costs which were associated with civic, political, and related activities incurred during the audit period. Audit staff reviewed and analyzed accounting detail records, invoices, engagement letters, press articles, advertisement contracts, and advertisements on social media platforms, and interviewed internal lobbyists, in order to understand the nature and extent of the lobbying activities.[40]

External Lobbyist Expenses

During its review, Audit staff discovered, based on responses provided to data requests, that FESC improperly recorded approximately $10.9 million of lobbying costs in utility operating expense accounts, rather than in Account 426.4, Expenditures for Certain Civic, Political and Related Activities, as required by the Commission's accounting regulations. Account 426.4 provides for the reporting of expenditures made

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[39] *See* Affidavit in Support of Criminal Complaint, *United States v. Larry Householder, et al.,* Case No. 1:20-MJ-00526 (July 17, 2020) (Affidavit in Support of Criminal Complaint).

[40] Audit staff conducted this audit to test compliance with the Commission's accounting requirements in the areas within the audit's objectives and scope. This audit report does not incorporate, and has no bearing on, the DOJ investigation and criminal complaint proceeding, or other ongoing federal and state agency-directed investigations of FirstEnergy's or its affiliated companies' activities.

for the purpose of influencing public opinion, such as lobbying expenses. FESC incorrectly accounted for amounts paid to outside firms that lobbied on behalf of FirstEnergy and its subsidiaries in Account 923, Outside Services Employed, and Account 568, Maintenance Supervision and Engineering (Major Only), as follows:

Lobbying Expenses	2015	2016	2017	2018	Jan to June 2019	Total
Account No. 923	1,880,798	1,865,456	2,875,150	2,914,619	881,004	10,417,027
Account No. 568	-	181,477	304,000	-	-	485,477
Total Operating Accounts	1,880,798	2,046,933	3,179,150	2,914,619	881,004	10,902,504

Audit staff determined that, out of the approximately $10.9 million of lobbying expenses initially disclosed, about $760,000 was charged to the FPUs and the Transmission Companies. The FPUs and the Transmission Companies properly reclassified and accounted for $341,000 of these lobbying costs in Account 426.4, but the balance – approximately $419,000 – remained in the utility operating expense accounts. FirstEnergy represented that the improper accounting for these external lobbying expenses resulted in approximately $58,000 of overbillings to the Transmission Companies' wholesale transmission formula rate customers.

Following audit staff's initial review of FirstEnergy's responses described above, in July 2020 the DOJ filed the criminal complaint described in greater detail in Section II, which alleged that funds received from FirstEnergy had been used for lobbying purposes. FirstEnergy informed audit staff on November 12, 2020 that its own internal investigation determined that data request responses previously provided to audit staff regarding lobbying expenses were incomplete, and FirstEnergy provided several supplemental data response updates. These supplemental data responses and audit staff's analysis of them and of other publicly available information revealed that there were additional amounts of improperly reported lobbying expenses, donations, and other costs incurred by FirstEnergy and its current and former subsidiaries. In accordance with 18 C.F.R. Sections 367.3 and 367.14, each service company must maintain books of account, and all other books, records, and memoranda that support the entries in the books of account and keep its accounts and records so as to be able to furnish accurately and expeditiously statements of all transactions with associate companies. The statements may be required to show the general nature of the transactions, the amounts involved in the transactions and the amounts included in each account prescribed in this part with respect to such transactions. FirstEnergy represented to audit staff that several payments identified in its supplemental data responses lacked sufficient supporting documentation, the background of which is provided in greater detail in Section II:

Payments to Section 501(c)(4) Entities and to Hardworking Ohioans, *Inc.*: FirstEnergy made payments of approximately $70.9 million to various 501(c)(4) entities and to Hardworking Ohioans, Inc. for lobbying or other nonoperating purposes, or that were not sufficiently supported. Of this total, $44.4 million was recorded in the accounts of FirstEnergy's former generation subsidiaries and $25 million was recorded in the accounts of FirstEnergy Corporation, which were not reviewed by the audit staff. Out of the $1.5 million that FirstEnergy identified as being charged to the FPUs and the Transmission Companies, $ 0.65 million was improperly recorded as General and Administrative costs, while around $0.85 million was improperly recorded as the cost of electric plant in service. FirstEnergy's improper capitalization of General and Administrative costs is discussed in Finding No. 1, Allocation of Overhead Costs to CWIP.

Payments to Sustainability Funding Alliance of Ohio, *Inc. and IEU-Ohio Administration, LLC*: From 2010 to early 2019, FirstEnergy made payments to Sustainability Funding Alliance of Ohio, Inc., and IEU-Ohio Administration Company, LLC, two small entities associated with a former Chairman of the PUCO, totaling $22.8 million.[41] FESC allocated around $11.9 million of the total payments to FirstEnergy's FPUs and Transmission Companies as General and Administrative costs, of which $6.7 million was recorded as electric plant in service and the balance of around $5.2 million as General and Administrative costs, which were used in customer rate development for certain of those regulated entities. An additional amount of $9 million, which was paid in part to Sustainability Funding Alliance of Ohio, Inc. under a different vendor number, and in part to IEU-Ohio Administration Company, LLC, was allocated to the FirstEnergy FPUs located in Ohio. FirstEnergy acknowledged that it did not have sufficient supporting documentation and detailed information, as required by 18 C.F.R Section 367.3, to support the total of around $22.8 million in payments made to Sustainability Funding Alliance of Ohio, Inc. and IEU-Ohio Administration Company, LLC, and the allocation of approximately $20.9 million of these amounts to the FPUs and Transmission Companies, and around $1.9 million to its former generation subsidiaries. FirstEnergy has estimated that around $185,000 in customer refunds are due, stemming

[41] As provided in the DPA between FirstEnergy and the United States Attorney's Office for the Southern District of Ohio, the former PUCO Chairman was identified as Public Official B in the DOJ's criminal complaint, wherein he was alleged by the DOJ to have operated in an official capacity as the PUCO Chairman to assist the passage of legislation and regulatory orders that benefited FirstEnergy in return for these monetary payments. *See United States v. FirstEnergy Corp.*, Case No. 1:21-CR-00086-TSB (S.D. Ohio), Deferred Prosecution Agreement (filed Jul. 22, 2021).

from the $20.9 million allocated to the FPUs and Transmission Companies. FirstEnergy identified certain of these transactions were either improperly classified, misallocated to certain of the FPUs and Transmission Companies, or lacked proper supporting documentation and resulted in amounts collected from customers. FirstEnergy represented that it would make the refunds and has already made the necessary accounting entries to correct this issue and prevent the expenses from impacting future rates.

Payments to Sixteen Entities Associated With One Person: In coordination with its filing of SEC Form 10-K for the year ended December 31, 2020, FirstEnergy revealed to audit staff in February 2021 that FirstEnergy was investigating payments totaling approximately $28.8 million made between 2003 and 2020 to sixteen entities associated with one individual. FESC allocated around $19.7 million of these payments to FirstEnergy's FPUs, $1.1 million to the Transmission Companies, $2.2 million to former generation subsidiaries, and $5.8 million to FirstEnergy and other nonregulated subsidiaries. FirstEnergy identified certain of these transactions were either improperly classified, misallocated to certain of the FPUs and Transmission Companies, or lacked proper supporting documentation and resulted in amounts collected from customers. FirstEnergy has estimated that around $9.6 million in customer refunds are due, stemming from the $20.8 million allocated to the FPUs and Transmission Companies. FirstEnergy represented that it would make the refunds and has already made the necessary accounting entries to correct this issue and prevent the expenses from impacting future rates.

As described above and in Section II, audit staff has confirmed with FirstEnergy the existence of several ongoing investigations by external entities into FirstEnergy's affairs. These include investigations by the SEC, the U.S. Internal Revenue Service, the PUCO, and the Ohio Attorney General. In addition, FirstEnergy continues to conduct internal investigations and examinations of various matters. FirstEnergy has committed that, in the event that final, conclusive results of one or more of the investigations calls into question the propriety of its past accounting and/or rate determination decisions and customer charges, it will provide notice to the Commission and initiate actions to attain compliance with Commission accounting requirements and make refunds to customers, as appropriate.

Internal Lobbyists' Expenses

Audit staff interviewed FESC employees who were classified as registered lobbyists in its Governmental Affairs Department that engaged in lobbying activities on behalf of FirstEnergy and its subsidiaries. Based on interviews pertaining to activities performed by the employees and reviews of their time cards and associated accounting for their labor, audit staff determined that FESC did not record the portion of the costs of labor in its Governmental Affairs Department that was associated with the performance of lobbying activities in Account 426.4, as required by the Commission's accounting regulations. As a result, FESC charged the improperly accounted for costs to FirstEnergy and its subsidiaries. The costs were included in the Transmission Companies' annual wholesale transmission revenue requirements and charged to their customers.

Further, audit staff found that FESC lacked formal procedures and oversight controls to help ensure that lobbying costs were accounted for appropriately. FESC should have had adequate controls in place to prevent such accounting errors. Also, audit staff is concerned about FESC's lack of adherence to its prevailing internal controls and procedures.

Recommendations

DAA recommends that FirstEnergy:

21. Critically review and strengthen internal controls in FirstEnergy and its subsidiaries. Establish and implement procedures governing methods to be used to appropriately identify, account for, track, report, and review all lobbying costs, donations, and any unsupported expenses, including, but not limited to, expenses of external lobbyists, monies paid to external corporate entities to be used for lobbying, and other external lobbying costs and internal lobbying costs, including employee lobbying time and other internal lobbying costs.

22. Train relevant staff on the internal control enhancements and procedures established, including internal controls over vendor creation in the accounts payable system, payments, accounting, and reporting violations; and provide periodic training in this area, as needed.

23. Perform an analysis of costs that FirstEnergy and its subsidiaries incurred associated with internal and external lobbying activities, including payments of FirstEnergy funds to outside entities for purposes of those entities using those funds for lobbying, and provide support to identify lobbying-related expenses improperly charged to utility operating accounts, for the audit period and, with respect to the specific issues discussed in this finding, for the entire period affected by or relevant to each such specific issue. Within 60 days of the issuance of this audit report and on a rolling basis within 60 days of conclusion of each internal or external investigation discussed in the finding or any new internal or external investigation, provide the results of the investigation arising directly from HB 6 or lobbying activities occurring prior to 2021, proposed correcting journal entries,

and FirstEnergy's analysis of the findings from each investigation and the related impact on prior and future accounting and rate development to audit staff.

24. Submit a refund analysis, within 60 days of issuance of this audit report and on a rolling basis within 60 days of conclusion of each investigation discussed in the finding or any new investigation arising directly from HB 6 or lobbying activities occurring prior to 2021, for DAA's review, that explains and details the following: (1) calculation of refunds resulting from correcting the improper accounting for external lobbying costs, donations, and unsupported costs in utility operating and plant accounts; and lobbying costs as identified pursuant to the analysis performed in response to Recommendation No. 23, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

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

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

5. Allowance for Funds Used During Construction

FirstEnergy's FPUs improperly included undistributed subsidiary earnings and accumulated other comprehensive income in equity balances used for the purpose of computing AFUDC rates. As a result, the companies over-accrued AFUDC during the audit period, which led them to overstate CWIP and plant-in-service balances.

Pertinent Guidance

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

> (a) The formula and elements for the computation of the allowance for funds used during construction shall be:
>
> $A_i = s(S/W) + d(D/D + P + C)(1 - S/W)$
> $A_e = [1 - S/W][p(P/D + P + C) + c(C/D + P + C)]$
>
> A_i = Gross allowance for borrowed funds used during construction rate.
> A_e = Allowance for other funds used during construction rate.
> S = Average short-term debt.
> S = Short-term debt interest rate.
> D = Long-term debt.
> D = Long-term debt interest rate.
> P = Preferred stock.
> P = Preferred stock cost rate.
> C = Common equity.
> C = Common equity cost rate.
> W = Average balance in construction work in progress plus nuclear fuel in process of refinement, conversion, enrichment and fabrication, less asset retirement costs (See General Instruction 25) related to plant under construction.
>
> (b) The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in § 35.13 of the Commission's Regulations [u]nder the Federal Power Act. The cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction[]. If such cost rate is not available, the average rate actually earned during the preceding three years shall be used. The short-term debt balances and related cost and the average balance for construction work in progress plus nuclear fuel in process of refinement, conversion,

> enrichment, and fabrication shall be estimated for the current year with appropriate adjustments as actual data becomes available.[42]

- Order No. 469, states in relevant part:

> [I]t will continue to be the Commission's policy that the undistributed earnings of subsidiaries are to be excluded from the common stockholder's equity in determining rate of return.[43]

- Order No. 627, the order establishing Account 219, Accumulated Other Comprehensive Income, states in relevant part:

> 70. One commenter recommended that the Commission state it will not incorporate derivative instruments, hedging activities, and other comprehensive income into its ratemaking process for utilities, because the value of these instruments are certain to change over time and the Commission would set rates incorrectly.
>
> 71. As stated in the NOPR, the proposed rule was not intended to prescribe the ratemaking treatment for items of other comprehensive income or for derivative instruments and hedging activities. The adoption of any particular rate treatment for these amounts is beyond the scope of this rulemaking. *The Commission will decide the appropriate treatment for these*

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[42] 18 C.F.R. Part 101, Electric Plant Instruction No. 3(17) (2021); see Amendments to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies (Classes A, B, C and D) To Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports, Order No. 561, 57 FPC 608 (Order No. 561), reh'g denied, Order No. 561-A, 59 FPC 1340 (1977) (Order No. 561-A), order on clarification, 2 FERC ¶ 61,050 (1978).

[43] Revisions in Uniform System of Accounts, and Annual Report Forms No. 1 and No. 2 to Adopt the Equity Method of Accounting for Long-Term Investments in Subsidiaries, Order No. 469, 49 FPC 326, at 327 (1973).

> *transactions on a case-by-case basis in individual rate proceedings.*[44]

Background

AFUDC represents the financing cost of construction and consists of two components: Allowance for Borrowed Funds (debt) and Allowance for Other Funds (equity). Electric Plant Instruction (EPI) No. 3(A)(17) provides a uniform formula for calculating a utility's maximum permitted AFUDC rates. Audit staff reviewed the FirstEnergy subsidiaries' processes and policies for computing their respective AFUDC rates and the application of such rates to the cost of their construction projects. Through its review, audit staff identified deficiencies in the FirstEnergy FPUs' method for calculating their respective AFUDC rates.

The FPUs improperly included balances recorded in Account 216.1, Undistributed Subsidiary Earnings, and Account 219, Accumulated Other Comprehensive Income, in deriving the equity component of the AFUDC rate calculation. The amounts in Account 216.1 represent retained earnings undistributed by the subsidiaries, and the amounts in the FPUs' Account 219 represent gains and losses which require appropriate rate treatment decision by the Commission on a case-by-case basis. Therefore, amounts in Accounts 216.1 and 219 were not available to the FPUs to be spent for any purposes, including to finance construction, and those amounts should not have been considered as funds available to the FPUs for construction in deriving the AFUDC rates.

As a result of improperly including amounts recorded in Accounts 216.1 and 219 in AFUDC rate calculations, the FPUs over-accrued AFUDC during the audit period. These amounts were capitalized as a component cost of construction and subsequently included in Account 106, Completed Construction not Classified-Electric, or Account 101, Electric Plant in Service.

Recommendations

DAA recommends that FirstEnergy:

27. Revise and implement the FPUs' processes and procedures to calculate their respective AFUDC rates consistent with EPI No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to prevent the inclusion of balances in Accounts 216.1 and 219 in the AFUDC rate calculations.

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[44] Accounting and Reporting of Financial Instruments, Comprehensive Income, Derivatives and Hedging Activities, Order No. 627, 101 FERC ¶ 61,032, at PP 70-71 (2002) (emphasis added) (footnotes omitted).

28. Train relevant staff on the revised AFUDC calculation method, and provide periodic training, as needed.

6. Service Company Billing Procedures

Billing information that FESC provided to FirstEnergy's subsidiaries pertaining to charges for services provided to them was insufficient. Specifically, FESC did not provide detailed information to reflect the services provided and showing the charges classified as direct costs, indirect costs, or compensation for use of capital, with the details of service company accounts by service provided, as required. As a result, the FirstEnergy subsidiaries misclassified costs charged by FESC.

Pertinent Guidance

- 18 C.F.R. § 367.27, General Instruction No. 27, Billing Procedures, states:

> Charges for services to associate public-utility companies must be made monthly with sufficient information and in sufficient detail to permit such company, where applicable, to identify and classify the charge in terms of the system of accounts prescribed by the regulatory authorities to which it is subject. The information provided to associate public-utility companies must provide a summary of the accounts by service provided and showing the charges, classified as direct cost, indirect cost, and compensation for use of capital.

- 18 C.F.R. § 367.14, General Instruction No. 14, Transactions with Associated Companies, states:

> Each service company must keep its accounts and records so as to be able to furnish accurately and expeditiously statements of all transactions with associate companies. The statements may be required to show the general nature of the transactions, the amounts involved in the transactions and the amounts included in each account prescribed in this part with respect to such transactions. Transactions with associate companies must be recorded in the appropriate accounts for transactions of the same nature. Nothing contained in this part, however, must be construed as restraining the service company from subdividing accounts for the purpose of recording separately transactions with associate companies.

- 18 C.F.R. § 367.9260, Account 926, Employee Pensions and Benefits, state in part:

(a) This account must 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 service company 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 related to this account. 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.

Background

FESC's method during the audit period to allocate and account for its costs of providing services to FirstEnergy and its subsidiaries consisted of multiple processes and procedures that were performed within its accounting systems. Audit staff observed the operation of the systems and evaluated information on costs output from the systems. Audit staff discovered that billing information FESC provided to FirstEnergy's subsidiaries pertaining to charges for services provided was insufficient. Specifically, FESC did not provide the detailed information required by the Commission's regulations to reflect the services it provided and showing service company accounts for the charges billed and classified as direct costs, indirect costs, or compensation for use of capital.

Audit staff found that, rather than provide detailed billing information as required, FESC provided certain aggregated cost information that made it difficult to discern the basis of costs charged. For example, FESC billing information pertaining to payroll taxes and employee benefit costs were combined with payroll costs in the accounting systems and billed to FirstEnergy's subsidiaries as an aggregated amount that was recorded in Account 923, Outside Services Employed. However, services provided by FESC on behalf of the FirstEnergy subsidiaries must be accounted for in the appropriate accounts for transactions of the same nature in accordance with the requirements of General Instruction No. 14, Transactions with Associated Companies. Account 926, Employee Pensions and Benefits, provides for the recording of expenses associated with employee benefits, and payroll taxes must be accounted for in the appropriate utility or nonutility account on a functional basis related to the labor provided. FESC's accounting and billing procedures resulted in the FirstEnergy subsidiaries not having the detailed information required to appropriately account for costs charged by FESC. As a result, the FirstEnergy subsidiaries misclassified some costs charged by FESC.

Recommendations

DAA recommends that FirstEnergy:

29. Revise FESC policies, procedures, and accounting systems so as to provide sufficient billing information to FirstEnergy's subsidiaries in accordance with the Commission's regulations.

30. Train relevant staff on the revised policies, procedures, and accounting systems and provide periodic training in this area, as needed.

7. Accounting for Fuel – Coal Supply and Other Consulting Services

The FirstEnergy FPU, Monongahela Power Company, improperly accounted for fixed monthly consultation fees paid in Account 501, Fuel, as a component cost of coal used in operations. The accounting led to costs being included in fuel used in operations that were not directly assignable and likewise not properly allocable to the cost of coal purchased and used. As a result, Monongahela Power Company may have overcharged wholesale customers, through operation of the fuel cost adjustment formula in its tariff, for the cost of fuel included as a component cost of generating electricity.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 501, Fuel, states in part:

> A. This account shall include the cost of fuel used in the production of steam for the generation of electricity, including expenses in unloading fuel from the shipping media and handling thereof up to the point where the fuel enters the first boiler plant bunker, hopper, bucket, tank or holder of the boiler-house structure. Records shall be maintained to show the quantity, B.t.u. content and cost of each type of fuel used.
>
> B. The cost of fuel shall be charged initially to account 151, Fuel Stock (for Nonmajor utilities, appropriate fuel accounts carried under account 154, Plant Materials and Operating Supplies) and cleared to this account on the basis of the fuel used. Fuel handling expenses may be charged to this account as incurred or charged initially to account 152, Fuel Stock Expenses Undistributed (for Nonmajor utilities, an appropriate subaccount of account 154, Plant Materials and Operating Supplies). In the latter event, they shall be cleared to this account on the basis of the fuel used. Respective amounts of fuel stock and fuel stock expenses shall be readily available.

- 18 C.F.R. Part 101, Account 151, Fuel Stock, states:

> This account shall include the book cost of fuel on hand.
>
> Items
>
> 1. Invoice price of fuel less any cash or other discounts.

2. Freight, switching, demurrage and other transportation charges, not including, however, any charges for unloading from the shipping medium.

3. Excise taxes, purchasing agents' commissions, insurance and other expenses directly assignable to cost of fuel.

4. Operating, maintenance and depreciation expenses and ad valorem taxes on utility-owned transportation equipment used to transport fuel from the point of acquisition to the unloading point.

5. Lease or rental costs of transportation equipment used to transport fuel from the point of acquisition to the unloading point.

- Monongahela Power Company, FERC Electric Tariff, First Revised Volume No. 1, Part 6, Rate Schedule- Wholesale for Resale Power Service, states in part:

Fuel Adjustment

A fuel cost adjustment shall apply to all kilowatthours billed under this rate schedule. The adjustment shall be determined by the following formula to the nearest 0.001 cent per kilowatthour:

$$A = \left\{ \frac{Fm}{Sm} - \frac{Fb}{Sb} \right\} \times L \times \frac{1}{1-T}$$

A = Fuel Cost Adjustment in cents per Kilowatthour

Fm = Fuel Cost in the current period relating to:

(a) Fossil and nuclear fuel consumed in generation in wholly-owned and jointly-owned stations and identifiable fossil and nuclear fuel costs in energy purchased plus the net energy cost of energy purchased on an economic dispatch basis less;

(b) Fossil and nuclear fuel costs recovered through intersystem sales.

All fuel costs will be those charged to Account 501, cleared through Account 151, and Account 518 in the month preceding the billing Month.

Sm = All kilowatthour sales to regular Customers in the current period.

Fb and Sb = Fuel and kilowatthour sales in the base period as defined above. The factor $\frac{Fb}{Sb}$ = 1.70 cent per kilowatt-hour

L = Adjustment factor to recognize losses to service voltage where different than average losses in the delivery system. This factor is 0.97.

T = The gross receipts tax rate in effect during the billing Month, expressed as a decimal.

The amount of fuel adjustment shall not be subject to any discounts.

Background

During the audit period, FirstEnergy's FPU, Monongahela Power Company, generated electric power using its coal-fired Fort Martin and Harrison power stations that are located in West Virginia. The two power stations had a combined capacity of 3,082 MW and used around 7.8 million tons of coal annually. As relevant here, Monongahela Power Company made wholesale sales of electricity in the PJM market under a tariff established on September 17, 2010.[45] Service rates of wholesale customers that purchased electricity from Monongahela Power Company pursuant to the tariff included the cost of fuel used to generate the electricity. The cost of fuel was determined based on a formula in an adjustment clause of the tariff that provided for fuel costs charged to Account 501 that were cleared through Account 151, Fuel Stock, in the month preceding the billing month.

Consulting Agreement Statement of Work

On June 1, 2018, Monongahela Power Company entered into an agreement with BCG Resources, LLC (BCG), titled Statement of Work for Purchase of Professional and

[45] Monongahela Power Company, FERC Electric Tariff, First Revised Volume No. 1.

Consulting Services (Statement of Work), that provided for monthly payments to BCG of $625,000, amounting to $7.5 million in payments for the initial term of the then-one year agreement, which included provisions for automatic yearly renewals. The agreement was renewed in subsequent years. Monongahela Power Company paid a total of $18.75 million in consulting service fees under the Statement of Work, which was composed of thirty monthly payments of $625,000 made from June 2018 until the agreement with BCG was terminated in November 2020.

The Statement of Work required BCG to provide management and advisory services at the direction of Monongahela Power Company including fuel sourcing and supply, coal blending, inventory strategy and management, renewables, regulatory services related to fuel and ash requirements and economic development, and additional services not defined in the Statement of Work subject to agreement of both parties.

Accounting for management and advisory services

Audit staff observed that the monthly payments made to BCG were directly charged by Monongahela Power Company to Account 501 without first being accounted for as inventoried fuel stock in Account 151, as required.[46] Account 501 provides for the recording of the cost of fuel actually used in operations to generate electricity. The cost of fuel used in operations for a given month should consider the inventoried cost of the fuel used as consistent with the company's inventory valuation method, e.g., first-in first-out, last-in first-out, or weighted average cost. The cost of inventoried fuel stock recordable in Account 151 that is subsequently used in operations and recorded in Account 501 is determined, in part, based on the invoice price of fuel purchased less any discounts, plus other expenses directly assignable to the cost of fuel. Certain consultant fees paid to acquire fuel related advisory services may be includible as a component cost of inventoried fuel stock.[47]

Monongahela Power Company attributed 100 percent of the monthly BCG consultant fees paid to fuel used in operations recorded in Account 501 without first determining: (1) the portion of the fees allocable to fuel stock inventory, (2) the related amount of fuel in inventory actually used in operations during the period recorded in Account 151, and (3) the inventoried cost of the fuel used including the portion of consultant fees appropriately included therein. However, only a portion of the monthly consulting fee payments, directly assignable to the purchase cost of coal, should have been recorded in Account 151 and then transferred to Account 501 when the coal was

[46] See, 18 C.F.R. Part 101, Account 501, Paragraph B.

[47] Other services provided by consultants such lobbying services are generally prohibited from inclusion as a component cost of fuel.

actually burned as used in operations. As a result, Monongahela Power Company may have overcharged wholesale customers, including other FirstEnergy FPUs, due to its accounting practices and the associated operation of the fuel cost adjustment formula in its tariff, for the cost of fuel included as a component cost of generating electricity.

Recommendations

DAA recommends that FirstEnergy:

31. Revise accounting policies and procedures for cost of fuel by the FPUs to ensure compliance with the Commission's accounting regulations.

32. Train relevant staff on the revised policies and procedures and provide periodic training.

33. Perform an analysis of all monthly payments made to consultants, including BCG, that were included in the cost of fuel used in operations during the audit period and submit the analysis to DAA with supporting documents within 60 days of issuance of this audit report. Based on the analysis, submit proposed adjusting accounting entries to record the consultation costs in the appropriate accounts for DAA's review and approval.

34. Revise the FirstEnergy FPUs' fuel inventory and other account balances impacted by the improper accounting after receiving DAA's approval of the proposed accounting entries per Recommendation No. 33 and restate and footnote the FERC Form No. 1 reports for current and comparative years as necessary.

35. Review collections received, including but not limited to uplift payments, during the audit period based, in part, on the cost of fuel and submit an analysis to DAA for review of retail and wholesale overcollections due to improper recording of costs in Account 501.

36. Submit a refund analysis if there were overcollections from wholesale customers, within 60 days of issuance of this audit report, for DAA's review, that explains and details the following: (1) calculation of refunds resulting from the improper accounting for fuel costs, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale customers to receive refunds; and (5) period(s) refunds will be made.

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

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

V. FirstEnergy's Response

FirstEnergy

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January 24, 2022

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Washington, DC 20426

Re: FirstEnergy Corp. Docket No. FA19-1-000

Dear Mr. Williams:

FirstEnergy Corp. and its subsidiaries ("FirstEnergy" or "the Company"), pursuant to Section 41.1(b) of the Commission's regulations in 18 C.F.R. Part 41, provides the following response to the Draft Audit Report of the Division of Audits and Accounting ("DAA") within the Federal Energy Regulatory Commission ("Commission" or "FERC")'s Office of Enforcement. Our response addresses the January 7, 2022 Draft Audit Report.

As discussed in Attachment A, FirstEnergy largely accepts the Findings and Recommendations in the Draft Audit Report. In many instances, DAA Staff's Recommendations have been implemented or are already underway. For the Recommendations that have not yet been implemented, we look forward to working cooperatively with DAA Staff during the compliance phase of the audit.

FirstEnergy is committed to fostering a strong culture of compliance, including ensuring compliance with the Commission's accounting regulations. We appreciate that the changes that have been implemented and will be implemented as part of this audit will help us achieve that goal. Our whole team would like to thank DAA Staff for their professionalism and courtesy throughout the audit.

Respectfully submitted,

/s/ Jason Lisowski

Jason Lisowski
FirstEnergy Corp., Vice President,
Controller & Chief Accounting Officer

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January 24, 2022

Responses to Specific Findings and Recommendations

Finding 1: Allocation of Overhead Costs to CWIP

FirstEnergy respectfully submits that its approach to capitalizing and allocating overhead costs to CWIP is consistent with the Commission's regulations. Specifically, as the costs in question generally were for services and expenses of employees of FirstEnergy Service Company, FirstEnergy used an "appropriate allocation method" as provided in Section 367.11 of Part 367 (Uniform System of Accounts for Centralized Service Companies). An "appropriate allocation method" under this Section does not require the use of the timecard reports or time study described in Part 101, which DAA Staff incorrectly relies on exclusively and without regard to Part 367.

FirstEnergy respectfully submits that DAA Staff's position would read Section 367.11 out of the regulations, which would be contrary to the regulation, established cannons of statutory/regulatory interpretation, and principles of prior notice and due process with regard to the proper application and interpretation of the regulation. Prior notice and due process are of particular importance here because, in 2010, DAA Staff audited FirstEnergy, FirstEnergy Service Company, and associated companies and, in the course of that audit, DAA Staff audited the cost allocations and billing by FirstEnergy Service Company, including capitalization of A&G overheads costs to construction, as well as evaluated the accounting of those costs on the utilities' books under the Uniform System of Accounts requirements under 18 C.F.R. Part 101. See December 6, 2010, Final Audit Report, Docket No. FA10-2-000. Unlike the current audit, where DAA Staff does not address Part 367, the 2010 audit expressly considered both Part 367 and Part 101, and did not result in any findings that FirstEnergy's allocation method was inconsistent with Commission regulations or any recommendations that FirstEnergy alter its approach. As such, FirstEnergy relied reasonably on the outcome of this audit to continue its practice of applying an "appropriate methodology" as permitted in Section 367.11 of the Commission's regulations for allocating and capitalizing FirstEnergy Service Company overheads.

Also important here is that the State Commissions that regulate FirstEnergy's franchised public utility affiliates during state jurisdictional rate proceedings have had opportunity to review FirstEnergy's existing allocation and capitalization of FirstEnergy Service Company overhead costs to its franchised public utility affiliates and have issued rate orders without modifying those rates. As such, these costs have been included in retail rates pursuant to lawfully-issued State Commission orders.

Nonetheless, as noted below in the Company's response to Recommendation 1, FirstEnergy has retained, and DAA Staff have approved, a consultant – Black & Veatch Management Consulting, LLC ("B&V") – to conduct a representative time study for allocation of overhead costs incurred in 2021 to CWIP, and to assist with the development of procedures

FirstEnergy subsidiaries shall use to periodically determine the allocation of overhead labor and labor-related costs.

Although B&V will develop capitalization rates for the audit period, FirstEnergy respectfully submits that the proper course here is to apply the 2021 capitalization rate to 2022 and future years, subject to reasonable plans to update the 2021 capitalization rate periodically. Reasons for prospective application of the B&V study results are that a large amount of expense could be run through forward-looking formula rates, as well as the fact that, as noted above that, during state jurisdictional rate proceedings, State Commissions previously have had opportunity to examine the capitalization rates that were applied to distribution accounts and have issued rate orders without modifying those rates.

Recommendation 1: Retain an independent third-party entity, subject to approval by DAA, to conduct a representative labor time study for allocation of overhead costs incurred in 2021 to CWIP, and to assist with the development of procedures FirstEnergy subsidiaries shall use to periodically determine the allocation of overhead labor and labor related costs capitalized by each FirstEnergy subsidiary into the cost of construction after 2021. The independent consultant should have expertise and experience independently performing time studies used in the determination of overhead capitalization rates of U.S. based utilities subject to the accounting requirements prescribed for public utilities and licensees or for natural gas companies under 18 C.F.R. Part 101 or Part 201, respectively. The time study should involve a representative sample of study participants (employees) that provides for extrapolation of the study results to the full population of FirstEnergy employees, and should include processes for application of the study results from the audit period to the issue date of this audit report, and processes for applying the capitalization rate(s) the study finds for 2021 back to the period January 1, 2015 through December 31, 2020, either with no change to the capitalization rates found in the study or with such modifications to the capitalization rate(s) the independent consultant finds reasonable and supported by evidence. The independent consultant should use its expertise and all relevant information available to it to make recommendations as to what the capitalization rate(s) should be for prior years for each FirstEnergy subsidiary, should set forth the basis for its recommendations, and provide both the recommendations and the basis therefore to FirstEnergy and DAA. If there is no recommendation by the independent consultant for any year or other period between January 1, 2015 and December 31, 2020 for any specific capitalizable cost center, then FirstEnergy should base its capitalization rate and the amount to be capitalized for such year or period on the rates and costs of such specific cost centers for which FirstEnergy can provide to DAA reasonable evidence as to the time employees in such cost centers spent having a definite relation to construction, and exclude from consideration those cost centers for which FirstEnergy cannot provide such evidence, per, for example, 18 C.F.R. Part 101, General Instruction No. 2 and § 41.8.

The progress of the study should be reported within 120 days and the time study results provided to DAA for review and consideration within 180 days of the date of issuance of this audit report, and the developed allocation procedures should be submitted when complete, but no later than 60 days after completion of DAA's review of the labor time study. At a minimum, the developed allocation procedures should provide a method for overhead cost allocation and capitalization to construction based on actual timecard distributions or where this procedure is impractical, based on periodic time studies.

FirstEnergy Response: *FirstEnergy respectfully requests that changes to capitalization rates and revised procedures should be applied prospectively only. As noted above in the response to Finding 1, FirstEnergy has proposed, and DAA Staff have approved, FirstEnergy's retention of B&V to conduct a representative time study for allocation of overhead costs incurred in 2021 to CWIP, and to assist with the development of procedures FirstEnergy subsidiaries shall use to periodically determine the allocation of overhead labor and labor-related costs capitalized by each FirstEnergy subsidiary into the cost of construction after 2021. The determined 2021 capitalization rate will be applied to 2022 and future years, subject to reasonable plans to update the rate periodically.*

Although changes to capitalization rates and revised procedures should be prospective only, B&V has prepared a Statement of Work that includes processes for application of the study results from January 1, 2015 to date, and processes for applying capitalization rates that B&V finds reasonable and supported by the evidence for this period. FirstEnergy will submit the updated Statement of Work for DAA Staff review.

Recommendation 2: Revise written policies, practices, procedures, and controls governing the methods used to account for, track, report, and review overhead labor and related costs, and all other costs allocated to construction projects to be consistent with Commission accounting requirements. In addition, adopt procedures to retain formal documentation supporting the amount of overhead costs allocated to electric plant accounts.

FirstEnergy Response: *Accept. The Company will revise its policies, procedures, and controls accordingly.*

Recommendation 3: Revise accounting processes and procedures to account for and report capitalized A&G amounts recorded in Accounts 920, Administrative and General Salaries, and 921, Office Supplies and Expenses, using Account 922, Administrative Expenses Transferred – Credit, consistent with Commission regulations.

FirstEnergy Response: *Accept. The Company will make the recommended revisions.*

Recommendation 4: Train relevant staff on the revised overhead allocation, control, and A&G accounting procedures and documentation, and provide periodic training in this area, as needed.

FirstEnergy Response: *Accept. The Company will provide the training accordingly.*

Recommendation 5: Train staff on the time reporting guidelines and establish a periodic training program in this area.

FirstEnergy Response: *Accept. The Company will provide the training accordingly.*

Recommendation 6: Within 30 days of the completion of Recommendation No. 1, submit an estimate to DAA, including the calculations and determinative components, of overhead costs that would have been allocated to CWIP from 2015 through the present consistent with the requirements of Electric Plant Instruction No. 4 and General Instruction No. 9. The estimate should be based on a recalculation of 2015's and subsequent years' overhead costs allocated to construction with labor and related costs removed from the cost of plant that were not associated with construction activities based on the methodology developed in response to Recommendation No. 1.

FirstEnergy Response: *Accept. The Company will submit the results of the B&V study to DAA Staff.*

Recommendation 7: With the response to Recommendation No. 6, submit proposed accounting entries to DAA that remove the overhead costs that were allocated to CWIP and electric plant in service from 2015 through the present that exceed the amount of costs that would have been allocated to the accounts based on the methodology developed in response to Recommendation No. 1. Also, provide proposed accounting entries to remove associated amounts from other accounts and balances affected by the inappropriately allocated cost such as the accumulated depreciation and ADIT accounts, and AFUDC balances capitalized into CWIP and electric plant in service. If the adjusting entries result in a significant impact to income for the current year, FirstEnergy subsidiaries may account for the transaction as a correction of a prior period error in Account 439, Adjustments to Retained Earnings. Such adjustments to retained earnings with the proposed accounting entries should be submitted to DAA.

FirstEnergy Response: *Based on the relevant facts and circumstances, FirstEnergy respectfully requests that changes to capitalization rates and revised procedures should be applied prospectively only. As noted above in FirstEnergy's comments in response to Finding No. 1, only prospective application is warranted, as retroactive application could result in a large amount of expense being run through forward-looking formula rates. Prospective application is further warranted as, during state jurisdictional rate* *proceedings, State Commissions previously have had opportunity to examine the capitalization rates that were applied to distribution accounts and have issued rate orders without modifying those rates. As such, FirstEnergy respectfully requests that the language of Recommendation No. 7 be updated to reflect that FirstEnergy will ensure that its accounting entries, on a going forward basis, reflect the B&V study results.*

Recommendation 8: Revise account balances for FirstEnergy subsidiaries' utility plant, accumulated depreciation, ADIT, and other account balances impacted by the inappropriate allocation of unsupported overhead costs after receiving DAA's approval of proposed accounting entries submitted per Recommendation No. 7, and restate and footnote the balances reported in the next-filed FERC Form No. 1 reports of the FirstEnergy subsidiaries for both the current and comparative years presented in each subsidiary's next-filed report, as necessary to reflect and disclose the revisions.

FirstEnergy Response: *Based on the relevant facts and circumstances, FirstEnergy respectfully requests that changes to capitalization rates and revised procedures should be applied prospectively only. Adoption of this course would leave all account balances intact, and thus require no further action with regard to FERC Form 1 reporting. As noted above in FirstEnergy's comments in response to Finding No. 1, only prospective application is warranted, as retroactive application could result in a large amount of expense being run through forward-looking formula rates. Prospective application is further warranted as, during state jurisdictional rate proceedings, State Commissions previously have had opportunity to examine the capitalization rates that were applied to distribution accounts and have issued rate orders without modifying those rates. As such, FirstEnergy respectfully requests that the language of Recommendation No. 8 be updated to reflect that no account balances will be revised.*

Recommendation 9: Submit a refund analysis to DAA that explains and details the following: (1) calculation of refunds that result from correcting the overstatement of transmission plant due to the improperly capitalized labor costs, as determined by the labor time study, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

FirstEnergy Response: *Based on the relevant facts and circumstances, FirstEnergy respectfully requests that changes to capitalization rates and revised procedures should be applied prospectively only. Adoption of this course would leave all account balances intact, and thus would not require a refund analysis. As noted above in FirstEnergy's comments in response to Finding No. 1, only prospective application is warranted, as retroactive application could result in a large amount of expense being run through forward-looking formula rates. Prospective application is further warranted as, during state jurisdictional rate proceedings, State Commissions previously have had opportunity to examine the capitalization rates that were applied to distribution accounts and have* *issued rate orders without modifying those rates. As such, FirstEnergy respectfully requests that the language of Recommendation No. 9 be updated consistent with this response.*

Recommendation 10: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

FirstEnergy Response: *Based on the relevant facts and circumstances, FirstEnergy respectfully requests that changes to capitalization rates and revised procedures should be applied prospectively only. Adoption of this course would leave all account balances intact, and thus would not require refunds or a refund report. As noted above in FirstEnergy's comments in response to Finding No. 1, only prospective application is warranted, as retroactive application could result in a large amount of expense being run through forward-looking formula rates. Prospective application is further warranted as, during state jurisdictional rate proceedings, State Commissions previously have had opportunity to examine the capitalization rates that were applied to distribution accounts and have issued rate orders without modifying those rates. As such, FirstEnergy respectfully requests that the language of Recommendation No. 10 be updated consistent with this response.*

Recommendation 11: Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

FirstEnergy Response: *Based on the relevant facts and circumstances, FirstEnergy respectfully requests that changes to capitalization rates and revised procedures should be applied prospectively only. Adoption of this course would leave all account balances intact, and thus would not require refunds or a refund report. As noted above in FirstEnergy's comments in response to Finding No. 1, only prospective application is warranted, as retroactive application could result in a large amount of expense being run through forward-looking formula rates. Prospective application is further warranted as, during state jurisdictional rate proceedings, State Commissions previously have had opportunity to examine the capitalization rates that were applied to distribution accounts and have issued rate orders without modifying those rates. As such, FirstEnergy respectfully requests that the language of Recommendation No. 11 be updated consistent with this response.*

Finding 2: Accounting of Vegetation Management Costs

FirstEnergy provides the following response to the four recommendations in the Draft Audit Report dealing with Accounting for Vegetation Management Costs:

Recommendation 12: Revise accounting policies and procedures for vegetation management activities in distribution corridors to be consistent with Commission accounting requirements.

FirstEnergy Response: *Accept. The Company has already remediated this Finding by revising its policies effective October 1, 2021.*

Although the policies have now been updated, it is the Company's position that the FPUs appropriately capitalized the cost to electric plant in service prior to this date, and therefore, there is no overstatement of electric plant in service, accumulated depreciation, ADIT, depreciation expenses, and other account balances, nor is there an understatement of operating expenses incurred.

Recommendation 13: Train relevant staff on the revised vegetation management accounting policy and procedures and provide periodic training.

FirstEnergy Response: *Accept. The Company will train our employees on the revised vegetation management accounting policy and procedures.*

Recommendation 14: Submit proposed accounting entries and supporting documentation to DAA that reflect the correction of the FirstEnergy FPU's CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by the capitalization of vegetation management expenses for the period from October 1, 2021 through the present within 60 days of issuance of this audit report.

FirstEnergy Response: *Accept. The Company will submit the requested accounting entries and supporting documentation reflecting the revised policy effective October 1, 2021. No corrections are necessary because the policy change was implemented by the Company as of October 1, 2021, and the Company did not have any further capitalization of vegetation management after this date. The requested accounting entries demonstrate that the capitalization of vegetation management expenses ceased on October 1, 2021, as proposed in Recommendation No. 12.*

Recommendation 15: Revise the FirstEnergy FPUs' CWIP, electric plant in service, accumulated depreciation, ADIT, and other accounts impacted by over-accrual of AFUDC after receiving DAA's approval of the proposed accounting entries per Recommendation No. 14 and restate and footnote the FERC Form No. 1 reports for current and comparative years as necessary.

FirstEnergy Response: *Accept. The Company has already completed the recommended policy and accounting changes as of October 1, 2021. Therefore, there is no additional information to provide. Since the changes are made prospectively from October 1, 2021, the Company disagrees with the Commission's recommendation to correct prior period balances and to restate prior Form 1s.*

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Finding 3: Accounting for Amortization of Regulatory Assets

FirstEnergy provides the following response to the five recommendations in the Draft Audit Report dealing with Accounting for Amortization of Regulatory Assets:

Recommendation 16: Revise policies, practices, and procedures to amortize or write off the regulatory assets consistent with Commission accounting requirements.

FirstEnergy Response: *Accept. The Company will revise our policies, practices, and procedures consistent with Commission requirements.*

Recommendation 17: Train relevant staff on the revised methods, and provide periodic training in this area, as needed.

FirstEnergy Response: *Accept. The Company will train our employees on the revised method.*

Recommendation 18: Submit a refund analysis, within 60 days of issuance of this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that result from the correction of ATSI's and TrAILCo's improper and unauthorized, respective, depreciation and amortization of plant and regulatory assets to the depreciation expense account and inclusion of the expenses in service rate determinations, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

FirstEnergy Response: *Accept. The Company will submit a refund analysis within 60 days from the issuance of the audit report, in accordance with the Commission's recommendation.*

Recommendation 19: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

FirstEnergy Response: *Accept. The Company will file a refund report after receiving DAA's assessment of the refund analysis.*

Recommendation 20: Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

FirstEnergy Response: *Accept. Accounting recorded correcting entries in Q3 2021. For transmission rate purposes, these corrections will be handled through the standard formula rate true-up process. For each impacted transmission entity, the 2021 actual transmission revenue requirement, which will be developed in the May/June 2022, will include these adjustments and therefore will be a component of the overall true-up for calendar year 2021 rates. This true-up plus interest in accordance with 35.19a will be* *included in the next projected transmission revenue requirement. For TrAILCo, this refund will occur from June 1, 2022 through May 31, 2023. For the remaining impacted entities, the refund will occur over calendar year 2023.*

Finding 4: Accounting for Lobbying Expenses, Donations, and Costs that Lacked Proper Supporting Documentation

FirstEnergy provides the following response to the six recommendations in the Draft Audit Report dealing with Accounting for Lobbying Expenses, Donations, and Costs that Lacked Proper Supporting Documentation:

Recommendation 21: Critically review and strengthen internal controls in FirstEnergy and its subsidiaries. Establish and implement procedures governing methods to be used to appropriately identify, account for, track, report, and review all lobbying costs, donations, and any unsupported expenses, including, but not limited to, expenses of external lobbyists, monies paid to external corporate entities to be used for lobbying, and other external lobbying costs and internal lobbying costs, including employee lobbying time and other internal lobbying costs.

FirstEnergy Response: *Accept. The Company will review and strengthen its internal controls in the Company and its subsidiaries accordingly.*

Recommendation 22: Train relevant staff on the internal control enhancements and procedures established, including internal controls over vendor creation in the accounts payable system, payments, accounting, and reporting violations; and provide periodic training in this area, as needed.

FirstEnergy Response: *Accept. The Company will provide the training accordingly.*

Recommendation 23: Perform an analysis of costs that FirstEnergy and its subsidiaries incurred associated with internal and external lobbying activities, including payments of FirstEnergy funds to outside entities for purposes of those entities using those funds for lobbying, and provide support to identify lobbying-related expenses improperly charged to utility operating accounts, for the audit period and, with respect to the specific issues discussed in this finding, for the entire period affected by or relevant to each such specific issue. Within 60 days of the issuance of this audit report and on a rolling basis within 60 days of conclusion of each internal or external investigation discussed in the finding or any new internal or external investigation arising directly from Ohio House Bill 6 (HB 6) or lobbying activities occurring prior to 2021, provide the results of the investigation, proposed correcting journal entries, and FirstEnergy's analysis of the findings from each investigation and the related impact on prior and future accounting and rate development to audit staff.

FirstEnergy Response: *The Company accepts this recommendation, subject to the points below.*

With respect to providing the results of future investigations, if any, into the requested lobbying-related expenses, FirstEnergy will provide responsive factual information but not information protected from disclosure by the attorney-client privilege and attorney work product doctrines or other relevant law.

Recommendation 24: Submit a refund analysis, within 60 days of issuance of this audit report and on a rolling basis within 60 days of conclusion of each investigation discussed in the finding or any new investigation arising directly from HB 6 or lobbying activities occurring prior to 2021, for DAA's review, that explains and details the following: (1) calculation of refunds resulting from correcting the improper accounting for external lobbying costs, donations, and unsupported costs in utility operating and plant accounts; and internal lobbying costs as identified pursuant to the analysis performed in response to Recommendation No. 23, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale transmission customers to receive refunds; and (5) period(s) refunds will be made.

FirstEnergy Response: *Accept. The Company will implement to the extent the results of Recommendation No. 23, if any, warrant a refund to customers.*

Recommendation 25: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

FirstEnergy Response: *Accept. The Company has already started to implement the refunds, and, to the extent the results of the analysis, if any, warrant an additional refund to customers, the Company will implement that additional refund as well.*

Recommendation 26: Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

FirstEnergy Response: *Accept. The Transmission Companies have already started to implement the refunds, and, to the extent the results of the analysis, if any, warrant an additional refund to customers, the Transmission Companies will implement that additional refund as well.*

Finding 5: Accounting for Funds Used During Construction

FirstEnergy makes the following response to the two recommendations in the Draft Audit Report dealing with Accounting for Funds Used During Construction:

Recommendation 27: Revise and implement the FPUs' processes and procedures to calculate their respective AFUDC rates consistent with EPI No. 3(A)(17) and other applicable Commission requirements. Revisions should include processes to prevent the inclusion of balances in Accounts 216.1 and 219 in the AFUDC rate calculations.

FirstEnergy Response: *Accept. The Company has already revised and implemented an AFUDC policy consistent with Commission requirements, including but not limited to, the exclusion of balances in Account 216.1 and 219 in the AFUDC rate calculations.*

Recommendation 28: Train relevant staff on the revised AFUDC calculation method, and provide periodic training, as needed.

FirstEnergy Response: *Accept. The Company will provide the training accordingly.*

Finding 6: Service Company Billing Procedures

FirstEnergy provides the following response to the two recommendations in the Draft Audit Report dealing with Service Company Billing Procedures:

Recommendation 29: Revise FESC policies, procedures, and accounting systems so as to provide sufficient billing information to FirstEnergy's subsidiaries in accordance with the Commission's regulations.

FirstEnergy Response: *Accept. The Company will revise its policies, procedures, and systems accordingly.*

Recommendation 30: Train relevant staff on the revised policies, procedures, and accounting systems and provide periodic training in this area, as needed.

FirstEnergy Response: *Accept. The Company will provide the training accordingly.*

Finding 7: Accounting for Fuel – Coal Supply and Other Consulting Services

FirstEnergy provides the following response to the eight recommendations in the Draft Audit Report dealing with Accounting for Fuel – Coal Supply and Other Consulting Services:

Recommendation 31: Revise accounting policies and procedures for cost of fuel by the FPUs to ensure compliance with the Commission's accounting regulations.

FirstEnergy Response: *Accept. The Company will revise the accounting policies and procedures accordingly.*

Recommendation 32: Train relevant staff on the revised policies and procedures and provide periodic training.

FirstEnergy Response: *Accept. The Company will train relevant staff on the revised policies and procedures and provide periodic training.*

Recommendation 33: Perform an analysis of all monthly payments made to consultants, including BCG Resources, LLC, that were included in the cost of fuel used in operations during the audit period and submit the analysis to DAA with supporting documents within 60 days of issuance of this audit report. Based on the analysis, submit proposed adjusting accounting entries to record the consultation costs in the appropriate accounts for DAA's review and approval.

FirstEnergy Response: *Accept. The Company will perform an analysis of all monthly payments made to consultants by Monongahela Power Company as described in Recommendation No. 33. Based upon the fuel cycle, the Company's understanding is that any fuel at issue would have already been burned in close proximity to the timing of payments under the contract and therefore any accounting impact arising from this review is anticipated to be de minimis.*

Recommendation 34: Revise the FirstEnergy FPUs' fuel inventory and other account balances impacted by the improper accounting after receiving DAA's approval of the proposed accounting entries per Recommendation No. 33 and restate and footnote the FERC Form No. 1 reports for current and comparative years as necessary.

FirstEnergy Response: *Accept. The Company will revise the FirstEnergy FPUs' fuel inventory and other impacted account balances. Based on a preliminary review, changes to the accounting entries are anticipated to be de minimis; however, if appropriate, FirstEnergy will footnote the FERC Form No.1 for the current year. There is no need to restate prior balances and revise previously issued Form 1s.*

Recommendation 35: Review collections received, including but not limited to uplift payments, during the audit period based, in part, on the cost of fuel and submit an analysis to DAA for review of retail and wholesale overcollections due to improper recording of costs in Account 501.

FirstEnergy Response: *Accept. The Company will review collections received and will provide the necessary support regarding such collections as part of the compliance phase. Based on the Company's preliminary investigation, if any refund is due, such refund is anticipated to be de minimis.*

Recommendation 36: Submit a refund analysis if there were overcollections from wholesale customers, within 60 days of issuance of this audit report, for DAA's review, that explains and details the following: (1) calculation of refunds resulting from the improper accounting for fuel costs, plus interest; (2) determinative components of the refund; (3) refund method; (4) wholesale customers to receive refunds; and (5) period(s) refunds will be made.

FirstEnergy Response: *Accept. The Company will do a refund analysis to determine if there was any effect on wholesale rates. Based on the fuel cycle, the Company's understanding is that any of the fuel at issue would have already been burned and therefore, if any refund is due, it would be de minimis.*

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Recommendation 37: File a refund report with the Commission after receiving DAA's assessment of the refund analysis.

FirstEnergy Response: *Accept. If, after the analysis performed pursuant to Recommendation No. 36, a refund is indicated, the Company shall file a refund report with the Commission.*

Recommendation 38: Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19a of the Commission's regulations.

FirstEnergy Response: *Accept. In the event a refund is indicated, the Company shall refund the amount in the refund report, with interest calculated in accordance with section 35.19a of the Commission's regulations.*