

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. FA20-7-000
May 20, 2022

Heather H. Grahame
General Counsel and Vice President –
Regulatory and Federal Government Affairs
NorthWestern Corporation
208 N. Montana Ave., Suite 205
Helena, MT 59601

Dear Ms. Grahame:

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 NorthWestern Corporation, d/b/a NorthWestern Energy (NorthWestern). The audit covered the period January 1, 2018 to October 31, 2021.
2. The audit evaluated NorthWestern's compliance with: (1) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101, and (2) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1. The enclosed audit report contains five findings of noncompliance and 29 recommendations that require NorthWestern to take corrective action.
3. On April 29, 2022, NorthWestern notified DAA that NorthWestern agrees with the five findings and agrees to implement the 29 recommendations. A verbatim copy of NorthWestern's response is included as Section V to the accompanying audit report. I hereby approve the audit report.
4. NorthWestern should submit its implementation plan to comply with the recommendations within 30 days of issuance of this letter order. NorthWestern should make quarterly submissions to DAA describing the progress made to comply with the recommendations, including the completion date for each corrective action. As directed

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

5. The Commission delegated 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. NorthWestern 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.

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

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

Sincerely,

**JANEL
BURDICK**

Digitally signed by
JANEL BURDICK
Date: 2022.05.18
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Janel Burdick
Director
Office of Enforcement

Enclosure



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

AUDIT REPORT

Audit of NorthWestern Corporation's
compliance with:

- Accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101; and
- Reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1

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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 NorthWestern Corporation, d/b/a NorthWestern Energy (NorthWestern). The audit evaluated NorthWestern's compliance with: (1) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101, and (2) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1. The audit covered the period January 1, 2018 to October 31, 2021.

B. NorthWestern Energy (NorthWestern)

NorthWestern is a public utility engaged in the generation, transmission, and distribution of electricity as well as the supply and transportation of natural gas. NorthWestern, headquartered in Sioux Falls, South Dakota, provides electric generation, transmission, and distribution services and natural gas supply and transportation services to approximately 743,000 customers in Montana, South Dakota, Nebraska, and Yellowstone Park. NorthWestern is organized into three business segments: (a) franchised public utility, involving the generation, transmission, and distribution of electricity in Montana and South Dakota; (b) natural gas utility, involving the production, transmission, and distribution of natural gas in Montana, South Dakota, and Nebraska; and (c) other entity, primarily consisting of unallocated corporate costs. In 2020, NorthWestern earned 80% of its utility business revenue from its regulated electric utilities and 20% of its utility business revenue from its natural gas operations.

NorthWestern provides FERC-jurisdictional firm and non-firm transmission services to its transmission customers in Montana and South Dakota. NorthWestern operates in two independent regions, with no direct interconnection, to provide service to customers in each state. NorthWestern's Montana electric operations are significantly larger than its South Dakota electric operations. The Montana service territory covers 107,600 square miles and contains 384,700 NorthWestern customers. The South Dakota service territory contains 69,300 customers. NorthWestern's power generation mix includes the following fuel types: hydroelectric, coal, wind, and natural gas. In addition to generating electricity using these fuel types, NorthWestern has also used long-term power purchase agreements to procure electricity to serve its customers. In 2020, NorthWestern earned 65% of its utility business revenue from its electric operations in Montana and 15% from its electric operations in South Dakota.

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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 five areas of noncompliance:

- *Allowance for Funds Used During Construction* – NorthWestern's method for calculating its Allowance for Funds Used During Construction (AFUDC) rate was inconsistent with the Commission's accounting regulations.

Specifically, NorthWestern inappropriately used prior month balances instead of prior year balances in the long-term debt and equity components for the purpose of computing its AFUDC rate and inappropriately included undistributed subsidiary earnings as a part of the equity component for the purpose of computing its AFUDC rate. Additionally, when applying AFUDC, NorthWestern improperly compounded its AFUDC on a monthly basis rather than compounding on a semi-annual basis and inappropriately included unpaid contract retention amounts in construction work in progress (CWIP) balances used in its AFUDC calculation.

These errors caused NorthWestern to over accrue AFUDC and to inappropriately overcharge FERC-jurisdictional transmission customers.

- *Accounting for Revolving Credit Facility Upfront and Commitment Fees* – NorthWestern inappropriately recorded in Account 181, Unamortized Debt Expense, upfront fees it paid when establishing its revolving line of credit, and inappropriately recorded in Account 921, Office Supplies and Expenses, commitment fees it paid for its revolving credit facility.
- *Accounting for Membership Dues* – NorthWestern misclassified \$19,188, constituting part of the lobbying portion of membership dues it paid during the audit period and therefore associated with nonoperating activities, in Account 930.2, Miscellaneous General Expenses, and Account 921, Office Supplies and Expenses, instead of in Account 426.4, Expenditures for Certain Civic, Political and Related Activities. This led to a reporting error in its 2018 FERC Form No. 1.
- *Accounting for Lobbying Expenses* – NorthWestern misclassified \$341,902 of lobbying expenses in various administrative and general expense accounts instead of Account 426.4, Expenditures for Certain Civic, Political and Related Activities. This resulted in NorthWestern inappropriately including these costs in transmission formula rate service cost determinations. As a result, FERC-jurisdictional transmission customers were overbilled \$32,509 in Montana and \$2,584 in South Dakota.

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- *Miscellaneous Accounting Classification Errors* – NorthWestern misclassified various costs in its books and records. As a result, the amounts reported on FERC Form No. 1 for Administrative and General Expenses were incorrect, which impacted development of the annual transmission revenue requirements used for determining charges for NorthWestern’s FERC-jurisdictional transmission customers in Montana and South Dakota. Specifically, misclassification of certain general advertising expenses in Account 923, Outside Services Employed, resulted in overbillings to FERC-jurisdictional transmission customers.

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 NorthWestern:

Allowance for Funds Used During Construction

1. Revise its policies and procedures to ensure that its AFUDC base and rate calculation is consistent with Electric Plant Instruction (EPI) No. 3(A)(17) and other applicable Commission requirements. Revisions should include procedures to: use prior year ending balances as reported in NorthWestern’s FERC Form No. 1 filings for the long-term debt and equity components; prevent balances in Account 216.1 from being included in the equity component; ensure AFUDC is compounded, at most, semi-annually; and prevent inclusion of unpaid contract retention amounts in the CWIP base in AFUDC calculations.
2. Provide training to staff on the revised policies and procedures described in the previous recommendation. Also, develop a training program that supports the provision of periodic training in this area, as needed.
3. Recalculate AFUDC for the period 2018 through 2021 in accordance with the requirements of EPI No. 3(A)(17) and the other pertinent guidance discussed in this finding. Based on the calculations, for periods in which AFUDC was over-accrued, submit a yearly estimate of over accruals to DAA within 60 days of receiving this audit report, with proposed corrected accounting entries and supporting documentation that reflects corrections to remove over-accrued AFUDC balances from plant and associated accounts, such as depreciation, income tax expense, accumulated provision for depreciation, and accumulated deferred income taxes (ADIT).

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4. Revise electric plant, accumulated provision for depreciation, ADIT, and other account balances impacted by over-accrual of AFUDC after receiving DAA's approval of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.
5. Submit a refund report, within 60 days of receiving DAA's approval of the proposed accounting entries, to DAA for review that explains and details the following: (1) calculation of refunds that include the amounts of inappropriate recoveries that resulted from improper AFUDC computations during the audit period; (2) determinative components of the refund; (3) refund method; (4) the customers to receive refunds; and (5) period(s) refunds will be made.
6. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
7. Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19(a) of Commission's regulations.

Accounting for Revolving Credit Facility Upfront and Commitment Fees

8. Revise existing accounting policies, procedures, and practices relating to accounting for credit agreement expenses used for general liquidity, such as upfront, commitment, revolving line of credit, and letter of credit fees, to be consistent with Commission accounting requirements.
9. Train relevant staff on the revised accounting policies and provide periodic training, as needed.
10. Submit proposed accounting entries and supporting documentation to DAA to reflect the transfer of credit agreement-related balances improperly recorded in Account 181 to Account 186, Miscellaneous Deferred Debits.
11. Revise miscellaneous deferred debit balances to appropriately account for and report credit agreement-related balances after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary, to reflect and disclose the revisions.

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Accounting for Membership Dues

12. Strengthen policies, procedures, and controls to account for the lobbying portion of membership dues consistent with the Commission's accounting requirements.
13. Train relevant staff on the revised policies, procedures, and controls and provide periodic training in this area, as needed.
14. Perform an analysis to identify other membership dues that were improperly accounted for during the audit period. Provide the results of the analysis to audit staff within 60 days of receiving this report.
15. Submit a refund report, within 60 days of receiving this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amounts of inappropriate recoveries that resulted from improper accounting of lobbying costs in transmission formula rates during the audit period; (2) determinative components of the refund; (3) refund method; (4) customers to receive the refunds, and (5) period(s) refunds will be made.
16. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
17. Refund the amounts disclosed in the refund report to FERC-jurisdictional transmission customers, with interest calculated in accordance with section 35.19(a) of the Commission's regulations.

Accounting for Lobbying Expenses

18. Develop and implement procedures and policies to track, report, review, and account for lobbying and other expenses of activities associated with influencing legislation and with other political activity consistent with Commission accounting requirements.
19. Train relevant staff on the procedures and policies and provide periodic training in this area, as needed.
20. Perform an analysis to identify other lobbying costs that were improperly accounted for during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.

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21. Submit a refund report, within 60 days of receiving this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amounts of inappropriate recoveries that resulted from improper accounting of lobbying costs in transmission formula rates during the audit period; (2) determinative components of the refund; (3) refund method; (4) customers to receive the refunds, and (5) period(s) refunds will be made.
22. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
23. Refund the amounts disclosed in the refund report to FERC-jurisdictional transmission customers, with interest calculated in accordance with section 35.19(a) of the Commission's regulations.

Miscellaneous Accounting Classification Errors

24. Strengthen policies, procedures, and controls to ensure that NorthWestern records the different administrative and general expenses in the proper accounts consistent with Commission accounting requirements.
25. Train relevant staff on the revised policies, procedures, and controls and provide periodic training in this area, as needed.
26. Perform an analysis to identify other administrative and general expenses that were improperly accounted for during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.
27. If the net results of the analysis from Recommendation 26 and the errors identified in this finding impacted formula rate billings, submit a refund report, within 60 days of receiving this report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amount of inappropriate recoveries that resulted from improper accounting of administrative and general expense impacting charges under transmission formula rates during the audit period; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) refunds will be made.

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28. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
29. Refund the amounts disclosed in the refund report to FERC-jurisdictional transmission customers, with interest calculated in accordance with section 35.19(a) of the Commission's regulations.

E. Implementation of Recommendations

Audit staff further recommends that NorthWestern submit the following for audit staff's review:

- A plan for implementing corrective actions that address each recommendation within 30 days after the issuance of this audit report;
- Quarterly reports to DAA describing NorthWestern's progress in completing each corrective action taken for each recommendation. NorthWestern should submit these nonpublic quarterly reports no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the issuance of this audit report, and continuing each calendar quarter until NorthWestern completes all recommended corrective actions; and
- Copies of any written policies and procedures developed or updated in response to the audit report's recommendations; copies of journal entries made to correct accounting errors and deficiencies; and other information supporting the corrective actions made. NorthWestern should submit these documents for audit staff's review in the first nonpublic quarterly report after it completes them.

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II. Background

A. Montana Open Access Transmission Tariff

Prior to 2019, NorthWestern's last general rate case was filed in 2006 and resulted in a settlement that was conditionally approved by the Commission in 2008.¹ On March 15, 2018, the Commission issued several orders to address the effects of the Tax Cuts and Jobs Act of 2017.² Pursuant to Section 206 of the Federal Power Act, the Commission issued its Stated Rate Order to Show Cause³ to public utilities that used stated transmission rates (rather than formula rates) under an Open Access Transmission Tariff (OATT). The Commission found that NorthWestern's stated transmission rates appeared to be unjust, unreasonable, and unduly discriminatory or preferential, or otherwise unlawful, and directed NorthWestern either to (1) propose revisions to its stated transmission rates, or (2) show cause why it should not be required to do so.⁴

Instead of proposing revisions to, or seeking to maintain its stated rates, on May 1, 2019, NorthWestern filed an application with the Commission that proposed revisions to its Montana OATT to change from stated rates to formula rates for transmission and certain ancillary services, and proposed revisions to certain ancillary service schedules. On June 28, 2019, the Commission accepted and suspended NorthWestern's proposed revisions to the Montana OATT, and terminated the show cause proceeding begun on March 15, 2018 as to NorthWestern.⁵ The revised Montana OATT uses a formula rate that is forward looking to determine the transmission revenue requirement. For 2020, the Montana OATT produced a revenue requirement of \$94.7 million and transmission rate base of \$465 million.

NorthWestern's Montana OATT sets forth its revenue requirement, rates, and charges for transmission service on its grid. During the audit period, NorthWestern recovered the costs associated with its Montana transmission facilities and operation and maintenance of those facilities pursuant to its Commission-approved transmission

¹ *NorthWestern Corp.*, 125 FERC ¶ 61,066 (2008).

² An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (Tax Cuts and Jobs Act).

³ *Alcoa Power Generating Inc.—Long Sault Division*, 162 FERC ¶ 61,224 (2018) (Stated Rate Order to Show Cause).

⁴ *Id.* P 4.

⁵ *NorthWestern Corp.*, 167 FERC ¶ 61,278 (2019).

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formula rate mechanism found in Attachment O-1, Formula Rate Protocols, and Attachment O-2, Formula Rate Template, of its Montana OATT.⁶ NorthWestern's Montana transmission system is directly interconnected with the transmission systems of Avista Corporation; Idaho Power Company; PacifiCorp; the Bonneville Power Administration; the Western Area Power Administration; and Montana Alberta Tie Ltd. NorthWestern's Montana transmission system combined with the many transmission systems with which it is directly interconnected is used for the transmission, interchange, purchase, and sale of power among all major electric systems in the west.

On June 16, 2021, NorthWestern joined the Western Energy Imbalance Market (EIM) operated by the California Independent System Operator. The EIM is a real-time market that uses technology to enhance its participants' electricity generation cost savings and grid reliability across the west. The Western Energy Imbalance Market serves 10 states, including portions of Arizona, California, Idaho, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming, and Montana.

B. South Dakota Transmission Formula Rate

On October 1, 2015, NorthWestern joined the Southwest Power Pool, Inc. (SPP) and transferred functional control of eligible 69-kV and 115-kV South Dakota transmission facilities. While SPP operates NorthWestern's South Dakota transmission system, NorthWestern owns and maintains its transmission facilities. The Commission approved NorthWestern's transmission formula rate under the SPP OATT when NorthWestern joined SPP.⁷ For 2020, NorthWestern's South Dakota transmission system formula rate produced an annual revenue requirement of \$7 million and transmission rate base of \$37.8 million.

SPP provides transmission services to eligible transmission customers over NorthWestern's transmission system in South Dakota and other transmission owners' high voltage transmission facilities pursuant to its Commission-approved OATT.⁸ NorthWestern's Transmission Owner Tariff sets forth its revenue requirement, rates, and charges for various transmission services utilizing its SPP-controlled transmission

⁶ NorthWestern FERC FPA Electric Tariff, FERC OATT Vol. 5 NWE Montana OATT 1.0.0, Attachment O, Att O - Formula Rate Protocols and Template.

⁷ See *NorthWestern Corp. and Southwest Power Pool, Inc.*, 157 FERC ¶ 61,008 (2016).

⁸ SPP Open Access Transmission Tariff, Sixth Revised Volume No. 1, Attachment H, Addendum 27 (NorthWestern's formula rate).

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facilities. During the audit period, NorthWestern recovered the costs associated with its transmission facilities and operation and maintenance of those facilities pursuant to its Commission-approved transmission formula rate mechanism in Attachment H, Addendum 27 of SPP's tariff.

C. Accounting and Financial Reporting

NorthWestern's accounting system primarily consists of an SAP SE (SAP) general ledger system and related modules.⁹ It is a system with several modules that process transactions for accounting, cost allocation, payroll, and financial reporting purposes. Additionally, NorthWestern uses other business systems that interface with the SAP general ledger system, including, for example, PowerPlan, which processes data relating to fixed assets and taxes. NorthWestern maintains the accounting records for its electric and natural gas operations, as well as for its other businesses, in its integrated SAP general ledger system. Transactions are initially recorded in the general ledger system following NorthWestern's own chart of accounts identifying internal company codes, cost centers, projects, and work orders, etc.

NorthWestern maps the balances in the general ledger accounts to the Commission's Uniform System of Accounts prescribed for public utilities and natural gas companies for regulatory reporting purposes.¹⁰ The mapping of transactions is done monthly in the FERC general ledger module maintained in NorthWestern's SAP general ledger system using various cost collectors, including company codes, profit centers, cost centers, and work orders, to produce regulatory reports. The transactions in the FERC general ledger are tied to the original entries posted in the general ledger under NorthWestern's own chart of accounts.

NorthWestern annually files one FERC Form No. 1 that reports certain financial data regarding its Montana and South Dakota electric utility business segments separately to facilitate transmission rate development. NorthWestern employees, consisting primarily of several regulatory accountants and also regulatory rate staff, prepare the FERC Form No. 1 and are responsible for the transmission formula rate inputs, which are

⁹ SAP SE is a German multinational software corporation that develops enterprise software, including several financial applications that are integrated into its general ledger module, to manage business operations.

¹⁰ See Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101 and Uniform System of Accounts Prescribed for Natural Gas Companies subject to the provisions of The Natural Gas Act under 18 C.F.R. Part 201.

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derived from the FERC Form No. 1 balances. There are several internal controls and checks and balances in place for the purpose of attempting to ensure that the correct balances are reported in NorthWestern's FERC Form No. 1 reports, and the correct transmission formula rate inputs are used. Some of these internal controls consist of safeguards to electronically catch any errors that arise during the reporting process as well as manual corrections to any misreported balances in the various FERC accounts that are utilized.

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III. Audit Objectives, Scope, and Methodology

A. Audit Objectives

The audit evaluated NorthWestern's compliance with: (1) the accounting requirements of the Uniform System of Accounts Prescribed for Public Utilities and Licensees under 18 C.F.R. Part 101, and (2) the reporting requirements of the FERC Form No. 1, Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report, under 18 C.F.R. § 141.1. The audit covered the period January 1, 2018 to October 31, 2021.

B. Audit Scope and Methodology

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

Audit Planning, Processes, and Administration

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

- *Reviewed Public Information* – Conducted an extensive review of public information before commencing the audit. This review provided audit staff an understanding of NorthWestern's corporate structure, the services it provides, major events affecting operations and finances, significant contracts, prior audit issues, and other key regulatory and business activities. Examples of materials reviewed included NorthWestern's annual reports and SEC Form 10-Ks, NorthWestern's FERC Form No. 1 filings, prior FERC audit reports, company-related web sites, and other relevant regulatory documents and media.
- *Identified Standards and Audit Criteria* – Identified the regulatory requirements and criteria for evaluating NorthWestern's compliance with each audit objective. These included NorthWestern's Transmission Owner Tariff, Commission accounting and reporting requirements, and Commission orders relevant to the audit.
- *Issued Data Requests* – Issued data requests to collect information not commonly available to the public. This included internal policies, procedures, and controls; nonpublic information about business practices, risk management, corporate structure, and contractual agreements; financial accounting and reporting activity; corporate compliance and regulatory filings; and other

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pertinent information. These data were used to test and evaluate NorthWestern's compliance with the Commission's requirements relevant to the audit objectives.

- *Conducted Teleconference Interviews* – Conducted multiple teleconferences with NorthWestern employees to discuss audit objectives, processes, procedures and operations, testing, data request responses, technical and administrative matters, and compliance concerns.
- *Conferred with Subject-Matter Experts* – Conferred with Commission staff in other offices to ensure that audit report findings were consistent with Commission precedent and policy.
- *Conducted Virtual Site Visits* – Due to the COVID-19 pandemic, audit staff conducted all site visits by conference call using Commission-approved software to interact with NorthWestern staff, instead of in-person site visits to NorthWestern's offices. The virtual site visits enabled audit staff to:
 - Discuss NorthWestern's corporate structure, departmental functions, and employee responsibilities with key company officials;
 - Learn about NorthWestern's transmission system and operations including the assets, departments, activities, functions, systems, and processes used;
 - Interview executives, managers, and staff responsible for accounting, financial reporting, transmission operations, and corporate compliance; and
 - Discuss and observe internal accounting and reporting procedures, processes, and controls relevant to audit scope.

Compliance with NorthWestern's Transmission Owner Tariff

Audit staff performed these actions to evaluate NorthWestern's compliance with the requirements of its Transmission Owner Tariff:

- *Formula Rate Schedules* – Reviewed NorthWestern's Commission-approved FERC-jurisdictional transmission formula rate and schedules included therein, and the input data as reported in NorthWestern's FERC Form No. 1 filings.

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- *Commission Orders* – Reviewed Commission orders accepting NorthWestern’s FERC-jurisdictional transmission formula rate. Reviewed Commission orders for background information about specific cost treatments and unique inputs, and other matters disclosed in the orders approving NorthWestern’s FERC-jurisdictional transmission formula rate.
- *Formula Rate Procedures* – Evaluated NorthWestern’s processes, procedures, and controls for preparing and reviewing its annual transmission revenue requirement filings and their supporting work papers.
- *Formula Rate Input Reconciliation* – Reconciled the FERC-jurisdictional transmission formula rate inputs to amounts reported in NorthWestern’s FERC Form No. 1 filings for 2018, 2019, and 2020. Evaluated the adequacy of disclosures provided by NorthWestern for formula rate inputs not derived from its FERC Form No. 1 filings.
- *Interviewed Employees* – Interviewed NorthWestern employees responsible for providing data inputs into the transmission formula rate and calculating the annual transmission revenue requirement. Assessed the level of oversight and controls employed by NorthWestern to ensure complete and accurate FERC-jurisdictional transmission formula rate inputs.
- *Mathematical Accuracy* – Evaluated the mathematical accuracy of computations performed by NorthWestern in applying its FERC-jurisdictional transmission formula rate to test whether inputs were accurate. For example, audit staff reviewed supporting documentation for the depreciation rate to test whether amounts were correctly populated into the FERC-jurisdictional transmission formula rate template.
- *Formula and Input Analysis* – Analyzed and assessed NorthWestern’s compliance with the Commission’s required accounting treatment relating to select formula rate inputs.

Compliance with Commission Accounting Regulations

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

- *Accounting Processes and Procedures* – Evaluated NorthWestern’s financial accounting processes, procedures, and internal controls for consistency with Commission financial accounting regulations under 18 C.F.R. Part 101. Audit staff interviewed NorthWestern employees about accounting practices, reviewed

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system processes for account assignments, and observed controls for achieving compliance with the Commission's accounting regulations.

- *Accounting Applications and Classifications* – Evaluated NorthWestern's chart of accounts for the audit period to determine whether it was consistent with the Commission's accounting regulations. Reviewed descriptions of accounting practices and tested specific accounts in sample months to determine whether accounting classifications complied with the Commission's accounting regulations.
- *Accounting Systems* – Reviewed NorthWestern's financial accounting systems for managing company financial records, such as for recording and tracking NorthWestern's costs, including the general ledger, work order, expense, billing, and accounts payable systems. Reviewed practices and procedures relating to the accounting cycle for charges and the mapping of these charges to the Uniform System of Accounts prescribed for public utilities.
- *Significant Accounting Matters* – Tested select accounts impacting or comprising inputs to the FERC-jurisdictional transmission formula rate to evaluate whether the nature of costs recorded in those accounts complied with the Commission's accounting regulations and NorthWestern's FERC-jurisdictional transmission formula rate requirements. Testing included, but was not limited to, the following accounting matters:
 - *Transmission versus Distribution* – Reviewed certain transmission operating and maintenance accounts to test whether costs related to transmission or, alternatively, distribution were recorded in the correct functional expense accounts;
 - *Administrative and General Expenses* – Tested select administrative and general expense accounts to determine whether NorthWestern recorded salaries, office supplies, outside services (e.g., consultant fees), pensions and employee benefits, etc., consistent with the respective accounts' instructions;
 - *Cost Allocations* – Examined support for and tested the application of corporate and associated company methodologies for allocating and recording shared service costs among state jurisdictions, and billing and accounting for non-power goods and services among associated companies;
 - *Accumulated Deferred Income Taxes* – Reviewed a monthly summary of deferred taxes that flowed into the rate base

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component of the FERC-jurisdictional transmission formula rate. Analyzed supporting documentation to evaluate how NorthWestern calculated the deferred tax component and underlying accounting entries made to the Uniform System of Account's deferred tax accounts (i.e., Accounts 190, Accumulated Deferred Income Taxes; 282, Accumulated Deferred Income Taxes – Other Property; and 283, Accumulated Deferred Income Taxes – Other);

- *Income Taxes and Tax Allocation Agreements* – Evaluated NorthWestern's consolidated income tax allocation agreement and the tax payment structure between NorthWestern and its non-jurisdictional subsidiaries, including the methodology to allocate the tax benefits/burden to those non-jurisdictional subsidiaries. Reviewed supporting documentation to validate the calculation of tax accruals and deferred income taxes;
- *Depreciation* – Reviewed NorthWestern's monthly depreciation expense and supporting calculations to determine whether NorthWestern used the proper accounts and recorded the correct amounts. Reviewed NorthWestern's depreciation expense calculation to test whether NorthWestern derived monthly depreciation expenses using approved depreciation rates on file with the Commission;
- *Other Contingent Liabilities* – Reviewed the Notes to the Financial Statements in NorthWestern's FERC Form No. 1 filings and identified information about accruals for potential future obligations. Analyzed information on commitments and environmental and legal contingencies, and assessed whether the amounts affected the FERC-jurisdictional transmission formula rates resulting from annual transmission revenue requirements; and
- *AFUDC* – Reviewed NorthWestern's AFUDC rate calculation for consistency with EPI No. 3, Order No. 561, and other Commission AFUDC guidance.¹¹ Reviewed NorthWestern's

¹¹ 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,

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methodology for determining the annual AFUDC rate to determine whether it was based on NorthWestern's own debt and equity book balances and to examine whether the short-term debt rate variance did not exceed 25 basis points. Reviewed work orders to test whether NorthWestern ceased accruing AFUDC during the following instances: (1) when an asset was placed in service; (2) during periods of suspension of construction; and (3) when plant was abandoned. Examined the components of NorthWestern's CWIP to determine whether NorthWestern only included amounts related to construction activities and properly allocated overheads.

Compliance with FERC Form No. 1

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

- *Reporting Process and Procedures* – Evaluated NorthWestern's financial reporting processes, procedures, and quality controls relating to the preparation of NorthWestern's FERC Form No. 1 filings.
- *Financial Reporting Instructions* – Evaluated NorthWestern's financial reporting for 2018 through 2020 to determine whether it complied with the account and page instructions of the FERC Form No. 1.
- *Financial Statement Account Balances* – Tied the account balances reported in NorthWestern's FERC Form No. 1 filings to NorthWestern's books and records (i.e. general ledger). To facilitate the review, audit staff reviewed select transactions to confirm the balances.
- *Account Variance Analysis* – Performed variance analyses for sample accounts reported in NorthWestern's FERC Form No. 1 filings with large balances, unusual activity, and/or significant fluctuations.
- *Notes to Financial Statements* – Reviewed the Notes to the Financial Statements in NorthWestern's FERC Form No. 1 filings for significant accounting matters and followed up with NorthWestern to understand financial statement and FERC-jurisdictional transmission formula rate implications.

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

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IV. Findings and Recommendations

1. Allowance for Funds Used During Construction

NorthWestern's method for calculating its AFUDC rate was inconsistent with the Commission's accounting regulations.

Specifically, NorthWestern inappropriately used prior month balances instead of prior year balances in the long-term debt and equity components for the purpose of computing its AFUDC rate and inappropriately included undistributed subsidiary earnings as a part of the equity component for the purpose of computing its AFUDC rate. Additionally, when applying AFUDC, NorthWestern improperly compounded its AFUDC on a monthly basis rather than compounding on a semi-annual basis and inappropriately included unpaid contract retention amounts in CWIP balances used in its AFUDC calculation.

These errors caused NorthWestern to over accrue AFUDC and to inappropriately overcharge FERC-jurisdictional transmission customers.

Pertinent Guidance

- 18 C.F.R. Part 101, EPI 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

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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.¹²

- 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.¹³
- Order No. 561 authorizes the compounding of AFUDC "no more frequently than semiannually."¹⁴

¹² 18 C.F.R. Part 101, Electric Plant Instruction No. 3(A)(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 and clarification granted*, Order No. 561-A, 59 FPC 1340 (1977) (Order No. 561-A), *order on clarification*, 2 FERC ¶ 61,050 (1978).

¹³ *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).

¹⁴ Order No. 561, 57 FPC 608, 612.

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- *Kern River Gas Transmission Co.*, 154 FERC ¶ 61,186, at P 17 (2016), stating: “The Commission has consistently upheld its general directive of FPC Order No. 561 that limits compounding of AFUDC to no more frequently than semiannual[ly].”

Background

To meet anticipated demand and reliability requirements, NorthWestern engaged in several major construction projects – including hydro generation upgrades, new transmission lines, transmission and distribution upgrades, etc. – during the audit period. NorthWestern’s accounting procedures included the accrual of AFUDC to CWIP. Audit staff reviewed NorthWestern’s calculation of the debt and equity cost components in its AFUDC rate calculations and application of its calculated AFUDC rate to construction project costs to test compliance with the Commission’s accounting regulations. NorthWestern computed separate AFUDC rates for its Montana and South Dakota utility operations.

EPI No. 3(A)(17), Allowance for Funds Used During Construction, sets the maximum AFUDC amounts chargeable to construction under the Commission’s regulations. The maximum AFUDC rate is calculated with actual balances for long-term debt, preferred stock, and common equity reported in the FERC Form No. 1 as of the end of the previous year; and the balances for CWIP and short-term debt are estimated as required, with appropriate adjustments as actual data becomes available. Audit staff reviewed the components and calculations of NorthWestern’s AFUDC rates to determine whether NorthWestern’s AFUDC rates and their application to NorthWestern’s CWIP were in compliance with the Commission’s accounting regulations.

Calculation of AFUDC rates

Long-Term Debt Component

Audit staff’s review of the long-term debt component revealed that NorthWestern inappropriately used the prior month balances for the long-term debt component when computing AFUDC. For example, the 2018 ending balance for long-term debt for the Montana operations was \$1,660,140,000; however, the figure that NorthWestern used for the long-term debt component of the AFUDC rate calculation was computed monthly based on the prior month’s balance sheet, ranging from \$1,660,140,000 in January 2019 to \$1,788,270,000 in December 2019 for NorthWestern’s Montana operations. Commission accounting regulations require the long-term debt component to be based on prior year end balances. Specifically, EPI No. 3(A)(17) requires that the long-term debt component “shall be the actual book balances as of the end of the prior year.” NorthWestern acknowledges that it used a different balance for long-term debt than the

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Commission's regulations require. After discussion with audit staff, NorthWestern revised its policies and procedures to ensure use of the prior year long-term debt ending balances for, respectively, the Montana and South Dakota utility operations, as the long-term debt components on their monthly AFUDC workpaper beginning in January 2021.

Equity Component

The Commission's accounting regulations require that the preferred stock and common equity component be based on prior year end balances for the AFUDC calculation. Audit staff determined that NorthWestern did not have preferred stock during the audit period. Audit staff also determined that NorthWestern inappropriately used the prior month balances instead of prior year end balances for the common equity component when computing AFUDC. EPI No. 3(A)(17) requires that the long-term debt, preferred stock, and common equity components "shall be the actual book balances as of the end of the prior year." NorthWestern acknowledged that it used a different balance for common equity than the Commission's accounting regulations require.

Audit staff's review of the common equity component that was included in NorthWestern's AFUDC calculation also revealed that NorthWestern inappropriately included balances from Account 216.1, Unappropriated Undistributed Subsidiary Earnings, in the equity component of the AFUDC rate calculation for 2018 and 2019. AFUDC includes the net cost of borrowed funds used for construction purposes and an allowed rate on other funds. Since the amounts in Account 216.1 were undistributed by the subsidiaries and therefore not available to finance construction, those amounts should not have been considered as funds available for construction in deriving the rates used in AFUDC. In Order No. 469, the Commission stated that undistributed earnings of subsidiaries are to be excluded from the common stockholder's equity in determining rate of return. NorthWestern acknowledged that Account 216.1 should not be included in AFUDC equity calculations and only prior year end balances of equity and debt should be used in AFUDC rate development. After discussion with audit staff, NorthWestern revised its policies and procedures to ensure use of the prior year ending balances and excluded Account 216.1 in the equity component on its monthly AFUDC workpaper beginning in January 2021.

Application of AFUDC

AFUDC Compounding

Audit staff tested NorthWestern's frequency of compounding its AFUDC – i.e., the frequency of adding calculated AFUDC to CWIP and commencing collecting AFUDC on the capitalized AFUDC – to determine whether the frequency met the Commission's semi-annual AFUDC compounding limit established in 1977 in Order No. 561 and

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continued to this day.¹⁵ Through discussion with NorthWestern staff, audit staff determined that NorthWestern improperly compounded AFUDC on a monthly basis in 2018 and 2019 rather than on a semi-annual basis. NorthWestern corrected the error and started compounding AFUDC on a semi-annual basis beginning in the first quarter of 2021.

CWIP Base

Audit staff reviewed NorthWestern's accounting policies and procedures for capitalizing AFUDC on construction projects. Audit staff determined that NorthWestern inappropriately included CWIP balances in its AFUDC rate calculation without first offsetting those balances against unpaid contract retention amounts and thereby effectively applying the calculated AFUDC rate to the unpaid contract retentions, thus accruing AFUDC on amounts not yet paid. The inclusion of these unpaid amounts as CWIP in the AFUDC calculations was not consistent with the Commission's accounting regulations. In accordance with EPI No. 3, contracted costs includible in CWIP balances, and thus AFUDC amount calculations, must represent amounts actually paid for work performed under a contract. Contract retentions that are not paid until future periods are not includible in AFUDC calculations. NorthWestern represented that it had not historically removed contract retention amounts from CWIP in its AFUDC calculation. After discussions with audit staff, NorthWestern revised its policies and procedures to track contract retention amounts and to remove these amounts from CWIP in its AFUDC calculations in the future.

Conclusion

As a result of NorthWestern's errors when computing AFUDC, audit staff determined that NorthWestern accrued AFUDC for 2019 in excess of the maximum

¹⁵ See Order No. 561, 57 FPC 608, 612 (rejecting monthly compounding of AFUDC, noting that monthly compounding "may result in excessive amounts capitalized," and holding that compounding of AFUDC occur "no more frequently than semiannually"); Order No. 561-A, 59 FPC 1340 (refusing, on rehearing, to permit more than semiannual compounding despite commenters' views that semiannual compounding might somewhat understate capital costs in some instances); *Trans-Elect NTD Path 15, LLC*, 117 FERC ¶ 61,214, at P 59 (2006) (stating that the Commission "required the use of semi-annual compounding to be used in the calculation of the AFUDC amount."), *order denying reh'g*, 119 FERC ¶ 61,093, at P 6 (2007); *Kern River Gas Transmission Co.*, 154 FERC ¶ 61,186, at P 17 (2016) (rejecting Kern River's request to use monthly AFUDC compounding and noting that "[t]he Commission has consistently upheld its general directive of FPC Order No. 561 that limits compounding of AFUDC to no more frequently than semiannual[ly]")

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amount of AFUDC allowed under the Commission's accounting regulations in EPI No. 3(A)(17). This led to the company including excessive AFUDC amounts in plant costs that were included in NorthWestern's annual transmission revenue requirements under its formula rate mechanisms, which resulted in Northwestern overcharging its transmission ratepayers.

Recommendations

DAA recommends that NorthWestern:

1. Revise its policies and procedures to ensure that its AFUDC base and rate calculation is consistent with Electric Plant Instruction (EPI) No. 3(A)(17) and other applicable Commission requirements. Revisions should include procedures to: use prior year ending balances as reported in NorthWestern's FERC Form No. 1 filings for the long-term debt and equity components; prevent balances in Account 216.1 from being included in the equity component; ensure AFUDC is compounded, at most, semi-annually; and prevent inclusion of unpaid contract retention amounts in the CWIP base in AFUDC calculations.
2. Provide training to staff on the revised policies and procedures described in the previous recommendation. Also, develop a training program that supports the provision of periodic training in this area, as needed.
3. Recalculate AFUDC for the period 2018 through 2021 in accordance with the requirements of EPI No. 3(A)(17) and the other pertinent guidance discussed in this finding. Based on the calculations, for periods in which AFUDC was over-accrued, submit a yearly estimate of over accruals to DAA within 60 days of receiving this audit report, with proposed corrected accounting entries and supporting documentation that reflects corrections to remove over-accrued AFUDC balances from plant and associated accounts, such as depreciation, income tax expense, accumulated provision for depreciation, and accumulated deferred income taxes (ADIT).
4. Revise electric plant, accumulated provision for depreciation, ADIT, and other account balances impacted by over-accrual of AFUDC after receiving DAA's approval of the proposed accounting entries, and restate and footnote the balances reported in the FERC Form No. 1 in the current and comparative years of the report, as necessary to reflect and disclose the revisions.

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5. Submit a refund report, within 60 days of receiving DAA's approval of the proposed accounting entries, to DAA for review that explains and details the following: (1) calculation of refunds that include the amounts of inappropriate recoveries that resulted from improper AFUDC computations during the audit period; (2) determinative components of the refund; (3) refund method; (4) the customers to receive refunds; and (5) period(s) refunds will be made.
6. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
7. Refund the amounts disclosed in the refund report to customers, with interest calculated in accordance with section 35.19(a) of Commission's regulations.

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2. Accounting for Revolving Credit Facility Upfront and Commitment Fees

NorthWestern inappropriately recorded in Account 181, Unamortized Debt Expense, upfront fees it paid when establishing its revolving line of credit, and inappropriately recorded in Account 921, Office Supplies and Expenses, commitment fees it paid for its revolving credit facility.

Pertinent Guidance

- 18 C.F.R. Part 101, Account 186, Miscellaneous Deferred Debits, states in part:
 - A. For Major utilities, this account shall include all debits not elsewhere provided for...which are in process of amortization....

- 18 C.F.R. Part 101, Account 930.2, Miscellaneous General Expenses, states:

This account shall include the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere.

- 18 C.F.R. Part 101, Account 181, Unamortized Debt Expense, states:

This account shall include expenses related to the issuance or assumption of debt securities. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, and the amounts thereof shall be charged to account 428, Amortization of Debt Discount and Expense. Any unamortized amounts outstanding at the time that the related debt is prematurely reacquired shall be accounted for as indicated in General Instruction 17.

- 18 C.F.R. Part 101, Account 921, Office Supplies and Expenses, states:
 - A. This account shall include office supplies and expenses incurred in connection with the general administration of the utility's operations which are assignable to specific administrative or general departments and are not specifically provided for in other accounts. This includes the expenses of the various administrative and general departments, the salaries and wages of which are includible in account 920.

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

Background

NorthWestern established two credit facilities with financial institutions for revolving lines of credit during the audit period. The primary revolving credit facility of \$400 million was entered into on December 12, 2016 with a termination date of December 21, 2021. The credit facility was replaced with a new facility on September 2, 2020 with a termination date of September 2, 2023. The second revolving credit facility of \$25 million was entered into on March 27, 2018 and extended annually to provide a swingline borrowing capability. As a condition of these agreements, NorthWestern paid an upfront fee associated with establishing or amending each agreement. In addition, NorthWestern paid quarterly commitment fees on the unused balance throughout the term of the agreements. The upfront fees paid for the new credit facilities totaled \$1,391,771 and the commitment fees totaled \$1,373,339 during the period from January 1, 2018 to April 30, 2021. Audit staff reviewed NorthWestern's accounting policies and procedures to record the borrowings, associated interest, upfront fees, and quarterly commitment fees associated with the revolving credit facilities.

Accounting for upfront and commitment fees

Audit staff determined NorthWestern inappropriately recorded upfront fees for new or amended revolving credit agreements in Account 181, Unamortized Debt Expense. The balance was amortized to Account 428, Amortization of Debt Discount and Expense, over the expected term of the agreement. Audit staff also determined that NorthWestern inappropriately recorded the quarterly commitment fees in Account 921, Office Supplies and Expenses. NorthWestern represented it believed that Item 2 in the definition for Account 921, which refers to "bank messenger and service charges," included commitment fees. NorthWestern treated commitment fees similar to a bank service charge and therefore classified these costs within Account 921.

NorthWestern's accounting to record the upfront fees associated with establishing the two lines of credit by charging Account 181 is inappropriate. Account 181 provides for expenses related to the issuance or assumption of debt securities. The upfront fees are not debt issuance cost but rather cost associated with establishing the line of credit. The fees are more appropriately accounted for in Account 186, Miscellaneous Deferred Debits. Account 186 provides for the recording of debits not elsewhere provided for in the Uniform System of Accounts, which are in process of amortization, such as the cost of the upfront fees incurred by NorthWestern. The upfront fees should have been

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amortized to Account 930.2, Miscellaneous General Expenses.¹⁶ Audit staff found that the revolving line of credit agreements were not established in conjunction with the acquisition of debt or directly associated with outstanding debt. Rather, NorthWestern represented that it entered into the agreements to create liquidity for general purpose needs. Additionally, the quarterly commitment fees associated with the revolving line of credit agreements that NorthWestern recorded in Account 921 should have been recorded in Account 930.2. Account 930.2 provides for the cost of labor and expenses incurred for the general management of a utility not provided for elsewhere in the Uniform System of Accounts, and the upfront fees and quarterly commitment fees most resemble a banking charge to support NorthWestern's utility operations as a whole when the credit facility is not associated with debt.

Recommendations

DAA recommends that NorthWestern:

8. Revise existing accounting policies, procedures, and practices relating to accounting for credit agreement expenses used for general liquidity, such as upfront, commitment, revolving line of credit, and letter of credit fees, to be consistent with Commission accounting requirements.
9. Train relevant staff on the revised accounting policies and provide periodic training, as needed.
10. Submit proposed accounting entries and supporting documentation to DAA to reflect the transfer of credit agreement-related balances improperly recorded in Account 181 to Account 186, Miscellaneous Deferred Debits.
11. Revise miscellaneous deferred debit balances to appropriately account for and report credit agreement-related balances after receiving DAA's assessment of the proposed accounting entries, and restate and footnote the balances reported

¹⁶ Upfront and quarterly commitment fees for credit facilities acquired in compliance with the provisions of specific debt agreements should be recorded as interest expense and included as a cost of the short-term or long-term debt they support, consistent with Commission precedent. *See System Energy Resources, Inc.*, Opinion No. 333, 48 FERC ¶ 61,321, at 62,064 (1989) (holding that bank fees for letters of credit associated with construction bonds for nuclear generating plant lowered the cost of interest on the specific issuances of long-term construction bonds, thereby functioning as interest on such bond issuances, and should be recorded in Account 427, Interest on Long-Term Debt).

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in the FERC Form No. 1 in the current and comparative years of the report, as necessary, to reflect and disclose the revisions.

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3. Accounting for Membership Dues

NorthWestern misclassified \$19,188, constituting part of the lobbying portion of membership dues it paid during the audit period and therefore associated with nonoperating activities, in Account 930.2, Miscellaneous General Expenses, and Account 921, Office Supplies and Expenses, instead of in Account 426.4, Expenditures for Certain Civic, Political and Related Activities. This led to a reporting error in its 2018 FERC Form No. 1.

Pertinent Guidance

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

This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing referenda, legislation or ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.
- 18 C.F.R., Part 101, Account 921, Office Supplies and Expenses, states, in part:

A. This account shall include office supplies and expenses incurred in connection with the general administration of the utility's operations which are assignable to specific administrative or general departments and are not specifically provided for in other accounts.
- 18 C.F.R., Part 101, Account 930.2, Miscellaneous General Expenses, states, in part:

This account shall include the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere.

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Background

Audit staff reviewed NorthWestern's accounting policies, processes, and procedures regarding accounting for membership dues and fees during the audit period. NorthWestern is a member of numerous organizations that perform lobbying activities in addition to other support functions on behalf of their members, such as the American Gas Association and the National Hydropower Association. NorthWestern paid membership dues or fees and received invoices that separately identified the portions that supported the organizations' lobbying activities. Audit staff evaluated detailed accounting records and supporting documentation, and interviewed employees with responsibility for ensuring that lobbying-related expenses were accounted for correctly.

Audit staff's review found that NorthWestern inappropriately accounted for the lobbying portion of its membership dues and fees totaling \$14,688 in Account 930.2, and \$4,500 in Account 921; rather than in Account 426.4 in 2018. Account 426.4 provides for reporting expenditures for the purpose of influencing public opinion, such as lobbying expenses. NorthWestern should have recorded the lobbying portion of the membership dues and fees in Account 426.4. NorthWestern attributed the misclassification to an oversight.

Upon inquiry of NorthWestern personnel, NorthWestern stated that during its review of the Commission Staff's 2018 Report on Enforcement,¹⁷ the company discovered that it had improperly accounted for the lobbying portion of its membership dues and fees and that this error was frequently found and corrected in Commission audits and described in audit reports' findings. NorthWestern stated that, while originally coded to Account 930.2 and reported as operating expense in NorthWestern's FERC Form No. 1 submission for 2018, the lobbying portion of membership dues and fees was reclassified to Account 426.4, via a top-side entry in 2018, to ensure that the lobbying expenses were not included in NorthWestern's South Dakota operation's FERC-jurisdictional transmission revenue requirement. NorthWestern did not have a FERC-jurisdictional transmission formula rate for its Montana operations during 2018. NorthWestern represented that the accounting systems were modified in the beginning of 2019 to correct the reporting error.

While NorthWestern attributed the reporting error to an oversight, audit staff concluded that, prior to the changes implemented in 2019 described above, the company did not have sufficient accounting procedures and controls in place to ensure that the portion of membership dues and fees designated for lobbying activities was correctly accounted for.

¹⁷ See 2018 Report on Enforcement, Docket No. AD07-13-12 (Office of Enforcement, Nov. 15, 2018).

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Recommendations

DAA recommends that NorthWestern:

12. Strengthen policies, procedures, and controls to account for the lobbying portion of membership dues consistent with the Commission's accounting requirements.
13. Train relevant staff on the revised policies, procedures, and controls and provide periodic training in this area, as needed.
14. Perform an analysis to identify other membership dues that were improperly accounted for during the audit period. Provide the results of the analysis to audit staff within 60 days of receiving this report.
15. Submit a refund report, within 60 days of receiving this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amounts of inappropriate recoveries that resulted from improper accounting of lobbying costs in transmission formula rates during the audit period; (2) determinative components of the refund; (3) refund method; (4) customers to receive the refunds, and (5) period(s) refunds will be made.
16. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
17. Refund the amounts disclosed in the refund report to FERC-jurisdictional transmission customers, with interest calculated in accordance with section 35.19(a) of the Commission's regulations.

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4. Accounting for Lobbying Expenses

NorthWestern misclassified \$341,902 of lobbying expenses in various administrative and general expense accounts instead of Account 426.4, Expenditures for Certain Civic, Political and Related Activities. This resulted in NorthWestern inappropriately including these costs in transmission formula rate service cost determinations. As a result, FERC-jurisdictional transmission customers were overbilled \$32,509 in Montana and \$2,584 in South Dakota.

Pertinent Guidance

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

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

Background

Audit staff reviewed NorthWestern's accounting policies, processes, and procedures regarding accounting for its civic, political, and lobbying activities during the audit period. NorthWestern's government and regulatory affairs department provides a number of functions to the organization – including monitoring of legislation, interacting with regulatory officials, and overseeing contract lobbyists – that include discussions with public officials about state and federal regulatory emerging industry issues. NorthWestern uses its own staff and contract lobbyists to carry out these functions. During the audit period, NorthWestern participated in lobbying activities that involved the Montana and South Dakota electric utility operations.

Audit staff discovered that during the audit period NorthWestern misclassified \$341,902 of lobbying expenses to various administrative and general expense accounts. Further analysis and subsequent inquiry with NorthWestern staff identified that the

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misclassified expenses included internal labor for staff that worked on lobbying activities, lobbying related business and travel expenses, and contract lobbyist invoices. These misclassified lobbying expenses were related to both the Montana and South Dakota electric utility operations for years 2018 and 2019. NorthWestern represented to audit staff that, during the audit period, there was a restructuring of its regulatory and legal budgets where a manual process was used to code the invoices. This new process and inadequate training led to lobbying expenses being charged to the incorrect FERC accounts. NorthWestern also presented a time study review of its employees' work hours for employees that worked on lobbying activities to assist in quantifying the total amount of the lobbying expense misclassification.

NorthWestern should have recorded these lobbying expenses in Account 426.4. Account 426.4 provides for reporting expenditures for the purpose of influencing public opinion, such as lobbying expenses. NorthWestern inappropriately included these lobbying expenses in the Montana operation's and South Dakota operation's transmission formula rate annual transmission revenue requirement determinations and overbilled FERC-jurisdictional transmission customers. NorthWestern inappropriately included \$69,465 in its South Dakota operation's transmission formula rate inputs, which resulted in a total overbilling of \$2,584 for 2018 and 2019. NorthWestern inappropriately included \$176,267 in its Montana operation's transmission formula rate inputs for 2019 that resulted in an overbilling of \$32,509. NorthWestern also misclassified \$96,170 of lobbying expenses in 2018, before its Montana transmission formula rate was in effect, thus not having an impact on transmission formula rate determinations. NorthWestern represents that it modified its tracking procedures in 2020 so that lobbying expenses are recorded to Account 426.4 instead of administrative and general expense accounts.

While NorthWestern attributed the error to inadequate training, audit staff concluded that the company did not have sufficient accounting procedures and controls in place to ensure lobbying activities were correctly accounted for in 2018 and 2019. NorthWestern's inappropriate inclusion of lobbying expenses in the Montana and South Dakota operations' formula rate inputs was improper and resulted in FERC-jurisdictional transmission customers being overbilled. NorthWestern is required to refund these over billed amounts to FERC-jurisdictional transmission customers with interest.

Recommendations

DAA recommends that NorthWestern:

18. Develop and implement procedures and policies to track, report, review, and account for lobbying and other expenses of activities associated with influencing legislation and with other political activity consistent with Commission accounting requirements.

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19. Train relevant staff on the procedures and policies and provide periodic training in this area, as needed.
20. Perform an analysis to identify other lobbying costs that were improperly accounted for during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.
21. Submit a refund report, within 60 days of receiving this audit report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amounts of inappropriate recoveries that resulted from improper accounting of lobbying costs in transmission formula rates during the audit period; (2) determinative components of the refund; (3) refund method; (4) customers to receive the refunds, and (5) period(s) refunds will be made.
22. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
23. Refund the amounts disclosed in the refund report to FERC-jurisdictional transmission customers, with interest calculated in accordance with section 35.19(a) of the Commission's regulations.

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5. Miscellaneous Accounting Classification Errors

NorthWestern misclassified various costs in its books and records. As a result, the amounts reported on FERC Form No. 1 for Administrative and General Expenses were incorrect, which impacted development of the annual transmission revenue requirements used for determining charges for NorthWestern's FERC-jurisdictional transmission customers in Montana and South Dakota. Specifically, misclassification of certain general advertising expenses in Account 923, Outside Services Employed, resulted in overbillings to FERC-jurisdictional transmission customers.

Pertinent Guidance

- 18 C.F.R Part 101, Account 921, Office Supplies and Expenses, states in part:
 - (a) This account shall include office supplies and expenses incurred in connection with the general administration of the utility's operations which are assignable to specific administrative or general departments and are not specifically provided for in other accounts. This includes the expenses of the various administrative and general departments, the salaries and wages of which are includible in account 920.
 -
 - Items
 -
 - 7. Membership fees and dues in trade, technical, and professional associations paid by a utility for employees. (Company memberships are includible in account 930.2.)
- 18 C.F.R Part 101, Account 923, Outside Services Employed, states in part:
 - (a) This account shall include the fees and expenses of professional consultants and others for general services which are not applicable to a particular operating function or to other accounts. It shall include also the pay and expenses of persons engaged for a special or temporary administrative or general purpose in circumstances where the person so engaged is not considered as an employee of the utility.
- 18 C.F.R. Part 101, Account 926, Employee Pensions and Benefits, states in part:

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

.....
Items

.....

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

.....

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

- 18 C.F.R. Part 101, Account 930.1, General Advertising Expenses, states in part:

(a) This account shall include the cost of labor, materials used, and expenses incurred in advertising and related activities, the cost of which by their content and purpose are not provided for elsewhere.

Note A:

Properly includible in this account is the cost of advertising activities on a local or national basis of a good will or institutional nature, which is primarily designed to improve the image of the utility or the industry, including advertisements which inform the public concerning matters affecting the company's operations, such as, the cost of providing service, the company's efforts to improve the quality of service, the company's efforts to improve and protect the environment, etc. Entries relating to advertising included in this account shall contain or refer to supporting documents which identify the specific advertising message. If references are used, copies of the advertising message shall be readily available.

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- 18 C.F.R. Part 101, Account 930.2, Miscellaneous General Expenses, states in part:
 - (a) This account shall include the cost of labor and expenses incurred in connection with the general management of the utility not provided for elsewhere.
.....
Items
.....
 - 2. Industry association dues for company memberships.
 - 3. Contributions for conventions and meetings of the industry.
- NorthWestern, FERC FPA Electric Tariff, FERC OATT Vol. 5 NWE Montana OATT 1.0.0, Attachment O, Att O – Formula Rate Protocols and Template, Table 6 – Transmission Formula Rate Template, Note H, states in part:

General Advertising Expenses (FERC Account 930.1) will be excluded.
- SPP Open Access Transmission Tariff, Sixth Revised Volume No. 1, Attachment H, Addendum 27 (NorthWestern’s formula rate), Attachment H, Appendix A, states in part:

Allocated Administrative & General Expenses

54 Total A&G

.....

59 Less General Advertising Exp Account 930.1

60 Administrative & General Expenses Sum (Lines 54 to 55) – Sum (Lines 56 to 59)

61 Wage & Salary Allocator

62 Administrative & General Expenses Allocated to Transmission

Background

Audit staff reviewed certain operations of NorthWestern’s Accounts Payable department, which is responsible for receiving and coding invoices for the purpose of recording invoice amounts in the correct FERC account. After invoices are received, they are processed using the SAP Workflow PTS system, where an automated process is used to link identifying information from the invoice to the master vendor list. Accounts

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Payable staff then review the invoices for proper account coding, and payment authorization and approval. After an invoice receives approval, Accounts Payable routes the invoice to a payment processor. During the audit period, NorthWestern had five invoice payment processors and one Accounts Payable Manager.

During fieldwork, audit staff reviewed a sample of expenses charged to administrative and general expense accounts to determine whether the charges were accounted for in accordance with the Commission’s accounting requirements. The sample included charges in 2019 to Accounts 920, Administrative and General Salaries; 921, Office Supplies and Expenses; 923, Outside Services Employed; 926, Employee Pensions and Benefits; 930.1, General Advertising Expenses; and 930.2, Miscellaneous General Expenses. As part of this review, audit staff examined NorthWestern’s invoicing and accounts payable processes, assessed supporting documentation, and interviewed employees who performed relevant accounting functions. From this review of a sample of transactions, audit staff determined that NorthWestern misclassified certain administrative and general expenses. Specifically, audit staff identified the following misclassifications:

Description	Account Used	Proper Account	Amount
Company Membership Dues	921/923	930.2	\$28,500
Educational Reimbursement Program	923	926	\$7,927
Employee Relocation Program	921/923	926	\$36,320
Advertising	923	930.1	\$34,880
Life Insurance Premium	923	926	\$4,495
Training Classes	923	926	\$9,740

NorthWestern should have classified the transactions mentioned above in the proper account as prescribed in the Uniform System of Accounts Prescribed for Public Utilities and Licensees at 18 C.F.R. Part 101. Audit staff has determined that the misclassifications identified above, with the exception of advertising expense coded to Account 923 instead of Account 930.1, General Advertising Expenses, would not have impacted transmission formula rate billings. Because items recorded in Account 930.1 are to be excluded from NorthWestern’s transmission formula rates under the applicable tariffs, improperly recording the general advertising expenses in Account 923 rather than 930.1 did improperly increase formula rate billings. Audit staff’s determination is based on the administrative and general expense accounts above being applied the same Wages and Salary Allocator for each respective formula rate for the separate South Dakota and Montana operations. For 2020, the Wages and Salary Allocator applied to the administrative and general expenses for the Montana operations was 18.25% and for the South Dakota operations was 3.83%. Moreover, since the misclassified costs identified by audit staff were based on a sample, NorthWestern should perform an analysis of its

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operating expense accounts and service requests to identify other costs improperly accounted for during the audit period.

Recommendations

DAA recommends that NorthWestern:

24. Strengthen policies, procedures, and controls to ensure that NorthWestern records the different administrative and general expenses in the proper accounts consistent with Commission accounting requirements.
25. Train relevant staff on the revised policies, procedures, and controls and provide periodic training in this area, as needed.
26. Perform an analysis to identify other administrative and general expenses that were improperly accounted for during the audit period. Provide the results of the analysis to audit staff within 60 days of the date of issuance of this audit report.
27. If the net results of the analysis from Recommendation 26 and the errors identified in this finding impacted formula rate billings, submit a refund report, within 60 days of receiving this report, to DAA for review that explains and details the following: (1) calculation of refunds that include the amounts of inappropriate recoveries that resulted from improper accounting of administrative and general expense impacting charges under transmission formula rates during the audit period; (2) determinative components of the refund; (3) refund method; (4) customers to receive refunds; and (5) period(s) refunds will be made.
28. File a refund report with the Commission after receiving DAA's assessment of the refund analysis.
29. Refund the amounts disclosed in the refund report to FERC-jurisdictional transmission customers, with interest calculated in accordance with section 35.19(a) of the Commission's regulations.

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V. NorthWestern's Response



April 29, 2022

Gerald Williams, Director & Chief Accountant
Division of Audits and Accounting | Office of Enforcement
Federal Energy Regulatory Commission
888 First Street NE, Room 5K-13
Washington, DC 20426

Re: *NorthWestern Corporation*, Docket No. FA20-7-000
Response to Draft Audit Report

Dear Mr. Williams:

NorthWestern Corporation d/b/a NorthWestern Energy submits this response to the draft audit report dated April 14, 2022. NorthWestern Energy agrees with the five findings and agrees to implement the 29 recommendations.

Within 30 days after the final report is issued, NorthWestern Energy will submit an implementation plan addressing the status of the 29 recommendations (both completed and open) and a timeline for completing each open recommendation. Further, NorthWestern Energy will submit quarterly reports until all corrective actions are complete, with the first report expected to be submitted by July 31.

Respectfully submitted,

Jeff B. Berzina
Controller
Jeffrey.Berzina@northwestern.com
(605) 390-9184

cc: Heather H. Grahame