**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TENNESSEE**

**April 5, 2001**

| | | |
|---|---|---|
| **IN RE:** | ) | |
| | ) | |
| **GASCO DISTRIBUTION SYSTEMS, INC.** | ) | **Docket No. 00-00998** |
| **ACTUAL COST ADJUSTMENT (ACA) AUDIT** | ) | |

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## NOTICE OF FILING BY ENERGY AND WATER DIVISION OF THE TENNESSEE REGULATORY AUTHORITY

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Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, Energy and Water Division of the Tennessee Regulatory Authority gives notice of its filing of the Gasco Distribution Systems, Inc.'s ACA Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of Gasco Distribution Systems, Inc. (the "Company").

2. The Company's ACA filing was received on October 23, 2000, and the Staff completed its audit of same on March 29, 2001.

3. On March 29, 2001, the Energy and Water Division issued its preliminary ACA audit findings to the Company, and on April 5, 2001, the Company responded thereto.

4. The preliminary ACA audit report was modified to reflect the Company's responses and a final ACA audit report (the "Report") resulted therefrom. The Report is attached hereto as <u>Exhibit A</u> and is fully incorporated herein by this reference. The Report

contains the audit findings of the Energy and Water Division, the Company's responses thereto and the recommendations of the Energy and Water Division in connection therewith.

5. The Energy and Water Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the recommendations and findings contained therein.

Respectfully Submitted:

Butch Phillips

Butch Phillips
Energy and Water Division of the
Tennessee Regulatory Authority

## CERTIFICATE OF SERVICE

I hereby certify that on this 5th day of April, 2001, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Mr. K. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Mr. Fred Steele
President and Chief Executive Officer
Gasco Distribution Systems, Inc.
4435 East Pike
Zanesville, OH 43701

Mr. Gordon Brothers
Treasurer and Chief Financial Officer
Gasco Distribution Systems, Inc.
4435 East Pike
Zanesville, OH 43701

Butch Phillips

Butch Phillips

COMPLIANCE AUDIT REPORT

OF

**<u>GASCO DISTRIBUTIONS SYSTEMS, INC.</u>**

**<u>ACTUAL COST ADJUSTMENT</u>**

**<u>Docket # 00-00998</u>**

PREPARED BY

**<u>TENNESSEE REGULATORY AUTHORITY</u>**

ENERGY AND WATER DIVISION

APRIL, 2001

EXHIBIT

A

COMPLIANCE AUDIT

**GASCO DISTRIBUTIONS SYSTEMS, INC.**

**ACTUAL COST ADJUSTMENT**

**Docket # 00-00998**

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## I. JURISDICTION AND POWER OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (T.C.A.) §65-4-104 gave jurisdiction and control over public utilities to the Tennessee Public Service Commission. By virtue of Chapter 305 of the Public Acts of 1995, jurisdiction and control over public utilities was transferred from the Tennessee Public Service Commission to the Tennessee Regulatory Authority (the "TRA" or "Authority") on July 01, 1996. T.C.A. §65-4-104 states that:

> The Authority shall have general supervision and regulation of, jurisdiction, and control over, all public utilities...

T.C.A states further in §65-4-111 that the public utilities are to maintain a Uniform System of Accounts:

> The Authority shall have the power after hearing, upon notice, by order in writing to require every public utility... to keep its books, records, and accounts so as to afford an intelligent understanding of the conduct of its business, and to that end to require every public utility of the same class to adopt a uniform system of accounting. Such system shall conform, where applicable to any system adopted or approved by the Interstate Commerce Commission of the United States. And to furnish annually, or at other times as the Authority may require, a detailed report of finances and operations as shown by said system of accounts.

The TRA responded to T.C.A. §65-4-111 by establishing its own rule 1220-4-1-1.11 regarding the uniform system of accounts which public utilities should maintain. The TRA's rule provides:

> The following uniform system of accounting will be followed by utilities and other companies making periodic reports to the Authority:
>
> 1. For Classes A and B gas companies - Uniform System of Accounts as adopted by the National Association of Regulatory Utility Commissioners as revised June 30, 1972, and any amendments or revisions pertaining thereto.

The TRA received its authority to examine the books and records of public utilities from T.C.A. §65-4-105 which states that the TRA would possess all the other powers conferred on the TRA. T.C.A. §65-3-108 gives the TRA:

> full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

## II. PURPOSE OF COMPLIANCE AUDITS

The two basic reasons for compliance audits are to assure compliance with the Uniform System of Accounts (USOA) and to assure that the utility is following all rules, regulations and directives adopted by the TRA.

Compliance audits provide the foundation of assurance underlying the basic objective of regulatory accounting, which is to provide a uniform method of recording transactions among similar companies. This uniform record keeping is accomplished through the adoption of the USOA and insures the integrity, reliability, and comparability of the financial data contained in financial reports filed with the TRA, which provides the TRA with one of its most useful regulatory tools for establishing just and reasonable rates.

## III. DESCRIPTION OF PURCHASED GAS ADJUSTMENT (PGA) RULE

The Tennessee Regulatory Authority issued an Order in Docket No. G-86-1, which adopted a new PGA rule beginning July 1, 1992. The PGA Rider is intended to permit the Company to recover, in a timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect gas costs from its customers. This PGA consists of three major components:

1) **The Actual Cost Adjustment (ACA)**
2: **The Gas Charge Adjustment (GCA)**
3) **The Refund Adjustment (RA)**

The ACA is the difference between the revenues billed customers by means of the GCA and the cost of gas invoiced the Company by suppliers plus margin loss (if allowed by order of the TRA in another docket) as reflected in the Deferred Gas Cost account. The ACA then "trues-up" the difference between the actual gas costs and the gas costs recovered from the customer through a surcharge or a refund. The RA refunds the "true-up" along with other supplier refunds.

For a more complete definition of the GCA and RA, please see the PGA Formula in Appendix A.

## IV. AUDIT TEAM

The TRA's Energy and Water Division is responsible for conducting ACA audits. Butch Phillips and Pat Murphy of the Energy and Water Division conducted the audit.

## V. OBJECTIVE AND SCOPE OF AUDIT

The order for Docket G-86-1 required that the Company

> each year...shall file with the Authority an annual report reflecting the transactions in the Deferred Gas Cost Account. Unless the Authority provides written notification to the Company within one hundred eighty (180) days from the date of filing the report, the Deferred Gas Cost Adjustment Account shall be deemed in compliance with the provisions of this Rule...

The objective of this audit was to determine that Purchased Gas Adjustments, which are encompassed by the ACA and were described earlier, approved by the TRA during the period from July 1, 1999, to June 30, 2000, had been calculated correctly and were supported by appropriate source documentation. To accomplish this task, the Staff conducted in-house audit work, during which the Company's calculations of gas costs incurred and gas costs recovered were tested

The Staff also audited a sample of customer bills to determine if the proper PGA rates were being applied in the Company's calculation of the customers' bills. These bills were selected to be representative of the residential, commercial and industrial customers in each of the Company's service areas. The sample was selected from all twelve months of the audit period. After recalculating each sample bill, the Staff discovered that the correct ACA refund factor was not applied to customer bills from November 1999 through June 2000. This fact is detailed in Staff Finding #1 on page 6 of this report.

The Staff's last ACA audit of Gasco Distribution Systems, Inc. was conducted in 1999 covering the period from July 1, 1998 to June 30, 1999.

## VI. BACKGROUND INFORMATION ON COMPANY AND GAS SUPPLIERS

Gasco Distribution Systems, Inc. (Company), with its office located in Jellico, Tennessee, is a subsidiary of The Titan Energy Group, Inc., which has its headquarters at 4435 East Pike, Zanesville, Ohio. The Company is a gas distributor which provides service to the City of Jellico, located in northeast Tennessee in Campbell county. It has approximately 381 customers and an annual sales volume of approximately 46,200 MCF. In addition to Tennessee, Gasco Distributions Systems also operates in Kentucky, Ohio, Pennsylvania, and West Virginia.

The natural gas used to serve this area is provided by GASCO, Inc. (the fuel manager), through long-term contracts with nonaffiliated third parties that deliver gas to the city gate.

## VII. ACA FINDINGS

The Company submitted an ACA filing on October 23, 2000, covering the period July 1, 1999, to June 30, 2000. This filing reflected an **over-collection** of gas costs from Tennessee customers for the period of **$12,468.52**. The Staff's audit results showed an additional over-collection in the ACA account of $11,616.25. A list of the exceptions noted is summarized below.

**SUMMARY:**

| | | | |
|---|---|---|---|
| FINDING #1 | ACA factor application | $11,317.93 | over-collection |
| FINDING #2 | Interest on account balance | $72.88 | under-collection |
| FINDING #3 | Interest on account balance | $371.20 | over-collection |
| | **Net Result** | **$11,616.25** | **over-collection** |

**FINDING #1:**

**Exception**

The Company did not apply the correct ACA refund factor for billing months November 1999 through June 2000.

**Discussion**

The Company did not apply the correct ACA refund factor to their customer bills for the months of November 1999 through June 2000. This was due to a clerical error on the part of the Company. This oversight resulted in an over-collection of $11,317.93. The Company had similar problems during the last ACA period, July 1998 through June 1999, failing to apply the ACA refund factor to customers' bills for several months. That error was partly responsible for the Company's high beginning balance at July 1999.

**Company Response**

We acknowledge the oversight, but we think we have resolved this problem for future rate changes. Starting this year, we have implemented a procedure where the billing clerk provides the officer in charge with a task sheet showing the changes that were made to all rates and GCR (ACA) factors and then the officer checks these rates against the approved tariff prior to any bills going out. The billing clerk will continue to test a sample of bills to see that they compute the right amounts as we have always done the first month of the new billing rates. This should prevent any future errors before they occur.

Additionally since the start of winter, we are no longer over-collected, but are in fact under-collected. Assuming a total beginning over collection of $24,084.76 with this error and the additional interest, we are $44,653.61 under collected by January 2001 in Jellico Division alone.

**FINDING #2:**

**Exception**

The Company used incorrect interest rates in calculating the interest on the ACA refund.

**Discussion**

The Purchased Gas Adjustment Rule states that the balance in the ACA account "shall be adjusted for interest at the rate provided for the calculation of interest with respect to the Refund Adjustment". The Company used incorrect interest rates for the entire audit period. The Staff recalculated the Company's filing using the correct interest rates, resulting in a $72.88 under-collection of interest costs.

**Company Response**

We used the monthly percentages rather than the quarterly determined by the average of these monthly rates. We don't anticipate any future problems with this computation.

**FINDING #3:**

**Exception**

The Staff calculated an over-collection of interest in the amount of $371.20.

**Discussion**

The Staff recalculated the amount of interest due to customers based upon Findings #1 and #2.

**Company Response**

The company agrees with the interest adjustment computed as the results of Finding #1.

## VIII. CONCLUSIONS AND RECOMMENDATIONS

We reviewed the gas costs and recoveries of Gasco Distribution Systems, Inc. for the 12-month period ended June 30, 2000. Based on Findings noted, the balance in the refund due customers account as of June 30, 2000 should be a **negative $24,084.77**. The correct ACA adjustment factor to be applied to customer bills, beginning with the April 2001 billing period, is a **negative $0.5017** (see Attachment 1). This factor takes into account the over-collection calculated in this audit period. The factor will stay in effect until the Staff's next audit, at which time a new factor will be calculated. The Company's next filing will cover the period July 1, 2000 to June 30, 2001.

Based on Staff Findings in the current audit and the fact that the Company did not remedy the issues in the last audit, we must conclude that Gasco has failed to comply with the Actual Cost Adjustment component of the Purchased Gas Adjustment ("PGA") Rule. **This adverse opinion is of great concern to the Staff**. The Company has shown deficiency in the following areas:

> **Timely filing of ACA**. While the PGA Rule does not specify the exact timing of the required annual filing, it is the Staff's expectation that companies will file within a reasonable time following the close of the period to be audited. Gasco's filing period ended June 30, 2000. Using TRA Rule 1220-4-1-.10(b) as a guideline, a reasonable time would approximate 60 days. Gasco's filing was received on October 23, 2000, 115 days following the close of the audit period.
>
> **Application of the ACA factor to customers' bills**. The three large gas companies that the TRA regulates calculate their ACA factor(s) at the end of the reporting period and automatically place this factor(s) into effect after Staff's review and approval of an appropriate PGA filing. After the fact, the Staff audits the deferred gas cost account and any findings are rolled in to the next audit period. However, the smaller gas companies, such as Gasco, do not have the staff or expertise to independently calculate and file a PGA in order to implement a surcharge (refund) factor prior to the Staff's audit. Therefore, the Staff reviews the company's calculations, makes any corrections necessary to the final balance due to or due from the customers and advises the company the correct factor to implement starting with the next billing following the release of the audit report.
>
> In the last audit (Docket # 99-00647), Staff advised Gasco that the correct ACA adjustment factor to apply to customer bills, beginning with the November 1999 billing, was a **negative $0.5915 (refund).** The Authority Order stated that "The ACA Audit Report,...is approved and adopted, including the findings and recommendations contained therein."[1] Staff Finding #1 reveals that the Company failed to change its billing system to implement the correct factor upon receiving the Staff's audit report. The Company states that this factor was not implemented

[1] TRA Order, dated November 24, 1999, page 2, paragraph 1.

until November 2000, a year after the change was ordered. This error materially contributed to the fact that the company was able to decrease their beginning over-collected balance **by only $2,342.45** during the twelve (12) month reporting period. **The Company was cited for this error in the last audit (Finding #2).** This indicates a **serious** flaw in the Company's internal accounting control. The Company was **out of compliance for 365 days** and could be subject to penalties, as outlined in T.C.A. §65-4-120.[2]

**Use of incorrect interest rates**. As noted in Finding #2, the Company used incorrect interest rates in its calculations for each month of the audit period. The interest rate is prescribed by the Energy and Water Division of the Tennessee Regulatory Authority on a quarterly basis. The rate is calculated according the formula specified in the PGA Rule (TRA Rule 1220-4-7-.03(1)(b)2(vii)). Each quarter, the interest rate letter is sent to all the gas companies. The Company has stated that one of its employees misinterpreted the letter and used the prime rates for each month listed in the computation of the arithmetic mean. However, the Staff maintains that the letter is very clear as to the rate that applies to the appropriate calendar quarter. **The Company was cited for this error in the last audit (Finding #3).** This is an example of extreme carelessness on the part of the Company.

The Company is currently under review for other infractions of the Authority rules, in Dockets 97-00160 and 97-00293. The Staff would recommend to the Authority that this compliance report be officially noticed and incorporated into that docket.

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[2] T.C.A. §65-4-120 states that "Any public utility which violates or fails to comply with any lawful order, judgement, finding, rule, or requirement of the commission, shall in the discretion of the commission be subject to a penalty of fifty dollars ($50.00) for each day of any such violation or failure, …"

## APPENDIX A

## PGA FORMULA

The computation of the GCA can be broken down into the following formulas:

$$\text{Firm GCA} = \frac{D + DACA}{SF} - DB + \frac{P + T + SR + CACA}{ST} - CB$$

$$\text{Non-Firm GCA} = \frac{P + T + SR\ \ CACA}{ST} - CB$$

where

| | | |
|---|---|---|
| GCA | = | The Gas Charge Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places. |
| D | = | The sum of all fixed Gas Costs. |
| DACA | = | The demand portion of the ACA. |
| P | = | The sum of all commodity/gas charges. |
| T | = | The sum of all transportation charges. |
| SR | = | The sum of all FERC approved surcharges. |
| CACA | = | The commodity portion of the ACA. |
| DB | = | The per unit rate of demand costs or other fixed charges included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves). |
| CB | = | The per unit rate of variable gas costs included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves). |
| SF | = | Firm Sales. |
| ST | = | Total Sales. |

The computation of the RA can be computed using the following formulas:

$$\text{Firm RA} = \frac{DR1 - DR2}{SFR} + \frac{CR1 - CR2 + CR3 + i}{STR}$$

$$\text{Non-Firm RA} = \frac{CR1 - CR2 + CR3 + i}{STR}$$

where

| | | |
|---|---|---|
| RA | = | The Refund Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places. |
| DR1 | = | Demand refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo. |
| DR2 | = | A demand surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment. |
| CR1 | = | Commodity refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo. |
| CR2 | = | A commodity surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment. |
| CR3 | = | The residual balance of an expired Refund Adjustment. |

i = Interest on the "Refund Due Customers" account, using the average monthly balances based on the beginning and ending monthly balances. The interest rates for each calendar quarter used to compute such interest shall be the arithmetic mean (to the nearest one-hundredth of one percent) of the prime rate value published in the "Federal Reserve Bulletin" or in the Federal Reserve's "Selected Interest Rates" for the 4th, 3rd, and 2nd months preceding the 1st month of the calendar quarter.

SFR = Firm sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.

STR = Total sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.

## Gasco Distributions Systems, Inc.

## Calculation of the ACA factor

| Line No. | Factor to be applied to residential, commercial and industrial customers: | | |
|---|---|---|---|
| 1 | Cost of Gas Purchased (7/99 - 6/00) | 198,507.82 | |
| 2 | Cost of Gas Recovered | 208,158.75 | |
| 3 | Under/(Over) Recovery | (9,650.93) | |
| 4 | Interest on Average Monthly Balances | (1,939.37) | |
| 5 | ACA Refunds (7/99 - 6/00) | (13,932.76) | |
| 6 | Beginning Balance (6/30/99) | (26,427.23) | |
| 7 | **Balance at 6/30/00** | **(24,084.77)** | **Over Recovery** |
| 8 | Sales Volumes (Actual 12 month ended 6/30/99) | 48,006 | MCF |
| 9 | ACA Factor (line 7 divided by line 8) | (0.5017) | Per MCF |