BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

April 24, 2003

IN RE:	)
	)
SHILOH FALLS UTILITIES, INC.	) **Docket No. 02-00289**
	)
COMPLIANCE AUDIT	)

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

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 Shiloh Falls Utilities, Inc.'s Compliance 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 Shiloh Falls Utilties, Inc. (the "Company").

2. The Staff began its audit on September 11, 2002 and the completed its audit of same on April 8, 2003.

3. On April 8, 2003, the Energy and Water Division issued its preliminary compliance audit findings to the Company, and on April 21, 2003, the Company responded thereto.

4. The preliminary compliance audit report was modified to reflect the Company's responses and a final compliance audit report (the "Report") resulted therefrom. The Report is attached hereto as Exhibit A 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 24th day of April, 2003, 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:

Mrs. Sara Kyle
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Mrs. Lisa Thomas, President
Shiloh Falls Utilities, Inc.
P. O. Box 1027
Savannah, Tennessee 38372

Mr. Gilbert Parrish, Attorney At-Law
65 Court Street
Savannah, Tennessee 38372

Butch Phillips

Butch Phillips

COMPLIANCE AUDIT REPORT

OF

SHILOH FALLS UTILITIES, INC.

DOCKET NO. 02-00289

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

ENERGY AND WATER DIVISION

April 2003

EXHIBIT A

COMPLIANCE AUDIT

<u>SHILOH FALLS UTILITIES, INC.</u>

DOCKET NO. 02-00289

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I. INTRODUCTION

The subject of this audit is Shiloh Falls Utilities, Inc. ("Company" or "Shiloh") compliance with the Rules and Regulations of the Tennessee Regulatory Authority ("TRA" or the "Authority"). At the direction of the Energy and Water Division's Chief, Dan McCormac, the compliance audit was requested and performed by Butch Phillips of the Energy and Water Division.

II. BACKGROUND

Shiloh is a small wastewater system located in Counce, Tennessee in Hardin County. It is owned in equal shares by Shackelford Development Company, Inc. and SPD Co., LLC. The companies are owned by the Shackelford family. The company currently has approximately 103 customers.

Shiloh was originally granted approval for a certificate of public convenience and necessity in Tennessee Public Service Commission ("TPSC") Docket No. 95-03948. The last time this company has been before this agency was in Docket No. 01-00378. In that Docket Shiloh was allowed to expand its existing territory to include a small retail customer.

The Authority Staff conducted an on-site audit of the Company's books and records at the Company's physical location located at 25 Old South Road, Counce, Tennessee. The Staff's findings and recommendations resulting from the audit can be found in section VI of this report.

III. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (T.C.A.) gives jurisdiction and control over public utilities to the Tennessee Regulatory Authority. T.C.A. §65-4-104 states that:

> The [A]uthority has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.

Further, T.C.A. §65-4-105 grants the same power to the Authority with reference to all public utilities within its jurisdiction as chapters 3 and 5 of Title 65 of the T.C.A. have conferred on the Department of Transportation's oversight of the railroads or the Department of Safety's oversight of transportation companies. By virtue of T.C.A. §65-3-108, this power includes the right to audit:

> The department is given full power to examine the books and papers of the companies, and to examine, under oath, the officers, agents, and employees of the companies and any other persons, to procure the necessary information to intelligently and justly discharge its duties and carry out the provisions of this chapter and chapter 5 of this title.

The Energy and Water Division of the TRA is responsible for auditing those companies under the Division's jurisdiction to ensure that each company is abiding by the above-stated statute as well as the Rules and Regulations of the Authority.

IV. SCOPE OF AUDIT

The Staff examined Shiloh's books and records for the twelve months ended December 31, 2001, and conducted tests of accounts as it considered necessary to determine if the Company is following the Uniform System of Accounts for Class C Wastewater utilities along with TRA rules, regulations, and other directives.

V. STAFF SUMMARY

The Company does not have its financial records in compliance with USOA and needs to have its financial records in compliance with TRA directives as soon as possible. The Staff has outlined the material deficiencies in this report and will work with the utility to ensure compliance. Shiloh has access to outside accounting personnel to assist in maintaining financial compliance.

Shiloh in addition to defiencies outlined later in this report has been fined by the Tennessee Department of Environment and Conservation ("TDEC"). The total amount of the fine was $15,000 (TDEC Case No. 02-0599). The fine resulted from noncompliance of various TDEC regulations. TDEC also ordered that Shiloh not connect any additional customers onto its system until approved by them.

VI. AUDIT FINDINGS

FINDING # 1:

Exception

The Company does not keep its books in accordance with the Uniform System of Accounts.

Discussion

TRA Rule 1220-4-1-.11(1)(g) for Class A, B, and C water companies requires utilities to follow the Uniform System of Accounts (USOA) as adopted and amended by the National Association of Regulatory Utility Commissioners (NARUC). This uniform record keeping insures the integrity, reliability and comparability among similar companies of financial data contained in financial reports submitted to the Authority. It provides the TRA one of its most useful regulatory tools for establishing just and reasonable rates. We noted the following exceptions to the USOA:

a. The Company's chart of accounts does not comply with the USOA.
b. Many entries in the Company's books are not kept "in such a manner to support fully the facts pertaining to such entries."[1]

This finding has no immediate effect on rates that the company is authorized to charge.

Recommendation

Staff recommends that the Company make the necessary changes in its accounting methods and procedures to comply with the Uniform System of Accounts for Class C Wastewater Utilities, beginning with calendar year 2003. The Company should also provide Staff with evidence that the changes have been made no later than thirty (30) days after the Directors' approval of this finding.

Company Response

The Company does utilize a Uniform System of Accounts and has made the adjustments to conform to the (USOA) as of the date of the filing of this response. The Company does admit that some entries may not be charted to the correct accounts as requested by the Authority. The Company is agreeable to make any corrections to the chart of

[1] National Association of Regulatory Utility Commissioners "1996 Uniform System of Accounts for Class C Wastewater Utilities", Accounting Instructions, page 8, section 2., paragraph B.

and/or any entries to the Company books as such exceptions are disclosed to the Company and as directed by the Authority.

FINDING # 2:

Exception

The Company is improperly recording revenues & expenses related to certain non-utility services.

Discussion:

During an examination of the monthly customer bills, Staff discovered that Shiloh is charging some customers $5.00 per month for repairs and maintenance of jointly owned grinder pumps. The grinder pumps are customer owned. However, since some building lots cannot support a separate grinder pump, several property owners must share a grinder pump. To facilitate the repair of these shared pumps, the Company provides this service for a monthly fee. Shiloh records the related transactions as utility revenues and expenses.

Shiloh is also acting as the middleman for the installation of customer owned wastewater equipment that would be normally installed by the developer at the time a house is built. The company does not perform this service itself. It subcontracts the work out to other parties and pays the for the work up front. The customers then reimburse Shiloh for the actual cost of installation. Staff discovered that Shiloh is also recording these transactions as utility revenues and expenses.

The proper accounting treatment for these transactions would be to record as non-utility items. Customer payments should be recorded as non-utility income (NARUC Account No. 421) and the repair costs of the shared grinder pumps should be recorded as non-utility expenses (NARUC Account No. 426). Since these costs are associated with the sharing of grinder pumps that are not part of the utility's assets, the expenses incurred by Shiloh would not be considered utility related. Staff would like to point out to the utility that potentially no cost recovery could be made in providing this non-utility related service and that the shareholders would bear the risk of any losses.

Recommendation:

Shiloh should record all revenues and costs associated with the above transactions as non-utility items. Shiloh should also provide Staff with evidence that the changes have been made no later than thirty (30) days after the Director's approval of this finding.

Company Response:

The Company is no longer collecting a $5.00 maintenance fee and has not collected said monies since November 2002. The Company no longer assists in the installation and/or repairs of residential sewer lines or grinder pumps.

FINDING # 3:

Exception:

The Company is placing billing caps on customer bills without prior approval from this Authority.

Discussion:

Staff discovered during a sampling of the customer bills that the management made the decision to cap the amount that a customer would pay for service. The cap was set at 10,000 gallons of usage per month. No approval was obtained from this Authority for the capping of customers' bills.

Recommendation:

Shiloh should cease the practice of capping customer bills immediately and seek approval from this Authority for such a business practice.

Company Response:

The Company is no longer utilizing billing caps.

FINDING # 4:

Exception:

The Company did not record $193,881 as a credit to a contributed capital account as ordered in the TPSC's May 20, 1996 Order in Docket No. 95-03948.

Discussion:

In Docket No. 95-03948, by Order dated May 20, 1996, Shiloh was ordered to record $193,881 (half of the gross plant in service) as a credit to a contributed capital account in accordance with USOA. During an examination of the Company's general ledger, Staff discovered that the Company did not record the plant amounts as required in the above docket.

The Company actually recorded $298,639.79 in initial plant costs. The Order stated that an entry for $193,881 should be made to a contributed capital account which was determined by the TPSC to be half of the gross plant in service. This would indicate a beginning total gross plant balance of $387,762 ($193,881 x 2).

The amount of the adjustment necessary to correctly state the beginning balance of the utility's net plant is a $89,123 ($387,762 minus $298,639) debit to Utility Plant in Service. The accumulated depreciation account should be adjusted to reflect the proper amount of depreciation expense since the above Order was issued. Also, a credit entry in the amount of $193,881 to USOA Account No. 271 "Contributions In Aid of Construction" is necessary to satisfy the terms of the Order issued in Docket No. 95-03948.

The Company also recorded $181,954.18 as a debit and credit, respectively, to general ledger accounts "Contributed Capital" and "USOA Owners Equity Adjust". This was not proper accounting treatment for ratemaking purposes. The Company should make the adjusting entries necessary to remove these entries.

Recommendation:

Shiloh should conform to the above Order immediately and make the necessary accounting entries.

Company Response:

The Company has no objection to making the adjusted entries requested by the Authority.

FINDING # 5:

Exception:

The Company has not obtained Authority approval for a loan as required by T. C. A. § 65-4-109.

Discussion:

Shiloh recorded a loan of $324,184.04 at the end of 2001 from a related company, SPD Co., LLC ("SPD"). Shiloh, as evidenced by its ledgers, has not attempted to repay the loan. This would suggest that the loan amount is actually an investment made by Shiloh's shareholders.

If this assumption is correct, then the Company should make a credit entry to USOA Account No. 211-Other paid in Capital and a debit entry to USOA Account No. 232-Notes Payable to remove the amount as a liability.

However, if the amount is actually a loan and has a repayment period of longer than one year, the Company is required by T. C. A. §65-4-109 to petition this Authority for approval of the loan.

Recommendation:

If the Company maintains that the amount recorded as a note payable is a loan, Shiloh should seek approval for the loan. Otherwise, the Company should make the above described accounting entries to restate the recorded amount.

Company Response:

The indebtness was incorrectly posted. The Company is agreeable to make a credit entry to USOA Account No. 211-Other paid in Capital and a debit entry to USOA Account No. 232-Notes Payable to remove the amount as a liability.