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The Woodlands, TX 77381

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August 30, 2006

Ms. Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

RE: ***Application of Bristol Tennessee Essential Services for a Certificate of Public Convenience & Necessity to provide Telecommunications Services.***
Docket Number 05-00251

Dear Chairman Kyle:

Please find attached our audit report of the Bristol Tennessee Essential Service's Cost Allocation Manual as described on page 2 in the Company's Settlement Agreement and referenced in the TRA Order of March 21, 2006.

If you have any questions or need additional information relating to this audit, please call me at 713-298-1760.

Sincerely,

William H. Novak

Attachment

cc: Edward Phillips
Guy Hicks
Charles B. Welch, Jr.

WHN CONSULTING

19 Morning Arbor Place
The Woodlands, TX 77381

August 30, 2006

Dr. R. Michael Browder
General Manager
Bristol Tennessee Essential Services
PO Box 549
Bristol, TN 37621-0549

RE: Audit of BTES Cost Allocation Manual

Dear Dr. Browder:

In accordance with the agreed upon procedures filed with the Tennessee Regulatory Authority ("TRA" or the "Authority") on May 22, 2006 in Docket 05-00251, we have examined the Cost Allocation Manual (the "CAM") of Bristol Tennessee Essential Services ("BTES" or the "Company").

As stated in the agreed upon procedures, the purpose of this examination was to:

1. Determine if the methods used to allocate costs to the appropriate business units are sufficient so that the operating results of each business unit present fairly, in all material respects, the financial position and results of operations of each business unit;
2. Determine if the CAM produces fair and reasonable results; and
3. To the extent consistent with purposes (1) and (2), minimize the time and expense necessary to record and audit the transactions.

With these requirements in mind, this examination does not provide an opinion on whether the financial statements of BTES taken as a whole are fairly presented in all material respects, but whether the CAM itself was developed in a manner that will produce fair and reasonable results. In addition, this examination does not include a review to determine whether the Company is in compliance with the CAM, and instead only examines the development of the CAM itself.

We feel that the two findings detailed in the audit report have been adequately addressed by the Company's management and are immaterial to the overall results of the CAM. In our opinion, subject to the limitations detailed above, the methodology described in the CAM to allocate common costs to the different business units of BTES is sufficient so that the financial position and results of operations for each business unit will be presented fairly in all material respects when these procedures are employed. In addition, the time and expense necessary to record, maintain and audit the ongoing changes to the CAM appear to be minimal.

Our complete audit report is attached. If you have any questions, please let me know.

Sincerely,

William H. Novak

BRISTOL TENNESSEE ESSENTIAL SERVICES
AUDIT OF COST ALLOCATION MANUAL METHODOLOGY

PRPARED BY WHN CONSULTING
AUGUST 30, 2006

BRISTOL TENNESSEE ESSENTIAL SERVICES
AUDIT OF COST ALLOCATION MANUAL METHODOLOGY
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1. BACKGROUND

On March 21, 2006, the Tennessee Regulatory Authority ("TRA") issued its order approving the application of Bristol Tennessee Essential Services ("BTES" or the "Company") for a Certificate of Convenience and Necessity ("CCN") to provide competing local telecommunication services.[1] Final approval of the CCN by the TRA was conditioned on a Settlement Agreement (the "Agreement") dated February 10, 2006, between BTES and the other parties in this docket.

One component of the Agreement requires BTES to submit to an independent audit of its cost allocation procedures. According to the Agreement, the purpose of the audit is to:

1. Determine if the methods used to allocate costs to the appropriate business units are sufficient so that the operating results of each business unit present fairly, in all material respects, the financial position and results of operations of each business unit;

2. Determine if the Cost Allocation Manual ("CAM") produces fair and reasonable results; and

3. To the extent consistent with purposes (1) and (2), minimize the time and expense necessary to record and audit the transactions.

With these requirements in mind, this audit does <u>not</u> provide an opinion on whether the financial statements taken as a whole are fairly presented in all material respects, but whether the CAM itself was developed in a manner that will produce fair and reasonable results. In addition, this audit does <u>not</u> include an examination to determine whether the Company is in compliance with the CAM, and instead only examines the development of the CAM itself.

On April 17, 2006, BTES executed a contract with WHN Consulting ("WHN") for an independent audit of its cost allocation procedures. On May 22, 2006, a work plan for the completion of the audit was submitted to the TRA for its consideration by WHN.

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[1] TRA Docket No. 05-00251.

2. PROCEDURES

We began our examination with a review of the existing legal statutes, rules and regulations for the allocation of costs by BTES. The existing requirements for allocations are as follows:

1. Loans made by one business unit to another must be at the highest rate of interest on earned or invested funds in accordance with TCA § 7-52-402 and § 7-52-603.
2. The Telephone business unit must make in lieu of tax payments and record state, local and federal taxes in accordance with TCA § 7-52-404.
3. The Telephone business unit must pay an amount for attachments to poles owned by other business units at the highest rate charged to any other entity in accordance with TCA § 7-52-405 and § 7-52-603.
4. The Cable & Internet business unit must make tax payments in accordance with TCA § 7-52-606.
5. The Company must comply with the Code of Federal Regulations, Title 47, Section 64.901 through 64.905 regarding allocation of costs by the Federal Communications Commission.
6. The Company must comply with the Code of Federal Regulations, Title 47, Section 32.27 regarding affiliate transactions by the Federal Communications Commission.

In addition to these requirements, the Company must also comply with the terms and conditions of the Agreement with the other parties in TRA Docket 05-00251.

We next asked the Company to provide us with their workpapers and supporting calculations for the CAM through a series of data requests. In addition, we conducted an on-site inspection and review of the cost allocation procedures at the Company's offices in Bristol, Tennessee.

Finally, we identified the common costs to be allocated. For this process, BTES provided us with a set of pro forma consolidated financial statements that reflected the actual operating results of the electric business unit for the twelve months ended June 30, 2005 along with the projected operating results of the Cable & Internet business unit and the Telephone business unit for their third year of operation. We then examined the specific allocation factors that BTES proposed to apply to the common costs contained within these consolidated financial statements.

The results of our examination of each individual allocation method are presented herein.

3.1 BALANCE SHEET ALLOCATIONS – PLANT IN SERVICE

The Company has calculated their total consolidated pro forma plant in service in the CAM to be $92,320,823.[2] This amount was calculated by taking the directly assigned plant in service for each business unit[3] and adding an allocated amount of the projected total joint plant in service[4] and existing fiber optic infrastructure plant in service.[5] The results of these pro forma calculations are presented below.

Plant in Service:	**Electric**	**Cable & Internet**	**Telephone**	**Total**
Directly Assigned Plant	$66,193,627	$8,370,001	$1,536,155	$76,099,783
Joint Plant	6,823,256	3,701,616	2,089,622	12,614,494
Existing Fiber Infrastructure	2,356,498	799,000	451,048	3,606,546
Total	**$75,373,381**	**$12,870,617**	**$4,076,825**	**$92,320,823**
Percentage	**81.64%**	**13.94%**	**4.42%**	**100.00%**

The allocation of the Joint Plant in Service to each business unit based on the number of homes passed (potential customers) appears appropriate. It matches the common plant that can't be specifically identified with the number of potential customers that will theoretically provide future revenues to recover the cost of the Joint Plant in Service.

Likewise, the allocation of the Existing Fiber Optic Infrastructure based on the expected number of customers after the third year of operations also appears appropriate. This existing plant is allocated based on the near term, full build-out of operations by the Cable & Internet and Telephone business units.

In addition to the Joint Plant in Service, when applicable, the poles owned by the Electric business unit are leased to the Cable & Internet and Telephone business units at the highest rate paid by an outside party for comparable pole attachments. This lease rate is appropriate and in accordance with TCA § 7-52-405 and § 7-52-603.

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[2] BTES Cost Allocation Manual, Appendix C, Page C-5.

[3] The directly assigned plant consists of the actual Electric plant at June 30, 2005 along with the projected Cable & Internet and Telephone plant after the first full year of operations.

[4] The total joint plant in service is an estimate of the fiber optic cable and electronics that will be added to the system over a four-year period. It is allocated to each business unit based on the number of homes passed by each business unit.

[5] The existing fiber optic infrastructure plant in service represents the balance at June 30, 2005 and is allocated to the different business units based on the expected number of customers in each business unit after the third year of operations.

4.1 INCOME STATEMENT ALLOCATIONS -- SUBSTATION ALLOCATOR

The Company uses the Substation Allocator to allocate those common expenses related to the systematic recovery of the plant in service devoted to the joint fiber infrastructure.

The Substation Allocator is calculated by taking the substation equipment related to the joint fiber infrastructure for each business unit, and dividing it by the total of all substation equipment related to the joint fiber infrastructure of BTES.

In developing the CAM, the Company calculated pro forma Substation Allocators of 61.02%, 33.37%, and 5.71% respectively for the Electric, Cable & Internet, and Telephone business units.[6] These factors were calculated by first allocating the total of the joint substation equipment to the different business units using the Joint Substation Equipment Allocators, and then adding in the direct assigned substation equipment to each business unit. These pro forma allocation factors were calculated by the Company as follows:

	Allocator[7]	Total
Joint Substation Equipment		**$208,893**
Electric	74.61%	$155,864
Cable & Internet	18.52%	38,694
Telephone	6.86%	14,335
Total	**100.00%**	**$208,893**

	Joint Equipment	Direct Equipment	Total Equipment	Substation Percentage
Electric	$155,864	$0	$155,864	61.02%
Cable & Internet	38,694	46,529	85,223	33.37%
Telephone	14,335	0	14,335	5.61%
Total	**$208,893**	**$46,529**	**$255,422**	**100.00%**

[6] BTES Cost Allocation Manual, Appendix C, Page C-6.

[7] During the course of this audit, the Company discovered an error in the original Substation Allocation calculation. The corrected allocation factors of Joint Substation Equipment are 56.59%, 27.75% and 15.66% respectively for the electric, cable & internet, and telephone business units and are based on the total Joint Plant and the Existing Fiber Infrastructure Plant allocated to each business unit. However, the methodology for calculating these factors remains the same.

In developing the CAM, the Company allocated the following pro forma amounts with the Substation Allocator:

Substations:	Electric	Cable & Internet	Telephone	Total
Depreciation	$1,952.64	$1,067.84	$179.52	$3,200.00
Taxes	1,525.50	834.25	140.25	2,500.00
Return On Investment	6,327.77	3,460.47	581.76	10,370.00
Total	**$9,805.91**	**$5,362.56**	**$901.53**	**$16,070.00**
Percentage	**61.02%**	**33.37%**	**5.61%**	**100.00%**

The Return on Investment ("ROI") component of the allocation represents the carrying costs of the substation assets owned by the Electric business unit that are used by the Cable & Internet and Telephone business units. The ROI applied is 6.65%, and is based on the consolidated return earned by BTES on its total net investment in utility plant. The ROI billing is necessary for the Company to comply with the terms of TCA § 7-52-402 and § 7-52-603 regarding loans from one business unit to another. However, the book entry to record the ROI allocated to the Electric business unit ($6,327.77) needs to be reversed out since these assets are already recorded on the Electric business unit's books.[8]

The Substation Allocator is the appropriate allocator of those expenses related to the systematic recovery of the fiber infrastructure plant in service. The Substation Allocator correctly recognizes the fiber infrastructure plant devoted to each business unit and then allocates those common expenses related to this plant to each of the business units.

[8] See Section 5 for a further discussion on this issue.

4.2 INCOME STATEMENT ALLOCATIONS -- SERVICES ALLOCATOR

The Company uses the Services Allocator to allocate a number of common administrative expenses related to supporting all of the business units.

The Services Allocator is calculated by taking the number of services (active customers) for each business unit, and dividing it by the total of all business unit services of BTES.

In developing the CAM, the Company calculated pro forma Services Allocators of 65.34%, 22.15%, and 12.51% respectively for the Electric, Cable & Internet, and Telephone business units. These factors were calculated by first taking the existing number of electric customers and then adding the projected number of cable & internet and telephone customers after three years of build-out. The total projected services were then divided into the services for each individual business unit to determine each allocation factor. These pro forma allocation factors were calculated by the Company as follows:

	Electric	Cable & Internet	Telephone	Total
Total Services	32,000	10,850	6,125	48,975
Percentage	**65.34%**	**22.15%**	**12.51%**	**100.00%**

In developing the CAM, the Company allocated the following pro forma amounts with the Services Allocator:

Services Allocator:	**Electric**	**Cable & Internet**	**Telephone**	**Total**
Postage	82,328.40	27,909.00	15,762.60	126,000.00
Bills	32,931.36	11,163.60	6,305.04	50,400.00
Delinquents	5,488.56	1,860.60	1,050.84	8,400.00
Support	39,988.08	13,555.80	7,656.12	61,200.00
Bristol Telephone	791.92	268.46	151.62	1,212.00
Online	7,840.80	2,658.00	1,501.20	12,000.00
Legal	25,482.60	8,638.50	4,878.90	39,000.00
HP Support	5,496.40	1,863.26	1,052.34	8,412.00
Loomis Fargo	4,116.42	1,395.45	788.13	6,300.00
Pitney Bowes	3,267.00	1,107.50	625.50	5,000.00
Postmaster	15,681.60	5,316.00	3,002.40	24,000.00
Collection Expense	0.00	0.00	0.00	0.00
Total	**$223,413.14**	**$75,736.17**	**$42,774.69**	**$341,924.00**
Percentage	**65.34%**	**22.15%**	**12.51%**	**100.00%**

The Services Allocator is an appropriate allocator of the common administrative expenses that can't be separated into a specific business unit. The Services Allocator correctly recognizes the number of active customers for each business unit, and then allocates those common administrative expenses to each of the business units based upon the number of services supplied.

4.3 INCOME STATEMENT ALLOCATIONS -- GENERAL ALLOCATOR

The Company uses the General Allocator to allocate the common operations & maintenance ("O&M") expenses related to supporting all of the business units.

The General Allocator is calculated by taking the O&M expense for each business unit, and dividing it by the total O&M expense for all business units of BTES.

In developing the CAM, the Company calculated pro forma General Allocators of 81.99%, 9.13%, and 8.88% respectively for the Electric, Cable & Internet, and Telephone business units.[9] These factors were calculated by first taking the pro forma O&M expense for each business unit and subtracting those O&M expenses that were to be allocated with the General Allocator. The total net O&M expense was then divided into the net O&M expense each individual business unit to determine each allocation factor. These pro forma allocation factors were calculated by the Company as follows:

	Total O&M Expense	Less Allocated Expenses	General Allocator	Percent
Electric	$5,250,287	$810,934	$4,439,353	81.99%
Cable & Internet	584,520	90,355	494,165	9.13%
Telephone	568,404	87,098	481,306	8.88%
Total	**$6,403,211**	**$988,387**	**$5,414,824**	**100.00%**

[9] BTES Cost Allocation Manual, Appendix C, Page C-1. Note that a rounding error exists in the CAM where the electric business unit states an allocation factor of 81.98% that should be 81.99%, and the telephone business unit states an allocation factor of 8.89% that should be 8.88%.

In developing the CAM, the Company allocated the following pro forma amounts with the General Allocator:

	Electric	Cable & Internet	Telephone	Total
General Allocator:				
Water and Sewer	1,151.03	128.17	124.80	1,404.00
Trash Collection	1,934.80	215.45	209.79	2,360.04
Extermination	305.00	33.96	33.07	372.03
Elevator Maintenance	2,709.56	301.72	293.79	3,305.07
Maintenance	22,532.49	2,509.11	2,443.15	27,484.75
Depreciation	18,754.33	2,088.39	2,033.49	22,876.21
Taxes	14,132.54	1,573.73	1,532.36	17,238.63
Return on Investment	59,803.98	6,659.47	6,484.42	72,947.87
Audit Expense	24,597.00	2,739.00	2,667.00	30,003.00
Dir. & Officers Liability	35,978.85	4,006.43	3,901.11	43,886.39
General Liability	21,348.47	2,377.26	2,314.77	26,040.50
Crime	10.17	1.13	1.10	12.40
Umbrella	48,843.08	5,438.92	5,295.95	59,577.95
Board Members	23,613.12	2,629.44	2,560.32	28,802.88
Total	**$275,714.42**	**$30,702.18**	**$29,895.12**	**$336,311.72**
Percentage	**81.99%**	**9.13%**	**8.88%**	**100.00%**

The Return on Investment ("ROI") component of the allocation represents the carrying costs of the plant assets owned by the Electric business unit that are used by the Cable & Internet and Telephone business units.[10] The ROI applied is 6.65%, and is based on the consolidated return earned by BTES on its total net investment in utility plant. The ROI billing is necessary for the Company to comply with the terms of TCA § 7-52-402 and § 7-52-603 regarding loans from one business unit to another. However, the book entry to record the ROI allocated to the Electric business unit ($59,803.98) needs to be reversed out since these assets are already recorded on the Electric business unit's books.[11]

The General Allocator is an appropriate allocator of the common O&M expenses that can't be separated into a specific business unit. The General Allocator correctly segregates the common O&M expenses based on the net direct O&M expenses of all business units.

[10] These plant assets include structures and improvements, communications, office furniture, power operating equipment and tool, shop and garage equipment.
[11] See Section 5 for a further discussion on this issue.

4.4 INCOME STATEMENT ALLOCATIONS -- EMPLOYEE HOURS ALLOCATOR

The Company uses the Employee Hours Allocator to allocate the common ancillary employee expenses related to supporting all of the business units.

The Employee Hours Allocator is calculated by taking the projected pro forma employee hours for each business unit, and dividing it by the total projected pro forma employee hours for all business units of BTES.

In developing the CAM, the Company calculated pro forma Employee Hours Allocators of 79.86%, 13.12%, and 7.02% respectively for the Electric, Cable & Internet, and Telephone business units. These factors were calculated by first taking the existing number of employee hours for the electric business unit, and then adding the projected employee hours of the cable & internet and telephone business units after three years of build-out. The total employee hours were then divided into the projected employee hours for each individual business unit to determine each allocation factor. These pro forma allocation factors were calculated by the Company as follows:

	Electric	Cable & Internet	Telephone	Total
Employee Hours	114,617	18,833	10,070	143,520
Percentage	**79.86%**	**13.12%**	**7.02%**	**100.00%**

In developing the CAM, the Company allocated the following pro forma amounts with the Employee Hours Allocator:

Employee Hours Allocator:	**Electric**	**Cable & Internet**	**Telephone**	**Total**
Verizon	11,979.00	1,968.00	1,053.00	15,000.00
KMC Telcom	16,291.44	2,676.48	1,432.08	20,400.00
Desktop Coop	64,207.44	10,548.48	5,644.08	80,400.00
Picnic	3,240.35	532.35	284.84	4,057.54
Awards Banquet	3,733.75	613.41	328.21	4,675.37
Christmas Party	9,096.78	1,494.49	799.64	11,390.91
Office Supplies	147,581.28	24,245.76	12,972.96	184,800.00
Total	**$256,130.04**	**$42,078.97**	**$22,514.81**	**$320,723.82**
Percentage	**79.86%**	**13.12%**	**7.02%**	**100.00%**

The Employee Hours Allocator is an appropriate allocator of the common ancillary employee expenses that can't be separated into a specific business unit. The Employee Hours Allocator correctly segregates the common employee expenses based on the total hours worked in all business units.

4.5 INCOME STATEMENT ALLOCATIONS -- VEHICLE ALLOCATOR

The Company uses the Vehicle Allocator to allocate the cost of their vehicle fleet to the different business units.

The Company allocates the total cost of each vehicle by using the same allocation method applied to the employee that the vehicle is assigned. The Vehicle Allocator is calculated by taking the average for each employee's Salary, Wage & Benefit Allocator that have vehicles assigned to them. In developing the CAM, the Company calculated pro forma Vehicle Allocators of 87.90%, 8.24%, and 3.86% respectively for the Electric, Cable & Internet, and Telephone business units.[12] These pro forma allocation factors were calculated by the Company as follows:

Vehicle Number	Allocation[13] Method	Electric	Cable & Internet	Telephone	Total
16	General	81.98%	9.13%	8.89%	100.00%
30	General	81.98%	9.13%	8.89%	100.00%
31	Dept Avg	80.36%	9.84%	9.80%	100.00%
32	C&I Cust	82.29%	12.57%	5.14%	100.00%
34	Time Sheet	20.00%	70.00%	10.00%	100.00%
35	Time Sheet	96.00%	2.00%	2.00%	100.00%
36	Time Sheet	96.00%	2.00%	2.00%	100.00%
37	Time Sheet	96.00%	2.00%	2.00%	100.00%
38	Time Sheet	65.00%	25.00%	10.00%	100.00%
40	Time Sheet	96.32%	2.20%	1.48%	100.00%
41	Time Sheet	98.00%	1.00%	1.00%	100.00%
43	Time Sheet	98.50%	1.00%	0.50%	100.00%
44	Estimated	92.00%	6.00%	2.00%	100.00%
48	Time Sheet	96.00%	2.00%	2.00%	100.00%
59	Time Sheet	98.50%	1.00%	0.50%	100.00%
60	Time Sheet	98.00%	1.00%	1.00%	100.00%
61	Time Sheet	98.00%	1.00%	1.00%	100.00%
63	Time Sheet	98.50%	1.00%	0.50%	100.00%
70	General	81.98%	9.13%	8.89%	100.00%
73	Time Sheet	98.50%	1.00%	0.50%	100.00%
79	Time Sheet	92.00%	5.00%	3.00%	100.00%
Average		**87.90%**	**8.24%**	**3.86%**	**100.00%**

[12] BTES Cost Allocation Manual, Appendix C, Page C-3.

[13] See Section 4.6 Income Statement Allocations – Salaries, Wages & Benefits, for a full description of each allocator.

In developing the CAM, the Company allocated the following vehicle costs through the individual pro forma allocations of each vehicle:

Vehicle Allocator:	**Electric**	**Cable & Internet**	**Telephone**	**Total**
Auto Fleet Expense	$160,043.02	$15,002.89	$7,028.05	$182,073.96
Total	**$160,043.02**	**$15,002.89**	**$7,028.05**	**$182,073.96**
Percentage	**87.90%**	**8.24%**	**3.86%**	**100.00%**

The individual components of the Vehicle Allocator are the most appropriate allocator of the auto fleet expense since it matches the allocation to each of the business units for each employee that is assigned a vehicle.

Finding #1:
The Company needs to separately calculate and allocate the Return on Investment ("ROI") related to the net book value of its vehicle fleet to the different business units.

The ROI represents the carrying cost of the vehicle fleet owned by the Electric business unit and used by the Cable & Internet and Telephone business units. The ROI that should be applied is the consolidated return earned by BTES on its total net investment in utility plant which is 6.65% for the twelve months ended June 30, 2005. The ROI billing is necessary for the Company to comply with the terms of TCA § 7-52-402 and § 7-52-603 regarding loans from one business unit to another.

The ROI calculation for the vehicle fleet is similar in concept to the ROI components allocated by the Company for the Substation Allocator (Section 4.1) and the General Allocator (Section 4.3). The ROI for the vehicle fleet is calculated as follows:

Gross Vehicle Plant @ June 30, 2005	$1,947,755.91
Less Accumulated Depreciation on Vehicle Plant @ June 30, 2005	1,449,394.96
Net Vehicle Plant @ June 30, 2005	$498,360.95
Consolidated Rate of Return Factor @ June 30, 2005	6.65%
Vehicle ROI to be allocated to the different business units	**$33,141.00**

The Vehicle ROI can then be allocated to the different business units by applying the Vehicle Allocation factors as follows:

Vehicle Allocator:	**Electric**	**Cable & Internet**	**Telephone**	**Total**
Percentage	**87.90%**	**8.24%**	**3.86%**	**100.00%**
ROI	**$29,130.94**	**$2,730.82**	**$1,279.24**	**$33,141.00**

In order to maintain a constant vehicle allocation factor calculation, the ROI for the vehicle fleet should be calculated and applied separately from the other vehicle allocation factors. In addition, the book entry to record the ROI allocated to the Electric business unit ($29,130.94) needs to be reversed out since these assets are already recorded on the Electric business unit's books.[14]

Company Response to Finding #1:

The Company concurs with Finding #1 and will implement its recommendation on a prospective basis.

[14] See Section 5 for a further discussion on this issue.

4.6 INCOME STATEMENT ALLOCATIONS -- SALARIES, WAGES & BENEFITS

The Company has 69 employees whose time is allocated in accordance with the functions that they provide. These individual allocations produce a weighted average allocation for total salary, wages & benefits of 83.80%, 10.52% and 5.68% respectively for the Electric, Cable & Internet and Telephone business units. The individual allocation methods making up this total are presented and described below.

	Positions	Electric	Cable & Internet	Telephone	Total
Timesheets	37	87.03%	8.85%	4.11%	100.00%
General Allocator	8	81.98%	9.13%	8.89%	100.00%
Department Average	4	89.48%	5.51%	5.01%	100.00%
Estimated	1	92.00%	6.00%	2.00%	100.00%
Comm/Ind Customers	1	78.77%	17.32%	3.91%	100.00%
Materials Issued	1	97.50%	1.25%	1.25%	100.00%
Customer Activity	9	80.00%	10.00%	10.00%	100.00%
Total Services	2	65.34%	22.15%	12.51%	100.00%
Customer Calls	4	10.00%	70.00%	20.00%	100.00%
Vehicles	2	87.90%	8.24%	3.86%	100.00%
Total/Average	**69**	**83.80%**	**10.52%**	**5.68%**	**100.00%**

Timesheets:
The employees that directly assign their time to the different business units through timesheets include the Company's Foremen, Linemen, Groundmen, Apprentices, System Engineers, Meter Readers, Engineer Assistants, Network Supervisors, Technicians and Managers. Since these employees can track their time to a particular project or job within each business unit, the direct assignment of their time through timesheets is the most appropriate allocation method.

General Allocator:
This group of employees includes the General Manager, Accounting & Finance Director, General Accountants, Accounting Secretaries, Administrative Secretaries, Project Coordinator, and Maintenance employees. These employees perform multiple services for the different business units without any precise means of allocation. Therefore the General Allocator appears to be the most appropriate allocator of their time.

Department Average:
This group of employees includes the Director of Management Services, the Director of Operations & Safety, the Director of Engineering. The time for these employees is allocated to the different business units based on the department average of the employees that they supervise. The Engineering Secretary's time follows the Director of Operations & Safety. This method appears to be the most reasonable since the result of their time should most closely track the employees below them.

Estimated:
This group only includes the Supervisor of Purchasing and Stores. Since the addition of two new business units will make a material change on how this employee's time will be spent, an estimate was necessary for the time allocation to the different business units.

Commercial/Industrial Customers:
This group only includes the Business Development Manager. Because her time is spent supporting the needs of the existing commercial and industrial customers, this allocator is the most appropriate.

Materials Issued:
This group only includes the Company's storekeeper. Because the cost for this employee most closely tracks the material issued to each business unit, it is the most reasonable allocator.

Customer Activity:
This group includes the Company's Customer Service Representatives. Because their cost is most closely tied to taking orders for new service for each business unit, the customer activity of BTES is the most reasonable method to allocate their time.

Total Services:
This group includes the Company's Night Dispatchers. Because their time cannot be clearly tied to any specific activity, it is allocated to each business unit based on the total number of services or customers in each business unit.

Customer Calls:
This group includes the Company's Help Desk Personnel. Their cost is most directly tied to the number of calls from customers that they receive for each business unit.

Vehicles:
This group includes the Company's Garage Mechanics. Because their time cannot be clearly tied to any specific activity, it is allocated to the average number of vehicles within each business unit.

Applying each employee's projected individual rate of pay and benefits to their appropriate allocation factor produces a total pro forma salary, wage and benefit expense of $3,796,597; $476,595; and $257,402 respectively for the Electric, Cable & Internet, and Telephone business units as shown below.

	Positions	Electric	Cable & Internet	Telephone	Total
Timesheets	37	$2,349,045	$238,967	$110,996	$2,699,008
General Allocator	8	527,226	58,716	57,173	643,115
Department Average	4	305,462	18,808	17,100	341,370
Estimated	1	94,666	6,174	2,058	102,898
Comm/Ind Customers	1	65,225	14,342	3,238	82,805
Materials Issued	1	53,174	682	682	54,538
Customer Activity	9	241,563	30,195	30,195	301,954
Total Services	2	30,579	10,366	5,855	46,800
Customer Calls	4	12,480	87,360	24,960	124,800
Vehicles	2	117,177	10,985	5,146	133,307
Total	**69**	**$3,796,597**	**$476,595**	**$257,402**	**$4,530,594**

The Company has properly attempted to allocate each employee's time to the different business units based on a methodology that most closely matches that employee's duties. This method of allocation for Salaries, Wages & Benefits appears reasonable and most closely matches the cause of each employee's cost to the proper business unit.

5.0 ROI ALLOCATION TO THE ELECTRIC BUSINESS UNIT:

The Company presently includes a Return on Investment ("ROI") component in its calculation of the Substation Allocation Factor (Section 4.1) and the General Allocation Factor (Section 4.3).[15] The ROI component of these allocations represents the carrying costs of the various assets that are owned and used by the Electric business unit that are also used by the Cable & Internet and Telephone business units. The ROI applied is based on the consolidated return earned by BTES on its total net investment in utility plant. The ROI billing is necessary for the Company to comply with the terms of TCA § 7-52-402 and § 7-52-603 regarding loans from one business unit to another.

Finding #2:
The Company needs to reverse the entries in its financial statements that were made to allocate ROI to the Electric business unit.

Since the assets that are jointly used by the Electric, Cable & Internet and Telephone business units are already recorded on the books of the Electric business unit, there is no need to further allocate ROI to the Electric business unit. Therefore, the entries made to record the ROI allocated to the Electric business unit need to be reversed out. In order to maintain a constant allocation factor calculation for those allocation factors containing an ROI component, the ROI reversal should be calculated and applied separately.

Company Response to Finding #2:
The Company concurs with Finding #2 and will implement its recommendation on a prospective basis.

[15] In addition, see Finding #1 contained in the discussion of the Vehicle Allocation Factor (Section 4.5).

6.0 CAM RECORDING, MAINTENANCE & AUDITING COST/BENEFIT ANALYSIS:

The final requirement of our examination was to ascertain whether the time and expense necessary to record, maintain and audit the transactions necessary to develop the CAM allocations is minimized. In this regard, we wanted to confirm that the Company had not taken on a costly and onerous procedure to keep its CAM up to date.

Currently, the Company updates its CAM allocations on a quarterly basis. We interviewed the Company's personnel responsible for updating the CAM allocation factors about this process. Their response to us was that all of the allocation factors only took two to three hours to update. To date, there has been no audit of the calculation of these CAM allocation factors.[16]

Given that the time involved in updating the allocation factors is only two to three hours on a quarterly basis, we conclude that the Company's internal cost to record and maintain the allocation factors is minimal. Although the Company has not yet conducted an audit of the updated quarterly allocation factors, we would expect this review to also be minimal.

[16] See Section 2(b) of the Settlement Agreement between BTES and the parties to TRA Docket 05-00251.

7.0 SUMMARY AND CONCLUSIONS

As described above, the Company's CAM uses the following allocators on its balance sheet.

Balance Sheet Allocators:	Electric	Cable & Internet	Telephone	Total
Plant in Service	81.64%	13.94%	4.42%	100.00%

In addition, the Company's CAM uses these allocators on its income statement.

Income Statement Allocators:	Electric	Cable & Internet	Telephone	Total
Substations Allocator	61.02%	33.37%	5.61%	100.00%
Services Allocator	65.34%	22.15%	12.51%	100.00%
General Allocator	81.99%	9.13%	8.88%	100.00%
Employee Hours Allocator	79.86%	13.12%	7.02%	100.00%
Vehicle Allocator (Various)	87.90%	8.24%	3.86%	100.00%
Wages & Benefits (Various)	83.80%	10.52%	5.68%	100.00%

Our examination of the allocation factors contained in the CAM revealed that the Company has attempted to most closely assign the appropriate cause of each cost (or cost driver) as the allocation method. We feel that the two findings detailed in the audit report have been adequately addressed by the Company's management and are immaterial to the overall results of the CAM. Although no single allocation method is perfect in assigning all common costs in all cases, in our opinion the methodology described in the CAM to allocate common costs to the different business units of BTES is sufficient so that the financial position and results of operations for each business unit will be presented fairly in all material respects when these procedures are employed.

In addition, the time and expense necessary for the Company's employees to record and maintain the ongoing changes to the CAM on a quarterly basis appear to be minimal.