

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TN**

**September 6, 2016**

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**IN RE:**

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**PETITION OF TENNESSEE**

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**DOCKET NO. 16-00015**

**WASTEWATER SYSTEMS, INC., FOR**

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**APPROVAL OF SPECIAL CONTRACT**

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**PETITION FOR RECONSIDERATION**

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Tennessee Wastewater Systems, Inc. ("TWSI", "Company" or "Utility"), pursuant to TCA § 4-5-317, requests the Tennessee Regulatory Authority ("Authority") to reconsider its Order dated August 19, 2016 in the above captioned proceeding so that TWSI may receive proper guidance for the accounting of the capacity development and per lot fees consistent with the Authority's accounting rules and generally accepted accounting principles.

The original petition filed in this docket requested Authority approval of a special contract between TWSI and developer, Signature Homes. The contract provides for the developer to pay TWSI a \$6000 per lot capacity development fee from which TWSI will pay for the engineering, design, and construction of the necessary components of the wastewater system along with a \$1200 per lot fee which helps the Company to recover various costs associated with its administrative, legal, regulatory, and inspection obligations.

The Authority approved the agreement, finding the contract to be "fair, reasonable, and in the public interest". *Order @ 4*. The Order further requires that "all contract revenues and per lot fees be accounted as "above the line" regulated revenues and that funds in excess of contract obligations be held

in the Company's reserves and will be available to fund other capital needs such as construction, upgrades, and expansion of Company-owned systems". *Id.* Lastly the Order states that since the Contract revenues are designated as "above the line", the revenues must be used in calculating the Company's revenue requirements and resulting customer rates and charges. *Id.* The Order creates multiple accounting issues for the Company that have yet to be resolved through informal means. First, the Order contradicts the Authority's own accounting rules with respect to booking the capacity development fee and per lot fee as regulated revenue. Second, the Order is not consistent with generally accepted accounting practices ("GAAP") in that it requires the revenue from this contract to be booked as "above the line" with any excess placed in a "below the line" reserve account. Per GAAP, revenue can only be categorized as either "above the line" or "below the line". It cannot be treated as both.

#### Contribution in Aid of Construction

The requirement that TWSI book the contract revenue as regulated income contradicts the Authority's accounting rules. TWSI, as directed in TRA Rules and Regs. 1200-04-01-.11(h) subscribes to the Uniform System of Accounts as adopted and amended by the National Association of Railroad and Utilities Commissioners ("NARUC"). The capacity development fee approved in the special contract is essentially a tap fee plus additional financial contributions by the developer to cover the costs associated with the engineering, design, and construction of the wastewater system. This revenue should be considered as a contribution in aid of construction ("CIAOC") as defined in NARUC's Uniform Statement of Accounts:

"Any amount or item of money, services, or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, which is utilized to offset the acquisition, improvement or construction costs of the utility's

property, facilities or equipment used to provide utility services to the public.”

*NARUC Uniform Statement of Accounts 271.*

The Authority’s requirement that TWSI book the contract revenue as regular “above the line” revenue contradicts the accounting rules the Authority requires TWSI to follow. CIAOC is a “below the line” item and is thus considered a balance sheet account. If the Authority is concerned with regulating the contract revenue as a “below the line” item, the Authority has the ability to regulate the capital account through TRA Rules and Regs. 1220-04-01-.01 which addresses capital accounts, budgets, and the reporting obligations utilities have to the Authority for the allocation and use of capital funds. Apart from the use of the funds paid by the developer to TWSI per the agreement, any excess funds in the capital account will be subject to Authority oversight subject to the aforementioned rule.

Further, there are significant benefits to both the Company and especially the ratepayer by allowing for the fees to be booked as CIAOC. The practice of excluding CIAOC from the rate base prevents customers from paying twice for the same asset (e.g. once from paying for a customer’s home and second time through utility rates)<sup>1</sup>. Recording what essentially amounts to tap fees as revenues instead of CIAOC would be also be shortsighted because it would require TWSI to file for an increase in rates when the revenue stream from tap fees declines as customers are placed on the system. Lastly, if TWSI is required to record the capital development and per lot fees as revenues, then the Company will be required to pay income tax on the receipts since it increases income. However, if TWSI is allowed to record the fees as CIAOC, there is no income tax associated with the receipt. Recording these fees as CIAOC leaves more funds available for plant improvements.

#### GAAP

The requirement in the Order that any excess funds realized from the contract revenues be

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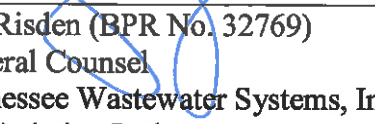
<sup>1</sup> Indiana Utility Regulatory Commission *Small Utility Accounting Manual*, pg. 22

placed in a reserve account is inconsistent with GAAP. The contract revenue may be booked either as "above the line" revenue with the utility given the opportunity to realize a return on the revenue (profit) or it can be booked as "below the line" unregulated income and placed in a reserve account for purposes of capital improvements. The revenue cannot properly be booked both ways.

#### Conclusion

TWSI respectfully requests the Authority to reconsider the accounting requirements in the Order so that the requirements are consistent with the Authority's accounting rules for wastewater utilities and generally accepted accounting practices; or in the alternative to granting the Petition, postpone action on the Petition and allow the Utility's accountants to meet with the TRA accounting staff to try to come to a resolution of these accounting issues. There are no parties to this matter other than TWSI so no one will be prejudiced should this Petition be postponed to allow TWSI to seek resolution of the accounting issues with the TRA accounting staff.

Respectfully submitted,



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Jeff Riden (BPR No. 32769)  
General Counsel  
Tennessee Wastewater Systems, Inc.  
851 Aviation Parkway  
Smyrna, TN 37167  
615-220-7171  
[jeff.riden@adenus.com](mailto:jeff.riden@adenus.com)

# Small Utility Accounting Manual



Water/Wastewater Division

## Contributions in Aid of Construction (CIAC)

**Common Error:** Donations of plant or money, typically provided by a developer or new customer, are recorded as Revenue on the Income Statement.

**Proper Accounting:** Donations of plant or money should be recorded as Contributions in Aid of Construction on the Balance Sheet.

Contributions in Aid of Construction (CIAC) are donations of plant, money or services provided to a utility at no cost. CIAC is a source of capital like debt or equity, thus, is a Balance Sheet account (Account 271). Such donations may come from developers, customers, governmental entities, or others to upgrade water and/or wastewater systems to accommodate new customers without burdening existing customers. Plant contributed to a utility increases Utility Plant in Service, but does not increase rate base of investor-owned utilities because CIAC is used as an offset to the plant. The practice of excluding CIAC from rate base also prevents customers from paying twice for the same assets – E.g., once from paying for a customer's home and a second time through utility rates. System Development Charges and Tap Fees (see next discussion on Tap Fees) also represent donations of money or plant, and thus, should also be recorded as CIAC, not revenue. More specifically, a System Development Charge is a utility charge associated with developing system capacity to accommodate the extra demand placed on the system by new customers. For a related discussion about CIAC amortization, see the explanation provided in the Accrual Accounting section of this document.

Municipal utilities should maintain CIAC reporting for IURC reports and filings. With the passing of GASB 34, some municipal utilities' Annual Reports reflect the removal of CIAC from the Balance Sheet and have charged it to Retained Earnings. Others have reported CIAC as operating revenue. Neither is correct for IURC reporting purposes. USoA should be followed and not GASB 34.

Example: XYZ Utility receives title from developer for mains, hydrants and other infrastructure within the Timber Ridge subdivision with a value of \$1,250,000 along with a \$1,500 System Development Charge for 10 homes.

	<u>Debit</u>	<u>Credit</u>
Utility Plant in Service	\$1,250,000	
Contributions in Aid of Construction		\$1,250,000
To record donation of mains, hydrants and other infrastructure in the Timber Ridge subdivision.		
Cash	15,000	
Contributions in Aid of Construction		15,000
To record collection of System Development Charge for Timber Ridge subdivision project (10 homes at \$1,500 each).		

## **Contributions in Aid of Construction (Continued)**

Remember, in either situation above, do not credit Revenue, but instead credit CIAC as reflected. Failure to do so will overstate Revenues and understate CIAC.

	<u>Debit</u>	<u>Credit</u>
Utility Plant in Service	\$1,250,000	
Revenue		\$1,250,000
To record donation of mains, hydrants and other infrastructure in the Timber Ridge subdivision.		
Cash	15,000	
Revenue		15,000
To record collection of System Development Charge for Timber Ridge subdivision project (10 homes at \$1,500 each).		

## Tap or Connection Fees

**Common Error:** *The fees generated from Tap Fees are recorded as revenue and the cost components are expensed on the Income Statement or one portion of the transaction is recorded on the Income Statement but not the other.*

**Proper Accounting:** *The fees should be recorded as Contributions in Aid of Construction and the cost components should be recorded as Utility Plant in Service.*

Tap fees are designed to recover all or a portion of the cost of materials and labor of connecting a customer to the nearest water or sewer line. Tap fees are often times recorded as revenue and the associated costs expensed on the Income Statement. However, Tap Fees should be recorded as CIAC because the fees represent a donation of plant (see prior discussion on CIAC) since the Tap Fees pay for the cost of labor, equipment and materials necessary to connect a customer to its system. When a utility installs a new meter, all costs associated with its installation should be capitalized in the Utility Plant in Service account because a tap and meter installation is an asset having an expected service life of more than one year. These costs include labor, associated payroll taxes and benefits, equipment costs, meter, yoke, pit, lid, copper service line and other material costs.

The proper accounting will depend, in part, on each utility's operation and accounting practices. Many small utilities simply hire a contractor to perform all taps where the contractor supplies all of the labor, equipment and materials. This practice is the easiest to account for and sample journal entries are shown in the first example below.

Example: XYZ Utility receives a \$1,600 payment to connect a new customer to its system at 101 W. Market Street and incurs the equivalent cost to perform the tap and install the meter.

	<u>Debit</u>	<u>Credit</u>
Cash	\$1,600	
Contributions in Aid of Construction		\$1,600
To record Tap Fee payment for new connection at 101 W. Market Street.		
Utility Plant in Service	\$1,600	
Cash		\$1,600
To record payment to Todd Excavating for tap and meter installation at 101 W. Market Street.		

**Tap Fee Discussion Continues on Next Page**



### ***Tap Fees (Continued)***

For utilities that use their own labor, equipment and purchase all of the materials at the time each tap is made, the transactions might look like the following entries:

	<u>Debit</u>	<u>Credit</u>
Cash	\$1,600	
Contributions in Aid of Construction		\$1,600
To record Tap Fee payment for new connection at 101 W. Market Street.		

	<u>Debit</u>	<u>Credit</u>
Utility Plant in Service	\$1,600	
Wages and Salaries Expense		\$400
Payroll Tax Expense		30
Health Insurance Expense		25
Pension Expense		40
Cash		1,105
To record crew tap and meter install at 101 W. Market Street and \$1,105 payment to Pete's Plumbing Supply for meter, yoke, pit, lid, copper line and other material.		

For utilities that use their own labor, equipment and purchase the tap and meter installation materials in advance of each tap, and record the material purchases in Inventory (an asset account on the Balance Sheet), the transactions might look like the following entries:

	<u>Debit</u>	<u>Credit</u>
Inventory	\$11,050	
Cash		\$11,050
To record purchase of 10 meters, yokes, pits and lids and 200' of copper service line from Pete's Plumbing Supply.		

	<u>Debit</u>	<u>Credit</u>
Cash	\$1,600	
Contributions in Aid of Construction		\$1,600
To record Tap Fee payment for new connection at 101 W. Market Street.		

	<u>Debit</u>	<u>Credit</u>
Utility Plant in Service	\$1,600	
Wages and Salaries Expense		\$400
Payroll Tax Expense		30
Health Insurance Expense		25
Pension Expense		40
Inventory		1,105

To record crew meter install at 101 W. Market Street and to reflect transfer of meter, pit, lid, copper line and other materials valued at \$1,105 out of Inventory.