BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

September 24, 2018

IN RE:	)	
	)	
TENNESSEE WASTEWATER SYSTEMS, INC.	)	**DOCKET NO.**
STAFF COMPLIANCE REVIEW FOR THE PERIOD	)	**18-00071**
JANUARY 1, 2016 THROUGH JUNE 30, 2017	)	

ORDER APPROVING COMPLIANCE REPORT OF TENNESSEE PUBLIC UTILITY COMMISSION UTILITIES DIVISION

This matter came before Vice Chair Kenneth C. Hill, Commissioner Herbert H. Hilliard, and Commissioner David F. Jones of the of the Tennessee Public Utility Commission ("TPUC" or "Commission"), the voting panel assigned to this docket, during a regularly scheduled Commission Conference held on July 23, 2018. The panel considered the Commission's Utilities Division (the "Staff") Compliance Report (the "Report") of Tennessee Wastewater Systems Inc.'s ("TWSI" or "Company") compliance review for the period January 1, 2016 through June 30, 2017, attached hereto as Exhibit 1 and incorporated herein by reference.

On November 2, 2017, in Docket No. 16-00139, the Commission denied TWSI's request for a rate increase due, in part, to several issues that were raised concerning whether the Company's billing and accounting records were sufficiently reliable for ratemaking purposes.[1] The Commission directed the Staff to examine the billing and accounting records and practices of TWSI and to report the results of this examination to the Commission.[2]

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[1] *See In re: Petition of Tennessee Wastewater Systems, Inc. for Approval of Adjustment of its Rates and New Tariff* Docket No.16-00139, *Final Order Denying Petition* (November 2, 2017).
[2] *Id.* at 23.

The Audit Staff conducted its examination and issued its Compliance Report with the Commission on July 12, 2018. Audit Staff reviewed TWSI's books and records for the period of January 1, 2016 through June 30, 2017. The areas examined included: Annual Report, General Ledger, Customer Billing, Wastewater Service Revenue, Developer Income, Operations and Maintenance Expense, Affiliate Transactions, Depreciation Expense, Utility Plant in Service, Taxes other than Income Taxes, and Escrow Charges.[3] The Report found that except for the eighteen findings and recommendations discussed in the report, the Company's billing and accounting records and practices for the review period substantially complied with the Commission rules and regulations.

The Audit Staff made eighteen (18) findings and recommendations:

Finding No. 1 is the Company's tariff should be clarified for certain commercial accounts. Based upon current tariff language, one is unable to determine the steps taken to calculate commercial account bills, without assistance from the Company. The Staff recommended the tariff should be clarified to state bills for commercial customers exceeding the highest rate band or with usage between rate bands will not be calculated using the rate bands, the Company agrees with the Commission Staff's recommendation and will modify its tariff accordingly to provide a more complete explanation of how the commercial bills are calculated.

Finding No. 2 is the Company's customer billing policies should be strengthened. The Staff recommended the Company should put in place billing polices ensuring customers' bills are computed according to the tariff rate schedules or pursuant to a special contract approved by the Commission. The Company agrees with the Commission Staff's recommendation. In response to this and another audit recommendation, the Company will modify the tariff accordingly to provide a more complete explanation as to how the commercial bills are calculated.

[3] *Compliance Report*, p. 3 (July 12, 2018).

Finding No. 3 is the Company's tariff should be updated periodically for flow-through-charges. The current flow-through rate is outdated and may not reflect actual pass-through costs. Residential customers in Rate Class 9 are billed a pass-through charge based upon a 2013 calculated rate.

Staff recommended the tariff should state that the Company will periodically calculate a new pass-through rate, stating periodic dates that the pass-through will be recalculated, i.e. monthly, quarterly, semi-annually, or annually, etc. The Company agrees with the recommendations and will modify the tariff to state pass-through rate will be periodically recalculated.

Finding No. 4 is Residential R-1 Rates should be billed to individual customers. The current tariff contains no language on how condominiums will be rated and billed. Staff recommends that the tariff should be clarified to state each condominium unit will be individually billed at the R-1 Rate. The Company agrees with the recommendation and will clarify in its tariff that each condominium will be billed individually at the R-1 Rate.

Finding No. 5 is the Company did not comply with the Commission directives in the *Order Affirming and Clarifying the Previous Order* ("*Clarifying Order*") entered on January 10, 2017 in Docket No. 16-00015, which directed TWSI to record per-lot capacity development fees as contributions in aid of construction pursuant to Account No. 271 of the of the Uniform System of Accounts ("USOA") and the per-lot fees for recovery of certain expenses as guaranteed revenues pursuant to Account No. 530 of the USOA.

A review of the developer contracts and invoices indicated that, according to the Commission's *Clarifying Order*, $144,000 of the $161,828 of developer payments for 2016 should have been recorded as guaranteed revenues, with the remaining balance recorded as contributions in aid of construction. The guaranteed revenues should have been reported in the 2016 annual report as regulated income pursuant to the USOA. Staff recommends that TWSI develop an accounting policy to record developer income and all related expenses into the accounts of the appropriate entity such that any mismatch between reported developer income and related expenses between TWSI's books and the books of the affiliates is eliminated and the policy should be consistent with the Commission's *Clarifying Order* regarding the accounting payments from developers. The Company agrees to develop a policy consistent with the Commission Staff's recommendation.

Finding No. 6 is the Company's developer charges should be supported by tariffs or contracts. The Company received a total of $16,000 from two developers in 2016 for which no contract or tariff was provided. During the period of January 2017 through June 2017, the Company received a total of $18,200 from three developers for which no contract or tariff was provided. Staff recommends the Company should take steps to ensure that all payments received from developers are supported by written contracts approved by the Commission or by authorized tariffs on file with the Commission. According to the Report, the Company responded that the amounts received from developers or lot owners as stated above were deemed by the Company to be unregulated developer revenue and/or contributions in aid of construction and not subject to the Commission's rules and regulations requiring an authorized tariff or Commission approved contract for the fees.

Finding No. 7 is the Company's documentation for employee-issued credit card transactions were not sufficiently maintained. Employees of TWSI are provided credit cards for miscellaneous expenses while performing job duties. A review of paper credit card statements revealed they do not have all receipts supporting each transaction listed and paid. Staff recommends that all receipts supporting credit card transactions should be provided to the home office and be reconciled and attached to the bank card statements prior to making payment. The Company agrees with the Commission Staff's recommendation and stated it had restated and reinforced its credit card policy with all employees.

Finding No. 8 is the Company's adjustments to accounts should be properly posted. Staff's examination of Materials and Supplies Account No. 720 revealed a check to Adenus Tech in the amount of $2,592. Staff was unable to find a related invoice. The Company's accountant found an invoice in the amount of $2,346 and an adjustment of $613 to support this payment. The $613 adjustment was not posted to the Materials & Supplies Account. Staff recommends the Company should ensure that all adjustments are posted to the proper accounts. The Company responded it agrees with the Commission Staff's recommendation. The Company further stated "in this instance the $613 was simply overlooked."

Finding No. 9 is TWSI is not making adjustments for out-of-period expenses. Annual permit fees are paid to the Tennessee Department of Environment and Conservation ("TDEC") for each wastewater site. Transactions in Quick Books recorded to Licenses and Permits Account No. 775.3 were reviewed and traced to supporting detail. The Staff found there were eighty-seven (87) payments recorded during 2016 applicable to the year of 2015. One payment was $1,380 and the remaining eighty-six (86) payments were for $350 each. The double recording of payments was due to two (2) annual payments being recorded in the same year.

Staff recommends the Company should ensure payments are made timely to avoid the recording of out-of-period payments in the current year. Furthermore, adjusting entries should be made to remove any out-of-period payments prior to completion of the annual report. The Company agrees with the Commission Staff's recommendation. The Company also stated the 2015 TDEC permit fees were not billed to TWSI until 2016 (TDEC was late in sending the bills). The bills were paid upon receipt.

Finding No. 10 is the Company's documentation of Adenus Technologies payments should be strengthened and improved. Adenus Technologies supplied the Company with wastewater system components, equipment and supplies during the review period, although the amounts charged to TWSI by Adenus Technologies for wastewater system components, equipment and supplies were supported by vendor invoices, the invoices alone did not provide adequate documentation of the reasonableness of the related transactions. Staff was unable to identify through the invoice or other supplemental information the wastewater system construction, repair or maintenance project related to the contract labor and equipment billed by the affiliate.

The Staff recommends the Company should strengthen and improve its documentation of amounts paid to Adenus Technologies for purchase of system components, equipment and supplies. The documentation should include identification of the specific wastewater system and the associated project or work order for which the materials were used. The Company agrees that in some circumstances, documentation of the expenses can be improved. The Company stated that transactions related to a specific project, site, or system will be noted on the invoices for the purchased equipment.

Finding No. 11 is TWSI's documentation of DRT Services payments should be improved. DRT Services provided labor and equipment to TWSI for construction, repair and maintenance of its wastewater systems which were recorded in the Company's general ledger to Sewer System Replacement Account No. 265.2; Contract Maintenance Account No. 736.02; Fuel Expense Account No. 750.1; and Equipment Rental Expense Account No. 775.26. Although the amounts charged to TWSI by DRT Services for wastewater system components, equipment and supplies were supported by vendor invoices; the invoices alone did not provide adequate documentation of the reasonableness of the related transactions. Staff was generally unable to identify through the invoice or other supplemental information the wastewater system construction, repair or maintenance project related to the contract labor and equipment billed by the affiliate.

Staff recommends the Company should strengthen and improve its documentation of amounts paid to DRT Services for contract labor and equipment. The documentation should include identification of the specific wastewater system and the associated project or work order for which the labor and equipment materials were used. The Company agrees with the Commission Staff's recommendation and has begun to implement more detailed documentation practices related to DRT Services incorporating the Commission Staff's minimum documentation suggestions.

Finding No. 12 is TWSI's procedures for verifying management fees should be strengthened. For the period January 2016 through June 2017, Staff reviewed the management fees accounts in the general ledger, and recorded amounts were reconciled to the timesheets of Adenus Group shared employees and fuel invoices. Upon reviewing the timesheets of Adenus Group shared employees, Staff noted that the Company understated management fees by $115,092 during the review period.

Staff recommends implementing additional procedures to ensure that management fees are verified to time records and properly recorded in the general ledger. The Company responded that the formula used on the spreadsheet to calculate management fees was incorrect, and it has since been updated with corrected formulas and hourly wage rates. In addition to updating the formula on the spreadsheet, TWSI's Comptroller now double checks the journal entries to ensure they match what is on the spreadsheet.

Finding No. 13 is the Company's IT fees should be correctly recorded and classified. Staff reviewed the Company's IT Expense Accounts recorded in the general ledger. The amounts were reconciled to the contract and invoices for the period of January 2016 through June 2017. Upon reviewing the general ledger to invoices to determine if IT expenses were recorded accurately and properly documented, Staff found that the Company inconsistently booked monthly computer license fees into different accounts and that IT expenses were misstated.

Staff recommends implementing additional procedures to ensure all IT expenses are consistently and correctly recorded in the general ledger. The Company responded that it is now using the correct IT expense account for the IT bills. The Company further stated, to avoid confusion, expenses are now posted to the correct billing period rather than the invoice date of the bill.

Finding No. 14 is the Company's property taxes should be paid timely and recorded to the proper accounting period. The Staff's examination of the Company's property taxes account revealed some payments are not being made timely resulting in interest and penalties of approximately $7500.

The Staff recommends the Company should pay all property taxes on a timely basis to avoid penalties and interest payments should be recorded in the proper accounting period and adjusting entries should be made to remove any out-of-period payments prior to completion of the annual report. The Company responded the referenced interests and penalties of $7,500 was a simple bookkeeping error. However, the Company agrees with the Commission Staff's recommendation.

Finding No. 15 is the Company's franchise taxes should be paid timely and recorded to the proper accounting period. Staff's review of the Company's franchise tax account found that the franchise and excise payments were not being made on a timely basis and recorded in the proper accounting period.

Staff recommends the Company should ensure that all franchise and excise payments are made on a timely basis and recorded in the proper accounting period and adjusting entries should be made to remove any out-of-period payments prior to completion of the annual report. The Company responded that the fourth quarter franchise taxes are not due until January 15th of the following year. The fourth quarter 2015 franchise tax payment was made according to its due date in the first quarter of 2016. The second and third quarter payments for 2016 were appropriately made during the 2016 calendar year. Otherwise the Company agrees with the Commission Staff's recommendation.

Finding No. 16 is the Company is not using a straight-line depreciation method for regulatory purposes. Amortization and depreciation for the year ended 2016 were recomputed and compared to the amounts reported in the Fixed Asset Model ("FAM"), general ledger and annual report. No material discrepancy was noted in the amortization of contributions in aid of construction. With respect to depreciation of non-contributed plant, annual depreciation expense was computed to be $71,637, whereas the Company reported $111,639, a difference of $40,002. For the period ended 2016, the Company used accelerated depreciation methods to compute and report its annual depreciation expense for most of its non-contributed plant, for regulatory accounting purposes the straight-line method should have been used to compute depreciation expense. As a result, the Company overstated its reported depreciation by $40,000, or 56%, for the year ended 2016. Prior to the end of fieldwork, the Company changed the depreciation rates maintained in the FAM to reflect the straight-line depreciation method for all depreciable plant accounts.

Staff recommends the Company should ensure that the straight-line method is used to compute annual depreciation expense for all depreciable plant accounts. The Company agrees with the Commission Staff's recommendation.

Finding No. 17 is the Company should develop and implement a Uniform Capitalization Policy. The Staff's review of the escrow and operating expense account activities revealed that the Company made significant expenditures for rehabilitation of a least thirteen (13) wastewater systems during the review period. Further review indicated significant amounts were expended for certain rehabilitation projects that should be capitalized in the Company's plant account. The

Company does not have a written capitalization policy, and it did not record any of the reviewed system rehabilitation expenditures as utility plant in service.

Staff recommends the Company should develop a written capitalization policy setting a threshold, above which qualifying expenditures are recorded as utility plant in service, consistent with the accounting instructions set forth in the USOA. The Company agrees with the Commission Staff's recommendation and will develop a written capitalization policy in accordance with the recommendation.

Finding No. 18 is the Company should be required to identify holders of capacity rights or other economic interests. During the Staff's review of developer income and escrow charge transactions, Staff ascertained that developers, affiliates, or other parties maintain the right to sell capacity to future customers in certain systems after ownership has been transferred to the Company. The sale of such capacity may occur years after the system has been transferred to TWSI, and TWSI does not receive any revenues from such sales. Furthermore, once the system is transferred to TWSI, the company's ratepayers bear the costs of system maintenance and capital additions and improvements. Although parties other than TWSI may retain an economic interest in the system through their right to sell system capacity to future customers, none of the costs associated with extraordinary maintenance or capital additions and improvements incurred after the system's transfer to TWSI is allocated to the other parties.

Staff recommends the Company be required to specifically identify anyone retaining an economic interest in a system prior to its construction, expansion or acceptance by TWSI. The Company responded it had no issue with identifying such parties, but requested that the Commission provide guidance on how such economic interests should be defined, and also requested that the Commission should promulgate rules if it wishes to weigh the interests of nonregulated parties in its consideration of such systems. The Staff responded that a rulemaking proceeding is not necessary or required for the Commission to evaluate such interests in its consideration of proposals to construct, expand, or accept conveyance of such systems.

During the regularly scheduled Commission Conference held on July 23, 2018, the panel considered the Staff's Compliance Report. Based on its review and consideration of the Report, the panel found that the Commission's Staff has conducted a compliance examination of the billing and accounting records, and practices of the Company in accordance with the Commissions directive contained in the *Final Order Denying Petition* issued on November 2, 2017 in Docket No. 16-00139. The panel found that except for the eighteen (18) findings and recommendations discussed in the Report, the Company's billing and accounting records and practices for the review period substantially complied with the Commission's rules and regulations. Thereafter, the panel voted unanimously to approve and adopt the July 12, 2018 Staff Compliance Report as filed.

IT IS THEREFORE ORDERED THAT:

The Staff Compliance Review of Tennessee Wastewater Systems, Inc. for the period January 1, 2016 through June 30, 2017, a copy of which is attached to this Order as Exhibit 1, is approved and adopted, and incorporated into this Order as if fully rewritten herein.

Vice Chair Kenneth C. Hill, Commissioner Herbert H. Hilliard, and Commissioner Chairman David F. Jones.

ATTEST:

Earl Taylor

Earl R. Taylor, Executive Director