BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

March 13 2000

IN RE:	)
	)
CHATTANOOGA GAS COMPANY	**)Docket No. 99-00759**
ACTUAL COST ADJUSTMENT AUDIT	)

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

Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Energy and Water Division of the Tennessee Regulatory Authority hereby gives notice of its filing of the Compliance Audit Report of the Actual Cost Adjustment Audit (hereafter "ACA") Component of the Purchased Gas Adjustment Rule for Chattanooga Gas Company 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 ACA audit of Chattanooga Gas Company (the "Company").

2. The Company's ACA filing was received on October 4, 1999, and the Staff completed its audit of same on March 3, 2000.

3. On March 7, 2000, the Energy and Water Division issued its preliminary ACA audit findings to the Company, and on March 10, 2000 the Company responded thereto.

4. The preliminary ACA audit report was modified to reflect the Company's responses and a final ACA audit report (hereafter the "Report") resulted therefrom. The

Report is attached hereto as Exhibit A and is fully incorporated herein by this reference. In addition to the recommendations of the Energy and Water Division the Report contains the audit findings of the Energy and Water Division and the Company's responses thereto.

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:

Pat Murphy

Pat Murphy
Energy and Water Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 13 March, 2000, 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. Gerald A. Hinesley
Director - Utility Accounting
AGL Resources, Inc.
PO Box 4569
Atlanta, GA 30302

Mr. William H. Novak
Director of Regulatory Analysis
AGL Resources, Inc.
P.O. Box 4569
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Pat Murphy

Pat Murphy

EXHIBIT

A

COMPLIANCE AUDIT REPORT
of the
ACTUAL COST ADJUSTMENT COMPONENT
of the
PURCHASED GAS ADJUSTMENT RULE
for
CHATTANOOGA GAS COMPANY

Docket No. 99-00759

Prepared by:

THE ENERGY AND WATER DIVISION
of the
TENNESSEE REGULATORY AUTHORITY

MARCH 2000

COMPLIANCE AUDIT REPORT
of the
ACTUAL COST ADJUSTMENT COMPONENT
of the
PURCHASED GAS ADJUSTMENT RULE
for
CHATTANOOGA GAS COMPANY
for the Year ended June 30, 1999

Docket No. 99-00759

TABLE OF CONTENTS

I. INTRODUCTION

The subject of this audit is Chattanooga Gas Company's (hereafter the "Company" or "Chattanooga Gas") compliance with the Actual Cost Adjustment and Refund Adjustment of the Purchased Gas Adjustment Rule (hereafter "PGA") of the Tennessee Regulatory Authority (hereafter the "TRA" or the "Authority"). The objective of the audit was to determine whether the Purchased Gas Adjustments, which are encompassed by the Actual Cost Adjustment (hereafter "ACA") as more fully described in section V., for the year ended June 30, 1999, were calculated correctly and were supported by appropriate source documentation. Also, because of the adverse opinion that resulted from the last audit, Staff will address the steps the Company has taken to correct the weaknesses reported.

II. AUDIT OPINION

The Staff's last audit of Chattanooga's Deferred Gas Cost account for the ACA period July 1, 1997 through June 30, 1998 resulted in fifty-five (55) exceptions, the net effect of which reduced the balance in the account by $1,806,996. The materiality of the findings and seriousness of the accounting deficiencies were such that Staff concluded the Company had failed to comply with the Actual Cost Adjustment component of the Purchased Gas Adjustment Rule. This adverse audit opinion resulted in the Company being placed on probation for a period of one year.[1]

The June 22, 1999 Authority Order required the Company to submit a summary of the steps taken by the Company to correct the deficiencies in its accounting procedures. The Company responded by letter dated July 6, 1999. In summary, those steps included: (1) contracting with an independent CPA firm to review future ACA filings before they are submitted to the TRA, (2) devoting two individuals full time to ensure that Tennessee operations are properly accounted for, and (3) conducting regular meetings with the TRA Staff. The independent accounting firm of Work & Greer, P.C. reviewed the Company's Actual Cost Adjustment ("ACA") filing for the audit period July 1, 1998 through June 30, 1999, and a copy of the Independent Accountant's Report ("Accountant's Report")[2] was provided to the Staff. Staff reviewed this report as part of its auditing process. Staff also looked at other concerns enumerated in last year's report to see if the Company had made the necessary corrections. The results of this review are detailed in Section VI.[3] Staff has had several meetings with the individuals responsible for the Tennessee operations and an on going dialog with the Company during the current audit has made the audit process much smoother.

The audit findings for the current ACA period are detailed in Section VII. The results of the audit increased the net underrecovery of $806,571.66 by $68,700.16. **The corrected net balance in the Deferred Gas Cost account should be $875,271.82**. Staff agrees that the Company has taken the necessary steps to correct the deficiencies cited in the last audit. The

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[1] The June 22, 1999 Authority Order is attached to this report as Exhibit B.
[2] The Accountant's Report is attached as Exhibit C.
[3] The Staff's audit report submitted May 13, 1999 is attached (in part) as Exhibit D.

Company has also advised Staff that they intend to retain the services of the independent CPA firm to review their ACA filing for one more year to assure that the necessary internal accounting controls and procedures are in place. Therefore, Staff concludes that for the current ACA filing period the Purchased Gas Adjustment mechanism as calculated in the Actual Cost Adjustment is working properly and in accordance with the TRA's rules.

III. BACKGROUND INFORMATION ON COMPANY

Chattanooga Gas Company, located at 6125 Preservation Drive in Chattanooga, Tennessee, is a wholly owned subsidiary of Atlanta Gas Light Company, which has its main office at 1251 Caroline St. N.E., Atlanta, Georgia. As a local distribution company (hereafter "LDC") Chattanooga Gas provides service to customers in Chattanooga and Cleveland, Tennessee, and environs in Hamilton and Bradley Counties in Tennessee, respectively. The natural gas used to serve these areas is purchased from three natural gas pipelines in accordance with separate and individual tariffs approved by the Federal Energy Regulatory Commission. The three interstate pipelines are Tennessee Gas Pipeline, East Tennessee Natural Gas, and Southern Natural Gas.

IV. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (T.C.A.) gave jurisdiction and control over public utilities to the Tennessee Regulatory Authority (hereafter the "Authority" or "TRA"). T.C.A. § 65-4-104 states:

> The Authority shall have 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. has 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 said power includes the right to audit:

> The department is given 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.

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 Tennessee statute as well as the Rules and Regulations of the Authority. This audit was performed by Pat Murphy of the Energy and Water Division.

V. DESCRIPTION OF PURCHASED GAS ADJUSTMENT RULE

Actual Cost Adjustment Audits:

The PGA Rule can be found in Chapter 1220-4-7 of the Rules of the Tennessee Regulatory Authority. The PGA Rule permits 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. The PGA consists of three major components:

1. **The Actual Cost Adjustment (hereafter the "ACA")**
2. **The Gas Charge Adjustment (hereafter the "GCA")**
3. **The Refund Adjustment (hereafter the "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 of this Report.

Section 1220-4-7-.03 (2) of the PGA rule requires:

> Each year, the Company 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. This 180 day notification period may be extended by mutual consent of the Company and the [Authority] Staff or by order of the [Authority].

Prudence Audit of Gas Purchases:

Section 1220-4-7-.05 of the PGA Rule requires, unless otherwise ordered by the Authority, an "Audit of Prudence of Gas Purchases" by a qualified consultant. This specialized audit evaluates and reports annually on the prudence of any gas costs included in the PGA. The Prudence Audit of the gas purchasing activities of Chattanooga was performed by PHB Hagler Bailly for the period July 1, 1998 to June 30, 1999. In its report PHB Hagler Bailly concluded "that AGL, acting on behalf of Chattanooga Gas Company during the period under review, acted prudently, overall, in the areas of gas supply planning and procurement."

VI. SCOPE OF ACA AUDIT

The Company's filing summarized the balance in the Deferred Cost Account at June 30, 1999, as follows:

Beginning Balance @ 6/30/98	$ 1,178,687
Activity during year ended 6/30/99:	
Gas Purchases	33,566,253
Gas Recoveries	(34,007,227)
Interest accrued during year ended 6/30/99	68,859

ENDING BALANCE @ 6/30/99	$ 806,571

We performed this audit to ascertain that the Company's calculations of gas costs incurred and recovered were correct. Also included in this audit were several prior period adjustments: ACA refunds and surcharges, an Interruptible Margin Credit Rider (IMCR) adjustment, a Weather Normalization (WNA) adjustment, and SS-1 negotiated margin loss adjustments.

A PGA filing was made with the TRA on June 29, 1999 to implement the surcharge for the 1997-1998 ACA balance as recommended by Staff in the last audit. On November 2, 1999, the Company made a PGA filing to implement a surcharge that included the remaining balances in the 1993-1994, 1994-1995, 1995-1996, 1996-1997 ACA filings and the current surcharge for the 1998-1999 ACA balance. Staff concludes that all refunds/surcharges have now been implemented by the Company.

We also reviewed the off-system sales of the Company for the current audit period. In the last audit, Staff reported that 76% of the Company's off-system sales of $16,083,482 were made to affiliates of the Company. During this audit period, off-system sales declined to $2,742,249 of which 26% of sales were to affiliates. Staff does not perceive a preference being afforded to Company affiliates, but will continue to monitor these sales as part of the ACA process. The Company's Interruptible Margin Credit Rider (IMCR) permits the Company to retain 50% of the gross profit from these sales and requires the Company to file annually with the TRA its calculations of profits/losses incurred under this Rider. The last IMCR filing was made on September 29, 1998. The Company states that at this time they are reconciling the account and will make another filing by May 1, 2000.

We 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. Since the Company's billing process is computerized, a sample of 68 bills was tested. These bills were selected to be representative of the residential, commercial, industrial and interruptible customers in the Company's service area. The sample was selected from the twelve-month period of July 1, 1998, through June 30, 1999. After recalculating each sample bill, we determined that the calculation methods utilized by the Company are correct.

VII. ACA FINDINGS

As previously stated, the Company's Actual Cost Adjustment filing dated October 4, 1999, reflected a net under-collection of gas costs from customers for the year ended June 30, 1999, of $806,571.66. The net effect of the Staff's findings, which are detailed below, increase the under-collection by $68,700.16 to $875,271.82. Effective December 1, 1999, the Company began surcharging its customers for the under-collection.

SUMMARY:

FINDING #1	Commodity Recovery	$ 65,961.16	under-recovery
FINDING #2	Interest Accrual	2,769.00	under-recovery
	Net Result	**$ 68,730.16**	**under-recovery**

A detail explanation for each of the above findings can be found beginning at page 6 of this report.

FINDING #1:

Exception:

The cost of gas recovered from the Company's off-system sales was overstated by $65,931.16.

Discussion:

On November 22, 1999, subsequent to Chattanooga Gas' filing of their Actual Cost Adjustment on October 4, the Company notified Staff of an error that was made in calculating the cost of gas recovered from off-system sales. In the delivery of natural gas, there is a small inherent fuel loss that occurs in the pipeline. In this instance, the cost recovery calculation error occurred when the Company applied a unit cost that included the cost of fuel loss to sales volumes that were already grossed up for the cost of fuel loss. Therefore, the cost of fuel loss was included twice. The result was an overstating of the cost recovery by $65,931.16.

Company Response:

The Company agrees with the finding. As stated in the discussion above, the Company discovered the error after making its ACA filing and subsequently informed the TRA Staff of the error.

FINDING #2:

Exception:

The Staff calculated an underrecovery of $2,769 in the commodity interest accrual.

Discussion:

As a result of the above finding related to the commodity portion of the ACA, the commodity interest accrual has been understated by $2,769.

Company Response:

The Company agrees with this finding.

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.

EXHIBIT

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

JUNE 22, 1999

IN RE:	)	
	)	
CHATTANOOGA GAS COMPANY	)	**DOCKET NO.**
ACTUAL COST ADJUSTMENT (ACA) AUDIT	)	**98-00776**
	)	
	)	

ORDER ADOPTING ACA AUDIT REPORT OF AUTHORITY STAFF

This matter came before the Tennessee Regulatory Authority ("Authority") at a regularly scheduled Authority Conference held on June 8, 1999, for consideration of the audit findings of the Authority's Energy and Water Division (the "Authority Staff") after review of Chattanooga Gas Company's ("Chattanooga Gas" or the "Company") annual deferred gas cost account filing for the period July 1, 1997, through June 30, 1998. The findings of the Authority Staff are contained in the Actual Cost Adjustment (hereafter "ACA") Audit Report attached hereto as Exhibit A.

The ACA Audit Report contains the audit findings of the Authority Staff, the responses thereto of Chattanooga Gas, and the recommendations of the Authority Staff in addressing its findings. The Company's Actual Cost Adjustment filing dated October 5, 1997, reflected a net under-collection of gas costs from ratepayers for the year ended June 30, 1998, of $2,985,682. The net effect of the Authority Staff's audit findings reduces the Company's under-collection by $1,806,996 to $1,178,686. The serious accounting deficiencies noted in the Audit Report and the materiality of the dollar findings resulted in the Authority Staff issuing an adverse opinion.

TRAN

After consideration of the ACA Audit Report and after hearing comments from a representative of Chattanooga Gas who did not refute or oppose the findings in the Audit Report, the Authority unanimously approved the Audit Report and adopted the findings and recommendations contained therein. Further, Chattanooga Gas' representative agreed to submit to the Authority, within thirty (30) days from the entry of this Order, a summary of the steps taken by the Company to correct the deficiencies in its accounting procedures. In approving the ACA Audit Report, the Authority expressed concern over the serious deficiencies noted by the Authority Staff and unanimously decided to place the Company on probation for a period of one (1) year. The Company was duly advised that at the conclusion of the probationary period, the Company must have corrected all of the deficiencies cited in the Audit Report in order to avoid further corrective action and possible sanctions by the Authority.

IT IS THEREFORE ORDERED THAT:

1. The ACA Audit Report, attached hereto as Exhibit A, is approved and adopted, and is fully incorporated in this Order as if restated verbatim herein.

2. As a result of the serious accounting deficiencies noted in the ACA Audit Report and the materiality of the dollar findings contained therein, Chattanooga Gas Company is hereby placed on probation for a period of one (1) year from and after the date of the entry of this Order. At the conclusion of this probationary period, the Company shall have corrected all deficiencies cited in the Audit Report in order to avoid further corrective action and possible sanctions by the Authority.

3. Chattanooga Gas shall submit within thirty (30) days from the entry of this Order, a summary of the steps taken by the Company to correct the deficiencies in its accounting procedures.

4. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within ten (10) days from the date of this Order.

Melvin J. Malone, Chairman

H. Lynn Greer, Jr., Director

Sara Kyle, Director

ATTEST:

K. David Waddell, Executive Secretary

EXHIBIT

C

W&G

CHATTANOOGA GAS COMPANY

INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

YEAR ENDED JUNE 30, 1999

WORK & GREER, P.C.
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS CONSULTANTS
206 CAPITOL BOULEVARD, NASHVILLE, TENNESSEE 37219-1801
(615) 259-7600 • FAX (615) 259-7603 • WWW.WORKGREER.COM

INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

October 14, 1999

Mr. Harrison F. Thompson
President
Chattanooga Gas Company

We have performed the procedures enumerated below, which were agreed to by you, solely to assist you in determining that the activity in the Deferred Gas Cost account of Chattanooga Gas Company for the twelve months ended June 30, 1999 is in compliance with the Actual Cost Adjustment of the Purchased Gas Adjustment Rule of the Tennessee Regulatory Authority (TRA). This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely your responsibility. Consequently, we make no representations regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

1. **Procedure** – Obtain a copy of the analysis of the deferred gas cost account (analysis) for the twelve months ended June 30, 1999 from your accounting personnel to determine it is clerically accurate.

   Finding – All rows, columns and ending balances on the analysis are clerically accurate.

2. **Procedure** – Determine that the balance in the deferred gas cost account at each month end as reflected on the analysis reconciles to the Company's general ledger balance.

   Finding – We were unable to reconcile the balance in the deferred gas cost account for the months of July 1998 through May 1999 since such reconciliations were not provided by accounting personnel. We were able to determine that your accounting personnel appropriately reconciled the deferred gas cost balances on the analysis at June 30, 1999 to the Company's general ledger balances at that date. Also, we agreed the beginning balances in the deferred gas cost accounts at June 30, 1998 on the analysis to revised audited balances from the TRA.

3. **Procedure** – Trace gas costs incurred for each month on the analysis to the schedule of "Purchased Gas Invoice Adjustments" and to invoices from suppliers and determine the costs are properly classified between demand and commodity costs. Also determine the schedule of "Purchased Gas Invoice Adjustments" is clerically accurate.

   Finding – All gas costs incurred on the analysis were traced to the schedule of "Purchased Gas Invoice Adjustments" net of storage gas withdrawals without exception. All costs on the schedule of "Purchased Gas Invoice Adjustments" were traced to invoices from suppliers with the following exceptions. The OBA imbalance cashout from East Tennessee Natural Gas Company for October 1998 was improperly allocated between Chattanooga Gas Company meters and Atlanta Gas meters. The cashout was recorded on the analysis as a commodity cost reduction of $246,126.05. The correct amount should have been a reduction of $277,895.20 resulting in an additional reduction to the commodity cost of gas of $31,769.15. This item was corrected on the analysis by your accounting personnel. Also, during the performance of our audit procedures your accounting personnel noted a cashout credit from SNG for June 1999 totaling $11,532.44 which was not recorded and an invoice from SNG for February 1999 totaling $28,128.06 which was never paid. Your accounting personnel revised the analysis to correct it for these two invoices. Finally, we noted two invoices from SNG which included GSR costs totaling $487.92 that were recorded to the demand cost component in error. Your accounting personnel revised the analysis to correct it for this error.

4. **Procedure** – Trace gas costs recovered for each month on the analysis to the Company's schedule of "Actual MCF Billed". Trace volumes on the "Actual MCF Billed" schedule to the Company's "Monthly Schedule of Customers, Volumes and Revenues" and to billing registers. Trace the cost recovery rates on the "Actual MCF Billed" schedule to the filed rates for the month. Determine that the volumes and rates on the "Actual MCF Billed" schedule are properly broken down between demand and commodity components. Determine the schedule of "Actual MCF Billed " is clerically accurate.

   Finding – We traced the commodity cost of gas recovered for each month on the analysis directly to the schedule of "Actual MCF Billed" each month. The demand cost of gas recovered on the analysis was not directly traceable to the "Actual MCF Billed" schedule. Miscellaneous general ledger adjustments were made each month to the demand component of deferred gas costs which had to be added to the "Actual MCF Billed" schedule amounts in order to trace to the analysis. These miscellaneous adjustments related mainly to standby charges billed to commercial customers but not on the "Actual MCF Billed" schedule. These adjustments were as follows:

Month	
July 1998	$513.07
August 1998	513.07
September 1998	513.07
October 1998	513.07
November 1998	513.07
December 1998	511.08
January 1999	511.08
February 1999	526.53
March 1999	526.53
April 1999	526.53
May 1999	519.86
June 1999	535.34
Total	$6,222.30

We agreed all of the miscellaneous adjustments above to the actual general ledger journal entries for each month. We were able to trace all volumes on the "Actual MCF Billed" schedule to the Company's "Monthly Schedule of Customers, Volumes and Revenues" for each month within one MCF.

With respect to tracing volumes of gas billed to customers as presented on the "Monthly Schedule of Customers, Volumes and Revenues" to detailed billing registers, we traced volumes billed to customers under rate schedule I-1 for January 1999 to actual invoices to customers. We also traced volumes billed to customers under rate schedule L-1 for June 1999 to actual invoices to customers within 100 MCF. We attempted to trace volumes billed under rate schedules R-1 and C-1 to a detailed billing register for December 1998. We were unable to trace those volumes. Based on our discussions with accounting personnel, these customers are billed through the CIS system, which is a dynamic database that changes daily based on any corrections, additions and deletions. Volumes presented on the "Monthly Schedule of Customers, Volumes and Revenues" for rate schedules C-1 and R-1 are obtained from a summary snapshot of the database at the end of each month. The system cannot produce a detailed billing register after the fact that ties to the original summary snapshot. We traced the cost recovery rates on the "Actual MCF Billed" schedule for each month to the filed rates for the month. We determined that the volumes and rates on the "Actual MCF Billed " schedule for each month were properly broken down between demand and commodity components. We also determined that the schedule of "Actual MCF Billed " for each month was clerically accurate.

5. **Procedure** - Vouch storage injection and withdrawal volumes to appropriate documentation including information from the pipelines and suppliers. Agree the costs for storage injections to the "Purchased Gas Cost Worksheet" and to invoices from pipelines and suppliers. Agree the costs for storage withdrawals to the company's running perpetual LIFO inventory records. Agree the month end storage gas inventory volumes to documentation from the pipelines and suppliers and to the perpetual inventory records. Agree the month end storage gas costs to the general ledger. Test the clerical accuracy of the perpetual LIFO inventory records.

   Finding – We were able to trace gas storage injection and withdrawal volumes to invoices from the pipelines or to gas storage management information reports from the pipelines. For LNG, we were able to trace boiloff volumes and liquefaction volumes to information from the LNG plant management company. We also were able to trace the cost of storage injections to the unit costs on the "Purchased Gas Cost Worksheets" and to invoices from pipelines and suppliers.

   In our review of the Company's accounting for the cost of storage withdrawals, we determined that the Company had not properly been accounting for these withdrawals on a LIFO basis. Apparently during 1997 the cost of storage withdrawals were no longer recorded based on the unit cost of the most recent injection. As a result, your accounting personnel revised all the perpetual gas storage records to properly cost the withdrawals since 1997 on a LIFO basis. Also, the volume balances on the perpetual records have not agreed to the gas storage balances as reported by the pipelines. Your accounting personnel also revised the perpetual gas storage records to "true-up" the gas storage volume balances to agree to the information from the pipelines at June 30, 1999. The LNG perpetual records were also revised to "true-up" the volume balance to agree to the information from the LNG management company at June 30, 1999. Following is an analysis of the adjustments to the deferred gas cost analysis as a result of these corrections:

	As previously reported	Adjustments to deferred gas cost	As revised
Gas in storage June 30, 1998	$5,444,722.29	($70,522.76)	$5,374,199.53
LNG inventory adjustment		59,481.15	59,481.15
Storage withdrawals:			
July 1998	97,280.00	(242.80)	97,037.20
August 1998	121,600.00	(22,722.50)	98,877.50
September 1998	165,694.00	(118.00)	165,576.00
October 1998	154,101.97	693.94	154,795.91
November 1998	365,610.02	(491.15)	365,118.87
December 1998	909,841.32	(21,516.34)	888,324.98
January 1999	983,913.45	(10,865.65)	973,047.80
February 1999	759,481.61	11,854.47	771,336.08
March 1999	965,153.82	413.70	965,567.52
April 1999	44,071.45	0.04	44,071.49

	As previously reported	Adjustments to deferred gas cost	As revised
May 1999	302,221.31	(3,149.50)	299,071.81
June 1999	492,125.51	(55,783.03)	436,342.48
Storage injections:			
July 1998	957,278.50	242.80	957,035.70
August 1998	824,390.13	22,722.50	801,667.63
September 1998	761,202.50	118.00	761,084.50
June 1999	1,647,472.32	60,088.00	1,587,384.32
		($29,797.13)	

We tested the clerical accuracy of the revised perpetual gas storage records to determine they were clerically accurate. We agreed the volumes of gas in storage at June 30, 1999 per the revised perpetual gas storage records to the volumes of gas in storage as of that date as reported by the pipelines except for CNG GSS. For CNG GSS we were able to trace injections and withdrawal volumes during the year to appropriate information from Dynegy, who manages the storage. We also reconciled the gas in storage at June 30, 1999 per the revised perpetual gas storage records to the general ledger balances at that date.

6. **Procedure** - Agree company use volumes to supporting documentation, recalculate the cost recovery and agree to the analysis.

   Finding – We agreed company use volumes as reported on the analysis to supporting documentation for all months. We recalculated the cost recovery for each month and agreed to the analysis. All months agreed except September 1998. The actual cost recovery for September 1998 for demand was $1,059.30 and for commodity was $1,606.47. The analysis reflected a demand recovery of $1,072.56 and a commodity recovery of $1,972.52. Your accounting personnel revised the analysis to reflect the correct recoveries.

7. **Procedure** - Agree unbilled gas costs on the analysis to the schedule of "Unbilled MCF Volumes" for each month. Test the computation of unbilled volumes and agree the cost recovery rates to the filed rates for the month. Test the clerical accuracy of the schedule of "Unbilled MCF Volumes."

   Finding – We agreed unbilled gas costs on the analysis to the schedule of "Unbilled MCF Volumes" for each month without exception. We recalculated the computation of unbilled volumes each month on a test basis and found no exceptions. We agreed the cost recovery rates to the filed rates for each month without exception. We also determined that the schedule of "Unbilled MCF Volumes" was clerically accurate for each month.

8. **Procedure** – Test the calculation of interest on the analysis. Agree the interest rates used to the prime rates published in the Federal Reserve Bulletin as required by TRA Rule 1220-4-7-.03(1)(b)2,(VII). Determine that interest is computed on the average monthly balance of the deferred cost accounts (commodity and demand).

   Finding – We tested the calculation of interest on the analysis as revised for corrections made by your accounting personnel as discussed in this report. We found no exceptions. We agreed the interest rates to Federal Reserve Bulletins and determined that interest was properly calculated on the average monthly balance of the deferred cost accounts in accordance with the TRA rule.

9. **Procedure** – Agree gas costs recovered from off-system sales on the analysis to the schedule of "Off-System Sales Revenue and Off-System Gas Costs". Agree sales volumes on the schedule to invoices to customers and purchased volumes and costs to supplier invoices. Test the clerical accuracy of the schedule of "Off-System

Sales Revenue and Off-System Gas Costs".

Finding – We agreed gas costs recovered from off-system sales on the analysis to the schedule of "Off-System Sales Revenue and Off-System Gas Costs" without exception. We agreed sales volumes on the schedule to invoices to customers. We were unable to trace unit costs of gas sold to specific invoices from suppliers and pipelines. As a result, your accounting personnel revised the calculation of gas cost recovered for each month to agree with unit cost information from suppliers and pipelines. In addition, in connection with this process your accounting personnel discovered that off-system sales volumes to Georgia Natural Gas were overstated by 253,894 dekatherms for March 1999. Your accounting personnel revised the analysis to correct for these errors. Following is an analysis of these revisions to the deferred gas costs:

	As previously reported	Adjustments to deferred gas cost	As revised
Off system sales:			
July 1998	$0.00	$0.00	$0.00
August 1998	51,312.03	5,237.42	46,074.61
September 1998	41,143.80	4,316.86	36,826.94
October 1998	87,495.89	5,404.70	82,091.19
November 1998	616,464.84	(155,436.29)	771,901.13
December 1998	499,884.00	(42,480.72)	542,364.72
January 1999	511,886.26	118,215.40	393,670.86
February 1999	355,504.97	30,665.16	324,839.81
March 1999	981,865.76	643,855.91	338,009.85
April 1999	0.00	0.00	0.00
May 1999	0.00	0.00	0.00
June 1999	0.00	0.00	0.00
	$3,145,557.55	$609,778.44	$2,535,779.11

We tested the corrected unit costs and volumes on your accounting personnel's revised off-system sales analysis and determined that the cost of fuel used by the pipeline was included twice, once in the calculation of the unit cost and once in the gross-up of volumes purchased for sale. As a result, we proposed to reduce the commodity cost of gas recovered from off-system sales by $65,931.16, from $2,535,779.11 to $2,469,847.95. Your accounting personnel concurred with the cost reduction and revised the analysis to correct for this error. This error was found after the Company filed the analysis with the TRA.

We tested the clerical accuracy of the revised schedule of "Off-System Sales Revenue and Off-System Gas Costs" and found no errors.

10. **Procedure** – Agree the SS-1 margin loss on the analysis to the schedule of "Calculation of Loss in Gross Profit From Sales Using Special Service Rate Schedule SS-1". Agree sales volumes and SS-1 rates on the schedule to invoices to customers and agree tariff rates (T-1 and L-1) to the Company's tariff rates for the month. Test the clerical accuracy of the schedule.

    Finding – We agreed the SS-1 margin loss on the analysis to the schedule of "Calculation of Loss in Gross Profit From Sales Using Special Service Rate Schedule SS-1" for each month with no exceptions. We agreed sales volumes and SS-1 rates on the schedule to invoices from customers with no exceptions. We agreed tariff rates (T-1 and L-1) to the Company's tariff rates in effect for each month without exception. We did note minor errors and rounding differences in the calculation of the margin loss resulting in an understatement of the margin loss for the year of $429.21. The analysis was not adjusted by your accounting personnel for this difference. Your accounting personnel did make an adjustment to the analysis to reduce the April 1999 margin loss by $10.06.

11. **Procedure** – Agree other miscellaneous items on the analysis such as consulting fees, ACA refunds and surcharges for prior years, weather normalization adjustments, and SS-1 adjustments and IMCR adjustments for prior periods to supporting documentation.

    Finding – We agreed consulting fees to invoices from consultants for the gas purchasing prudence review without exception. We agreed ACA refunds and surcharges to supporting schedules. We traced volumes of gas used in the ACA refunds and surcharge schedules to the "Actual MCF Billed" schedules for each month without exception. We agreed the refund and surcharge rates to the Company's tariffs without exception. We tested the clerical accuracy of the ACA refunds and surcharge schedules and found no errors.

    The Company had presented an underrecovery of $96,015 on the analysis related to the weather normalization adjustment for the November 1997 through April 1998 heating season. The Company had incorrectly netted a $6,268 overrecovery from the 1996-97 weather normalization adjustment, which was included in the refunds due customers' account. Your accounting personnel revised the analysis to increase the weather normalization adjustment to $102,283 to correct for this error. We agreed the $102,283 to correspondence with TRA related to their audit of this amount.

    In connection with the audit of the ACA filing for the year ended June 30, 1998, the TRA increased the deferred gas cost commodity account by $336,286.16. This adjustment related to storage withdrawals for April 1998, which the Company subtracted from storage withdrawals in error. TRA increased storage withdrawals but failed to decrease spot market purchases and transportation costs by the same amount. In connection with reconciling the deferred gas cost account balances on the schedule to the general ledger balances at June 30, 1999, your accounting personnel noted the error. The analysis has been revised to reduce the deferred gas cost commodity account by the $336,286.16. We reviewed the TRA finding and supporting documentation to determine the adjustment appears proper.

    The Company has an interruptible margin credit rider (IMCR) in its tariff, which authorizes the Company to flow back to its customers 50% of the gross profit margin that results from sales to off-system customers. In addition the Company is authorized to recover 90% of the margin loss from sales using special service rate schedule SS-1. The recovery of the SS-1 margin loss is to be recovered through the ACA filing with the TRA and the IMCR is to be given back to ratepayers through a separate IMCR filing with the TRA. In the IMCR filing for the period from February 1, 1996 through July 31, 1998, the Company included SS-1 margin losses in the filing in error. As of July 1998, the Company has posted an IMCR adjustment of $461,213.14 as a commodity cost recovery on the analysis for the total SS-1 margin losses included in the IMCR filing for the period from February 1, 1996 through July 31, 1998. In addition the Company has included margin loss adjustments on the analysis for 1996 totaling $19,308.47 and 1997 totaling $54,340.71. These two adjustments are to correct for SS-1 margin losses not previously reflected in ACA filings. We reviewed the documentation supporting these adjustments to determine they appear proper.

12. **Procedure** – Select a sample of 25 customer bills covering all rate classes from those issued for the year and determine the customers were billed at the correct filed rates.

    Finding – We selected a sample of 25 customer bills covering all rate classes for the year ended June 30, 1999 and recalculated the billed amounts based on filed tariff rates. We noted no errors in our recalculation of these 25 billings.

Following is a summary of the revisions to the deferred gas cost accounts on the analysis that have been reflected by your accounting personnel since we began our agreed-upon procedures engagement:

	Deferred Gas Cost Commodity	**Deferred Gas Cost Demand**	**Total**
June 30, 1999 balance as originally presented to us	($888,953.08)	$1,542,200.04	$653,246.96
OBA imbalance from 10/98	(31,769.15)		(31,769.15)
SNG cashout credit for 6/99	(11,532.44)		(11,532.44)
SNG 2/99 invoice never paid	(28,128.06)		(28,128.06)
SNG GSR costs posted to demand in error	0	(487.92)	(487.92)
Storage gas inventory adjustments at 6/30/98	(70,522.76)		(70,522.76)
LNG inventory adjustment	59,481.15		59,481.15
Storage withdrawals during 1999	(101,926.82)		(101,926.82)
Storage injections during 1999	83,171.30		83,171.30
Company use gas	366.05	13.26	379.31
Cost of off-system sales	609,778.44	-	609,778.44
SS-1 margin loss for 4/99	(10.06)		(10.06)
Weather normalization	6,268.00		6,268.00
TRA 4/98 storage withdrawal adjustment	(336,286.16)		(336,286.16)
Miscellaneous correction to storage	(17.13)		(17.13)
Interest adjustment due to above revisions	(25,052.00)	(21.00)	(25,073.00)
Balance June 30, 1999 as filed with the TRA	($735,132.72)	$1,541,704.38	$806,571.66
Off-system sales costing error found after filing with the TRA	65,931.16	0.00	65,931.16
Interest adjustment due to off-system sales error	2,769.00	0.00	2,769.00
Balance 30, 1999 as corrected	($666,432.56)	$1,541,704.38	$875,271.82

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures other matters might have come to our attention that would have been reported to you.

This report is intended solely for your information and use and is not intended to be and should not be used by anyone other than you.

Wink & Wheeler, P.C.

EXHIBIT

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

May 13, 1999

IN RE:

CHATTANOOGA GAS COMPANY
ACTUAL COST ADJUSTMENT AUDIT) **Docket No. 98-00776**

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

Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Energy and Water Division of the Tennessee Regulatory Authority hereby gives notice of its filing of the Compliance Audit Report of the Actual Cost Adjustment Audit (hereafter "ACA") Component of the Purchased Gas Adjustment Rule for Chattanooga Gas Company 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 ACA audit of Chattanooga Gas Company (the "Company").

2. The Company's ACA filing was received on October 5, 1998, and the Staff completed its audit of the filing on April 23, 1999.

3. On April 27, 1999, the Energy and Water Division issued its preliminary ACA audit findings to the Company, and on May 7, 1999, the Company responded thereto.

4. The preliminary ACA audit report was modified to reflect the Company's responses and a final ACA audit report (hereafter the "Report") resulted therefrom. The

Report is attached hereto as <u>Exhibit A</u> and is fully incorporated herein by this reference. In addition to the recommendations of the Energy and Water Division, the Report contains the audit findings of the Energy and Water Division and the Company's responses thereto.

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:

Laura J. Foreman
Energy and Water Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 13 day of May, 1999, 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. Harry Thompson
President
Chattanooga Gas Company
6125 Preservation Drive
Chattanooga, TN 37416

Mr. Gerald A. Hinesley
Director - Utility Accounting
AGL Resources Service Company
PO Box 4569
Atlanta, GA 30302-9470

Laura J. Foreman

Laura J. Foreman

COMPLIANCE AUDIT REPORT
of the
ACTUAL COST ADJUSTMENT COMPONENT
of the
PURCHASED GAS ADJUSTMENT RULE
for
CHATTANOOGA GAS COMPANY
for the Year Ended June 30, 1998

Docket No. 98-00776

Prepared by:
THE ENERGY AND WATER DIVISION
of the
TENNESSEE REGULATORY AUTHORITY
MAY 1999

COMPLIANCE AUDIT REPORT
of the
ACTUAL COST ADJUSTMENT COMPONENT
of the
PURCHASED GAS ADJUSTMENT RULE
for
CHATTANOOGA GAS COMPANY
for the Year ended June 30, 1998

Docket No. 98-00776

TABLE OF CONTENTS

I. INTRODUCTION

The subject of this audit is Chattanooga Gas Company's (hereafter the "Company" or "Chattanooga Gas") compliance with the Actual Cost Adjustment and Refund Adjustment of the Purchased Gas Adjustment Rule (hereafter "PGA") of the Tennessee Regulatory Authority (hereafter the "TRA" or the "Authority"). The objective of the audit was to determine whether the Purchased Gas Adjustments, which are encompassed by the Actual Cost Adjustment (hereafter "ACA") as more fully described below, for the year ended June 30, 1998, were calculated correctly and were supported by appropriate source documentation.

II. AUDIT OPINION

The Company reported the results of the activity in the Deferred Gas Cost account for the ACA year ended June 30, 1998, as a net under-recovery of $2,985,682. **Fifty-five exceptions were noted by the Staff during the audit, the net effect of which is a reduction of $1,806,996 in the Deferred Gas Cost account. A detail of these exceptions can be found in Section VII of this Report. The correct balance in the Deferred Gas Cost account at June 30, 1998, therefore, should be $1,178,686.**

A prudence audit of the Company's gas purchasing activities is also required by the PGA Rule. Such an audit was performed by TB&A Management Consultants (hereafter "TB&A") and is attached hereto as Attachment 1. Per their report, TB&A has determined:

> Based on our review and analysis of the information provided, Chattanooga Gas Company is continuing to be proactive and responsive to the ongoing changes in the natural gas supply and local gas distribution marketplace in a manner comparable to the actions of LDCs across the country. The gas supply management department at AGL Energy Services acting on behalf of Chattanooga Gas Company appears to be appropriately organized and staffed to assure that customers will continue to enjoy secure, reliable gas supplies at reasonable prices. Actual gas cost performance has been consistent or better than market indicators.

Although TB&A concluded in its prudence audit that the gas supply management department "appears to be appropriately organized and staffed," the Authority's Staff audit of the ACA has not resulted in a similar conclusion regarding the accounting for such gas purchasing activities. It is apparent from the number of the current ACA audit findings, the total dollar amount of such audit findings, and the reasons for each finding, that the Company's procedures for accounting of its gas purchases and recoveries are deficient. **Therefore, the Staff concludes that the Company has failed to comply with the Actual Cost Adjustment component of the Purchased Gas Adjustment Rule.**

This adverse opinion for the year ended June 30, 1998, is of great concern to the Staff. Just two years ago, the ACA audit for the year ended June 30, 1996, did not produce any findings and, therefore, the Staff issued an unqualified opinion. One year ago, the Staff issued a qualified opinion for the year ended June 30, 1997, that, subject to certain procedures being implemented, the Company was deemed to be in compliance. **It is, therefore, imperative that the Company immediately implement the necessary internal accounting controls and procedures to reverse this trend and ensure that the next ACA audit does not result in another adverse opinion.**

One of the most important responsibilities of the Tennessee Regulatory Authority is to ascertain that the public utilities under its jurisdiction are operating with the proper level of expertise wherein the TRA can say in good faith to the ratepayers that the rates they are being charged throughout the year are just and reasonable. A significant part of those rates is the Purchased Gas Adjustment factor and the subsequent related Actual Cost Adjustment factor, both of which are the subject of this audit. Due to Findings 1 through 5 of the audit report for the ACA year ended June 30, 1997, and all of the findings cited in this ACA audit report for the year ended June 30, 1998, the Staff of the TRA does not have an adequate comfort level with the accounting procedures of Chattanooga Gas Company to provide the ratepayers with such assurance.

III. BACKGROUND INFORMATION ON COMPANY

Chattanooga Gas is located at 6125 Preservation Drive, Chattanooga, Tennessee, and is a wholly owned subsidiary of Atlanta Gas Light Company, which has its main office at 235 Peachtree Street, Atlanta, Georgia. As a local distribution company (hereafter "LDC") Chattanooga Gas provides service to customers in Chattanooga and Cleveland, Tennessee, and environs in Hamilton and Bradley Counties in Tennessee, respectively. The natural gas used to serve these areas is purchased from three natural gas pipelines in accordance with separate and individual tariffs approved by the Federal Energy Regulatory Commission. The three interstate pipelines are Tennessee Gas Pipeline, East Tennessee Natural Gas, and Southern Natural Gas.

The Company submitted the ACA filing which is the subject of this audit on October 5, 1998. It was mutually agreed to by the Company and TRA Staff to extend the 180 day notification date to June 1, 1999. The extension was necessary to enable the Company to complete its responses to the Staff's data requests and to enable the Staff sufficient time to properly analyze the Company's responses.

As of the date of this report, the Company had not initiated a surcharge for the results of this ACA period. **It is, therefore, recommended that the Company implement a surcharge with the July 1999 billing for the corrected amount of under-recovery of $1,178,686 and use its best efforts to have the same fully surcharged by June 30, 2000.**

IV. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (T.C.A.) gave jurisdiction and control over public utilities to the Tennessee Regulatory Authority (hereafter the "Authority" or "TRA"). T.C.A. § 65-4-104 states:

> The Authority shall have 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. has 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 said power includes the right to audit:

> The department is given 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.

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 Tennessee statute as well as the Rules and Regulations of the Authority. This audit was performed by Laura J. Foreman of the Energy and Water Division.

V. DESCRIPTION OF PURCHASED GAS ADJUSTMENT RULE

Actual Cost Adjustment Audits:

The PGA Rule can be found in Chapter 1220-4-7 of the Rules of the Tennessee Regulatory Authority. The PGA Rule permits 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. The PGA consists of three major components:

1. **The Actual Cost Adjustment (hereafter the "ACA")**
2. **The Gas Charge Adjustment (hereafter the "GCA")**
3. **The Refund Adjustment (hereafter the "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 of this Report.

Section 1220-4-7-.03 (2) of the PGA rule requires:

> Each year, the Company 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. This 180 day notification period may be extended by mutual consent of the Company and the [Authority] Staff or by order of the [Authority].

Prudence Audit of Gas Purchases:

Section 1220-4-7-.05 of the PGA Rule requires, unless otherwise ordered by the Authority, an "Audit of Prudence of Gas Purchases" by a qualified consultant. This specialized audit is to evaluate and report annually on the prudence of any gas costs included in the PGA. On October 1, 1998, TB&A Management Consultants issued their "Report on the Gas Purchasing Activities of Chattanooga Gas Company for the Combined Periods: July 1, 1997, to June 30, 1998," which is attached hereto as Attachment 1. As discussed in Section II of this ACA audit report, TB&A determined the Company to be prudent in its gas purchasing activity during the year ended June 30, 1998.

VI. SCOPE OF ACA AUDIT

The Company's filing summarized the balance in the Deferred Cost Account at June 30, 1998, as follows:

Beginning Balance @ 6/30/97	$ 1,647,068
Activity during year ended 6/30/98:	
Gas Purchases	43,880,443
Gas Recoveries	(42,871,223)
Interest accrued during year ended 6/30/98	329,394

ENDING BALANCE @ 6/30/98	2,985,682

This audit was performed to ascertain that the Company's calculations of gas costs incurred and recovered were correct. Also included in this audit were four prior period adjustments: a refund adjustment effective October 1, 1994; a surcharge adjustment which should have been effective November 1, 1996; a refund adjustment effective July 1, 1997; and a surcharge adjustment which should have been effective November 1, 1997.

An audit of a sample of customer bills was also performed to determine if the proper PGA rates were being applied in the Company's calculation of the customers' bills. Since the Company's billing process is computerized, a sample of 68 bills were tested. These bills were selected to be representative of the residential, commercial, industrial and interruptible customers in the Company's service area. The sample was selected from the twelve month period of July 1, 1997, through June 30, 1998. After recalculating each sample bill, it was determined that the calculation methods utilized by the Company are correct.

During the current audit, the Staff also analyzed the off-system sales of the Company. An off-system sale is a sale of gas to a customer who is not within the jurisdictional territory of the LDC. Treatment of the profit from any off-system sale is addressed in the "Interruptible Margin Credit Rider" of the Company's tariff which states:

> This Interruptible Margin Credit Rider is intended to authorize the Company to recover not more than fifty percent (50%) of the gross profit margin that results from off-system sales of gas should such sales be made to off-system customers by the Company.

Prior to July 1, 1996, the total of the Company's off-system sales was insignificant. For the years ended June 30, 1997, and June 30, 1998, however, not only did the off-systems sales activity increase substantially but the Company's sales of gas to its "off-system" affiliates also increased significantly. During the year ended June 30, 1997, the Company's off-system sales totaled $16,083,482 of which $6,405,136, or 40%, were to various affiliates of the Company. During the year ended June 30, 1998, however, the percentage increased by 36% to 76% when $7,739,584 of the Company's off-system sales of $10,123,453 were to affiliates of the Company. Although the Staff's analysis of the gross profit percentages derived from these sales did not indicate the existence of any affiliate preference, the Staff questions whether the framers of the Interruptible Margin Credit Rider anticipated that the majority of its off-system sales would be to affiliated companies when they allowed the Company to retain 50% of the gross profit from these sales. **The Staff will continue to carefully scrutinize all future off-system sales of Chattanooga Gas to ascertain that no preference is being afforded the affiliates and to ensure that the Company's reserve margin does not exceed a reasonable level to adequately serve its ratepayers. Should any affiliate preference with off-system sales be indicated in the future, the Staff recommends that the Authority consider a show cause proceeding as to why the Company's tariff should not be amended to exclude sales to off-system affiliates from the profit sharing allowed in the Interruptible Margin Credit Rider.**

VII. ACA FINDINGS

As previously stated, the Company's Actual Cost Adjustment filing dated October 5, 1997, reflected a net under-collection of gas costs from customers for the year ended June 30, 1998, of $2,985,682. The net effect of the Staff's findings, which are detailed below, reduce the under-collection by $1,806,996 to $1,178,686. The Company has responded to the majority of the Staff's findings by stating that the Company will "adjust the ACA schedule and its general ledger accordingly." As the Staff has discussed with the Company in prior audits, any adjustments to the ACA should be held in abeyance by the Company until the final ACA report has been issued by the Authority. In the month following the issuance of the audit report, the Company should then record, in the current ACA, all adjustments required to comply with said audit findings.

SUMMARY:

FINDING #1	Pipeline Refunds		Procedural	
FINDING #2	Inventory		no effect	
FINDING #3	Inventory		no effect	
FINDING #4	Inventory		no effect	
FINDING #5	Inventory		no effect	
FINDING #6	Billing		Procedural	
FINDING #7	Commodity Accrual	$	11,452.16	under-recovery
FINDING #8	Commodity Accrual		(172.14)	over-recovery
FINDING #9	Demand Accrual		(74.55)	over-recovery
FINDING #10	Commodity Accrual		197.57	under-recovery
FINDING #11	Commodity Accrual		671.44	under-recovery
FINDING #12	Demand Accrual		(254.28)	over-recovery
FINDING #13	Commodity Accrual		(29.45)	over-recovery
FINDING #14	Commodity Accrual		(1,269,540.34)	over-recovery
FINDING #15	Commodity Accrual		21.49	under-recovery
FINDING #16	Commodity Accrual		49.66	under-recovery
FINDING #17	Demand Accrual		(9.64)	over-recovery
FINDING #18	Commodity Accrual		24,345.48	under-recovery
FINDING #19	Commodity Accrual		1,280.55	under-recovery
FINDING #20	Demand Accrual		(2,944.00)	over-recovery
FINDING #21	Commodity Accrual		95.64	under-recovery
FINDING #22	Commodity Accrual		(9,077.24)	over-recovery
FINDING #23	Commodity Accrual		(2,061.00)	over-recovery
FINDING #24	Commodity Accrual		73.96	under-recovery
FINDING #25	Commodity Accrual		(677,984.00)	over-recovery
FINDING #26	Commodity Accrual		5,441.14	under-recovery
FINDING #27	Commodity Accrual		(33,952.82)	over-recovery
FINDING #28	Commodity Accrual		(12,629.22)	over-recovery

FINDING #29	Demand Accrual	.00	no effect
FINDING #30	Demand Accrual	8.35	under-recovery
FINDING #31	Commodity Accrual	214.16	under-recovery
FINDING #32	Commodity Accrual	153,274.00	under-recovery
FINDING #33	Demand Accrual	(4,783.00)	over-recovery
FINDING #34	Commodity Accrual	677,984.00	under-recovery
FINDING #35	Commodity Accrual	10,000.00	under-recovery
FINDING #36	Commodity Accrual	(17,393.25)	over-recovery
FINDING #37	Commodity Accrual	7,999.74	under-recovery
FINDING #38	Commodity Accrual	(12,377.14)	over-recovery
FINDING #39	Commodity Accrual	(153,274.00)	over-recovery
FINDING #40	Demand Accrual	4,783.00	under-recovery
FINDING #41	Commodity Accrual	(16,463.15)	over-recovery
FINDING #42	Commodity Accrual	(749,766.00)	over-recovery
FINDING #43	Demand Accrual	(45,616.00)	over-recovery
FINDING #44	Commodity Accrual	(6,856.04)	over-recovery
FINDING #45	Commodity Accrual	749,766.00	under-recovery
FINDING #46	Demand Accrual	(642,187.00)	over-recovery
FINDING #47	Commodity Accrual	11,389.75	under-recovery
FINDING #48	Commodity Accrual	336,286.16	under-recovery
FINDING #49	Commodity Accrual	(10,997.98)	over-recovery
FINDING #50	Commodity Accrual	1,692.91	under-recovery
FINDING #51	Commodity Accrual	(56,534.24)	over-recovery
FINDING #52	Demand Accrual	5,576.69	under-recovery
FINDING #53	Commodity Accrual	36,221.89	under-recovery
FINDING #54	Commodity Accrual	(103,076.22)	over-recovery
FINDING #55	Demand Accrual	(17,768.76)	over-recovery
	Net Result	**$ (1,806,995.72)**	**over-recovery**

A detail explanation for each of the above findings can be found beginning at page 8 of this report.