COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MOUNTAIN UTILITIES, INC., FOR: (1) ORDER AUTHORIZING A RATE INCREASE; (2) INTERIM ORDER TO IMMEDIATELY IMPLEMENT ITS PROPOSED RATES ON AN EMERGENCY BASIS PURSUANT TO KRS 278.190; (3) ORDER APPROVING BORROWING $162,000 FROM THE COMMONWEALTH OF KENTUCKY, DEPARTMENT OF LOCAL GOVERNMENT; (4) ORDER AUTHORIZING A CERTIFICATE OF CONVENIENCE AND NECESSITY TO RECONSTRUCT THE TOM'S CREEK AREA OF THE SYSTEM	)	CASE NO. 9546

O R D E R

On July 17, 1986, the Commission staff issued a financial audit report for Mountain Utilities, Inc., ("Mountain") for the period January 1, 1984, to December 31, 1984. Mountain has been given to August 20, 1986, to file written recommendations contained in the report. As of the date of this Order, no response has been filed.

In order for the information contained in the report to be considered in this proceeding, the Commission finds that this report and any further correspondence concerning this report should be included in the record of this proceeding.

IT IS THEREFORE ORDERED that the Commission staff's financial report for Mountain for the period of January 1, 1984, to December 31, 1984, attached hereto, and any further correspondence

concerning this report shall be included as a part of the record in this proceeding.

Done at Frankfort, Kentucky, this 18th day of August, 1986.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director

Mountain Utilities, Inc.
Financial Audit Report
For the Period January 1, 1984 to December 31, 1984

COMMENTARY

Mountain Utilities, Inc. ("Mountain") purchased Shale Gas Co. on June 20, 1967, and began operating as a natural gas utility. Mountain operates the system pursuant to a certificate of convenience and necessity issued its predecessor. Mountain's service area includes the towns of Staffordsville, Wittensville, Nippa and vicinity in Johnson County serving some 525 customers. Natural gas is purchased wholesale from Kentucky West Virgina Gas.

In 1981, Mountain received a certificate of convenience and necessity to reconstruct and renovate its gas system. The construction project was funded through a low interest loan channeled through the Gas System Restoration Project, the Federal Economic Development Administration, Appalachian Regional Commission, and Kentucky Department of Local Government.

Mountain was informed that the financial audit section of the Public Service Commission would perform a financial audit for the calendar year ending December 31, 1984.

The audit was performed at the offices of Allen, England and Hensley, CPAs, Prestonsburg, Kentucky, by Mary Anne Gill, Financial Audit Supervisor, and Penelope L. Scott and Marvin C. Goff, Jr., Auditors, on October 23, 24, 25, 28, 30, 31, November 1, 1985, and March 12 and 13, 1986. All records were made available for inspection.

PURPOSE

Financial audits are concerned with the financial history represented by the corporate books and with the summarization and disclosure of financial statements from those records. The financial audit section provides the Commissioners and the Commission Staff timely and professional compliance, financial, and operational audit reports on a routine basis of companies under the regulatory jurisdiction of the Kentucky Public Service Commission.

The objective of the financial audit is to provide reasonable assurance to the Commission that:

(1) The accounting records and Annual Report fairly present the financial activities of the utility;
(2) Internal accounting controls are adequate and effective in promoting efficiency and protecting the assets of the utility;
(3) Financial statements and reports comply with established policies, generally accepted accounting principles, the

Uniform System of Accounts, and other applicable rules and regulations; and

(4) Operational policies that promote the well-being of the entity are effective and enforced.

SCOPE

The audit examination includes the analysis and verification of selected balance sheet, income statement, and retained earnings accounts for the audit period January 1, 1984, to December 31, 1984. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The scope is not restricted to accounting and financial matters, and includes a related review of operations and activities in order to evaluate the effectiveness, efficiency, and economy of management practices which affect the financial condition of the utility.

GENERAL AUDIT FINDINGS AND RECOMMENDATIONS

It is the general finding of the auditors that the balance sheet as of December 31, 1984, and the related statements of income and retained earnings do not present fairly the financial condition of Mountain Utilities, Inc. The balance sheet as of December 31, 1984, and the related statements of income and retained earnings containing the adjustments directed herein do present fairly the financial position of Mountain Utilities, Inc. at December 31, 1984, in conformity with generally accepted accounting principles. Mountain is directed to make the appropriate adjustments in accordance with the audit findings or to submit evidence supporting reasons why the adjustments should not be made.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The company is subject to regulation by the Kentucky Public Service Commission with respect to its rates and accounting. Mountain's accounting policies conform with the applicable system of accounts entitled "Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act" ("Uniform System of Accounts"), as provided by the Federal Energy Regulatory commission. The Uniform System of Accounts and the Rules and Regulations contained therein have been adopted by the Kentucky Public Service Commission for use by its jurisdictional utility companies. A description of the company's significant accounting policies follows.

Method of Accounting

The utility subscribes to the accrual method of accounting and financial reporting. In accordance with industry practice, Mountain recognizes purchases of gas on a current basis, whereas

income is recognized as billed resulting in recognition of income one month after the recognition of expense.

Utility Plant and Depreciation

Utility plant is stated at original cost. Mountain replaced substantially all of its existing plant during 1981 and 1982. Expenditures for replacements are capitalized; maintenance and repairs are charged to operations. A provision is made for depreciation on the basis of estimated service lives of assets using the straight-line method.

SPECIAL FINDINGS AND RECOMMENDATIONS

Internal Control

General accounting services are performed by Stephen R. Allen, CPA, pursuant to an agreement with Mountain to provide said services. Additional outside accounting services, accounts receivable billing, are performed by Computer and Utility Services, Inc. The functions provided by these service organizations may be considered a part of the auditee company's internal control system and may therefore be subject to study and evaluation by the auditors.

As part of our examination, we performed a minimum study and evaluation of the service organizations' systems of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. That study and evaluation was limited to a preliminary review of the system to obtain an understanding of the control environment and the flow of transactions through the accounting system.

A small business often does not have enough personnel to permit adequate separation of duties and restricted access to assets. The most critical area of separation of duties is usually handling cash and the related accounts receivable recordkeeping. We believe that the handling of cash and related recordkeeping are adequately separated due to personnel of two different entities performing these functions. Internal control is further enhanced by Stephen R. Allens's direct personal interest and involvement in the accounting controls. The willingness of a principal stockholder and officer of the utility to participate in and to even perform key controls makes processing and reconciliation procedures more effective.

Generally, we find that internal control over the separation of duties for cash and receivables is adequate. Our study and evaluation did disclose certain other conditions, described below, which we believe to be material weaknesses. We are setting forth several observations and recommendations which should be implemented.

Cash Receipts. Deposits are made at irregular intervals throughout the month. We recommend daily deposits of cash receipts.

Accounts Receivable. There is no established procedure or control to balance the credits to the accounts receivable ledger printout to the monthly general journal entry crediting accounts receivable. Mountain should immediately install procedures and controls to coordinate the posting of credits to accounts receivable with the depositing of customer payments on accounts.

Continuing Property Records. The company does not maintain readily accessible continuing property records. We recommend that a subsidiary plant ledger be maintained with the accounting records to contain at a minimum a card or sheet for each unit of property, showing details such as description, location, cost, vendor, date of purchase or installation, estimated salvage value, rate and method of depreciation, depreciation accumulated to date, and repairs. Supplementary information to the plant ledger would include documentation of periodic physical inventories and periodic appraisals of property, plant, and equipment for insurance purposes.

Payroll. The company does not maintain documentation of authorized hourly rates nor authorized payroll deductions. Proper authorization of payroll deductions is important to comply with legal requirements and to provide an audit trail. We recommend that Mountain establish a personnel file for its full-time employee containing current W-4 and K-4 forms and wage rate authorizations.

Utility Plant, Accumulated Depreciation, Depreciation Expense, Materials and Supplies

Net utility plant at December 31, 1984, includes $746,901.00 classified as Account 106 "Completed Construction Not Classified" which is a temporary account established in the Uniform System of Accounts to avoid significant omissions in reporting. For the purpose of reporting to the Commission, the classification of gas utility plant in service by descriptive account is required. The $746,901.00 represents the cost of the major reconstruction of the system in 1981 and 1982 and should be reclassified in accordance with the Uniform System of Accounts, Gas Plant Accounts.

Included in the $746,901.00 is the cost of a supply of pipe that was surplus at the end of the reconstruction project. At the conclusion of the construction, an inventory of the surplus pipe was performed by Larry Amburgey, Investigator Supervisor, Public Service Commission. Prices obtained from the original pipe purchase invoices were applied to the inventoried quantities to value the pipe at original cost. Reclassification entry number 102 based on this valuation, in the amount of $22,162.48, is directed to reclassify the cost of the surplus pipe to Account 150 " Materials and Supplies." Related entries are recommended to

adjust for accumulated depreciation and depreciation expense applied to the surplus pipe. Adjusting entry number 3 is directed to adjust accumulated depreciation and retained earnings for the period November 20, 1982, through December 31, 1983 for $615.60, and to adjust depreciation expense for 1984 in the amount of $554.06.

During 1984, Mountain recorded a $1,000.00 sale of the surplus pipe by crediting Account 106 "Completed Construction Not Classified" for the full amount realized from the sale. A gain on the sale was not recognized. Adjusting entry number 4 is directed to adjust account 106 "Completed Construction Not Classified" for the total sales price, Account 150 "Materials and Supplies" for the cost of the pipe sold, and Account 421.1 "Gain on Disposition of Property" for the difference between the amounts realized and the net amount at which materials were carried in the materials and supplies account.

We were advised by Stephen R. Allen that Mountain had advertised the surplus pipe for sale in 1984. While one small sale of the pipe occurred during 1984, the probability of future sales occurring is remote. The pipe has been exposed to various weather conditions for several years, and the Public Service Commission has deemed the pipe unsuitable and unsafe for natural gas transmission. Adjusting entry number 1 is recommended to reduce the value of the pipe to its net realizable value, which is zero, and to record a loss.

The review of accumulated depreciation revealed that depreciation on a $4,281.00 addition in 1983 was not provided for in 1983 and 1984. Adjusting entry number 5 is recommended to adjust accumulated depreciation, depreciation expense and retained earnings.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
101	Gas Plant In Service-Classified	137,776.00	-	137,776.00
106	Completed Construction Not Classified	746,901.00	<22,162.48> 1,000.00	725,738.52
110	Accumulated Provision for Depreciation, Depletion and Amortization	<144,569.00>	1,169.66 <107.00>	<143,506.34>
150	Materials and Supplies	-	22,162.48 <556.50> <21,605.98>	-0-

403	Depreciation and Depletion Expense	25,145.00	<554.06> 214.00	24,804.94
421.1	Gain on Disposition of Property	-	<443.50>	<443.50>
421.2	Loss on Disposition of Property	-	21,605.98	21,605.98

Current Assets

Cash is fairly stated and properly classified in accordance with the Uniform System of Accounts. All cash on deposit is in institutions whose accounts are insured by an agency of the federal government.

Customer Accounts Receivable at December 31, 1984, are understated $1,304.50. A schedule of cut-off collections was prepared at year end to adjust the general ledger account to the ending balance per the December billing register. Due to a clerical error, the cut-off collections amount was doubled resulting in an excessive credit adjustment to accounts receivable. The credit entry to adjust accounts receivable was concurrently debited to four expense accounts. Adjusting entry No. 2 is recommended to adjust Customer Accounts Receivable and the four operating expense accounts to actual, and the remainder is adjusted to Account 903 "Customer Accounts Supplies and Expenses" as a miscellaneous cash shortage.

Other Accounts Receivable represents an amount due from the Department of Local Government as of December 31, 1984, is fairly stated and properly classified.

Mountain uses the direct write-off method of recording uncollectible accounts. The direct write-off method is not acceptable for the purposes of generally accepted accounting principles. This method recognizes a bad debt expense only when a specific account is determined to be uncollectible. The weaknesses of this method are that bad debts expense is not matched with the related sales revenues, and that accounts receivable are always overstated because no attempt is made to account for unknown bad debts included therein. We recommend that Mountain immediately perform an aging analysis to determine the collectibility of accounts receivable. An aging of accounts receivable prepared and analyzed on a routine basis will provide the necessary documentation to compare past and present experience relating to write-offs. As a result of this analysis, an entry should be recorded to establish a reserve adequate to reduce receivables on the balance sheet to the amount expected to be collected.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
131	Cash and Working Funds	14,386.00	-	14,386.00
142	Customer Accounts Receivable	45,178.00	1,304.50	46,482.50
143	Other Accounts Receivable	891.00	-	891.00

Proprietary Capital

Common capital stock is properly classified and fairly presented in accordance with the Uniform System of Accounts.

Unappropriated Retained Earnings have been adjusted for the effect of the error in accumulated depreciation and for the effect of the sale of materials and supplies. Both adjustments were discussed previously in this report.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
201	Common Capital Stock	<60,000.00>	-	<60,000.00>
216	Unappropriated Retained Earnings	119,871.00	<722.60> 19,517.92	138,666.32
439	Adjustments to Retained Earnings	-	<615.60> <107.00>	<722.60>

Long-Term Debt

Through the Gas System Restoration Project, Mountain was able to borrow $700,000.00 at 5.125% interest with a 30 year repayment schedule. The funds were used to renovate and reconstruct a substantial portion of the distribution system in 1981 and 1982.

In accordance with the Uniform System of Accounts, the portion of long term debt that is matured and unpaid, without any specific agreement to extend the time of payment, shall be classified in Account 238 "Other Current and Accrued Liabilities." Reclassification entry number 104 is directed to reclassify matured principal in the amount of $8,094.83 from Account 224 "Other Long Term Debt" to Account 238 "Other Current and Accrued Liabilities."

The conditions of the DLG loan agreement contain at least two items of audit significance. The terms of the loan provide that Mountain shall place 5% of its annual gross revenue in an escrow account until $50,000.00 is accrued, and shall maintain liability insurance during the term of the loan with the Commonwealth of Kentucky named on the insurance policy as an additional insured.

The company has not complied with either of the aforementioned terms. We recommend that Mountain begin immediately placing 5% of gross revenues into an escrow account, and that Mountain secure liability insurance for an appropriate amount of coverage, with the Commonwealth of Kentucky named on the liability insurance policy as an additional insured.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
224	Other Long-Term Debt	<697,024.00>	8,094.83	<688,929.17>
238.1	Other Current and Accrued Liabilities - Matured Interest	-	<28,070.00>	<28,070.00>
238.2	Other Current and Accrued Liabilities - Matured Principal	-	<8,094.83>	<8,094.83>
431.2	Other Interest Expense - DLG	35,746.00	-	35,746.00

Current and Accrued Liabilities

A note payable in the amount of $35,000.00 was found to be fairly stated and properly classified as a current obligation. The note is the final portion of the $125,000.00 settlement to satisfy the judgement in Pratt, et al., v. Mountain Utilities Company, Inc. Related interest expense of $4,000.00 and accrued interest of $4,322.00 are also fairly stated and properly classified.

Accounts payable in the amount of $77,814.00 were found to represent current obligations, were fairly stated and properly classified.

Taxes accrued per books in the amount of $694.00 represent payroll taxes withheld, accrued sales tax payable, and federal unemployment tax payable. Taxes collected through payroll deductions and for transmittal to taxing authorities should be classified in Account 238 "Other Current and Accrued Liabilities" in accordance with the Uniform System of Accounts. Reclassification entry number 105 is directed to reclassify taxes payable to Account 238 "Other Current and Accrued Liabilities." The $56.05 remaining in Account 236 "Taxes Accrued" is the federal unemployment tax liability and is properly classified.

Accrued interest in the amount of $28,070.00 represents matured and unpaid interest on the Department of Local Government loan. In accordance with the Uniform System of Accounts, matured and unpaid interest should be classified in Account 238 "Other

Current and Accrued Liabilities." Reclassification entry number 101 is recommended to reclassify this amount.

Interest on customer deposits has not been accrued, which understates liabilities and overstates current and prior earnings. We recommend in concordance with the preparation of a schedule of customer deposits, that an appropriate amount of accrued interest on customer deposits be determined and posted to the accounts.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
231	Notes Payable	<35,000.00>	-	<35,000.00>
232	Accounts Payable	<77,814.00>	-	<77,814.00>
236	Taxes Accrued	<694.00>	637.95	56.05
237.1	Interest Accrued - DLG	<28,070.00>	28,070.00	-
237.2	Interest Accrued - Pratt	<4,322.00>	-	<4,322.00>
238.3	Other Current and Accrued Liabilities - Taxes Payable	-	<637.95>	<637.95>
431.1	Other Interest Expense - Pratt Notes	4,000.00	-	4,000.00
431.4	Other Interest Expense - Other	1.00	-	1.00

Customer Deposits

The balance in customer deposits could not be substantiated. While the liability for customer deposits is significant, supporting records for current deposits are weak and for older deposits are nonexistent. We recommend that the utility begin immediately to reconcile the individual customer deposits which support this balance and to adjust this account accordingly for any differences.

It is the practice of the utility to refund only those deposits for which the customer requests a refund. It is likely that this has resulted in accounts which are now nonrefundable due to the inability to locate the depositors. The utility has a legal liability pursuant to KRS 393.080 and KRS 393.110 to report and surrender abandoned deposits together with interest accrued thereon to the Kentucky Revenue Cabinet. If deposits are known to be refundable to a specific customer, then the utility should make

every attempt to locate the customer and to refund the deposit with interest.

It is also the practice of the utility to pay interest only on those deposits which are refunded. Interest should also be paid on those deposits applied to final bills, even when the final bill exceeds the amount of the deposit. This will effectively give the customer the benefit of the interest earned.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
235	Customer Deposits	17,510.00	-	17,510.00
431.3	Other Interest Expense - Meter Deposits	155.00	-	155.00

Revenues

Revenues are fairly stated but are not properly classified in accordance with the Uniform System of Accounts. Mountain records all revenues as from residential sales. The Uniform System of Accounts provides for the separate reporting for residential or domestic purposes from that supplied to commercial and industrial customers. We recommend that the utility begin immediately to classify gas sales accordingly.

Penalties charged on past due accounts are properly charged in accordance with the tariff in effect during the audit period, but are improperly classified. The Uniform System of Accounts provides for the reporting of additional charges imposed because of the failure of customers to pay gas bills on or before a specified date in Account 487 "Forfeited Discounts." Reclassification entry number 103 is directed to properly classify these charges.

A test of miscellaneous service fees charged disclosed an improper $25.00 service charge in accordance with the tariff in effect for the audit period. A $25.00 reconnection fee was collected from customers whose service was disconnected for nonpayment. The proper charge according to the tariff is $15.00. While the amount overcharged is not material, and no audit adjustment is required, we recommend that the company discontinue charging the improper fee and begin charging $15.00.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
480	Residential Sales	<384,019.00>	-	<384,019.00>
487	Forfeited Discounts	-	<7,865.67>	<7,865.67>

488	Miscellaneous Service Revenues	<8,398.00>	7,865.67	<532.33>
495	Other Gas Revenues	<45,199.00>	-	<45,199.00>

Operating Expenses

A post closing general journal entry by the company overstated various operating expense accounts by $309.05. Adjusting entry number 2 is directed to reverse this entry, and to fairly state the various expense accounts.

Account 761 "Mains and Services Labor" includes the salary of the only full-time employee. A test of time sheet records for six months of 1984 proved that although less than 100% of this employee's time was spent working specifically for Mountain, Mountain did receive the equivalent benefit of one full-time employee. Employee time is shared with East Kentucky Utilities, an arrangement that appears to be mutually beneficial.

Account 762 "Mains and Services Supplies and Expenses" includes charges for various supplies and expenses. The account is overstated $20.00 due to the post closing entry discussed previously for which an adjusting entry is directed.

Account 765 "Miscellaneous Distribution Expenses" include freight charges on various shipments. In accordance with the Uniform System of Accounts, transportation expenses incurred are considered a cost of the supplies ordered and are not accounted for separately.

Account 768 "Maintenance of Meters and House Regulators" includes payments to two individuals. A $37.50 per month, or $450.00 annual payment is made to a retired employee for meter testing. No payroll taxes are withheld from this wage. Also charged to this account is a monthly payment to another retired employee. This employee does not have any labor duties, and the payment represents some type of informal retirement plan. The total annual payment is $1,800.00.

Office space, clerical labor, accounting services, preparation of rate case filings and annual report filing are provided by Stephen R. Allen in accordance with an agreement to provide said services for $1,900.00 per month, or $22,800.00 annually. The fee is allocated among accounts 902 "Accounting and Collecting Labor", 920 "Administrative and General Salaries", and 921 "Office Supplies and Expenses". While this agreement is mentioned in the minutes of the board of directors meeting of January 2, 1984, there is no formal contract.

Account 903 "Accounting and Collecting Supplies and Expenses" includes $3,300.00 paid for billing services rendered. A truck is leased from the same company that provides the billing services

for $3,000.00 annually, and is charged to Account 933 "Transportation Expense." There are no formal contracts for either of these services.

Account 904 "Uncollectible Accounts" includes direct charges to write-off various accounts receivable. The proper accounting treatment for these charges was previously discussed in the Receivables section of this report.

Account 921 "Office Supplies and Expenses" includes amounts paid for postage, telephone, and miscellaneous supplies. The account is overstated $157.03 due to the post closing entry for which an adjustment was directed previously.

Account 924 "Property Insurance" includes amounts paid for workers compensation insurance and for an encroachment permit.

Account 926 "Employee Pensions and Benefits" includes Blue Cross/Blue Shield coverage for the full-time employee and for the directors, and a lump sum benefit paid to a former employee who is terminally ill. The previously discussed post closing entry overstates this account $30.00 for which an adjusting entry is directed.

Account 930.2 "Miscellaneous General Expenses" includes $3,600.00 paid to directors in 1984. The directors were required to attend one meeting in in 1984.

Account 931 "Rents" includes payments totaling $2,987.20 for rental of the meter shop.

Account 933 "Transportation Expense" includes gasoline, oil, and vehicle repairs. The post closing entry overstates this account $102.02. An adjustment reversing this entry was directed previously.

With the exception of the post closing entry which overstated four expense accounts, expenses are properly authorized, correctly recorded, fairly presented and properly classified in accordance with the Uniform System of Accounts. Expenses are properly matched with appropriate revenues.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
	Other Gas Supply Expenses:			
730	Natural Gas Purchases	235,095.00	-	235,095.00
	Distribution Expenses:			

761	Mains and Services Labor	14,172.00	-	14,172.00
762	Mains and Services Supplies & Expenses	2,158.00	<20.00>	2,138.00
765	Miscellaneous Distribution Expenses	10.00	-	10.00
768	Maintenance of Meters and House Regulators	2,250.00	-	2,250.00
	Customer Accounts Expense:			
902	Accounting and Collecting Labor	7,500.00	-	7,500.00
903	Customer Accounts Supplies & Expenses	3,300.00	<995.45>	2,304.55
904	Uncollectible Accounts	8,261.00	-	8,261.00
	Administrative and General Expenses:			
920	Administrative and General Salaries	13,200.00	-	13,200.00
921	Office Supplies and Expenses	5,165.00	<157.03>	5,007.97
924	Property Insurance	761.00	-	761.00
926	Employee Pensions and Benefits	5,874.00	<30.00>	5,844.00
930.2	Miscellaneous General Expenses	3,634.00	-	3,634.00
931	Rents	2,987.00	-	2,987.00
933	Transporation Expenses	5,160.00	<102.02>	5,057.98

Other Expenses and Deductions

Account 408.1 "Taxes Other Than Income Taxes" properly includes the employer's portion of FICA, various ad valorem taxes, and the Public Service Commission assessment. These expenses were correctly recorded, properly classified, and fairly presented in accordance with the Uniform System of Accounts.

The following represents the audit findings discussed herein.

USOA	Account	Per Books	Adjustment	Per Audit
408.1	Taxes Other Than Income Taxes	7,417.00	-	7,417.00

Related Party Transactions

Our review disclosed related party transactions for the audit period in the amount of $35,687.20 as follows:

Related Party	Description	Amount	Relationship*
Stephen R. Allen, CPA	Accounting Services	$22,800.00	Brother
	Directors Fee	720.00	
Computer & Utility Services	Billing Service	3,300.00	Brother (1/6 Interest)
	Truck Lease	3,000.00	
Building and Development Corp.	Meter Shop Rental	2,987.20	Father (1/2 Interest)
David D. Allen	Director Fees	720.00	Self
John Allen, Jr.	Directors Fee	720.00	Father
Judith Colvin	Directors Fee	720.00	Sister
Robert Allen	Directors Fee	720.00	Brother
Total		$35,687.20	

* Relationship to David D. Allen, President/Stockholder at December 31, 1984.

Related party transactions are fairly stated and adequately disclosed in the financial statements. Due to scope limitations we will make no findings nor recommendations on the relative benefit or cost of any of these services if performed at arms length.

Contingencies

The purpose of the review of contingencies is to determine that loss (or gain) contingencies are properly disclosed in the financial statements. All transactions for the audit period were reviewed for their possible effect as a contingency.

Loss contingencies discovered include collectibility of accounts receivable and uninsured property. Each item is discussed further as follows.

Collectibility of Accounts Receivable. In accordance with generally accepted accounting principles and the Uniform System of Accounts, accounts receivable must be reported at their net realizable value (i.e. equal to the gross amount of receivables less an estimated allowance for uncollectible accounts). Pursuant to Financial Accounting Standards Board ("FASB") Statement Number 5 "Contingencies", if it is probable that 100% of the accounts receivable will not be collected and the amount of loss contingency (uncollectible receivables) can be reasonably estimated, an accrual must be charged against income.

The noncollectibility of accounts is an event that is probable and can be reasonably estimated, and therefore should be disclosed in the financial statements according to FASB Statement Number 5.

Uninsured Property. The company is uninsured with respect to the risk of future loss or damage to its property by fire, explosion or other hazard. This is an existing uncertainty according to FASB Statement Number 5. However, the absence of insurance does not mean that an asset has been impaired or a liability incurred as of the date of the financial statements.

The uninsured property is not a required disclosure according to FASB Statement Number 5.

Subsequent Events

The purpose of the review of subsequent events is to disclose events or transactions occurring between the audit date and the date of the end of the field work to determine the material effect on the financial statements.

The auditors' search for subsequent events generally include a review of interim financial statements, discussions with management, review of the minutes of board of directors meeting, inquiring about litigation, claims, and contingent liabilities, and obtaining letters of representation from management and legal counsel.

Audit procedures performed in the search for subsequent events included reading the minutes for the subsequent period, examining the interim financial statements, inquiry of management and observation while in the field, obtaining management and legal representation letters, attending Public Service Commission hearings during the subsequent period, inquiring of DLG regarding delinquency of loan payment and other procedures as necessary in the circumstances.

The subsequent events noted during the review are presented as follows. None require an adjustment to or disclosures as a part of the financial statements for the audit period.

Delinquent DLG Loan Payments. As of the conclusion of the field work, March 13, 1986, delinquent payments totalled $54,269.59 including principal and interest. Mountain has sought relief from the delinquency by requesting that the Gas System Restoration Board refinance the loan and attach the outstanding delinquent payments to the end of the loan. Mountain has also requested an additional loan to complete the reconstruction of the system and to retire two bank loans.

Stock Transfer. On January 2, 1985, David D. Allen, President, transferred 10 shares to stock to Stephen R. Allen, Vice President. As a result of the transfer Stephen R. Allen owns 20 shares of stock and Robert Allen owns 5 shares.

Corporate Officers Change. On January 2, 1985, David D. Allen, President, became Vice President, and Stephen R. Allen, Vice President became President.

Directors Fees/Benefits. Effective November, 1985, directors fees and Blue Cross/Blue Shield benefit payments were discontinued.

We are satisfied that all material subsequent events have been disclosed.

CONCLUSION

The foregoing action is without prejudice to the right to require hereafter such adjustments as may be considered proper from additional information which may come to the attention of the Commission.

The audited financial statements implementing all audit findings and recommendations contained in this report are attached hereto.

March 13, 1986

Respectfully submitted,

Mary Anne Gill
Mary Anne Gill
Audit Supervisor

Penelope L. Scott
Penelope L. Scott
Auditor

Marvin C. Goff, Jr.
Marvin C. Goff, Jr.
Auditor

MOUNTAIN UTILITIES INC.
BALANCE SHEET
DECEMBER 31, 1984

ACCT. NO.	ACCOUNT TITLE	BALANCE PER BOOKS 12/31/84	ADJUSTMENTS & RECLASSIFICATIONS DR	CR	FINAL BALANCE 12/31/84
	ASSETS AND OTHER DEBITS				
	UTILITY PLANT:				
101	GAS PLANT IN SERV. - CLASSIF.	137776.00			137776.00
106	COMPLETED CONST. NOT CLASSIF.	746901.00	1000.00	22162.48	725738.52
110	LESS: ACCUM.PROV.FOR DEPR., DEPL. & AMORT.	-144569.00	1169.66	107.00	-143506.34
	NET UTILITY PLANT	740108.00			720008.18
	CURRENT & ACCRUED ASSETS:				
131	CASH & WORKING FUNDS	14386.00	0.00	0.00	14386.00
142	CUSTOMER ACCTS. RECEIVABLE	45178.00	1304.50	0.00	46482.50
143	OTHER ACCTS. RECEIVABLE	891.00	0.00	0.00	891.00
150	MATERIALS AND SUPPLIES	0.00	22162.48	22162.48	0.00
	TOT.CURRENT & ACCRUED ASSET	60455.00			61759.50
	TOTAL ASSETS AND OTHER DEBITS	800563.00			781767.68

MOUNTAIN UTILITIES INC.
BALANCE SHEET
DECEMBER 31, 1984

ACCT. NO.	ACCOUNT TITLE	BALANCE PER BOOKS 12/31/84	ADJUSTMENTS & RECLASSIFICATIONS DR	CR	FINAL BALANCE 12/31/84
	LIAB. AND OTHER CREDITS				
	PROPRIETARY CAPITAL:				
201	COMMON CAPITAL STOCK	60000.00	0.00	0.00	60000.00
216	UNAPPRO. RETAINED EARNINGS	-119871.00	19517.92	722.60	-138666.32
	TOTAL PROP. CAPITAL	-59871.00			-78666.32
	LONG-TERM DEBT:				
224	OTHER LONG-TERM DEBT:				
	DLG LOAN	697024.00	8094.83	0.00	688929.17
	TOTAL LONG-TERM DEBT	697024.00			688929.17
	CURRENT & ACCRU. LIAB.:				
231	NOTES PAYABLE:				
	PRATT JUDGEMENT	35000.00	0.00	0.00	35000.00
232	ACCOUNTS PAYABLE	77814.00	0.00	0.00	77814.00
235	CUSTOMER DEPOSITS	17510.00	0.00	0.00	17510.00
236	TAXES ACCRUED	694.00	637.95	0.00	56.05
237	INTEREST ACCRUED:				
237.1	DLG LOAN	28070.00	28070.00	0.00	0.00
237.2	PRATT JUDGEMENT	4322.00	0.00	0.00	4322.00
238	OTHER CURRENT AND ACCRUED LIABILITIES:				
238.1	DLG-INTEREST	0.00	0.00	28070.00	28070.00
238.2	DLG-PRINCIPAL	0.00	0.00	8094.83	8094.83
238.3	TAXES PAYABLE	0.00	0.00	637.95	637.95
	TOTAL CURRENT & ACCRU.LIAB.	163410.00			171504.83
	TOTAL LIAB. & OTHER CREDITS	800563.00			781767.68

MOUNTAIN UTILITIES INC.
STATEMENT OF RETAINED EARNINGS
DECEMBER 31, 1984

ACCT. NO.	ACCOUNT TITLE	BALANCE PER BOOKS	ADJUSTMENTS & RECLASSIFICATIONS DR	CR	FINAL BALANCE (YEAR)
216	BALANCE BEGIN. OF YEAR	-175496.00	0	0	-175496.00
439	ADJUST. TO RETAINED EARNINGS	0	0	722.60	722.60
433	BAL. TRANSFERRED FROM INCOME	55625.00	19517.92		36107.08
216	BALANCE END OF YEAR	-119871.00	19517.92	722.60	-138666.32

MOUNTAIN UTILITIES INC.
STATEMENT OF REVENUES AND EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 1984

ACCT. NO.	ACCOUNT TITLE	BALANCE PER BOOKS 12/31/84	ADJUSTMENTS & RECLASSIFICATIONS DR	CR	FINAL BALANCE 12/31/84
	OPERATING REVENUES:				
480	RESIDENTIAL SALES	384019.00	0.00	0.00	384019.00
	TOTAL GAS SERVICE REVENUES	384019.00			384019.00
	OTHER OPERATING REVENUES:				
487	FORFEITED DISCOUNTS	0.00	0.00	7865.67	7865.67
488	MISC. SERVICE REVENUES	8398.00	7865.67	0.00	532.33
495	OTHER GAS REVENUES	45199.00	0.00	0.00	45199.00
	TOTAL OTHER OPER. REV.	53597.00			53597.00
	TOTAL GAS OPERATING REVENUES	437616.00			437616.00

MOUNTAIN UTILITIES INC.
STATEMENT OF REVENUES AND EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 1984

ACCT. NO.	ACCOUNT TITLE	BALANCE PER BOOKS 12/31/84	ADJUSTMENTS & RECLASSIFICATIONS DR	CR	FINAL BALANCE 12/31/84
	OPERATING EXPENSES:				
	OTHER GAS SUPPLY EXPENSES:				
730	NATURAL GAS PURCHASES	235095.00	0.00	0.00	235095.00
	TOTAL OTHER GAS SUPPLY EXP.	235095.00			235095.00
	DISTRIBUTION EXPENSES:				
761	MAINS & SERVICES LABOR	14172.00	0.00	0.00	14172.00
762	MAINS & SERV. SUP. & EXP.	2158.00	0.00	20.00	2138.00
765	MISC. DISTRIB. EXP.	10.00	0.00	0.00	10.00
768	MAINT. OF METERS & HOUSE REG.	2250.00	0.00	0.00	2250.00
	TOTAL DISTRIBUTION EXP.	18590.00			18570.00
	CUSTOMER ACCOUNTS EXPENSE:				
902	ACCT'ING. & COLLECT. LABOR	7500.00	0.00	0.00	7500.00
903	SUPPLIES AND EXPENSES	3300.00	0.00	995.45	2304.55
904	UNCOLLECT. ACCOUNTS	8261.00	0.00	0.00	8261.00
	TOTAL CUSTOMER ACCTS. EXP.	19061.00			18065.55
	ADMIN. & GENERAL EXPENSES:				
920	ADMIN. & GENERAL SALARIES	13200.00	0.00	0.00	13200.00
921	OFFICE SUP. & EXPENSES	5165.00	0.00	157.03	5007.97
924	PROPERTY INSURANCE	761.00	0.00	0.00	761.00
926	EMPLOYEE PENSIONS & BENEFITS	5874.00	0.00	30.00	5844.00
930.2	MISC. GENERAL EXPENSES	3634.00	0.00	0.00	3634.00
931	RENTS	2987.00	0.00	0.00	2987.00
933	TRANSPORTATION EXPENSES	5160.00	0.00	102.02	5057.98
	TOTAL ADM. & GEN. EXPENSES	36781.00			36491.95
	TOTAL GAS OPER. & MAINT. EXP.	309527.00			308222.50
403	DEPREC. & DEPLETION EXP.	25145.00	214.00	554.06	24804.94
408.1	TAXES OTHER THAN INCOME TAX:				
	PAYROLL TAX	1244.00	0.00	0.00	1244.00
	PROPERTY TAX	3980.00	0.00	0.00	3980.00
	PSC ASSESSMENT	2193.00	0.00	0.00	2193.00
	TOTAL OTHER TAXES	7417.00			7417.00
	TOTAL GAS OPER. EXPENSES	342089.00			340444.44
	NET OPERATING INCOME	95527.00			97171.56

MOUNTAIN UTILITIES INC.
STATEMENT OF REVENUES AND EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 1984

ACCT. NO.	ACCOUNT TITLE	BALANCE PER BOOKS 12/31/84	ADJUSTMENTS & RECLASSIFICATIONS DR	CR	FINAL BALANCE 12/31/84
	OTHER INCOME:				
421.1	GAIN ON DISPOSITION OF PROPERTY	0.00	0.00	443.50	443.50
421.2	LOSS ON DISPOSITION OF PROPERTY	0.00	21605.98	0.00	-21605.98
	TOTAL OTHER INCOME	0.00			-21162.48
	OTHER DEDUCTIONS:				
431	OTHER INTEREST EXP.				
431.1	PRATT NOTES	4000.00	0.00	0.00	4000.00
431.2	DLG	35746.00	0.00	0.00	35746.00
431.3	METER DEPOSITS	155.00	0.00	0.00	155.00
431.4	OTHER	1.00	0.00	0.00	1.00
	TOTAL OTHER DEDUCTIONS	39902.00			39902.00
	NET INCOME	55625.00			36107.08

MOUNTIAN UTILITIES, INC.
AUDIT ADJUSTMENTS
FOR THE PERIOD JANUARY 1, 1984 TO DECEMBER 31, 1984

USOA	ACCOUNT	DEBIT	CREDIT
	(1)		
421.2	Loss on Disposition of Property	21,605.98	
150	Materials and Supplies		21,605.98
	(to write off the remaining surplus pipe)		
	(2)		
142	Customer Accounts Receivable	1,304.50	
903	Customer Accounts Supplies and Expenses		995.45
762	Mains and Services Supplies - Expenses		20.00
921	Office Supplies and Other Expense		157.03
926	Employee Pensions and Benefits		30.00
933	Transportation Expenses		102.02
	(to adjust overstated accounts receivable to balance per printout and to adjust for error in posting cut-off collections for 1984)		
	(3)		
110	Accumulated Provision for Depreciation, Depletion and Amortization of Gas Utility Plant in Service	1,169.66	
439	Adjustments to Retained Earnings		615.60
403	Depreciation and Depletion Expense		554.06
	(to adjust accumulated depreciation and depreciation expense on materials and supplies)		
	(4)		
106	Completed Construction Not Classified	1,000.00	
150	Materials and Supplies		556.50
421.1	Gain on Disposition of Property		443.50
	(to record the sale of materials and supplies)		

Mountain Utilities, Inc.
Audit Adjustments
Page 2

(5)

USOA	ACCOUNT	DEBIT	CREDIT
403	Depreciation and Depletion Expense	214.00	
439	Adjustments to Retained Earnings		107.00
110	Accumulated Provision for Depreciation Depletion and Amortization of Gas Utility Plant in Service (to adjust for depreciation on 1983 plant addition)		107.00

MOUNTAIN UTILITIES, INC.
AUDIT RECLASSIFICATIONS
FOR THE PERIOD JANUARY 1, 1984 TO DECEMBER 31, 1984

USOA	ACCOUNT	DEBIT	CREDIT
	(101)		
237.1	Interest Accrued	28,070.00	
238.1	Other Current and Accrued Liabilities (to reclassify matured interest - DLG)		28,070.00
	(102)		
150	Materials and Supplies	22,162.48	
106	Completed Construction not Classfied (to reclassify pipe left over from GSRP, valued at cost and based on PSC inventory)		22,162.48
	(103)		
488	Miscellaneous Service Revenues	7,865.67	
487	Forfeited Discounts (to reclassify penalties collected on past due customer accounts)		7,865.67
	(104)		
224	Other Long-Term Debt	8,094.83	
238.2	Other Current and Accrued Liabilities (to reclassify matured principal - DLG in accordance with USOA)		8,094.83
	(105)		
236	Taxes Accrued	637.95	
238.3	Other Current and Accrued Liabilities (to reclassify payroll taxes and sales taxes payable)		637.95