Missouri Public Service Commission

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August 9, 2007

Randy Maffett, Managing Partner
Southern Missouri Gas Company, L.P.
1001 Fannin, Suite 550
Houston, Texas 77002

Re: 2006 Missouri Public Service Commission (PSC) Annual Report (BMAR-2007-1344)

Dear Mr. Maffett:

I am responding to the Sartain Fischbein Company (Sartain) letter dated July 6, 2007 as forwarded from your legal counsel, Mr. James Fischer. This letter from Sartain was in response to an annual report deficiency letter from me sent in June 2007 regarding possible deficiencies contained within Southern Missouri Natural Gas (SMNG) filing of their 2006 Missouri Public Service Commission (PSC) Annual Report. The Sartain letter was not persuasive on all points it addressed, and the Staff continues to assert that SMNG's 2006 PSC Annual Report filing is deficient and in need of correction.

As a starting point for this discussion, the Staff maintains that SMNG is required to keep its books and records according with the Uniform System of Accounts (USOA) for Natural Gas Companies:

> PART 201 – Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provision of the Natural Gas Act
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> Note: Order 141, 12FR 8504, Dec. 19, 1947, provides in part as follows:
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> "*Prescribing a system of accounts for natural gas companies under the Natural Gas Act.* The Federal Power Commission acting pursuant to authority granted by the Natural Gas Act (58) Stat. 821, as amended; 15 U.S.C. an Sup. 717 et seq.), particularly section 8(a), 10(a) and 16 thereof, and finding such action necessary and appropriate for carrying out the provisions of said Act, ordered that: (b) Said system of accounts and said rules and regulations contained therein be and the same are hereby prescribed and promulgated as the system of accounts and rules and regulation of the Commission to be kept and observed by natural gas companies subject to the jurisdiction of the Commission, to the extent and in the manner set forth therein;"

In my initial letter in this matter, I stated it is Staff's belief that SMNG's 2006 Annual Report submittal was not in conformity with the USOA. For the reasons stated below, the Staff continues to hold this belief, and reiterates its request that SMNG take appropriate corrective actions. The focus of this letter deals with the response by Sartain to Question No. 1 in the Staff's June 2007 letter. I will respond to each point in which the PSC Staff (Staff) disagrees with the response of Sartain to this question.

The Staff's Question 1, and Sartain's response, reads in entirety as follows:

> **Staff Question 1:** "The Company did not report a utility plant acquisition adjustment ([acquisition adjustment] Page 200, line 12). Please explain why the Company does not show an acquisition adjustment or provide documentation describing and detailing the reasons why the Company is not required to reflect such adjustment. Also, update all schedules affected by any change to this account. Commission rules require a response within 20 days of notice of deficiency."
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> **Sartain's response:** "Prior to its acquisition by Sendero, SMNG did not report a utility plant acquisition adjustment on its annual reports to MoPSC. The acquisition of SMNG by Sendero in 2005 was for an amount less than its book value. An acquisition adjustment would occur (if approved by MoPSC) when an entity is acquired at an amount greater than its book value and these excess amounts are recorded on the books of the acquired entity. However, as discussed in Item 3 below, any amounts paid by Sendero in excess of or less than the book value of SMNG at the time of acquisition, would not be reflected on the books and records of the Company. Therefore, there is no acquisition adjustment in the annual report."

If, in the first sentence in Sartain's response to Staff Question No. 1 quoted above, Sendero is alleging that under the Staff's interpretation of the USOA the former owners on SMNG should have also reflected an acquisition adjustment in its PSC Annual Report submissions to reflect the difference in the purchase price paid for the SMNG properties by that entity from the net original cost of the property reflected by its initial owners, the Staff would agree. However, the possible failure of the prior owners to follow the USOA properly in this respect is not relevant to Sendero's current obligation under Commission rules to adhere to the USOA in its submitted PSC Annual Report. The Staff contends that if the acquisition of SMNG by Sendero in 2005 resulted in an acquisition adjustment as defined in the USOA, an acquisition adjustment should have been reported in SMNG's 2005 and 2006 MoPSC Annual Report.

Sartain's response to Staff Question No. 1 also states that "an acquisition adjustment would occur (if approved by MoPSC) when an entity is acquired at an amount greater than its book value and these excess amounts are recorded on the books of the acquired entity." The Staff disagrees with this statement by Sartain. The Uniform System of Accounts (USOA) clearly explains the treatment of gas plant acquisitions adjustments; *PART 201 – Uniform System of*

Accounts Prescribed for Natural Gas Companies Subject to the Provision of the Natural Gas Act:

18CFR Ch. 1 (4-1-01 Edition), page 580

114 Gas plant acquisition adjustments.

A. This account shall include the difference between (a) the cost to the accounting utility of gas plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated provisions for depreciation, depletion, and amortization and contributions in aid of construction with respect to such property.

C. Debit amounts recorded in this account related to plant and land acquisition may be amortized to account 425, Credit amounts recorded in this account shall be accounted for as directed by the Commission.

115 Accumulated provision for amortization of gas plant acquisition adjustments.

This account shall be credited or debited with amounts which are includible in account 406, Amortization of Gas Plant Acquisition Adjustments or account 425, Miscellaneous Amortization, for the purpose of providing for the extinguishment of amounts in account 114, Gas Plant Acquisition Adjustments, in instances where the amortization of account 114 is not being made by direct write-off to the account.

Based upon the above quotes from the USOA, it is clear that the prescribed acquisition adjustment accounting in the USOA applies to any difference between the purchased value of a utility's net assets and their value when first devoted to public service, whether that difference is positive or negative, or whether the assets were purchased at a premium or a discount. Therefore, an acquisition adjustment should be booked and subsequently amortized when a purchaser buys utility property at a discount from its net original cost as booked by its initial owner, as is the case with Sendero's purchase of the SMNG assets.

The Sartain responses to Staff Questions Nos. 2, 3 and 4 in the June 2007 Staff Letter primarily relate to Sartain's interpretation of current generally accepted accounting principles (GAAP) as they pertain to appropriate financial recording of the net value of SMNGs assets. As neither the Commission nor the Staff is responsible for promulgating or enforcing GAAP as it applies to the financial reporting of a utility's operations for non-regulatory purposes, we will not have any further comment on Sartain's response to these questions. However, this should not be interpreted as meaning the Staff agrees with Sartain's responses to these questions. Moreover, the Staff notes that the Commission's prescribed USOA is not consistent in every respect with the provisions of GAAP as they apply to non-regulated entities, and that regulated utilities under the PSC's jurisdiction are nonetheless obligated to follow the USOA in its Annual Report submittals to the PSC.

In conclusion, the Staff requests that SMNG submit corrected pages to its 2006 Annual Report as discussed above, including appropriate reflection of an acquisition adjustment in SMNG's balance sheet and amortization of that acquisition adjustment on SMNG's income statement. Of course, such accounting will not affect the ability of SMNG, the Staff and other parties to argue for different valuations of SMNG's net assets for ratemaking purposes in subsequent SMNG rate proceedings before the Commission. Also, the Staff would highly recommend that the Company maintain its regulatory books in such a manner that all supporting documentation for acquisition costs and expenses, impairment studies, auditor's work-papers and/or any material related to the transactions associated with the acquisition of SMNG and other transactions associated with the acquisition are preserved on a going forward basis.

Commission rules require a response to this notice of deficiency within 20 days. Should you have any further questions, please contact me at (573) 526-6960 or e-mail me at dana.eaves@psc.mo.gov. Thanks you for your attention to this matter.

Respectfully,

Dana Eaves

Dana Eaves
Utility Regulatory Auditor III

cc: James Fischer, Lera Shemwell