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Opinion No. 01-097

Accounting method under Tenn. Code Ann. § 68-221-1010(a)(2)

QUESTIONS

1. If, after applying the accounting method provided for in Tenn. Code Ann. § 68-221-1010(a)(2), a water system or wastewater facility is in a deficit position and is referred to the Water and Wastewater Financing Board (the "Board"), does the Board continue using that same accounting method in determining user rates sufficient to correct the deficit?

2. Is the accounting method provided for in Tenn. Code Ann. § 68-221-1010(a)(2) to be used in all subsequent financial audits if the water or wastewater facility's customer base remains at 900 or fewer customers?

3. How should any conflict between general accounting principles and the accounting principles provided for in Tenn. Code Ann. § 68-221-1010(a)(2) be resolved, since depreciation is an operating expense that must be reflected in net income and the Comptroller's position is that depreciation must be considered in the cost of operation?

OPINION

1. If, after applying the accounting method provided for in Tenn. Code Ann. § 68-221-1010(a)(2), a water system or wastewater facility is in a deficit position and is referred to the Board, the Board is to continue using that same accounting method (not depreciating grant fund acquired assets) in determining user rates to correct the deficit.

2. The accounting method provided for in Tenn. Code Ann. § 68-221-1010(a)(2), (not depreciating grant fund acquired assets), is to be used in all subsequent financial audits, as long as the system's or facility's user base remains at 900 or fewer customers.

3. Any conflict between general accounting principles and the accounting principles provided for in Tenn. Code Ann. § 68-221-1010(a)(2), (not depreciating grant fund acquired assets), is to be resolved in favor of a strict interpretation of the statute, that is, not depreciating those particular assets.

ANALYSIS

The opinions sought concern interpretation of the Wastewater Facilities Act of 1987 (the "Act") and, specifically, the 1992 amendment that is codified at Tenn. Code Ann. § 68-221-1010(a)(2). Before addressing the Act, it is necessary to correct an apparent misconception. As framed, the presented questions give the appearance that auditors, or the Comptroller in interpreting their report, use two distinctive accounting methods in determining whether a water system or wastewater facility is in a deficit condition — one method for systems or facilities serving 900 or fewer customers and another method for all other systems or facilities. That is inaccurate, and the issue appears to be one of rate setting or adjustment criteria rather than of accounting methods or principles.

Tenn. Code Ann. § 9-3-211 mandates for certain offices, charged with the care and control of public funds, an annual audit of financial records and transactions covering each fiscal year. Subparagraph (c) of that statute provides that all such audits performed by internal audit staffs of any such department, office, agency, division or board "shall be conducted in accordance with the standards established by the comptroller of the treasury, pursuant to § 4-3-304(9)."

Tenn. Code Ann. § 4-3-304(9) provides in pertinent part:

> The department of audit has the power and is required to: [e]stablish minimum standards for the performance of audits by the internal audit staffs of local governments, . . . utility districts, political subdivisions, state departments, boards, commissions, . . . or other entities of the state. These standards, which shall be established by the comptroller of the treasury, shall include "Standards for the Professional Practice of Internal Auditing" published by the Institute of Internal Auditors, Inc., or such other standards as may be approved by the comptroller of the treasury.

Therefore, *all* audits performed by state and local internal audit staffs *must* be conducted in accordance with the Comptroller's standards.

Tenn. Code Ann. § 9-2-102 imposes a duty on the Department of Audit "to prescribe a uniform system of bookkeeping designating the character of books, reports, receipts, and records, and the method of keeping same, in all state, county and municipal offices, including utility districts, which handle public funds." All officials are required by the statute to adopt and use that system.

So, the distinction between the treatment of the two systems or facilities is not one of accounting methods but, rather, that grant funded assets are depreciated in one type and not depreciated in the other.

Codified at Tenn. Code Ann. §§ 68-221-1001, *et seq.*, the Act was promulgated for three primary purposes. Those are to:

> (1) Facilitate statewide compliance with state and federal water quality standards;
> (2) Provide local governments in the state with low-cost financial assistance relative to necessary wastewater facilities through the creation of a self-sustaining revolving loan program so as to improve and protect water quality and public health; and
> (3) Establish fiscal self-sufficiency of wastewater facilities.

Tenn. Code Ann. § 68-221-1002(a).

The Act established the Board to "determine and ensure the financial integrity of certain water systems and wastewater facilities." *See* Tenn. Code Ann. § 68-221-1008(a)(1). The Board is charged with the responsibility of furthering the legislative objective of self-supporting water systems and wastewater facilities in this state and shall be deemed to be acting for the public welfare in carrying out the provisions of §§ 68-221-1007 through 68-221-1012. *See* Tenn. Code Ann. § 68-221-1008(a)(2).

Under the provisions of Tenn. Code Ann. § 68-221-1010(a)(1), the Board is authorized to investigate water systems or wastewater facilities and take specified measures dealing with any such entity that the Comptroller has determined, based on the system's or facility's audit report, has a retained earnings deficit in any one (1) year or, for a period of three (3) consecutive years, has an operating deficit, or is currently in default on any of its debt instruments. However, if a water system or wastewater facility has total equity at least four (4) times greater than total debt, depreciation expense shall not be considered in determining the above criteria for the Comptroller's filing the report with the Board.

Tenn. Code Ann. § 68-221-1003(9)(A) & (B) defines "wastewater facility" as follows:

> (A) "Wastewater facility" means any facility, including the reserve capacity thereof, whose purpose is to collect, store, treat, neutralize, stabilize, recycle, reclaim or dispose of wastewater, including treatment or disposal plants, interceptors, outfall, and outlet sewers, pumping stations, equipment and furnishings thereof and their appurtenances which are necessary to accomplish the foregoing purposes.
>
> (B) "Wastewater facility" also includes best management practice projects for controlling non-point sources of water pollution, failed innovative/alternative waste water construction projects, and the planning or replanning requirements of designated management authorities.

Subsection (a)(2) of Tenn. Code Ann. § 68-221-1010 provides:

> In any local government having a water or wastewater facility serving not more than nine hundred (900) water or wastewater customers, in determining whether a facility has a retained earnings deficit or an operating deficit, depreciation shall not include depreciation on assets acquired with grant funds received from a state or federal agency.

It is the depreciation element, and its application to or exclusion from the process of determining whether a deficit condition exists, that are at issue. The term "depreciation," as used in the context of the statute, is defined in the State's Official Compilation of Rules and Regulations, Ch. 1200-22-6-.02(11) as "[a]n element of expense resulting from the use of long-lived assets. It is conventionally measured by allocating the expected net cost of using the asset (original cost less estimated salvage value) over its estimated useful life in a systematic and rational manner."

The three questions presented in your request concern subsection (a)(2), and the accounting method exception (the exempting from depreciation of state or federal grant fund acquired assets) it provides for water systems or wastewater facilities serving 900 or fewer customers.

We first address whether, once a facility serving 900 or fewer customers is in a deficit position and referred to the Board, the exemption from depreciation provided for in Tenn. Code Ann. §68-221-1010(a)(2) continues to be used by the Board in determining user rates sufficient to correct the deficit.

The general rule for interpreting statutes is to look at the statute as a whole to ascertain the legislative purpose and intent. A resort to legislative history is appropriate in interpreting statutes if the language of the statute is not clear. *See James Cable Partners, L.P. v. City of Jamestown*, 818 S.W.2d 338 (Tenn. Ct. App. 1991); s*ee also In re Blue Diamond Coal Company*, 147 B. R. 720 (Bankr. E.D.Tenn. 1992).

As to guidance in answering the three questions presented, the text of subsection (a)(2), which originated with a 1992 amendment, is silent. *See* 1992 Tenn. Pub. Acts. Ch. 1023, § 1. Thus, the purpose and intent of the General Assembly in adopting the amendment is unclear from a reading of the statute, and it becomes necessary to look for that in the history of the legislation.

Senator McKnight, a sponsor of Senate Bill 2290, explained it to the Senate Energy and Natural Resources Committee on February 19, 1992:

> There are many small communities across the State that, through the years, have gotten either federal or state grants to improve their water or sewerage system. Now . . . they're having to put up capitalization funds for depreciation . . . [and] there's just no way they can do it. For an example, the City of Gibson, if they have to follow through with this, people will be increased on their water bills by over $40 per month. There are a number of little towns across the State that are this way.

(Audiotape on file at Tennessee Library and Archives).

Comments similar to those of Senator McKnight were made by one of the House sponsors, Representative Davis, who stated:

> [This] allows small communities in Tennessee . . . [to] be able just to keep a fund balance for their pipes and pumps and not to keep a fund balance for grants and federal grants . . . as they have to do right now. They could have a $400,000 grant, and the Board now has declared they've got to keep a $400,000 fund balance, and it would make small towns . . . have to raise their water rates . . ..

(Audiotape on file at Tennessee Library and Archives, House Session April 28, 1992).

If the local government facilities falling within the coverage of the 1992 amendment were found to be in a deficit condition, without depreciating their grant acquired assets, we believe that the Board must continue to exclude the depreciation of those particular grant acquired assets in its efforts to rectify the deficit condition through increased user rates. Otherwise, the General Assembly's intent regarding user rates in very small communities would not be accomplished. Thus, depreciation should not be a factor.

The same rationale applies to the second and third questions presented. Therefore, as long as the system or facility maintains a base of 900 or fewer customers, we believe that depreciation of grant acquired assets should continue to be excluded from consideration in determining whether a deficit condition exists. We believe further that should there be any conflicts between general accounting principles and those mandated by Tenn. Code Ann. § 68-221-1010(a)(2), they should be resolved by strictly adhering to the language of the statute.

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