



**NORTH CAROLINA
PUBLIC STAFF
UTILITIES COMMISSION**

September 5, 2023

Ms. A. Shonta Dunston, Chief Clerk
North Carolina Utilities Commission
4325 Mail Service Center
Raleigh, North Carolina 27699-4300

Re: Docket No. W-1300, Sub 60 – Public Staff Response to Paragraph 5 of the Commission’s Order Granting Motion of Old North State Water Company, Inc. for Extension of Time to File Report and Rescheduling Hearing

Dear Ms. Dunston:

On January 11, 2023, Old North State Water Company, Inc. (ONSWC) filed Old North State Water Company, Inc.’s Confidential Response to Public Staff Report filed on December 12, 2022 (January 11th Filing). According to page 8 of the January 11th Filing, ONSWC stated that “Mr. McDonald plans to hire an outside firm in the Spring of 2023 to thoroughly review the accounting needs and processes and to perform an accounting review of ONSWC and its financial statements.” Later, on June 12, 2023, the Commission issued its Order Granting Motion of Old North State Water Company, Inc. for Extension of Time to File Report and Rescheduling Hearing (June 2023 Order) directing ONSWC to: “file the outside accounting review with the Commission no later than August 4, 2023.” The Commission directed the Public Staff to: “notify the Commission of any updates or modifications to the recommendations made in [the Public Staff’s Report on ONSWC’s Compliance with Laws and Recapitalization Plan], specifically including, but not limited to, its response to ONSWC’s proposal for Integra to convert some of its secured debt to an equity interest in ONSWC” no later than September 5, 2023. The Public Staff is submitting this letter in response to that directive.

The Public Staff reviewed the filing ONSWC made on August 4, 2023, submitting the outside accounting review (August 4th Filing) as well as the January 11th Filing. The recommendations the Public Staff made in the Public Staff Report

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on ONSWC's Compliance with Laws and Recapitalization Plan (PS December 2022 Report) filed on December 12, 2022, that have not already been addressed by the Commission remain unchanged. In short, the Public Staff continues to recommend the Commission do the following: (1) consider declaring John McDonald a *de facto* public utility based on his ownership interest in ONSWC; (2) order a management audit pursuant to North Carolina Gen. Stat. § 62-37(b); (3) order a full forensic audit of ONSWC's books and records; and (4) order a full forensic audit of the financial statements of Integra Water, LLC, and its subsidiaries (specifically, Integra Water Madison County, LLC; Integra Water Creola, LLC; and Integra Water Vinemont, LLC).

The Public Staff continues to have concerns about ONSWC's accounting function and is conducting discovery in an attempt to better understand the basis for the information shown in the financial statements included in the August 4th filing. The outside accounting review completed by Haynes Downward LLP does not provide a full and complete assessment of ONSWC's accounting needs and processes and its financial statements. According to the scope of work set forth in the proposal provided by Haynes Downward LLP and filed by ONSWC in this docket on June 7, 2023, the review does not involve obtaining an understanding of ONSWC's internal controls; assessing fraud risk; testing accounting records by obtaining sufficient and appropriate audit evidence through inspection, observation, confirmation, or examination of source documents; or expressing an opinion regarding ONSWC's financial statements. In fact, the proposal states that the firm "will not express an opinion regarding the financial statements" and its work "cannot be relied upon to identify or disclose financial statement misstatement." Equally important, the evaluation criteria used to complete the limited examination is based on Generally Accepted Accounting Principles (GAAP) without any consideration for regulatory and ratemaking accounting concepts. Commission Rules R7-35 and R10-21 require water and wastewater utilities, respectively, to maintain books and records in accordance with the Uniform System of Accounts. A review should consider ONSWC's accounting capabilities through that lens as well in order to provide a comprehensive assessment.

In addition, in the Public Staff's view, the accounting review completed by Haynes Downard LLP does not satisfy the Commission's request because the scope of the review does not align with the Commission's instructions set forth in the June 2023 Order. Further, the review does not provide in-depth coverage of the transactions between ONSWC and Integra Water, LLC; Integra Water Madison County, LLC; Integra Water Creola, LLC; Integra Water Vinemont, LLC; John McDonald; Chatham North Holdings, Inc.; and ONSWC-Chatham North, LLC. Specific discussion of those transactions is limited to Note 5 to the financial statements included in the August 4th filing. This coverage is of limited value because the information contained therein is already known.

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Lastly, the Public Staff continues to have concerns about ONSWC's capital structure because ONSWC is highly leveraged. ONSWC's offer to convert a portion of the long-term debt presently owed to Integra Water, LLC (or an Integra Water affiliate) does not ameliorate those concerns because there is presently nothing to compel Mr. McDonald to follow through on that commitment (absent a Commission order requiring him to do so) facts and circumstances ONSWC discussed in CONFIDENTIAL Paragraph 8b of the January 11th Filing remain unresolved when the loans mature in December 2024. Those concerns, notwithstanding, the Public Staff intends to explore this issue in more detail in the upcoming hearing scheduled to convene on October 2, 2023, at 2:00 p.m. before completely discounting this as a viable option.

If you have any questions, please do not hesitate to reach out to me.

Sincerely,
/s/ Reita D. Coxton
Staff Attorney