

# STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: September 22, 2010

AT (OFFICE): NHPUC

FROM: Robyn Descoteau, Examiner

SUBJECT: Lakes Region Water Company Inc.  
DW 08-070 Step 3  
FINAL AUDIT REPORT

TO: Mark Naylor, Director, Gas Water Division  
Jayson Laflamme, Analyst, Gas Water Division

ORIGINAL
DW 08-070
#12
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## Introduction

The NHPUC Audit Staff (Audit) has conducted an audit of Lakes Region Water Company Inc. (Company, LRWC) continuing property record additions to plant for Hidden Valley, Gunstock Glen and Brake Hill for years ending 2008 and 2009. The audit was conducted in conjunction with DW 08-070.

## Projects at Hidden Valley, \$128,808:

Costs associated with plant additions in Hidden Valley totaled \$128,808. The Plant additions associated with the Hidden Valley projects were detailed as follows:

<u>Account #</u>	<u>Description</u>	<u>Amount</u>
304	Structures	\$22,635
307	Wells	\$40,517
311	Pumping Equipment	13,472
330	Distribution Reservoirs	791
331	Mains	47,733
334	Meters	2,575
339	Other	1,085
		<u>\$128,808</u>

The Company provided Audit with General Ledger printouts detailing charges for the years 2008, and 2009. For each year, copies of Vendor invoices and Journal Entries were provided.

Dawson & Sons (Pump House)	\$7,384
LRWS (Pump House/Extend Well/Control Panel/Antenna/Misc)	5,376
Frase Electric (Wiring)	4,705
Northern Woods Tree Service/Excavation (Frost Wall)	3,500

Labor and Materials (Run drain)	645
FW Webb (Misc. parts)	545
Coleman Concrete (Pump House floor)	247
Water Industries (Misc. parts)	183
Misc Small Vendors (Ossipee Mtn. Electric/A&B Lumber)	50
Structures	\$22,635
HydroSource Associates (Consulting)	\$22,191
Hartley Well Drilling (814' drilling)	10,896
Northeast Water Production (ZonFrac w/ 10 sets)	5,000
Skillings & Sons (Set Jaswell/install Bentonite Pellets)	1,556
James Dawson (48-hr pump test well #2)	599
LRWS (Work on well reports)	140
Labor and Materials (Tie in wells/plumb pressure tank/wells)	135
Wells	\$40,517
RE Prescott (Control Panels)	\$10,000* <sup>1</sup>
LRWS (Set Pump/Mount, Install Panel/Hook up, tie-in well/Gravel)	2,273 ✓
<i>Missing Journal Entry</i>	855
Labor and Materials (Plumbing)	344
Pumping Equipment	\$13,472
Andrew Foss (1,000 gallon tank)	\$744
Labor and Materials (Plumbing)	47
Distribution Reservoirs	791
Lewis Engineering	\$14,820* <sup>2</sup>
LRWS (740'-3" HDPE/3" GV/PRV/Vault By-pass/Drainage Pipe)	29,598 (5072)
FW Webb (Misc parts)	1,606
Public Works Supply (Misc parts)	743* <sup>3</sup>
EJ Prescott (Misc parts)	583* <sup>4</sup>
Labor and Materials (Install PRV/tie in wells)	383
Mains	\$47,733
Labor/Materials (6 hrs-\$113/EII-\$288/USA BB-\$1,167/Inve-\$10)	\$1,578
Labor/Materials (8 hrs-\$151/Webb-\$209/USABB-\$221/Inve-\$47)	628
Labor/Materials (9 hrs)	170
Labor/Materials (6 hrs-\$113, Inve-\$10)	123
Labor/Materials (4 hrs)	76
Meters and Meter Installations	\$2,575
Generating Solutions (Monitoring hardware/antenna)	\$1,085
Other	\$1,085

- \*1 The Asset card was \$10,000, the 4/2/10 payment was \$10,000, but the two invoices referenced on the payment stub, which were also attached, totaled \$18,751.62.
- \*2 Lewis Engineering backup shows that the work done was related to NH DES A.O.
- \*3 Public Works Supply costs of \$143.84 are included twice. **\$144 should be removed. (Audit Issue #4)**
- \*4 EJ Prescott issued credit of \$268.49, full amount of invoice was recorded in the Asset record. **\$268 should be removed. (Audit Issue #4)**

**Projects at Gunstock Glen, \$84,774:**

Costs associated with plant additions in Gunstock Glen totaled \$84,774. The plant additions associated with the Gunstock Glen projects were detailed as follows:

<u>Account #</u>	<u>Description</u>	<u>Amount</u>
304	Structures	\$40,917
311	Pumping Equipment	5,870
330	Distribution Reservoirs	798
331	Mains	<u>37,189</u>
		<b>\$84,774</b>

The Company provided Audit with General Ledger printouts detailing charges for the years 2008, and 2009. For each year, copies of invoices and Journal Entries were provided.

LRWS (Concrete Addition/Wood frame/Electrical)	\$33,650	✓
Fraser Electric	4,001	
Labor & Materials	3,191	
Misc Small Vendors (Building Permit)	<u>75</u>	
Structures	\$40,917	
EOS Research (Engineering Services)	\$4,086	
Water Industries (2 HP 3-stage Booster)	969	
LRWS (look for leak & install Booster Pump)	787	
FW Webb	<u>28</u>	
Pumping Equipment	\$5,870	
Water Industries (WX255 Tank)	\$505	
Labor and Materials (Tie in plumbing between tanks/refill tanks)	<u>293</u>	
Distribution Reservoirs	\$798	
LRWS (Site work w/ 4" main to St/Interconn to Brake Hill)	\$36,500	✓
Labor and Materials (leak repair/new valve/tie in pump house)	<u>689</u>	
Mains	\$37,189	

During the Audit review of Steps 1 and 2, Audit noted two 2008 Pumping Equipment additions totaling \$5,911 that were going to be included in Step 3: the Company looked for a leak and installed a booster pump, \$1,784 and it also purchased two three-phase, 5 horsepower pumps, \$4,127. The \$1,784 has been included in Step 3 as noted above. However, the purchase of two three-phase pumps, \$4,127, was not included as these pumps were replacement pumps.

**Projects at Brake Hill, \$31,611:**

Costs associated with plant additions in Brake Hill totaled \$31,611. The plant additions associated with the Brake Hill projects were detailed as follows:

<u>Account #</u>	<u>Description</u>	<u>Amount</u>
304	Structures	\$31,611

The Company provided Audit with General Ledger printouts detailing charges for the years 2008, and 2009. For each year, copies of invoices and Journal Entries were provided.

LRW Services	\$27,200	✓
Labor and Materials	2,448	
Fraser Electric	<u>1,963</u>	
Structures	\$31,611	

The Company depreciates its assets using the straight-line depreciation method. A 50-year life (2.00% rate) has been applied to the pump house described above. This is consistent with similar structures reviewed by Audit. One-half year depreciation was taken during 2009.

**Depreciation**

The Company depreciates its assets using the straight-line depreciation method. Differences were noted in the rates used to calculate depreciation when the filing schedules, Attachment C, Page 2 of 5, were compared to the Company's depreciation (book) schedules. (See Audit Issue #1) Differences in Accumulated Depreciation and Net Book Value were also noted.

**Hidden Valley**

	<u>Cost</u>	<u>Filing Rate</u>	<u>Book Rate</u>	<u>Filing Annual</u>	<u>Book Annual</u>	<u>Filing Accum</u>	<u>Book Accum</u>	<u>Filing Net Value</u>	<u>Book Net Value</u>
Structures	\$22,635	2.50%	2.00%	\$566	\$453	\$283	\$497	\$22,352	\$22,138
Wells	40,517	3.33%	2.00%	1,349	810	675	810	39,842	39,706
Pumps	13,472	10.00%	10.00%	1,347	1,347	674	1,021	12,798	12,451
Dist Reservoirs	791	2.22%	2.50%	18	20	9	30	782	762
Mains	47,733	2.00%	2.00%	955	955	477	1,431	47,256	46,301
Meters	2,575	5.00%	5.00%	129	129	64	64	2,511	2,511
Other	<u>1,085</u>	5.00%	5.00%	<u>54</u>	<u>54</u>	<u>27</u>	<u>27</u>	<u>1,058</u>	<u>1,058</u>
	<u>\$128,808</u>			<u>\$4,418</u>	<u>\$3,768</u>	<u>\$2,209</u>	<u>\$3,880</u>	<u>\$126,599</u>	<u>\$124,927</u>

Gunstock Glen

	<u>Cost</u>	<u>Filing Rate</u>	<u>Book Rate</u>	<u>Filing Annual</u>	<u>Book Annual</u>	<u>Filing Accum</u>	<u>Book Accum</u>	<u>Filing Net Value</u>	<u>Book Net Value</u>
Structures	\$40,917	2.50%	2.00%	\$1,023	\$818	\$511	\$1,146	\$40,406	\$39,771
Pumps	5,870	10.00%	10.00%	587	587	294	382	5,577	5,487
Dist Reservoirs	798	2.22%	2.00%	18	16	9	13	789	785
Mains	<u>37,189</u>	2.00%	2.00%	<u>744</u>	<u>744</u>	<u>372</u>	<u>372</u>	<u>36,817</u>	<u>36,817</u>
	<u>\$84,774</u>			<u>\$2,371</u>	<u>\$2,165</u>	<u>\$1,186</u>	<u>\$1,913</u>	<u>\$83,588</u>	<u>\$82,860</u>

Brake Hill

	<u>Cost</u>	<u>Filing Rate</u>	<u>Book Rate</u>	<u>Filing Annual</u>	<u>Book Annual</u>	<u>Filing Accum</u>	<u>Book Accum</u>	<u>Filing Net Value</u>	<u>Book Net Value</u>
Structures	\$31,611	2.00%	2.50%	\$790	\$632	\$395	\$316	\$31,216	\$31,295

While reviewing the Company's depreciation records associated with the above additions, Audit noted several instances of calculation errors. An inconsistency was noted in the start up of the depreciation life of an asset. Some assets that had been placed in service during 2008 were correctly calculated with a ½ year depreciation in 2008 and a full year in 2009. While other assets that had been put in service during 2008 had a ½ year depreciation in 2008 and another ½ year in 2009, instead of the correct amount of a full year. (See Audit Issue #2)

Affiliate Agreement

Audit conducted a test of the Affiliate Agreement between Lakes Region Water Company, Inc. and LRW Water Services, Inc. dated April 1, 2009, signed February 15, 2010. The Affiliate Agreement was signed solely by Thomas Albert Mason ("Jr."), as both the President of Lakes Region Water Company, Inc. and the President of LRW Water Services, Inc. Audit selected five (5) LRW Services invoices for testing purposes:

- 1) Hidden Valley system – 2008 Mains, Asset #18: \$5,073  
 PRV Installation:  
 Excavator - 16 hrs @ \$125 = \$2,000 (rate equals agreement)  
 Labor - 16 hrs @ \$50 = \$800 (Audit Issue #4)  
 Vault By-Pass, gauges & small PRV - \$688 (Audit Issue #3) OK proof at exit audit  
 Drainage Pipe Installation (lg excavator) - 6 hrs @ \$125 = \$750 (rate equals agreement)  
 Drainage Pipe - \$375 (Audit Issue #3) Explanation provided – no proof  
 Sandy Fill - \$280 (Audit Issue #3) Explanation provided – no proof  
 Dump Truck (10 wheeler) – Remove Water - 2 hrs @ \$90 = 180 (rate equals agreement)
- 2) Hidden Valley system – 2008 Pumps, Asset #43: \$2,273  
 Set New Pump - 6 hrs @ \$50 = \$300 (rate equals agreement)  
 Mount Panel - 6 hrs @ \$50 = \$300 (rate equals agreement)  
 Hook up Well -Tie In - 10 hrs @ \$50 = \$500 (rate equals agreement)  
 Install Panel - 18.5 hrs @ \$50 = \$925 (rate equals agreement)  
 Gravel - \$248 (Audit Issue #3) Explanation provided – no proof
- 3) Gunstock Glen system – 2008 Structures, Asset #1: \$47,650  
 Concrete Addition - Duggan Concrete: \$2,700, markup: \$550 = \$3,250 (Audit Issue #3 & #4)  
 Wood frame building - Mike Kepple: \$14,800, markup: \$2,400 = \$17,200 (Audit Issue #3 & #4)  
 Control upgrade - \$21,500 (Audit Issue #3) Questionable proof: \$2,000 duplicated  
 Electrical upgrade - \$5,700 (Audit Issue #3) Vendor report only – no proof

- 4) Gunstock Glen system – 2009 Mains, Asset #1: \$36,500  
 Sitework including 4” main to street - \$5,500  
 Lg excavator - 21 hrs @ \$125 = \$2,625  
 Labor - 11 hrs @ \$35 = 385  
 Install 125’ of 4” main @ \$14.80/ft = \$1,850 (Audit Issue #3) Explanation provided – no proof  
 Fill - \$640 (Audit Issue #3) Explanation provided – no proof  
 Interconnection to Brake Hill (Boring under Belknap Mtn Rd) - \$8,500  
 6” sleeve - \$4,900 (Audit Issue #3) Explanation provided – no proof  
 Pipe and fittings - \$920 (Audit Issue #3) Explanation provided – no proof  
 Lg excavator - 10 hrs @ 125 = \$1,250  
 Labor - 18 hrs @ 35 = \$630  
 Repair road & paving - \$800 (Audit Issue #3) Explanation provided – traded services  
 Gunstock Glen-Brake Hill Interconnection Engineering - \$22,500 (Audit Issue #3) OK: proof at exit
- 5) Brake Hill system – 2009 Structures, Asset #4: \$27,200  
 Remove and dispose of old pump station and tank - \$3,500  
 Labor - 20 hrs @ \$50 = \$1,000 (rate equals agreement)  
 10 wheeler - 4 hrs @ \$90 = \$360 (rate equals agreement)  
 Lg excavator - 8 hrs @ 125 = \$1,000 (rate equals agreement)  
 Fill - \$450 (Audit Issue #3) Explanation provided – no proof  
 Disposal Fee - \$690 (Audit Issue #3) OK – proof at exit audit  
 Construct new driveway into pump station - \$2,950  
 Lg excavator - 6 hrs @ \$125 = \$750 (rate equals agreement)  
 Dozer - 6 hrs @ \$95 = \$570 (rate equals agreement)  
 Gravel - \$1,630 (Audit Issue #3) Explanation provided – no proof  
 Install temporary pump station - \$1,800  
 Temporary tank & parts - \$1,150 (Audit Issue #3) Explanation provided– traded services  
 Labor - 13 hrs @ \$50 = \$650 (rate equals agreement)  
 Install concrete and wood frame building - \$11,700  
 Wood building - \$9,500 (Audit Issue #3) Explanation provided – traded services  
 Concrete - \$2,200 (Audit Issue #3) Explanation provided – traded services  
 Excavate and fill driveway for well #2 - \$4,475  
 Fill and gravel - \$2,575 (Audit Issue #3) Explanation provided – no proof  
 Dozer - 20 hrs @ \$95 = \$1,900 (rate equals agreement)  
 Supply VFD controls and pump motors - \$2,775  
 2 sub drives and motors - \$2,075 (Audit Issue #3) Explanation provided – proof: 8/31/10 quote  
 Labor - 14 hrs @ \$50 = \$700 (rate equals agreement)

As shown above, most of the labor and truck charged tied to the agreement without exception. However, Audit did note one labor charge for Hidden Valley (\$800) which was questionable due to the fact that labor was supposed to be included in the cost of the vehicle rental. (See Audit Issue #4)

**Audit did not receive or review meaningful backup to most materials and subcontractor charges.** LRW Services provided copies of invoices to a few contractors and these invoices appeared to support the project cost. LRW Services provided proof of payment to some contractors, however, no support for the work done by these contractors was provided. LRW Services also provided explanations as to how the several of the costs were calculated, but no invoices showing the actual costs were provided. (See Audit Issue #3)

**AUDIT ISSUE #1**  
**Depreciation Rates – Filing vs. Book**

**Background:**

Differences were noted in the rates used to calculate depreciation when the filing schedules, Attachment C, Page 2 of 5, were compared to the Company's depreciation (book) schedules.

**Issue:**

Annual Depreciation, Accumulated Depreciation and Net Book Value as stated in the Filing do not agree with those carried on the Company's Ledger.

**Recommendation:**

The Filing should be adjusted so that it equals the Company's Ledger.

**Company Comment**

The Company generally uses the PUC's "Typical Water Company Service Lives & Depreciation Rates." The Company will adjust its book to conform to the filing, except for Brake Hill structures, where the Company will adjust the filing to its books. The adjustment to the books amount to \$1,015. See attached detail analysis.

**Audit Response**

Audit respectfully disagrees with the Company's Comment. The Filing should equal the Company's Ledger. Service Lives and Depreciation Rates should not be changed without a full Utility Plant review by Commission Staff and the Commission's approval of proposed Service Life and Depreciation Rate changes. See State of NH Public Utilities Commission, Part PUC 610, Uniform System of Account for Water Utilities, General Instructions, 610.01(e)(17)(B.) Utility Plant – Depreciation that states:

*"When the straight-line method is used, the rates shall be reviewed periodically and adjusted with Commission approval so that the depreciation accrual will bear a reasonable relationship to the service life, the estimated net salvage, and the cost of plant in service."*

## **AUDIT ISSUE #2**

### **Inconsistent Depreciation Calculations**

#### **Background:**

While reviewing the Company's depreciation records, an inconsistency was noted in the start up of the depreciation life of an asset. Some assets that had been placed in service during 2008 were correctly calculated with a ½ year depreciation in 2008 and a full year in 2009. While other assets that had been put in service during 2008 had a ½ year depreciation in 2008 and another ½ year in 2009, instead of the correct amount of a full year.

#### **Issue:**

Depreciation Expense and Net Book Values are incorrect.

#### **Recommendation:**

The Company needs to complete a full review of its depreciation schedules and correct those assets which are not being depreciated correctly.

#### **Company Comment**

The Company completed a full review of its depreciation schedules and will correct those assets which are not being depreciated correctly in 2010. Based on the review, a net increase of \$359 and \$1,583 should be added to the 2008 and 2009 depreciation expense and accumulated depreciation, respectively. See attached summary of depreciation review by PUC account and division.

#### **Audit Response**

Audit concurs with the Company's Response.

### **AUDIT ISSUE #3**

#### **Affiliate Agreement between Lakes Region Water Company, Inc. and LRW Water Services, Inc.**

##### **Background:**

On 6/29/10, Audit issued an Audit Request requesting copies of LRW invoices and detailed support. Audit also made an offer to visit the LRW office to review this support.

On 7/9/10, Audit sent a reminder e-mail to the Company requesting a status update on the Audit Request. The same day the e-mail was sent out, Norman Roberge, the Company Accountant, responded that the Company would "get you the material within the first couple of days of next week." [July 12-16].

On 7/23/10, Audit received a PDF from the Company containing copies of LRW Water Services invoices and spreadsheets detailing invoice line items as support. Also contained were proof of payment support for two subcontractors that had been paid by LRW Water Services.

##### **Issue:**

It is the Company's responsibility to be certain that it complies with all New Hampshire Rules and Regulations. As such, RSA 366:5 states, "the burden shall be on the public utility and affiliate to prove the reasonableness of any such contract, arrangement, **purchase**, or sale with, from or to an affiliate."

Although Audit was able to test the Affiliate Agreement between Lakes Region Water Company and LRW Water Services, the backup provided during Audit's review did not provide adequate detail to prove that many of the amounts charged to the Water Company were charged appropriately.

##### **Recommendation:**

Copies of all invoices, including subcontractor/vendor invoices, substantiating the proposed capital additions are required.

The Affiliate Agreement between the two Companies appears to be inadequate as written at this time. It does not cover all the aspects of the arrangement between the Affiliates, such as the hiring of subcontractors and use of materials. The billing process for these types of charges, at minimum, should be addressed in the contract.

## Company Comment

The Company needs more time to obtain supporting documentation for LRW Water Services invoices. The Company will review its Affiliate Agreement and work with the PUC Staff to make the Affiliate Agreement more inclusive.

## Audit Response

A copy of the DRAFT Audit Report was sent to Tom Mason, Jr. on 7/28/10 with a request to have the Audit Report comments to the PUC by 8/11/10. Audit stated that no extensions would be available as the Final Audit Report was due on 8/13/10. The Division Director of Gas/Water and the Chief Auditor allowed the Company additional time to respond to the DRAFT Audit Report. The Company Comment above was received on 8/14/10. Per the Division Director of Gas/Water and the Chief Auditor, Audit will allow the Company additional time to obtain supporting documentation from LRW Water Services.

At 4:00 pm on September 17, 2010, a fax containing the Company's response to Audit Issue #3 was received from Steve St. Cyr. The fax detailed each cost questioned by Audit. In addition, the Company provided explanations of how the costs were calculated for some of the questioned items, copies of vendor invoices for some items, and copies of the Company's 'Vendor Quick Report' (payment report) to support some items.

An explanation of how the cost was calculated, though helpful, is not proper supporting documentation for proof of costs. An example of what was written by the Company and what Audit was expecting: "The pit charged \$6.25 per yard and the delivery charge was \$3.75, totaling \$10.00 per yard delivered." Audit was expecting to review a receipt from the pit showing that \$6.25 per yard is charged and \$3.75 is charged for the delivery charge. This was not provided by the Company.

Regarding copies of vendor invoices: Audit reviewed the invoices for the Vault By-Pass, \$688 – the invoice provided appeared to be appropriate. Audit reviewed the invoices submitted for the Control Upgrade, \$21,500 – there were charges of \$2,031 submitted by the Company twice (as invoice support and as 'vendor quick report' support) to makeup the total \$21,500. Audit reviewed the invoices submitted for the Brake Hill Interconnection Engineering, \$22,500 – the seven (7) invoices submitted were dated beginning 09/13/06 through 06/10/08, totaled \$25,373 and contained costs for both Brake Hill and Gunstock Glenn whereas the job was an interconnection.

The Company submitted a quote from a company as support for 2 subdrives and motors, \$2,075 – the quote accurately supports the amount of the item that Audit requested support for. However, the quote appears to have been sent to Tom Mason on 8/31/10. Audit notes that the quote was sent to LRW Water Services during the Audit, not during the job process or prior to billing.

Audit notes that the Company stated on four occasions that a job cost was arrived at through an agreement "reached between the parties as a service trade", using the dollar amount a company owed LRW as a basis. Therefore, Audit considers there was no adequate support sent by the Company for these items.

## AUDIT ISSUE #4

### Items Recommended for Exclusion

#### Background:

During Audit's review, five items were found that should be excluded from the Step 3 adjustment. The items found were (1) included twice, (2) credited by the vendor, or (3) not included as part of the Affiliate Agreement.

#### Issue:

Plant Additions will be overstated with the inclusion of the charges listed below.

#### Recommendation:

1. Public Works Supply costs of \$143.84 are included twice. **\$144 should be removed.**
2. EJ Prescott issued credit of \$268.49, full amount of invoice was recorded in the Asset record. **\$268 should be removed.**
3. Hidden Valley System PRV Installation Labor - 16 hrs @ \$50 = \$800. Labor is included in vehicle charge. **\$800 should be removed.**
4. Concrete Addition - Duggan Concrete: \$2,700, markup: \$550 = \$3,250. Markup is not included or stated in the Affiliate Agreement. **\$550 should be removed.**
5. Wood frame building - Mike Kepple: \$14,800, markup: \$2,400 = \$17,200. Markup is not included or stated in the Affiliate Agreement. **\$2,400 should be removed.**

#### Company Comment

The Company agrees with recommendations 1 & 2 as such, agrees to remove the related charges. The Company disagrees with recommendation 3. The labor is not included in the vehicle charge. The Company disagrees with recommendation 4 & 5. While not specifically identified in the Affiliate Agreement, the Company believes that it is reasonable for LRW Water Services and other contractors to have a markup built into its charges. The Company believes that the 16% - 20% markup identified is reasonable. The Company will incorporate a markup in its Affiliate Agreement.

#### Audit Response

Audit concurs with the Company regarding recommendations #1 & #2. **\$412 should be removed.**

Audit respectfully disagrees with the Company regarding recommendation #3. The Affiliate Agreement, Appendix B, states; "Personnel including a pick-up (vehicle) is \$50.00 Per Hour"- therefore the labor is included in the vehicle charge. **\$800 should be removed.**

Audit respectfully disagrees with the Company regarding recommendations #4 & #5. Markup is not included or stated in the Affiliate Agreement. **\$2,950 should be removed.**