

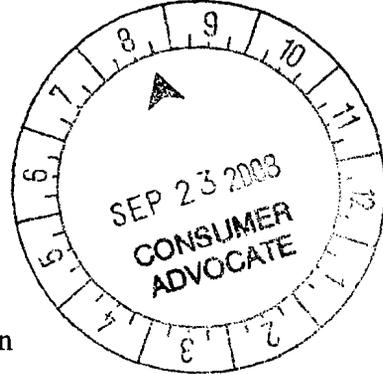
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STATE OF NEW HAMPSHIRE

Inter-Department Communication

ORIGINAL	
N.H.P.U.C. Case No.	DW 08-070
Exhibit No.	4
Witness	Panel'
FROM:	Stuart Hodgdon, Chief Auditor Kobyn Descoteau, Examiner
DO NOT REMOVE FROM FILE	

DATE: September 22, 2008
AT (OFFICE): NHPUC



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

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

Introduction

The NHPUC Audit Staff (Audit) has conducted an audit of Lakes Region Water Company Inc. (Company, LRWC) continuing property records for years ending 2005, 2006 and 2007. The audit was conducted in conjunction with DW 08-070, a petition for approval of financing and step increases. DW 08-070 proposed NHPUC approval of costs associated with six specific projects that equaled \$779,930.

Water Storage Tank/Main at Paradise Shores:

Costs associated with plant additions in Paradise Shores were included in DW 08-070, Step 2. The plant additions were associated with the development of the Emerson Path Tank and were detailed as follows:

<u>Account #</u>	<u>Description</u>	<u>Amount</u>
303	Land	\$48,352
304	Water Tank	470,481
304	Pump House	17,360
331	Mains	<u>213,807</u>
		<u>\$750,000</u>
	CIAC Water Tank	\$209,445
	CIAC Pump House	555
	CIAC Mains	<u>90,000</u>
		<u>\$300,000</u>

The Company provided Audit with General Ledger printouts detailing charges for the years 2004, 2005, 2006, 2007, and 2008 (through 8/15/08). For each year, copies of invoices and Journal Entries were provided. The majority of the Emerson Path Tank project costs were received by the Company and reviewed by Audit, however; per the Company representative, a few straggler costs may follow. The Mains were fully built and were used and useful as of July 4,

2008. Half of the tank was used and useful as of July 4, 2008. The other half was delayed until early August due to a piece of tank roofing which needed to be rebuilt.

<u>Account #</u>	<u>Description</u>	<u>Amount</u>
021801050	Unfinished Construction	\$451,044
021603304	Tanks	29,060
021603314	Mains	173,456
501603304	Tanks	10,000
	Costs reviewed but not in General Ledger as of 8/15:	
	DBU Construction	27,000
	DBU Construction	10,000
	Baybutt Construction	11,145
	Lakes Region Water Services	39,119
	Lakes Region Water Services	(62,810)
	Rounding variance	(47)
	Total as of 08/15/08	<u>\$687,967</u>

The Company provided Audit with an Excel spreadsheet analysis of the Emerson Path Tank Project from Inception to 08/15/08. These costs were traced to the Company's General Ledger Report (detailed above).

<u>Description</u>	<u>Gross Total</u>	<u>Insurance Settlement</u>	<u>Net of Insurance</u>
Land	\$48,352	\$0	\$48,352
Tank			
Engineering	36,648	(36,648)	0
Legal	31,658	(31,658)	0
Demolition	56,560	(56,560)	0
Site work	4,627	0	4,627
Tank (Baybutt)	422,435	(74,970)	347,465
Tank (Other Contractors)	89,969	(61,325)	28,644
Tank Cleaning	212	0	212
Capital Interest (split weighted avg)	<u>37,416</u>	<u>(27,964)</u>	<u>9,452</u>
Total Tank	679,525	(289,125)	390,400
Main			
Main Pipe/Other Contractors	243,398	0	243,398
Lakes Region Water Co work	2,141	0	2,141
Capital Interest (split weighted avg)	<u>14,551</u>	<u>(10,875)</u>	<u>3,676</u>
Total Main	260,090	(10,875)	249,215
Total Tank Project as of 8/15/08	<u>\$987,967</u>	<u>\$300,000</u>	<u>\$687,967</u>

Wells and related projects at Hidden Valley, \$151,964:

Costs associated with plant additions in Hidden Valley were split between Step 1, \$54,159, and Step 3, \$97,805. The plant additions associated with the Hidden Valley projects were detailed as follows:

<u>STEP 1:</u>	<u>Account #</u>	<u>Description</u>	<u>Amount</u>
	307	Wells	\$16,723
	311	Pumping Equipment	20,249
	331	Mains	14,615
	333	Services	1,331
	334	Meters	740
	339	Other	<u>501</u>
			\$54,159

<u>STEP 3:</u>	<u>Account #</u>	<u>Description</u>	<u>Amount</u>
	307	Wells	\$97,805

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<u>STEP 1:</u>		
	See WELLS summary below:	
	Labor and Materials	\$13,602
	Water Industries	5,907
	LRWS	<u>2,100</u>
	Pumping Equipment	\$21,609
	LRWS (water line)	\$11,335
	LRWS (tie in water line/services)	2,380
	LRWS (leak repair/valve replacement)	525
	Blow off	202
	Replace valve stand	<u>173</u>
	Mains	\$14,615
	Repair/Replace broken valve stand/rod	\$271
	Repair leaking valve	622
	Replaced 2 old valves	367
	Replace rod/stand	<u>71</u>
	Services	\$1,331
	Meter Pit	\$171
	Change meters at pump house	284
	Repair 2 meters	293
	Irreconcilable Difference	<u>(8)</u>
	Meters and Meter Installations	\$740
	Pump House Electric Pit	\$247
	Air release valve	<u>254</u>
	Other Miscellaneous Equipment	\$501

STEP 3: See WELLS Summary below:

The Company was unable to provide Audit with the data needed to determine which WELL costs belong to Step 1 and which costs belong to Step 3. The following is a summary of total WELLS costs reviewed by Audit:

WELLS Summary:	Costs prior to 2005 (unaudited)	\$18,932
	Labor and Materials	21,396
	Hartley Well	18,000
	Lakes Region Water Services (LRWS)	9,586
	Hydro-Frac	5,700
	Artesian Well Co	5,550
	Capital Interest	4,919
	Skillings	1,300
	Well Meter	104
	Irreconcilable Difference	<u>175</u>
	Wells & Springs	\$85,662
	Hartley Well (814' feet drilling)	\$10,896
	Hydrosorce (well)	8,975
	Northeast Water Pumps (well)	5,000
	Lakes Region Water Services (well)	<u>855</u>
	Construction Work in Progress	\$25,726
	TOTAL WELLS on Company books:	<u>\$111,388</u>
	STEP 1	16,723
	STEP 3	<u>97,805</u>
	TOTAL FILING:	<u>\$114,528</u>
	Unexplained Variance to Filing:	<u>\$3,140</u>

RETIREMENTS:

Description:	2006 Accum Deprec	2007 Depreciation	2007 Amt Retired
Pumping Equipment	\$5,828	\$0	\$5,828
Pumping Equipment	<u>2,332</u>	<u>0</u>	<u>2,332</u>
	\$8,158	\$0	\$8,158

Main Replacements and Other Improvements at 175 Estates, \$167,594:

Costs associated with plant additions in 175 Estates were included in DW 08-070, Step 1.

New blow off valve	\$156	
Main (LRWS - \$25.50/ft & gravel)	32,795	
Locate existing mains (LRWS)	12,720	
Maine Drilling & Blasting	15,400	
Inventory/Materials	5,044	
Brush clearing	<u>824</u>	
Mains (1,220' of 4" DRII Fusion Main)		\$66,939
LRWS (Installation)	\$36,190	
GMI Asphalt	11,090	
LRWS (Materials)	2,185	
Inventory/Materials	<u>7,738</u>	
Mains (1,120' of 2" PVC)		\$57,203

LRWS	\$2,660	
Inventory/Materials	<u>12,996</u>	
Filter SORB scale system		\$15,656
Bernasconi Enterprises	\$7,185	
Frase Electric	3,670	
LRWS (bulkhead)	2,075	
Inventory/Materials	<u>9,020</u>	
Pump House		\$21,950
Replace Pump		\$5,459
Pump House Meter (LRWS)		\$175
Set pitless pump and replace check valve in Pump Station (LRWS)		<u>\$212</u>
Total amount filed in DW 08-070:		<u>\$167,594</u>

RETIREMENTS:

	2006	2007	2007
<u>Description:</u>	<u>Accum Deprec</u>	<u>Depreciation</u>	<u>Amt Retired</u>
Structure	\$8,006	\$0	\$11,498
Pumping Equipment	4,133	0	4,877
Mains	9,984	0	20,307
Services	<u>2,607</u>	<u>0</u>	<u>3,299</u>
	\$24,730	\$0	\$39,981

Well and other improvements at Indian Mound, \$10,395:

Costs associated with plant additions in Indian Mound included in DW 08-070, Step 1.

Skillings & Sons	\$6,951	
LRWS	<u>893</u>	
New Well – 50' deep/45' casing/506 flow		\$7,844
Pump Installation Materials	\$1,364	
Labor	35	
LRWS	<u>140</u>	
Pump Installation		\$1,539
Replace Valve Stand (LRWS)		\$385
Well and Clubhouse Meters		\$333
Check Valve at Lake Ossipee Village (Audit Issue #1)		<u>\$294</u>
Total amount filed in DW 08-070:		<u>\$10,395</u>

There were no retirements noted.

Mains and Pump Station at Gunstock Glen, \$90,000:

The installation of mains and completion of the pump station at Gunstock Glen is not expected to be completed until late Fall, 2008. The costs of these plant additions are included in DW 08-070, Step 3. Audit reviewed two 2008 Pumping Equipment additions totaling \$5,911: 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.

Vehicles, Shop Equipment and Other Equipment, \$74,477:

Costs associated with Common Plant additions were included in DW 08-070, Step 1.

2007 GMC Sierra	22,244	
Cap for GMC Sierra	734	
2007 Chevy Silverado	<u>34,670</u>	\$57,648
Levellogger	632	
Gear wrenches	89	
Pitless Adapter Puller	209	
Mechanical indenter	321	
Levellogger	519	
Pipe elevators	1,183	
Miscellaneous small tools	<u>147</u>	3,100
Meter Reader	9,049	
Flow recorder software	<u>4,680</u>	<u>13,729</u>
Total amount filed in DW 08-070:		<u>\$74,477</u>

RETIREMENTS:

<u>Description:</u>	<u>2006 Accum Deprec</u>	<u>2007 Depreciation</u>	<u>2007 Amt Retired</u>
Tanker, insta-chains, hoses	\$8,604	0	\$11,432
2003 GMC Sierra, cap	<u>\$32,483</u>	<u>0</u>	<u>\$32,483</u>
	\$41,087	0	\$43,915

Capitalized Interest (Allowance for Funds Used During Construction – AFUDC)

On large capital projects, Lakes Region Water Company records Capitalized Interest, commonly referred to as Allowance for Funds Used During Construction or AFUDC. Audit reviewed the Company's Capitalized Interest charge for two projects; Paradise Shores and Hidden Valley. The interest rate used in the calculation was 7.47%. During the review process it was noted that the Company recorded Capitalized Interest as a Debit to the project and a Credit to Interest Expense. According to the Uniform System of Accounts for Water Utilities, the Credit should be recorded to PUC Account 420, AFUDC. (See Audit Issue 2)

Review of prior Audit Issues relating to Plant and Depreciation

Audit conducted a review of the Plant and Depreciation Audit Issues from DW 05-137. A summary of the Audit Issue and its current status follow:

Audit Issue #4 was associated with continuing property records and stated, "...the continuing property records should accurately reflect the details of the transaction and location of the asset." The property records reviewed in conjunction with this audit contained appropriate details of the transaction and location of the asset. Items such as Services and Meters are summarized, and then totals for quantity and value of assets installed are reported. This format is used by several other utilities. This audit issue has been resolved.

Audit Issue #5 was associated with how Transportation Equipment was recorded and retired. It stated, "Those transportation pieces which were traded for the new equipment were not properly booked against accumulated depreciation in full, as required by the NH PUC Chart of Accounts section 610.01(e)(10)." One piece of equipment was traded in 2007. Audit reviewed the entries associated with the new equipment and the retirement of the old equipment. Entries associated with the purchase of a 2007 GMC Sierra and retirement of the Company's 2003 GMC Sierra, traded into the dealer as part of the purchase, appear to be done correctly. This audit issue has been resolved.

Audit Issue #7 related to Contributions in Aid of Construction. It stated, "Records maintained by LRW should reflect the assets and related costs which were in fact contributed, thus ensuring that should the asset be retired, both the plant account (and accumulated depreciation) and CIAC account (and accumulated amortization of CIAC) reflect proper accounting." Continuing property records reviewed during this audit contained notations of CIAC. This audit issue has been resolved.

Audit Issue #8 related to the amortization of franchise and organization costs. Audit pointed out that the Company was booking amortization costs to depreciation accounts. The Company responded that it "...sees no reporting or cost benefit to a change in current practice." Audit concurs, based on recent discussions between Mark Naylor and Stuart Hodgdon where it was decided that, "We agree that as long as not affecting rate making then it does not matter if amortized or depreciated." This audit issue has been resolved.

Conclusion

Audit is gracious for the support provided by the Company Representative, Norm Roberge during this audit.

A general comment regarding the capitalization of repairs should be noted. During the cost review process, Audit observed several repairs that had been questionably capitalized. Unless the repair is extraordinary in nature and/or significantly extends the life of the asset, the repair should be expensed. Going forward, the Company should be more cognizant of capital repairs versus expendable repairs.

In addition to the projects detailed above, Audit reviewed the Capital additions associated with the Company's other divisions. The activity reviewed was for the period from 2005 through 2007. These audit records will be kept for reference during the next full rate case audit.

AUDIT ISSUE #2

Capitalized Interest Available Funds Used During Construction (AFUDC)

Background:

On large capital projects, Lakes Region Water Company records Capitalized Interest, commonly referred to as Allowance for Funds Used During Construction or AFUDC.

Issue:

The Company recorded Capitalized Interest as a Debit to the project and a Credit to Interest Expense.

Recommendation:

According to the Uniform System of Accounts for Water Utilities, the Credit should be recorded to PUC Account 420, AFUDC.

Company Comment

The Company accepts the above recommendation and will record future capitalized interest through account 420. It should be noted that the Company has reported the gross interest expense by note and shown the capitalized interest as a reduction of gross interest in its annual report on supplemental schedule F-35.

Audit Response

Audit accepts the Company's response.

