

# STATE OF NEW HAMPSHIRE

## Inter-Department Communication

DATE: January 14, 2013

AT (OFFICE): CONFIDENTIAL

**FROM:** Karen Moran, Chief Auditor  
Bridget Nelson, Examiner  
James Schuler, Examiner  
Paul Tessier, Examiner

N.H.P.U.C. Case No. #
Exhibit No. # 4
Witness L. Goghue, D. Wape R. Descoteau
DO NOT REMOVE FROM FILE

**SUBJECT:** Pittsfield Aqueduct Company, Inc.  
**FINAL** Audit Report – DW 13-128

**TO:** Mark Naylor, Director of Water and Gas Division  
Jayson Laflamme, Utility Analyst  
Robyn Descoteau, Utility Analyst

### INTRODUCTION

By Order #25,292 issued on November 23, 2011 in docket DW 11-026, the City of Nashua was authorized to purchase all outstanding shares of Pennichuck Corporation. The regulated entities owned by Pennichuck Corporation, Pennichuck Water Works (PWW), Pennichuck East Utilities (PEU), and Pittsfield Aqueduct Company (PAC), as well as the two unregulated entities, The Southwood Corporation (TSC) and Pennichuck Water Services Company (PWSC) remain as individual legal entities, each 100% owned by Pennichuck Corporation. The City's purchase of the stock of Pennichuck Corporation did not change the legal status of the regulated or unregulated entities.

The estimated purchase costs on which the City Acquisition Bonds (general obligation bonds) would be used were reported to be:

	<u>Estimated</u>	<u>Actual Costs</u>
Merger consideration	\$137,793,398	\$138,413,923
Bond issuance costs and fees	\$ 1,800,000	\$ 996,460
Transaction costs and fees	\$ 5,286,875	\$ 3,859,505
Severance costs	\$ 2,219,612	\$ 2,300,113
Rate Stabilization fund	<u>\$ 5,000,000</u>	<u>\$ 5,000,000</u>
Total Estimated Costs	\$152,099,885	\$150,570,000

The merger consideration and transaction costs have been established as a Municipal Acquisition Regulatory Asset (MARA) on the financial books of the regulated utilities. The asset will be depreciated based on the amortization of the City Acquisition bonds. PUC Audit conducted an independent audit of the costs included above, and the resulting MARA. The report was issued on 11/19/2013.

The Merger consideration represents the \$29 per outstanding share of stock at the date of the purchase (1/25/2012). Bond issuance costs and fees represent the estimated legal fees and fees associated with First Southwest, the City's financial advisor, and other fees. Transaction costs and fees represent those costs for both the City and Pennichuck Corporation resulting from the transaction, including legal, accounting, investment banking, and due diligence. The fees were specifically estimated to exclude eminent domain costs incurred by Pennichuck (or any subsidiary) as outlined in docket DW 10-091. Severance costs represent those costs relating to the termination of senior corporate management of Pennichuck Corporation. Rate stabilization fund represents an infusion of cash from the City and Pennichuck Corporation to PWW to provide a funding source for payment of the bonds, in the event of adverse revenue developments in the regulated utilities.

The city financing costs of \$150,570,000 were allocated to affiliate equity accounts. PWW allocation was reduced by the \$5,000,000 Rate Stabilization Fund (detailed in the Order). As of 1/25/2012, closing date of the transaction, the financing was verified to the following accounts:

PWW 2201-100-001 Common Stock	\$	30,000	
PWW 2211-000-001 Additional Paid in Capital	\$132,688,434	\$127,688,435	
Plus the Rate Stabilization Fund in 2131-300-001		\$ 5,000,000	
PAC 6201-100-001 Common Stock	\$	100	
PAC 6211-000-001 Additional Paid in Capital	\$ 2,506,739	\$ 2,506,839	
PEU 7201-100-001 Common Stock	\$	100	
PEU 7211-000-001 Additional Paid in Capital	\$ 15,904,329		
PEU 7219-000-001 Other Comprehensive Income	\$ (529,702)	\$ 15,374,727	
Total Allocated City Bond Financing		\$150,570,000	

Refer to the Equity portion of this report for further information relating to PAC. Refer to the audit reports for PWW and PEU for further information.

The resulting MARA assets were recorded as of 1/25/2012 in the following deferred accounts:

PWW 2188-100-001 Acquisition Premium MARA	\$ 78,783,384
PAC 6188-100-001 Acquisition Premium MARA	\$ 1,443,498
PEU 7188-100-001 Acquisition Premium MARA	\$ 8,964,574
Total MARA as of 1/25/2012	\$ 89,191,456

Refer to the Deferred Debits portion of this audit report for further information regarding the PAC Acquisition Premium. Refer to the audit reports for PWW and PEU for further information.

PUC Audit also conducted a review of the eminent domain costs incurred by the City of Nashua. The Order indicates that Nashua can be paid for the eminent domain

costs incurred by it through dividends paid by the utilities. The cap on the repayment in any year is \$500,000, with an overall repayment not to exceed \$5,000,000. Refer to the audit report issued October 1, 2013.

As outlined in the Order, simultaneous rate cases for PWW, PEU, and PAC were to be filed not later than June 1, 2013 with test year ending 12/31/2012. On May 31, 2013 the three Pennichuck regulated utilities filed full rate cases and were assigned the following docket numbers:

Pennichuck East Utilities	DW 13-126
Pittsfield Aqueduct	DW 13-128
Pennichuck Water Works	DW 13-130

Individual audits will be conducted, with individual audit reports issued, in accordance with the specified procedural schedules.

### **Dockets and Orders since the Prior Rate Case**

The prior rate case for test year 2009 was docketed as DW10-090, with four orders resulting. Order #25,106 suspended the tariff and scheduled a prehearing conference. Order #25,154 approved temporary rates. Order #25,229 issued in June 2011 approved permanent rates and the accompanying settlement agreement. Order #25,279 approved the temporary/permanent rate recoupment, recovery of rate case expenses, and a motion for confidential treatment. Refer to the Revenue portion of this report for testing for compliance with the prior rate case orders.

PAC was party to the City of Nashua eminent domain proceeding, which was docketed as DW04-048 with the purchase and settlement determined in docket DW 11-026 via Order #25,292 outlined in the MARA section above.

### **Allocation Factors**

Audit was provided with the PWW filing schedule Puc 1604.01(26) schedule of allocation factors used throughout the test year. Specifically:

#### **Allocation of Corporate Costs \$427,043**

PWW	\$335,418	78.54%	
PEU	\$ 67,108	15.71%	
<b>PAC</b>	<b>\$ 7,450</b>	<b>1.74%</b>	Verified to GL 6930-500-001
PWSC	\$ 15,331	3.59%	
TSC	\$ 1,736	0.41%	

Allocation of Return on common Assets \$723,043

PWW	\$555,120	76.78%	
PEU	\$120,789	16.71%	
<b>PAC</b>	<b>\$ 11,550</b>	<b>1.60%</b>	Verified to GL 6930-510-001
PWSC	\$ 34,514	4.77%	
TSC	\$ 1,070	0.15%	

Allocation of PWW Work Order costs \$1,635,686

PWW	\$1,076,662	65.82%	
PEU	\$ 239,906	14.67%	
<b>PAC</b>	<b>\$ 21,245</b>	<b>1.30%</b>	Verified to GL 6930-510-001
PWSC	\$ 297,873	18.21%	
TSC	\$ -0-	0.00%	

Allocation of Management Fee \$5,737,028

PWW	\$4,286,519	74.73%	
PEU	\$ 933,491	16.27%	
<b>PAC</b>	<b>\$ 92,977</b>	<b>1.62%</b>	Verified to GL 6930-510-001
PWSC	\$ 416,315	7.25%	
TSC	\$ 7,726	0.13%	

Audit reviewed the calculations of the factors in the PWW audit. Refer to the audit report for DW 13-130, and to the Expense portion of this report.

**Rate Filing and Annual Report**

Audit verified the 2012 PUC Annual Report to the detailed general ledger and rate filing without exception.

**Minutes of the Board of Directors**

Audit reviewed the Pennichuck Corporation minutes of 2012 and 2013, which, after Nashua purchased the company, are on the Pennichuck.com website.

At the first meeting of the corporate directors, 1/27/2012 a three member Audit Committee and a three member Compensation and Benefits Committee were established. Directors for each of the subsidiaries were appointed. John L. Patnaude was appointed as Chief Executive Officer and Donald L. Ware was appointed Chief Operating Officer for the corporation and all subsidiaries. Salaries of \$190,000 and \$173,000 were noted respectively. Discussion took place regarding property tax appeals in Litchfield and Merrimack. Approval of a \$10,000,000 line of credit with RBS Citizens, National Association was documented. The Board acknowledged and accepted the obligation to pay the \$120,008,863 senior unsecured note originally incurred by the transitory company, Nashua Water Acquisition Corporation to the city of Nashua. At the completion of the merger, the note became the obligation of Pennichuck Corporation.

A non-public session on 2/24/2012 discussed the base rent \$291,975 of the corporate office, with the lease expiring on 7/31/2013. At the public session 2/24/2012, it was noted that the Company filed property tax appeals for 2011 in Litchfield, Merrimack, and Weare.

The 3/23/2012 meeting noted the first presentation of the Audit Committee's report to the Board. The financial statements of ParenteBeard LLC were presented with an unqualified opinion. The Compensation and Benefits Committee recommended certain changes to the 401(k) and pension plans, and appointed trustees of the plan. The Investment Committee discussed that RBS Citizens and Mass Mutual had been trustees prior to the acquisition of Pennichuck by the City. Any funds at RBS Citizens were to be transferred to the co-trustee Mass Mutual. Larry Goodhue was appointed as Chief Financial Officer, Treasurer and Controller of the corporation and all subsidiaries, to replace Thomas C. Leonard. Suzanne L Ansara was appointed Corporate Secretary. The Board approved a dividend in the amount of \$69,977.89 to be paid 4/25/2012 to the City to supplement the monthly interest and note payment made by the Company to the City.

The minutes of the 5/25/2012 approved the acceptance of electricity supplier bids from TransCanada (for the Water Treatment Plant and the Timberline Booster Station) and Nextera for all other Pennichuck accounts. The minutes reflect the approval of Melanson Heath & Company, PC to be the independent auditors, replacing ParenteBeard, LLC.

7/27/2012 minutes reflect the approval of Thomas J. Leonard as Chairman of the Board. Minutes also reflect that the Board member from the Merrimack Valley Regional Water District had not yet been recommended. The Board approved a dividend in the amount of \$69,977.89 to be paid 8/3/2012 to offset the monthly interest and note payment by the Company to the City for the funding of the City's acquisition debt. A boardwalk design and construction on a conservation easement deed from the North Concord Street Properties, LLC to PWW in the amount of \$40,000 was approved. In a non-public session on 7/27/2012, the Board approved transferring existing remains of the sluiceway and headgates at the former concrete dam in the Souhegan River in Merrimack to the town of Merrimack for no consideration. The Board *"requested that management prepare its position concerning the City of Nashua's Resolution R-12-39 relative to the request for a dividend to the City of Nashua in the amount of \$2.2 million by Pennichuck Corporation."*

9/28/2012 minutes indicate The Board approved a dividend in the amount of \$69,977.89 to be paid 10/25/2012 to offset the monthly interest and note payment by the Company to the City for the funding of the City's acquisition debt.

11/16/2012 minutes reflect the approval of a dividend in the amount of \$69,977.89 to be paid 1/2/2013 to offset the monthly interest and note payment by the Company to the City for the funding of the City's acquisition debt. The minutes also reflect discussion of PEU financing from CoBank to refinance a Series D bond of \$925,000 and \$1,723,150 to refinance current intercompany debt. The minutes reflect

approval must be obtained from the Board of Aldermen and the NHPUC. Loan closing is anticipated March 2013.

Minutes of the 1/25/2013 meeting include the court concluding that employee salary information may be considered confidential, with the exception of the top three executives. L. Goodhue requested Board approval of a loan from Pennichuck Corp to PEU in the amount of \$3million (10 year 2.65%) to replace short term intercompany receivables between the Company and PEU.

The annual meeting took place on March 23, 2013.

4/26/2013 minutes reflect the approval of a dividend in the amount of \$69,977.89 to be paid 5/6/2013 to offset the monthly interest and note payment by the Company to the City for the funding of the City's acquisition debt. The minutes also reflect that PEU will seek SRF funding of \$450,000 and \$400,000 and requested approval from the Board to pursue the funding and approvals from the Nashua Board of Aldermen and NHPUC.

At the 6/28/2013 meeting the Board authorized the Corporation to guaranty the SRF loans for PEU, as requested by NHDES.

The 7/26/2013 minutes reflect the approval of a dividend in the amount of \$68,309.89 to be paid 8/5/2013 to offset the monthly interest and note payment by the Company to the City for the funding of the City's acquisition debt.

The 8/23/2013 minutes reflect the approval of a special dividend on 10/2/2013 in the amount of \$500,000.

Minutes of the Board's Audit Committee and Compensation and Benefits Committee were reviewed in conjunction with the Pennichuck Corporation Board minutes above.

There were no meetings in 2012 and one in 2013 of the subsidiary PAC Board of Directors. At the 2/22/2013 meeting, the only order of business addressed was the approval of a distribution from PAC to Pennichuck Corporation in the amount of \$103,150.22 on 2/28/2013. The distribution would be from retained earnings \$34,576.02 and from additional paid in capital \$68,574.20.

## **UTILITY PLANT**

### **Bidding**

The Company states that they follow the general bid process for significant capital projects that exceed \$10,000 as defined by the Company's requisition policy. Audit received PAC's Record of Bids/Proposals from 2010 through 2012 and tested the policy

against the sample of projects chosen for review. The Company's Bid Process Overview – Significant Capital Projects lists exceptions to the bid process as:

- Emergency/Critical projects where time does not allow for the bidding process
- Emergency or unplanned work being conducted by municipalities.
- Work requiring uniquely qualified and highly specialized contractors.

#### **Additions and Retirements to Plant**

Activity since the prior audit (DW 10-091, test year ended 2009) was reviewed with the following activity noted:

	Total Additions	Total Retirements/Adjustments
2010	\$245,841	\$31,813
2011	\$90,373	\$4,146
2012	\$244,218	\$15,480/ (\$26,325)

Audit tied the year-end balances of the PUC Annual Report for 2010, 2011 and 2012 to the filing Schedule 2 – Plant in Service and the Continuing Property Records with no exceptions. The following are the specific projects chosen for review:

#### **Joy Street Main Replacement, Pittsfield, 2010 Work Order #1004948/01**

The total work order for the above project was \$107,991. Three bids were received with the lowest bidder chosen. J. Parker and Daughters, Inc. replaced 500' of 6" unlined cast iron water main with 8" ductile iron water main which included street pavement repair required by NHDOT which was caused by a previous main break in January of 2010.

PAC Engineering and IS overhead totaled \$5,547 with no PAC labor for this work order. The project was charged to the general ledger as follows:

#6331-002-001 – Pavements-Distribution Mains	\$ 600
#6331-100-001 – Distribution Mains-6" or Larger	96,551
#6331-200-001 – Distribution Mains-4" or Under	240
#6331-250-001 – Gates – 4" or Under	900
#6331-251-001 – Gates – 6" or Larger	<u>9,700</u>
Total Project Cost per General Ledger	\$107,991
Project Costs per Work Order	\$107,991

The initial estimate for the project was \$114,000 per the Capital Improvement Request and the filed E-22. The final work order cost was \$107,991 and was closed in January, 2011.

Audit reviewed all invoices for timeliness, account distribution, proper approvals for payment and other source documents provided for the project with no exceptions noted.

**Joy Street Main Replacement, Pittsfield, 2012 Work Order #1205749/01**

The total work order for the above project was \$188,497. As with the 2010 work order for the Joy Street project, three bids were received with the lowest bidder, R.H. White chosen. The work order was for replacement of 1,700' of 6" water main with 8" water main which has had a history of leaks from Warren Street down Joy Street to Blake Street.

PAC Engineering and IS overhead totaled \$5,547 and PAC labor totaled \$549 on the Work Order Detail Report. The project was charged to the general ledger as follows:

#6331-100-001 – Distribution Mains-6" or Larger	\$176,232
#6331-251-001 – Gates – 6" or Larger	2,570
#6333-200-001 – Distribution Mains-4" or Under	6,023
#6335-000-001 – Hydrants	3,430
Total Project Cost per General Ledger	\$188,255
Project Costs per Work Order	<u>\$188,497</u>
Variance	(\$242)

The initial estimate for the project was \$142,410 per the Capital Improvement Request and the filed E-22. However the project cost for work order #1201819/01 is \$270,545. The Company explained the estimate was based on historic costs and several items had to be added to the work. A temporary main, a new connection, reconstruction of traffic control loops damaged during reconstruction, and night premium for night. Bids also came in at higher levels than the original estimate.

Audit reviewed all invoices for timeliness, account distribution, proper approvals for payment and other source documents provided for the project with no exceptions noted.

**Berry Pond Water Quality Evaluation, Bathymetric Survey, 2011 Work Order #1104152/01**

This project totaling \$26,325 in year 2011 was for enhancing security at the Will Street Facility in Nashua. Total PAC labor was \$166. PAC Engineering and IS overhead totaled \$368 and PAC labor totaled \$1,416 on the Work Order Detail Report. Substructure, Inc. provided the survey planning and mobilization along with processing and analyzing data and providing a report totaling \$24,000.

The project was initially charged to account 6305-000-001 - Reservoirs and Dams in 2011 and reclassified to a deferred account 6186-285-001 – Berry Pond Bathymetric Survey on 2/29/2012. Refer to the Deferred Debits section of this report for further information.

Audit reviewed all invoices for timeliness, account distribution, proper approvals for payment and other source documents provided for the project with no exceptions noted.

**Pittsfield WTP Generator, 2012 Work Order #1200273/01**

This work order was for the final costs of installing an emergency propane generator at the Water Treatment Plant. The total cost of this work order was \$17,371 and posted to the general ledger on 12/1/2012. The Company partnered with Electrical Installations, Inc. to design and install the generator and perform the integration into the facilities electrical system. Bids were requested by Electrical Installations, with three received. Milton Cat was the low bidder and awarded the contract.

PAC Engineering and IS overhead totaled \$592 and PWW labor totaled \$865 on the Work Order Detail Report.

The project was charged to the general ledger as follows:

#6310-000-001 – Power Generation Equipment	<u>\$17,371</u>
Total Work Order Cost per General Ledger	\$17,371
Project Costs per Work Order	\$17,371

Audit reviewed all invoices for timeliness, account distribution, proper approvals for payment and other source documents provided for the project with no exceptions noted.

**Retirements/ Cost of Removal**

Combined plant retirements reported on the Asset Disposition Report totaled \$15,480 for the 2012 test-year. This amount agreed with the PUC Annual Report Schedule F-8 - Utility Plant in Service, the Continuing Property Records and the general ledger accounts below:

#6331-400-001 – Mains, Unknown Size	\$ 2,123
#6334-000-001 – Metering Equipment	11,441
#6334-100-001 – Radios for Metering	1,583
#6335-000-001 – Hydrants	<u>333</u>
Total Retirements	\$15,480

(Note: The Continuing Property Records total \$15,588 represents \$15,480 and the transfer in of one meter for \$108). The Cost of Removal totaled \$18,825 shown on the Annual Report schedule F-11 - Accumulated Depreciation of Plant in Service and ties to the Cost of Removal Report representing two work orders for the Joy Street Main Replacement. The Company recorded no salvage value for retired assets.

### **Construction Work in Progress (CWIP)**

The general ledger ending balance for account 6105-222-001 – Contractor Clearing/CWIP totaled \$41,506 consisting of two projects, the Berry Pond Dam Removal and the Joy Street Main Replacement. This figure ties to the 2012 PUC Annual Report and the filing schedule 2, Balance Sheet.

### **Allowance for Funds Used During Construction (AFUDC)**

Audit submitted a request for AFUDC balance and calculations and the Company responded that no AFUDC was recorded in 2012 for any of the utilities.

### **Engineering, Information System (IS) Overhead Calculation**

All the project folders audited contained monthly schedules showing the work-order number, the engineer's initials, labor hours, hourly rates and the total charge for that particular month. The Engineering and IS Overhead is calculated by using the hours worked for the project in the month, multiplied by the employee's hourly rate plus a factor in the overhead percentage based on the prior year's management fee schedule of benefits.

### **Contributions in Aid of Construction**

The general ledger shows the ending CIAC balance for the test-year 2012 of \$1,148,636. This figure agrees with the Annual Report schedule F-46 and the filing Schedule 2B for the three years 2010, 2011 and 2012. The CIAC balance has not changed in the three years reviewed.

Accumulated Amortization of CIAC, account 6272-101-001 – Reserve for Amortization of CIAC for the test-year 2012 totaled \$337,170 on the general ledger and agrees with the Annual Report and the filing Schedule 2B.

The general ledger shows Amortization Expense of CIAC, account 6405-300-001 for the test-year 2012 of \$22,893. This figure agrees with the Annual Report and the filing Schedule 1. Audit traced twelve months of credits for each account being amortized and recalculated amortization rates with no exceptions.

### **Accumulated Depreciation**

Audit verified the Accumulated Depreciation total of \$(1,155,170) from the annual report and the filing Schedule 2 to the following general ledger accounts:

6108-000-001 Accumulated Depreciation	\$(1,329,724)
6108-001-001 Accumulated Depreciation-Cost of Removal	\$ 34,232
6108-002-001 Accumulated Depreciation-Gain/Loss	<u>\$ 140,322</u>
	\$(1,155,170)

The Chart of Accounts requires that utilities book asset disposition and related cost or salvage to the appropriate plant account and accumulated depreciation account. PAC uses a Gain/Loss account which is a sub account of the accumulated depreciation general ledger. The net effect of the sub-accounting is in compliance with the chart of accounts. The book cost of the retirement is recorded to the accumulated depreciation in the amount of what has been recorded as depreciation expense and the remaining balance is recorded as accumulated depreciation gain or loss.

#### Depreciation Expense

Depreciation Expense account 6403-000-001 totaled \$100,431 per the general ledger, which was verified to the PUC annual report and the filing Schedule 1. Audit recalculated several accounts for accuracy and found no exceptions.

### **CURRENT AND ACCRUED ASSETS**

#### PAC Cash and Bank Reconciliation \$900

Audit verified the reported cash on hand per the PUC annual report and filing schedule 2 to the following general ledger accounts:

6131-110-001 Petty Cash-Pittsfield	\$900
6131-120-001 Cash Bank of America	\$-0-
6131-125-001 Cash RBS Citizens Bank	\$-0-
Total Cash at 12/31/2012	\$900

The Company was asked to provide the reconciliations affecting the entities involved in the rate filing Dockets. The documents appear to be in order. The Treasury Narrative section 12(g) used by the Accounting division of PWW specifies the cash reconciliation process:

- a) All RBS Citizens account reconciliations, including the investment accounts, are done as part of the month-end closing process, are tracked and scheduled within the Monthly Closing Checklist, by the Senior Accountant; these reconciliations are reviewed and approved by the Accounting Manager on a monthly basis. (TR-8)
  - ◆ The Company's main account is a Concentration Account with RBS Citizens
    - ◆ This account is used as the main operating account to collect cash receipts and to fund the zero balance subsidiary accounts
    - ◆ On a daily basis, checks that clear through the zero balance subsidiary accounts are funded by the concentration account
    - ◆ If the concentration account does not have enough to fund the subsidiary account, the Company has setup an automatic withdrawal to occur from the Line of Credit to cover the shortage
    - ◆ The bank sends notification to the CFO that a transfer has occurred
  - ◆ The decision to initiate transfers shall depend primarily upon the likelihood that operating cash balances are trending towards a negative position (e.g., the need to draw on the Company's line of credit), the incremental cost of drawing on the line of credit, and the interest income forgone

- ◆ The company currently holds five zero balance disbursement accounts (“ZBA Accounts”) with the RBS Citizens, which are all funded by the concentration account
  - ◆ Pennichuck Water Works
  - ◆ Southwood Corporation
  - ◆ Pennichuck Water Service Company
  - ◆ Pittsfield Aqueduct Company
  - ◆ Pennichuck East Utility
- ◆ The Company has one payroll account that is also funded by the concentration account, which Paylocity uses to do ACH transactions for the tax payment and forwards to the appropriate tax authority
  - ◆ Both direct deposit and live employee checks are drawn from the RBS Citizens account
  - ◆ Paylocity wires the money for the direct deposit to each employee’s account
- ◆ The Company has a Section 125 plan that allows employees to designate a portion of their paycheck for childcare (up to the IRS mandated statutory limit) and medical expense (up to IRS mandated statutory limit) reimbursements (funds are drawn from the PCP Concentration account)
  - ◆ These funds are tax exempt, but are forfeited and revert back to the Company if they are not used
  - ◆ As claims are made by employees, they will be distributed to Combined Services or CGI (as the broker for these services was changed in mid-2013) LLC through an ACH payment
- ◆ The Senior Accountant uses Macola to reconcile each company’s outstanding checks for the month with the aid of the bank statement, and then Macola generates a list to show what cleared during the month and what is still outstanding
- ◆ When a customer bounces a check due to non-sufficient funds in the customer’s account, the Customer Service Department receives notification from the bank
  - ◆ The Customer Service Department maintains a list of the bounced checks and the resolution of each
  - ◆ If the check can be re-deposited, it will be included in a separate deposit to the bank
  - ◆ If the check cannot be re-deposited, it will be recorded through the MUNIS to Macola Interface at the end of the month
- ◆ Deposits from the Daily Cash Proof Sheet are compared to the bank statement at the end of each month by the Senior Accountant

The cash reconciliations are created in Excel by the Senior Accountant and maintained on the Company’s network, which is backed up nightly

Accounts Receivable net \$36,368

Audit verified the total reported Accounts Receivable in the PUC annual report, as well as the filing schedule 2, to the following general ledger accounts:

6141-000-001 Accounts Receivable Billed Water Revenue	\$38,038
6143-901-001 Allowance for Doubtful Accounts	<u>\$ (1,670)</u>
Net Receivables	\$36,368

The billed water revenue receivable figure represents 5% of the total revenue for the year. Audit reviewed the monthly aging summary and noted the following:

Current	52.2%
1-30 days in arrears	0.5%
31-60 days in arrears	15%
61-90 days in arrears	7.6%
91-120 days in arrears	6.1%
Over 120 days in arrears	18.6% representing \$7,047

Audit reviewed the Allowance for Doubtful Accounts which is offset to the Uncollectible Accounts 6904-000-001. At year end, the expense account reflected a net \$7,887.

Materials and Supplies Inventory \$5,901

Audit verified the total reported Materials and Supplies noted in the PUC annual report and the filing schedule 2, to the following general ledger accounts:

6151-101-001 Inventory Meters	\$3,990
6151-700-001 Inventory PAC	<u>\$1,911</u>
Total Inventory	\$5,901

Annual inventories are conducted, with the most recent test year inventory conducted in October 2012.

Prepayments-Other \$9,168

Prepayments-Other reflect prepaid insurance and other miscellaneous expenses. The total was verified from two general ledger accounts to the PUC annual report, as well as to the filing schedule 2.

6162-100-001 Prepaid Insurance	\$6,553
6162-700-001 Prepaid Expenses	<u>\$2,615</u>
	\$9,168

Audit reviewed all of the transactions for the 6162 Prepayment accounts with no exceptions. The prepaid insurance account contained monthly debits transactions to cash management and credit transactions to record monthly insurance expenses. Account 2162-700-001, Prepaid Expenses, contains entries to "record prepaid expenses". Payments to the State of New Hampshire are also noted in this account.

Prepaid Taxes \$22,021

The total noted in this line item, which was noted in the PUC annual report and the filing schedule 2, is comprised of one asset account and one liability account. Specifically:

Asset	6163-310-001 Prepaid Property Taxes	\$23,585
Liability	6236-115-001 Local Property Tax Payable	<u>\$(1,564)</u>
	Net Prepaid Tax	\$22,021

Audit reviewed the second issue Pittsfield property taxes and recalculated the prepaid amount which properly represents ½ of the 2012 second issue.

Refer to the Taxes portion of this report for a detailed summary of the Local Property Tax Payable.

Accrued Utility Revenues \$67,790

Accrued utility revenue represents the unbilled portion of revenue related to a specific year. Audit verified the reported amount from the PUC annual report to the filing schedule 2, to the following general ledger accounts:

6173-150-001 Unbilled Water Revenue	\$65,519
6173-152-001 Unbilled Revenue-Recoupment	\$ (2,894)
6173-154-001 Unbilled Revenue-Recoup 2009	<u>\$ 5,165</u>
Total Unbilled at 12/31/2012	\$67,790

Account 6461-100-001, Unbilled Revenue reflected a net change for the year of a debit \$(58,243). Audit reviewed the unbilled revenue calculations for the month end December 2012 and January 2013. Entries are automatic reversals. The December calculation of \$65,519 was verified to a customer service billing cycle summary page outlining one read-date category and the number of days from the prior billing cycle to the end of the year (7). The January entry, in the amount of \$66,751 was similarly supported. There were no exceptions noted.

Audit requested clarification of the balances remaining in the 6173-152-001 and 6173-154-001, both of which should have been fully collected prior to year-end. The Company agreed and noted that the amounts “*should have been reversed with the offset to 6461-200-001, Water Sales-Unbilled Recoupment at the end of 2012. The balances will be adjusted in 2013.*” As a result, the corresponding revenue account is understated by the net of the two, or \$2,271. Refer to the Revenue portion of this report for additional information.

Miscellaneous Deferred Debits \$1,458,586

Audit verified the total Deferred Debits noted on the filing Schedule 2 Attachment C to fourteen specific general ledger accounts included in the filing.

The largest balance is in account 6186-100-001, Acquisition Premium MARA which at year end reflected \$1,426,010. Audit verified that the original posting of the MARA on 1/25/2012 was to account 6188-100-001 in the amount of \$1,459,175. Amortization of the deferral began in March 2012 at \$1,590 per month. Refer to the Amortization-Other portion of this report, below.

Audit requested clarification of one debit entry in account 6186-285-001 in the amount of \$26,325. The offset was noted as a reduction to plant in service account 6305-000-001, Reservoirs & Dams. The Company indicated that the amount had been booked to the plant in service account in September 2011 and transferred in February 2012 after detailed review of the bathymetric survey for the Berry Pond reservoir. Audit requested the supporting documentation and was provided with the 2011 work order summary of labor, contractors, and overhead. The majority of the cost, \$24,000, was verified to an invoice from Substructure, Inc. for survey planning, mobilization and demobilization, multibeam bathymetric survey and sub-bottom profile surveying, process the data, analyze the data and provide a report.

Amortization Other \$24,967

Audit verified the total amortization expense to the PUC annual report schedule F49, the filing schedule 1, and the general ledger accounts:

6407-100-001 Amortization Acquisition Premium	\$17,488
6407-320-001 Amortization Expense-Deferred Charges	<u>\$ 7,479</u>
Total Amortization Expense	\$24,967

Audit verified that the Amortization Acquisition Premium total of \$17,488 was noted as a pro forma in the filing, schedule 1, attachment F, in accordance with Order 25,292 and related settlement. The amortization expense was noted in account 6407-100-001 from March through December 2012 without exception.

There are also two other pro forma adjustments in the filing. The Deferred costs relating to the Sarbanes –Oxley legislation were fully amortized in 2012, thus the elimination of \$1,074 is accurate. A reduction of \$728 was also noted in the filing related to Berry Pond.

## **LIABILITIES AND EQUITY**

### **Common Stock**

Common Stock listed in the filing on schedule 2A in the amount of \$(100) agrees with the PUC annual report as well as with the general ledger account #6201-100-001. The figure has remained constant for several years.

### **Other Paid in Capital**

Other Paid in Capital of \$(2,506,739) in the filing on schedule 2A and the PUC annual report was also verified to the general ledger, account #6211-000-001 without exception. The pro forma noted in the filing on schedule 3, attachment A reflects the elimination of \$(237,129) which was verified to the beginning balance in the general ledger, as well as to the 4/13/2012 Pennichuck Corporation filing noted in the pro forma.

### **Retained Earnings**

Retained Earnings as noted in the filing on schedule 2A was verified to the following general ledger activity and PUC annual report without exception:

6215-500-001 Retained Earnings Beginning Balance	\$(829,124)
Debit on 1/25/2012	<u>\$ 826,112</u>
6215-500-001 Preliminary Ending Balance	\$ (3,012) at 12/31/2012
Net Income per Income Statement F2 Annual Report	<u>\$ (31,564)</u>
Adjusted Retained Earnings at Year End F3 Annual Report	\$ (34,576)

Audit noted that the pro forma in the filing schedule 3, attachment A reflects elimination of \$826,112 the debit entry which posted on 1/25/2012.

### **Debt**

#### **Advances from Associated Companies**

PAC does not reflect external long term debt, rather shows intercompany advances and payables/receivables among each of the Pennichuck affiliates. Audit verified the total noted on the PUC annual report agreed with the filing schedule 2A and to the following accounts:

6223-202-001 Interco Advance from PCP	\$(776,850) 7% per year
6233-300-001 Interco Pay/Rec PAC/PCP	\$ (45,999) rate varies
6233-400-001 Interco Pay/Rec PAC/TSC	\$ -0-
6233-500-001 Interco Pay/Rec PAC/PWS	\$ -0-
6233-600-001 Interco Pay/Rec PAC/PWW	\$ -0-
6233-650-001 Interco Pay/Rec PAC/PWW-RSF	\$ (4,996)
6233-700-001 Interco Pay/Rec PAC/PEU	<u>\$ -0-</u>
Net Intercompany	\$(827,845)

The initial petition to borrow from the PCP was approved by Commission Order 24,610 on 3/31/2006 with the proceeds used to finance the acquisition of Central Water Company and Consolidated Water Company (approved in docket DW05-132). Interest was initially approved at 6.5% per year, with a balloon payment of 725,839 due five years from the date of the note, 5/9/2006.

In docket DW07-120, the Commission approved, by Order 24,827, an intercompany loan in the amount of \$2,500,000. The funding was used for capital improvements at Locke Lake and Birch Hill systems. The loan was originally an SRF financing, but due to delays with the approval at the Executive Council, the PCP was chosen as the lender so that construction could begin before the winter. The financing was approved at 7% with a balloon payment due 10 years from the date of the note. Subsequently, in dockets DW08-052 and DW09-051, via Order 25,051, the Locke Lake and Birch Hill systems (the North Country systems) were transferred to PEU, along with the long term indebtedness associated with them.

Ending balances were verified to the appropriate affiliate's general ledger at year end. The zero balance accounts had activity throughout the year, all of which were paid in full by year-end. At year-end, the advances exceed 10% of net fixed plant. Audit noted that the Company petitioned the Commission via docket DW13-247 for approval of a higher short term debt limit. By Order #25,581 issued August 10, 2013, PAC received approval through 2014 for short term debt limit of 18% of net fixed plant.

Audit verified the ending balance of the Rate Stabilization Fund (RSF) loan to the receivable balance on the general ledger of PWW, account 2233-650-001. PWW maintains the \$5,000,000 rate stabilization fund in accordance with the Commission's Order 25,292. Refer to the PWW audit report in docket DW 13-130.

Interest expense in the amount of \$57,062 as noted on the PUC annual report was verified to the general ledger 6427-115-001. Audit verified the interest expense offsets posted to the intercompany accounts as follows:

	<u>12/31/2012</u>	true-up <u>GJ #453</u>	<u>Total</u>
6223-202-001 Interco Advance from PCP	\$(54,380)	\$(4,532)	\$(58,911)
6233-300-001 Interco Pay/Rec PAC/PCP	\$(14,135)	\$ (578)	\$(14,712)
6233-400-001 Interco Pay/Rec PAC/TSC	\$ (3)	\$ (0)	\$ (3)
6233-500-001 Interco Pay/Rec PAC/PWS	\$ (82)	\$ (4)	\$ (86)
6233-600-001 Interco Pay/Rec PAC/PWW	\$(23,382)	\$(1,085)	\$(24,467)
6233-700-001 Interco Pay/Rec PAC/PEU	<u>\$ 39,460</u>	<u>\$ 1,657</u>	<u>\$ 41,117</u>
	\$(52,523)	\$(4,542)	\$(57,062)

Audit requested clarification of how the interest is calculated and was provided with the following:

*"...on a monthly basis, intercompany interest is calculated on the outstanding average monthly balance for the intercompany accounts. In 2012, amounts that*

*were in a net borrowed position incurred interest at the Fed Discount Rate, while amounts that were in a net invested position earned interest at the MMA Rate. ...The average balances are then assessed interest as described above, based upon the overall borrowed (negative) or invested (positive) aggregate intercompany balance for each company... ”*

Audit reviewed the monthly interest journal entries and noted that for the December 2012 “true-up” the Company included a thirteenth month of interest related to the Intercompany Advance from the PCP, or an overstatement of interest in the amount of \$4,532. **Audit Issue #1**

#### Accounts Payable

The PUC annual report, filing schedule 2A, and general ledger account #6231-000-001 each reflect an accounts payable year-end balance of \$(104,325). For detailed review, refer to the Expense portion of this report.

#### Customer Deposits

The PUC annual report reflects a Customer Deposit total of \$2,089, which agrees with the filing schedule 2A. Audit verified the debit figure to account #6235-250-001, Hardship Case-Credits. Hardship Case credits reflect miscellaneous receivable credits which are used to offset small customer account balances.

#### Miscellaneous Current and Accrued Liabilities

Audit verified the reported \$(25,104) from the PUC annual report to the filing schedule 2A to the following general ledger accounts without exception:

6241-300-001 Miscellaneous Current Accrued Liability	\$ (7,607)
6241-350-001 Accrued Liability – Retainage	<u>\$(17,497)</u>
	\$(25,104)

The miscellaneous accrued liability was verified to four credit entries at 12/31/2012. The entries are for payments, fees, work orders and miscellaneous payables. The largest entry, \$6,920, was offset to Construction Work in Progress, account 6105-222-001.

The Accrued Liability- Retainage account contained five journal entries. Four credit entries were to accrue retainage and one debit entry for \$1 was to correct the retainage. The entries were offset to the Construction Work in Progress account 6105-222-001 and relates to work order #1205749/01, 2012 Joy Street Main Replacement.

## REVENUE

### Revenue

Billed revenue was noted in the PUC annual report, the filing Schedule 1, and the general ledger to be a net total of \$(691,120). Audit reviewed the activity within each of the following accounts:

6460-200-001 CBFRR	\$(134,346)	
6460-998-001 CBFRR Contra	<u>\$ 134,346</u>	<u>\$ -0-</u>
6461-000-001 Water Sales Billed Revenue	\$(508,154)	
6461-001-001 Water Sales Billed Recoup	\$ (52,689)	
6461-100-001 Unbilled Revenue	\$ 5,484	
6461-200-001 Unbilled Recoup	<u>\$ 52,758</u>	<u>\$(502,601)</u>
6462-000-001 Fire Protection	<u>\$(181,369)</u>	<u>\$(181,369)</u>
Subtotal Revenue per filing schedule 1		\$(683,970)
6471-300-001 Miscellaneous Service Rev	<u>\$ (7,151)</u>	<u>\$ (7,151)</u>
Total Reported Revenue		\$(691,120)

The CBFRR is a revenue recovery mechanism established to ensure that funds are available for the city to pay the bond taken to purchase the Pennichuck Corporation. Audit verified that eleven months of CBFRR, \$12,213, sum to the \$134,346 which was noted in the general ledger. Refer to Docket DW 11-026.

Metered Sales in account 6461-000-001 represent Billed Revenue. Audit reviewed the account activity and noted one monthly credit entry throughout the test year. One abatement debit was noted. The Company indicated that abatements represent cancel/rebills, or adjustments such as correcting for an estimated bill vs. actual meter read.

Account 6461-001-001, Water Sales Billed Recoupment, represents the remaining authorized amount of the difference between temporary and permanent rates from the prior rate case. Offsets were noted in account 6461-200-001. The \$69 variance was noted in 6461-001-001 to be an abatement. Refer to Docket DW 10-090, Order #25,279, issued on 10/21/2011 regarding the approved recoveries. Refer as well to dockets DW08-052 and DW09-051, Order #25,051 which authorized recovery of rate case related expense over an 18 month period. Based on a review of these revenue accounts and the related balance sheet accrued revenue accounts, there is an overstatement in the revenue account of net \$2,271 or 4%. The error will not impact the rate case as prior rate case recoveries are not part of the current revenue requirement in this docket.

The Company began the recoveries related to the DW10-090 case in November 2011 and concluded in October 2012. Audit requested clarification of the earlier dockets' recovery timeframe, as the entries in the general ledger reflect activity for August and September 2012 only. Order #25,076 in docket DW 08-052 authorized an 18 month recovery of \$109,157 or \$3.40 per customer. The Order was issued on 2/24/2010. The Company noted that the recovery began in April 2010. The Company noted that for a period in *"2011 the monthly recoupment was applied to the incorrect Accounts Receivable Unbilled Revenue Recoupment account. The monthly interface between MUNIS and the GL was not updated to reflect the appropriate account. An entry was made in August 2012 to reclassify."*

Account 6461-100-001, Unbilled Revenue reflected a net change for the year of a debit \$(58,243). Audit reviewed the unbilled revenue calculations for the month end December 2012 and January 2013. Entries are automatic reversals. The December calculation of \$65,519 was verified to a customer service billing cycle summary page outlining one read-date category and the number of days from the prior billing cycle to the end of the year. The January entry, in the amount of \$66,751 was similarly supported. There were no exceptions noted.

#### Tariff Review

Audit reviewed the twelve month history of a variety of customer classes to ensure that the tariffed rates were properly assessed, to ensure the recoupment between temporary rates and permanent rates were accurately assessed as Ordered, and to ensure that the accurate amount was charged for the recovery of rate case expenses resulting from the prior rate case. Audit was provided with a 12 month summary by billing cycle. Pennichuck has a subsystem that reviews each individual customer account history from the establishment of temporary rates through permanent rates, and calculates the individual specific consumption recoupment. Audit reviewed the calculations which were mathematically correct, verified to the Munis billing system, and overall recovered the amount authorized by the Commission. Because of the individual customer calculation, each customer was found to have varying recoupment rates.

Audit reviewed the 2012 customer histories and for three of the customers, saw no recoupment. Audit was provided with the 2011 histories which reflected the recoupment in full for each, as the properties transferred ownership, and thus the final bills reflected each customer's remaining portion of the recoupment.

Audit was provided with the Pittsfield hydrant annual charge calculation which identified the inch-foot charge by the size of the pipe and the total feet as of 12/31/2011. The worksheet indicates the town had 65 hydrants at the same period. Therefore, the hydrant charge of \$87.13 per month or \$1,045.56 per year amounted to \$67,961.40 while the inch-foot per pipe size total of 494,756 was multiplied by the tariff \$0.18358 for a total annual charge of \$90,827.67. The combined total of \$158,789.07 divided by twelve monthly charges was \$13,232.42 which Audit verified to the payment history from Munis.

### Rent/Lease Receipts

Audit requested documentation that would support any third party rental/lease agreements for attachments to any tanks or structures, and was informed that the Company does not currently rent any space on utility assets.

### Expenses

#### Accounts Payable

The PUC annual report, filing schedule 2A, and general ledger account #6231-000-001 each reflect an accounts payable year-end balance of \$(104,325).

Audit reviewed all of the activity in the one Accounts Payable account and noted that the majority of the payments were to the same vendors each month. Audit selected 26 general ledger transactions to review in detail. Supporting documentation for each selection was provided to Audit. 18 of the invoices reviewed by Audit were charged straight to PAC without exceptions. Audit's findings are noted below:

#### Customer Refund

Audit reviewed 2 refunds to customers. One refund was for an overpayment on an inactive account and the other was to correct consumption. No exceptions were noted.

#### Petty Cash

Audit reviewed a petty cash reimbursement for \$77.49. Audit questioned a receipt for headphones. The receipt showed one set of headphones being returned (value of \$13.59) and another set being purchased (\$19.99). The receipts shows a total of \$6.40 being due however, the petty cash fund shows the expense as \$19.99. Audit questioned why this was and PAC responded that the employee never submitted the original receipt. Once returning to the office the employee realized the headphones did not have the correct connection and returned to the store to purchase the replacement. The entire \$77.49 was allocated between PWW (\$50 for Fuel) and PEU (\$27.49 to CWIP and Small Tools).

#### Travel and Expenses

Audit did not note any travel and expense reimbursements during review of the general ledger. Audit inquired with PAC and it was noted that there were no T&E reimbursements in 2012. PAC noted that they historically had minimal T&E reimbursements and since Nashua acquired the companies, all three companies (PAC, PWW and PEU) have reduced these expenses.

See the O&M Expenses section below for the detail of the remaining 8 invoices.

**Operations and Maintenance (O&M) Expenses \$367,969**

The filing Schedule 1, reflects the total O&M Expenses of \$367,969. Audit reviewed the detailed general ledger activity for all of the O&M Expense accounts.

**Production Expenses \$104,680 is comprised of the following:**

6610-xxx-001 Maintenance Supervision and Engineering   \$ 21,828

The total was verified to two individual general ledger accounts and reflects an increase of 20% over 2011. Audit reviewed the transactions in the two general ledger accounts with no exceptions.

6623-100-001 Power Purchased: Treatment Plant Elec       \$4,655

Audit reviewed the activity in the Power Purchased account and noted that transactions were for three Public Service invoices per month. The percentage change over the 2011 year-end was 4%. No exceptions in the general ledger were noted.

6624-100-001 Oper Labor: Treatment Plant                       \$ 32,616

The total for the Pumping Labor and Expenses was verified to this general ledger account without exception. The account decreased 14% over 2011. The general ledger detail was reviewed and contained twelve monthly entries for Maintenance. No exceptions were noted.

6626-xxx-001 Miscellaneous Expenses                               \$ 10,340

The total Miscellaneous Expenses was verified to three individual general ledger accounts and represents a reduction of 5% from the same period, 2011. Audit reviewed the general ledgers of all three accounts in detail and noted they contained entries for vendor invoices, intercompany reclassifications, and accruals. No exceptions were noted.

**Northeast Pump and Instrument**

Audit reviewed an allocated invoice of \$1,889.29 from 2/27/2012. \$1,462.64 was allocated to PAC's Treatment Plant Operating Expense account 6626-100-001 and \$426.65 was allocated to PEU's Booster Station General Maintenance account. Audit verified the general ledger transactions and no exceptions were noted.

United States Plastic Corp

Audit reviewed a \$541.74 United States Plastic Corp. invoice from September 27. This invoice was allocated between PAC and Pennichuck East Utility (PEU). In general ledger account 6626-100, Operating Expense: Treatment Plant, PAC's expense of \$353.90 was recorded. PEU's portion was recorded in an end of month lump sum allocation to account 7633-199, Booster Station General Maintenance. The journal entry reference was noted as "Record Interco Expense from PAC". No exceptions were noted.

6631-xxx-001 Maintenance of Structures and Improvements\$ 12,525

The total Maintenance of Structures and Improvements was reviewed and verified to two individual general ledger accounts without exception. For the year, the total represents an increase of 12% over the same period ending 2011.

6633-199-001 Booster Station General Maintenance \$ 0

Audit reviewed the detailed general ledger for account 6633-199-001. The account contained two transactions, the accrual of a work order and the debit for the completed work. The account contained a zero balance at the end of 2012. No exceptions were noted.

6641-xxx-001 Chemicals \$ 7,717

The total of the Chemicals accounts was verified to four specific general ledger accounts without exception. The account balance decreased 2% over 2011. Audit reviewed the activity in all four accounts without exceptions.

Harcros Chemicals Inc.

Audit reviewed an invoice from August 15, 2012 for \$1,530.94. This invoice had journal entries showing \$309.55 being allocated to each PAC and PEU's Chlorine accounts (6641-110-001 and 7641-110-001 respectively). The remaining \$911.84 was placed into inventory on PW's books in account 2151-201-001, Inventory:WTP Chemicals. Audit was able to trace all of the transactions from PAC's intercompany transfer to PEU and PW accounts (6233-700-001 and 6233-600-001) to PEUs and PW's general ledger. No exceptions were noted.

6642-xxx-001 Operation Labor and Expenses \$ 13,450

Operation Labor and Expenses total was verified to two individual general ledger accounts without exception. Activity in the accounts included vendor invoices, lab fees, and accruals. The total for the year represented a decrease over 2011 of 28%.

### Hach Company

An invoice for \$979.52 from March 28, 2012 was reviewed by Audit. This invoice was allocated evenly between PAC and PEU. \$489.76 was charged to each company's Laboratory Expense account (6642-200-001 for PAC and 7642-200-001 for PEU). Audit was able to trace the transaction between both companies' general ledger with no exceptions.

6652-220-001 Maint Proc Equip: SCADA & Other                      \$ 1,549

Audit reviewed the detailed general ledger for account 6652-220-001 with no exceptions. Activity in the account included monthly Metrocast invoices, two other vendor invoices, and a reclassification from PWW. The change from 2011 was a reduction of 40%.

### **Transmission & Distribution Expenses \$69,657 is comprised of the following:**

6660-xxx-001 Operation Supervision and Engineering                      \$ 14,552

Operation Supervision and Engineering was verified to two specific general ledger accounts. Audit reviewed the general ledger detail for both accounts without exceptions. The change from 2011 was an increase of 20%.

6662-003-001 Misc. Gen Expense/Operations                                      \$ 15

Audit reviewed the one journal entry, for an AP reclassification from PWW, in the miscellaneous general expenses account without exception.

6663-xxx-001 Meter Expenses    \$ 5,364

Total Meter expenses were verified to two specific general ledger accounts. The balance at year-end 2012 represents an increase of 84% over the same period 2011. In a response provided with the Annual Report, PAC noted the large increase was due to costs associated with the periodic testing of meters increasing. Audit reviewed both Meter accounts with no exceptions.

6665-100-001 Small Tools Expense    \$ 796

The balance in the Small Tools Expenses account reflects a 16% reduction over the 2011 year-end balance. The account contained ten transactions for the same vendor and six reclassifications for invoices paid by PWW and PEU. No exceptions were noted in the general ledger detail.

6673-xxx-001 Maintenance of Transmission & Distribution Mains \$ 17,450

The total for the year represents a 70% decrease over the same period 2011 and was verified to four specific general ledger accounts without exception. All of the accounts transactions were for "Pittsfield Maintenance" except one reclassification AP from PWW entry.

6675-000-001 Maintenance: Services \$ 22,055

Audit reviewed the detailed general ledger for the Maintenance: Services account. Debit entries were for vendor invoices, maintenance, and one reclassification from PWW. The account also contained one credit entry to reclassify a dump truck. The Maintenance: Services account balance increased 75% from 2011. Audit referenced a memo that was included with PAC's Annual Report noting that the large increase in the account balance over last year's was due to increased costs associated with leak detection efforts and repairs.

6676-000-001 Maintenance: Meters \$ 1,584

The Maintenance: Meters account increased 334% over 2011 ending balance. Because of the significant increase, PAC provided a note with their Annual Report that stated the increase was due to an increase in meter maintenance. Transactions in general ledger account 6676-000-001 reflect entries for maintenance, a vendor invoice, a transfer and a reclassification. Audit selected the transfer and reclassifications for further review. PAC provided supporting documentation for both journal entries in the amounts of \$56.30 and \$425.40. Both entries were to account for the replacement of chamber components. PAC noted that *"In 2012, the Company determined that chamber comps would no longer be capitalized as part of the meter. The Company began expensing this portion of the meter due to their relative cost and replacement frequency when compared to the actual meter itself."* The reclassification journal entry moved the chamber components from a capital work order which had posted to account 6334-000-001, Metering Equipment, to a maintenance work order while the transfer journal entry was a direct charge for chamber components. Audit noted the \$425.40 entry included \$8 in overhead. Capital items may include overhead, while the Maintenance expense items should not. Due to the immateriality of the overstated expense, Audit will not request a change to the filing.

6677-xxx-001 Maintenance of Hydrants \$ 4,462

The Hydrant maintenance total was verified to three specific general ledger accounts with a combined total of twelve journal entries. The total represents a decrease over 2011 of 16% and was reviewed in detail. There were no exceptions noted.

6678-000-001 Monitor Contractors Marking \$ 3,379

Account 6678-000-001 contained general ledger transaction for Dig Safe and "Pittsfield Maintenance" with no exceptions noted. The total for the year represents an increase of 21% over the 2011 balance.

**Customer Account & Collection Expense \$21,095 is comprised of the following:**

6902-xxx-001 Meter Reading Expense \$ 3,488

The total Meter Reading expense was verified to three individual general ledger accounts without exception. The combined balance represents a decrease of 2% from the prior year-end. The accounts and related activity were reviewed in detail with no exceptions noted.

6902-xxx-001 Customer Records and Collection Expense \$ 9,719

The total as noted on the PUC annual report, account 903 was verified to two specific accounts. The total for the year represents a decrease of 12% from the prior year. No exceptions were noted in the review of the general ledger detail.

6904-000-001 Uncollectible Accounts \$ 7,887

Audit reviewed the activity in the Uncollectible account, as the balance at 12/31/2012 represented a decrease from 2011 of 37%. The general ledger account contained twelve monthly entries to adjust the allowance. The uncollected receivable figure represents 22% of the total receivables at year-end. No exceptions were noted.

**Administrative & General Expense \$39,316 is comprised of the following:**

6921-xxx-001 Office Supplies and Other Expenses \$ 4,426

The total was verified to two individual general ledger accounts without exception. Activity in the accounts included postage, vendor invoices, and phone costs. The total for the year was a reduction of 17% from 2011 yearend balance.

6923-000-001 Outside Services Employed \$ 8,250

The balance in the Outside Services account increased 223% from the same period in 2011. The Outside Services account only contained two transactions, a \$300 reclassification from PWW and \$7,950 for Applied Economics. PAC noted in a memo provided with their Annual Report that the extravagant increase was primarily due to services rendered for the valuation of the Company's assets (Applied Economics). Audit reviewed the Applied Economic invoice as noted below:

Applied Economic Research, Inc.

An invoice for \$7,950 for a summary appraisal report for Berry Pond Land in Pittsfield was reviewed by Audit. The expense was posted to Outside Services, account 6923-000-001 and appears to be non-recurring. Pro Forma Adjustment Schedule 1, Attachment C, Page 1, eliminated the cost of these valuation services.

6924-000-001 Insurance Expense \$ 19,390

The Insurance expense account reflects a decrease from 2011 of 61%. Audit reviewed all of the general ledger transactions for the year without exceptions.

6928-000-001 Regulatory Commission Expenses \$ 2,019

Audit verified the reported Regulatory Commission expense to the general ledger noted, as well as to the PUC Assessment books for the quarterly payments required during the test year. There were no exceptions noted.

6930-xxx-001 Miscellaneous General Expenses \$ 2,324

Audit verified the total to five specific general ledger accounts without exception. The total for the year represents a decrease from 2011 of 22%. The accounts and related activity were reviewed in detail with no exceptions noted.

6950-500-001 Maintenance Computer Equip: PAC \$ 2,907

Audit reviewed the detailed general ledger for the Computer Equipment Maintenance account. Activity in the account included, recording prepaid expenses, and once reclassification of computer expense from PWW. The total for the year represents an increase of less than 1% over the year-end 2011 balance.

**Inter Div. Management Fee \$(133,222) is comprised of the following:**

Miscellaneous General Expenses

6930-500-001 Intercompany Mgmt Fee: PCP	\$ 7,450
6930-510-001 Intco Mgmt Fee: PWW	\$ 125,772

Account 6930-500-001, Intercompany Management Fee-PCP reflected the \$7,450 of the total allocation from Pennichuck Corporation to all subsidiaries, \$427,043. The PAC portion was recalculated without exception. Refer to the Allocation Factors portion of this report. The overall allocation was tested and reviewed in the PWW detailed audit. Refer to the audit report in DW 13-130.

Account 6930-510-001, Intercompany Management Fee-PWW reflected a total of \$125,772, which, as above, was tested for allocation purposes in the PWW audit report for DW 13-130. Refer to the Allocation Factors portion of this report.

## Payroll

Pennichuck Corporation (PNNW) and their other subsidiaries (Pennichuck East Utility, Inc., Pittsfield Aqueduct Company, Inc., Pennichuck Water Service Corporation, and The Southwood Corporation) do not have any employees of their own. All employees are employed by PWW to help further the efficient and cost effective operation of PNNW. The parent and other subsidiaries rely upon and utilize PWW's employees. The payroll function is managed at the Company's corporate office in Merrimack, NH. Monthly intercompany transfers are performed to allocate the payroll costs to each subsidiary. Audit reviewed the payroll function and accounting in detail as part of the Pennichuck Water audit. Refer to the audit report in DW 13-130, issued on 1/6/2014.

## TAXES

### Property Tax Expense

Audit verified the property taxes paid during the test year, \$97,369 to the following:

2012 NH DRA Utility Property Tax	\$17,270
½ of 2 <sup>nd</sup> Issue 2011 Pittsfield	\$20,436
Full 1 <sup>st</sup> Issue 2012 Pittsfield	\$36,078
½ of 2 <sup>nd</sup> Issue 2012 Pittsfield	<u>\$23,586</u>
Property tax expense	\$97,370 verified to the general ledger 6408-110-001

Audit also verified that the reported expense agrees with the PUC annual report as well as with the filing schedule 1.

### Prepaid Property Taxes

Audit calculated the prepaid property tax figure to be \$23,586, which agrees with the general ledger account 6163-310-001, Prepaid Property Taxes. The PUC annual report and the filing schedule 2 reflect the prepaid tax figure to be \$22,020. That figure is comprised of an asset and a liability account:

6163-310-001 Prepaid Property Taxes	\$23,585
6236-115-001 Local Property Taxes Payable	<u>\$ (1,565)</u>
	\$22,020

Audit requested clarification of the Local Property Tax Payable account. The Company provided the following: *"We book property taxes on a monthly basis for both local property taxes and state utility taxes. The local property taxes are based on the last year's full year tax amount (the amount reflected on the 12/1 bills each year for the full year), by dividing that amount by 12 and recording it to expense. The offset is either Local Property Taxes Payable or Prepaid Property Taxes, depending on the month of the year. As the property tax year runs from April 1 to March 31 each year, but semi-annual payments are due on 7/1 and 12/1 each year, a portion of the year we are prepaid on*

*local property taxes, and a portion of the year we are accruing taxes that will be due and payable at the next billing date. As to state utility taxes, we utilize the tax amount from the previous year's appraisal valuation from the NHDRA, plus an estimated factor for additions to be included in the current year's appraisal (which is received on December 15<sup>th</sup> of each year). We do this such that the monthly accrued amount is level loaded within the year, and the "true up" required to the actual calculated valuation from the NHDRA received just before year-end, is minimized. Without doing this, the month of December would include 100% of the valuation increases each year, which are actually earned throughout the year. As State Utility Taxes have quarterly estimated payments due, they are always in an accrued taxes position, unlike the local property taxes."*

#### Federal and State Tax Returns

Audit requested and was provided with the external accountant's tax worksheet which provided the basis for the federal tax return. There were no exceptions noted.

Audit reviewed the 2012 Federal form 1120, filed at the Pennichuck Corporation level. Schedule M identified information at the subsidiary level, which Audit reviewed and verified to the general ledger

The State of NH Business Profits tax form does not exactly replicate the information noted on the Federal form, due to the temporary and permanent differences between book and tax information on the federal form. Audit verified the State tax form and the expenses associated with it to the general ledger.

Audit verified the Deferred Income tax total of \$525,782 to the general ledger account 6282-200-001.

The Provisions for Income Taxes, \$31,196 total was verified to the tax worksheets as well as the filing schedule 1 and the following accounts without exception:

6409-102-001 Provision for Fed Inc Tax Current	\$ (7,550)
6409-113-001 Provision for NHBPT Current	\$ (2,597)
6410-102-001 Provision for Fed Inc Tax Deferred	\$32,074
6410-113-001 Provision for NHBPT Deferred	<u>\$ 9,269</u>
Net Income Tax	\$31,196

## **Audit Issue #1**

### **Intercompany Interest Expense**

#### **Background**

Interest expense in the amount of \$57,062 as noted on the PUC annual report was verified to the general ledger 6427-115-001. Audit verified the interest expense offsets posted to the intercompany accounts as follows:

	<u>12/31/2012</u>	<u>true-up</u> <u>GJ #453</u>	<u>Total</u>
6223-202-001 Interco Advance from PCP	\$(54,380)	\$(4,532)	\$(58,911)
6233-300-001 Interco Pay/Rec PAC/PCP	\$(14,135)	\$ (578)	\$(14,712)
6233-400-001 Interco Pay/Rec PAC/TSC	\$ (3)	\$ (0)	\$ (3)
6233-500-001 Interco Pay/Rec PAC/PWS	\$ (82)	\$ (4)	\$ (86)
6233-600-001 Interco Pay/Rec PAC/PWW	\$(23,382)	\$(1,085)	\$(24,467)
6233-700-001 Interco Pay/Rec PAC/PEU	<u>\$ 39,460</u>	<u>\$ 1,657</u>	<u>\$ 41,117</u>
	\$(52,523)	\$(4,542)	\$(57,062)

#### **Issue**

Audit reviewed the monthly interest journal entries and noted that for the December 2012 “true-up” the Company included a regular recurring interest payment of \$4,532, which represented a thirteenth monthly entry for the test year.

#### **Recommendation**

The 7% approved interest rate on the Intercompany Advance equates to twelve equal monthly interest payments of \$4,532. Therefore, the annual report and general ledger are overstated by the thirteenth entry of \$4,532.

#### **Company Response**

The audit issue is correctly stated. The Company did inadvertently overstate the intercompany interest. An error occurred at year-end 2012, in that the first entry to record intercompany interest for the month was not reversed, prior to the second entry being calculated for intercompany transactions during the month. This process has been enhanced to eliminate this from recurring on a going forward basis.

#### **Audit Conclusion**

Audit concurs with the Company response.