# STATE OF NEW HAMPSHIRE

**Inter-Department Communication**

**DATE:** January 6, 2014
**AT (OFFICE):** NHPUC

**FROM:** Karen Moran, Chief Auditor
David Goyette, Analyst
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**SUBJECT:** Pennichuck Water Works
**FINAL** Audit Report – DW 13-130

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

| | Estimated | Actual Costs |
|---|---|---|
| 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 | $ 5,000,000 | $ 5,000,000 |
| 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 PWW. Refer to the audit reports for PAC 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 PWW Acquisition Premium. Refer to the audit reports for PAC 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 each of the three Pennichuck regulated utilities filed full rate cases and was 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

Audit reviewed dockets and Orders relating to PWW since the prior rate case, DW 10-091 test year ended 12/31/2009. The following summarize the activity:

### Docket DW 11-018

Special Contract with Anheuser-Busch, Inc. (combined with Rate Case DW 10-091) - Commission Order 25,230 issued 6/9/2011 approved a settlement agreement for the DW 10-091 rate case. The agreement allowed an overall rate of return of 7.98% based on cost of equity 9.75% and cost of long-term debt 6.19%; required an initial deferred credit of $157,256 relating to certain cell tower leases that were sold in 2007 and related imputed income going forward; regarding Anheuser-Busch, Inc., a 10-year 4th special contract; change to rate design was in accordance with the revised cost of service study; permanent rates take effective on or after 6/16/2010 with the temporary rate recovery over 12 months; establish a WICA surcharge.

Commission Order 25,278 issued 10/21/2011 approved the recovery of the temporary rate difference as well as rate case expenses.

### Docket DW 11-026

Joint Petition of City of Nashua, Pennichuck Corporation, et al, for approval to acquire stock in Pennichuck Corporation. Commission Order 25,292 issued on 11/23/2011 approved the acquisition by Nashua of all stock of Pennichuck Corporation, outlined the cost of the acquisition, and established the CBFRR, MARA, and Rate Stabilization Fund.

Docket DW 11-191

Petition for Authority to Provide Water Service and Charge Rates in the Harvest Estates Development in Derry. Order 25,297 12/5/2011 approved the PWW operation as a public utility in an area known as the Harvest Estates in the town of Derry.

Docket DW 11-198

Pennichuck Water Works, Inc. and Manchester Water Works Request to Modify Franchise boundaries. Order 25,300 issued on 12/13/2011 approved the transfer of three specific lots in Bedford from the MWW service territory to the PWW Powder Hill franchise.

Docket DW 12-109

Request for Franchise and Rates, Beede Waste Oil Site, Plaistow. The Commission approved a franchise request in Plaistow for customers in the vicinity of the Beede Waste Oil Site (a superfund site). The developer will pay for and construct a water main extension from an adjacent PWW system, Twin Ridge. Rates charged to the customers will be the general metered rates. PWW agrees to pay the developer a tone-time amount equal to the anticipated annual revenue from each customer connection made within 5 years. The developer agrees to pay PWW a one-time system upgrade fee of $20,526.

Docket DW 12-359

Petition for Water Infrastructure and Conservation Adjustment (WICA) was opened on 12/19/2012. The Order approving the 2013 projects was issued 5/15/2013.

**Allocation Factors 2012**

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% | verified to general ledger account 2930-500-001 |
| PEU | $ 67,108 | 15.71% | |
| PAC | $ 7,450 | 1.74% | |
| PWSC | $ 15,331 | 3.59% | |
| TSC | $ 1,736 | 0.41% | |

Audit verified the total corporate costs to the Pennichuck Corporation general ledger year end balances for:

| | |
|---|---|
| Insurance | $ 38,950 |
| Professional Fees and Services | $ 57,400 |
| Auditors Expenses and SEC Legal | $186,702 |
| Corp. Governance/Amer Stock | $ 4,398 |
| Directors' Fees Meetings, Corp. Sec | $ 26,127 |
| Edgar Filings | $ 36 |
| Board of Directors | $113,435 |
| Total Corporate Costs | $427,047 four dollar difference is immaterial. |

Audit reviewed the PCP general ledger details and noted that several entries which appear to be non-recurring. Specifically within the following accounts, Audit noted:

| | | |
|---|---|---|
| 1793-400-000 Insurance | $ 11,570 | net 1/1/2012 – 1/25/2012 |
| 1794-100-000 Professional Fees | $ 19,958 | Rath, Young, Pignatelli |
| 1801-301-000 Auditor Expenses/SEC/Legal | $111,552 | McLane, Parente Bearde, Other |
| 1801-302-000 Corporate Governance | $ 4,398 | Entire ledger balance |
| 1801-303-000 Directors | $ 21,994 | Fees, Wages, Amex, Other |
| 1801-304-000 Edgar Filing | $ 36 | Entire ledger balance |
| 1801-305-000 Board of Directors | $ 4,943 | All non-board payments |
| | $174,451 | |

While PCP is unregulated, the recommended allocation cost for the test year would be reduced by the above items, thus allocating the $427,047 to $252,596. The reduced amount to allocate would be spread among the subsidiaries. Audit was provided with the proforma expenses attached to Staff data request 1-8, which sum to $145,943.

Allocation of Return on common Assets (on the books of PWW) $723,043

| | | |
|---|---|---|
| PWW | $555,120 | 76.78% |
| PEU | $120,789 | 16.71% |
| PAC | $ 11,550 | 1.60% |
| PWSC | $ 34,514 | 4.77% |
| TSC | $ 1,070 | 0.15% |

The allocation of the return on common assets is a calculation spread among all affiliated companies. The net book value noted in the filing on the Return on Common Assets Allocation page 9, were verified to the general ledger of PWW. The amount to allocate, $723,043 is result of the net book value multiplied by 6.04% return on assets. The allocations were based primarily on the simple ratio of total revenues and employees, and assets and customers.

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

| | | |
|---|---|---|
| PWW | $1,076,662 | 65.82% |
| PEU | $ 239,906 | 14.67% |
| PAC | $ 21,245 | 1.30% |
| PWSC | $ 297,873 | 18.21% |
| TSC | $ -0- | 0.00% |

PWW work order costs represent wages from the Synergen system (for union employees) and from the general ledger for non-union employees who work at the laboratory at the water treatment plant and Will Street. Benefits are calculated based on the 2011 actual expenses incurred. PWW CWIP is not used and useful so is not included within the calculation of the work order costs to be allocated.

<u>Allocation of PWW Management Fee $5,737,028</u>

| | | |
|---|---|---|
| PWW | $4,286,519 | 74.73% |
| PEU | $ 933,491 | 16.27% |
| PAC | $ 92,977 | 1.62% |
| PWSC | $ 416,315 | 7.25% |
| TSC | $ 7,726 | 0.13% |

Year to date expenses identified in the filing on supporting schedule "operating expense allocation (to other subsidiary companies) represent the general ledger balances to be allocated, on the PWW books, $5,838,586. The final column represents direct charges, $101,559 thus deducted from the total expense. The allocation ratio for tier 1 (allocation across all companies) is based on revenues for the regulated companies, and revenues, full-time equivalents, and square footage at the Manchester St facility. Tier 2 allocations (across the regulated companies and PWSC) are based on the simple ratio of total assets and customers. Tier 3 allocations spread PWW costs across PWW, PEU, and PWS. The ratios are based on total assets and customers. Tier 4 allocations are spread among the regulated entities only and are based on total assets and customers.

The allocation of benefits ratios are based on the union and non-union portions of benefits incurred during 2011. The total benefits as a percentage of wages was 54.7% overall.

Audit verified that the total PWW allocated expenses agreed with the general ledger:

| | | | |
|---|---|---|---|
| Total Return on Assets | $ 723,043 | PWW Allocation | $ 555,120 |
| Total PWW Work Order | $1,635,686 | PWW Allocation | $1,076,662 |
| Total PWW Management Fee | $5,737,028 | PWW Allocation | $4,286,519 |
| | $8,095,757 | | $5,918,301 |

Of the total PWW expenses to allocate, $5,918,301 remained with PWW, thus the $2,177,456 was owed to PWW from all of the other affiliated companies. That total, $2,177,458 was verified to the general ledger account 2930-510-001 without exception.

One additional intercompany account, 2930-520-001, Intercompany Management: Inside General Counsel, had an entry on 1/25/2012 and one on 2/29/2012 which sum to the account total of $5,118. These appear to be non-recurring entries. Refer to the <u>Non-recurring</u> portion of this audit 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 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 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.

Pennichuck Water Works, Inc. Board Minutes

Audit also reviewed the subsidiary Board minutes of PWW and noted the following:

- 7/27/2012 approved the 4th amendment to Lease between Heron Cover Office, LLC and PWW for a five year term beginning 8/1/2012, with an approximate annual savings of $20,000. The minutes also reflect the acceptance of a conservation easement deed from North Street Properties, LLC.
- Reference in the 8/24/2012 minutes note that renovations, energy efficient upgrades and installation of LED lighting at a cost of $6,500 would be completed at the corporate office at the expense of the landlord.
- 9/28/2012 minutes approve the training agreement between PWW and the NH DRED for first-aid, CPR/AED training, and the acceptance of a grant from DRED up to $9,525 of the training costs.
- 10/26/2012 indicated that PWW is preparing a request to the IRS to allow it to use the VEBA funds for additional employee benefits.

Audit verified that each of the Pennichuck companies is properly listed in good standing with the NH Secretary of State.

## 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 PWW's Record of Bids/Proposals 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 were 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 and Adjustments | |
|---|---|---|---|
| 2010 | $160,210,263 | $ 939,644 | $ 1,016 |
| 2011 | $164,918,620 | $ 400,542 | $ -0- |
| 2012 | $168,162,476 | $1,505,156 | $46,235 |

Audit selected specific account additions and retirements for detailed review. Audit tied the year-end balances of the CPRs to the PUC Annual Report for 2010, 2011 and 2012 and to the filing with no exceptions. The following are the specific projects Audit chose for review:

Lake Street, Nashua, 2012 Water Main Improvements Work Order #1201819- $270,545

Two bids were received in response to PWW's request for proposals and for this project, the lowest bidder was chosen.

The total work order for the above project was $270,545. Albanese D & L Inc. performed the work and billed PWW through monthly requisitions. In the cost sharing agreement with the City of Nashua, PWW reimbursed Nashua $8,317 for the work order.

Police detail for the project totaled $5,223 consisting of an hourly rate of $38.75, Medicare Reimbursement at 1.45%, Pension Reimbursement of $19.95, a service charge of $3/hour and cruiser usage at $20/hour. These charges were passed through to PWW in the Albanese requisitions.

PWW Engineering and IS overhead totaled $12,280 and PWW labor totaled $1,676 on the Work Order Detail Report. The overhead rate charged was 80.27% on union employees with an additional 2% on the entire work order including the fully loaded labor.

The project was charged to the general ledger as follows:

| | |
|---|---|
| #2331-002-001 – Pavements-Distribution Mains | $23,124 |
| #2331-200-001 – Distribution Mains-New | 204,584 |
| #2331-250-001 – Distribution Mains-Gate Valves | 7,277 |
| #2333-200-001 – Renewed Services | 31,706 |
| #2335-000-001 – Fire Protection Equipment-Hydrants | 3,854 |
| Total Project Cost per General Ledger | $270,545 |
| Project Costs per Work Order | $270,545 |

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 work. Bids also came in at higher levels than the original estimate.

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

Will Street, 2012 Security Upgrades, Work Order #1201405 - $101,906

No listing for this project was found on the Record of Bids and Proposals. A request for clarification on why no bids were listed was answered in the following manner:

> "*The security work regarding access, the enhancement of the existing video system and the addition of card access at all entry points was performed on a no bid basis by B&S Locksmiths. This facility had an existing security system that was initially provided by B&S. The security system would have had to been replaced if another vendor than B&S was selected to upgrade and enhance the existing system. The fence work for the electronic gates was bid to Penny Fence Company and Granite City Fence. The pass gates had to be swing gates as there was insufficient room for slide gates. Only Gate City Fence bid on the project as Penny Fence Company did not have access to an electronic swing gate. The generator was bid by the Electrician, Electrical Installation Inc., as part of this project. The Electrician received pricing from Caterpillar and Kohler Generator. This project did not show up on the project bid list since none of the selected components were the result of Pennichuck seeking proposals and having two or more responsive bids*."

The Company's explanation for the lack of a bidding process fits their criteria for contracting out to the best vendor with unique skills for the project.

This project totaling $101,906 in year 2012 was for enhancing security at the Will Street Facility in Nashua. Total PWW labor was $1,416. Labor is charged 80.27% overhead with an additional 2% on the entire work order including the fully loaded labor.

PWW Engineering and IS overhead totaled $368 and PWW labor totaled $1,416 on the Work Order Detail Report. The overhead rate charged was 80.27% on union employees with an additional 2% on the entire work order including the fully loaded labor and totaled $969. The upgrades were all new assets with no retirements.

The project was charged to the general ledger as follows:

| | |
|---|---|
| #2304-700-001 – General and Miscellaneous Structures | $26,013 |
| #2310-000-001 – Power Generation Equipment | 43,506 |
| #2347-110-001 – Computer Equip-Hardware/Software | 33,047 |
| Total Project Cost per General Ledger | $102,566 |
| Project Costs per Work Order | $101,906 |
| Variance | $660 |

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

Amherst/Court Street 2012 Main Replacement, Work Order #1203891 - $84,223

No listing for this project was found on the Record of Bids and Proposals. A request for clarification on why no bids were listed was answered as follows:

> "*This work was not budgeted so budget dollars were transferred from the Nashua/Myrtle St project that was not going to be completed. The Company received less than two weeks' notice from the Town of Amherst that they would be replacing the road drainage in this area. The transite (asbestos cement) main would be compromised and needed immediate replacement/relocation. RH White Construction was selected based on availability and a unit price contract had to be negotiated with them in order to meet the project schedule*."

The Company's explanation for the lack of a bidding process fits their criteria for emergency municipal work.

This project was to replace 600" of existing water main on Courthouse Road in Amherst. The total cost of this work order was $84,223 and was completed in the summer of 2012 by R.H. White Construction.

PWW Engineering and IS overhead totaled $79,196 and PWW labor totaled $1,799 on the Work Order Detail Report. The overhead rate charged was 80.27% on union employees with an additional 2% on the entire work order including the fully loaded labor and totaled $1,231.

The project was charged to the general ledger as follows:

| | |
|---|---|
| #2331-200-001 – Distribution Mains-New | $73,370 |
| #2331-250-001 – Distribution Mains-Gate Valves | 4,878 |
| #2333-200-001 – Renewed Services | 3,802 |
| #2335-000-001 – Fire Protection Equipment-Hydrants | 2,173 |
| Total Project Cost per General Ledger | $84,223 |
| Project Costs per Work Order | $84,223 |

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

Kessler Farm Generator, 2012 Work Order #1206044, New Asset - $27,000

This was an emergency project, thus no bid was required. This project was to install a new emergency generator in the Kessler Farm Development. The grand total for the project was $36,447. This install was one location of what was called Standby Generator Project. The Capital Improvements Request shows the Kessler Farm location as an emergency project. The entire project was for new emergency generators in 15 locations in PWW and PEU service areas in 2012. The generators were provided by

Kraft Power and the contractor for the job was Turning Point Development of Nashua which had the $110,800 contract to install the generators. Audit noted no mark-up on vendor materials.

There were no Engineering and IS charges and no PWW labor charges

The project was charged to the general ledger as follows:

| | |
|---|---|
| #2310-000-001 – Power Generation Equip. | $36,447 |
| Total Project Cost per General Ledger | $36,447 |
| Project Costs per Work Order | $36,447 |

Audit reviewed all invoices for timeliness, account distribution and proper approvals for payment with no exceptions noted.

Twin Ridge New Well 2011 WO #1104890 - $84,043

Two bids were received in response to PWW's request for proposals and for this project, the lowest bidder was chosen. Audit noted two contractors' costs and requested clarification of the work order. The Company indicated that "*the work referenced on the record of bids is for a pipeline from the new well to the existing treatment/pumping station. The bid pipeline for the pipeline was issue to three bidders of which only two responded, DBU and Lewis Builders. The work covered by the $84,043 is associated with consulting services contract (primarily HydroSource, Inc. and Promised Land survey, LLC) for the exploration, drilling, testing, sampling, State and local permitting of the new well*."

The Company booked $84,043 in 2011 to the above work order for the installation, permitting and construction of a new water supply well at the Twin Ridge and Rolling Hills Development in Plaistow to make up for declining water supply. HydroSource Associates provided preliminary geographical surveys, test well siting and a recommendations report for almost all costs for this phase of the project.

PWW Engineering and IS overhead totaled $9,028. There was no PWW labor or overhead charged on the order.

The project was charged to the general ledger as follows:

| | |
|---|---|
| #2307-100-001 – Wells and Springs | $84,043 |
| Total Project Cost per General Ledger | $84,043 |
| Project Costs per Work Order | $84,043 |

Audit reviewed all invoices for timeliness, account distribution and proper approvals for payment with no exceptions noted.

Great Bay Treatment and Generator, 2010 Work Order #1000530 - $215,947

No listing for this project was found on the Record of Bids and Proposals. Audit understood the work to be emergency in nature thus within the parameters for exceptions to the bid policy.

This 2010 work order was for an addition to the existing station to house water filtration and disinfection equipment along with an emergency stand-by generator. The bulk of the work was performed by Arlen Company Construction LLC, Electrical Installations Inc., and R.E. Prescott. PWW closed the work order to Plant in Service in early 2011 for $215,947. The Company's internal Capital Request and Authorization form and the E-22 form filed with the Commission estimates a total project cost of $134,000. The Company states that the over run was due to the conditions of the site approval, the addition of the wells to the station generator and design needs increase the scope of the work.

PWW Engineering and IS overhead totaled $17,130 and PWW labor totaled $860 on the Work Order Detail Report. The overhead rate charged was 80.27% on union employees with an additional 2% on the entire work order. There was no overhead charged to the work order.

The project was charged to the general ledger as follows:

| | |
|---|---|
| #2304-800-001 – Water Treatment Structures | $171,243 |
| #2310-000-001 – Power Generation Equipment | 13,329 |
| #2311-210-001 – Electric Pumping Equip.-Pumps | 1,077 |
| #2320-000-001 – Purification system Equipment | 29,643 |
| #2334-000-001 – Metering Equipment | 655 |
| Total Project Cost per General Ledger | $215,947 |
| Project Costs per Work Order | $215,947 |

There were no retirement related to the new additions. Audit reviewed all invoices for timeliness, account distribution and proper approvals for payment provided for the project folder with no exceptions noted.

Drew Woods/Hi Lo Interconnection WO #1004357 - $197,314

This project was a response to unplanned work being conducted by a municipality that PWW provides service to and that impacted PWW's system.

This 2010 work included the construction of a seasonal, shallow bury water main to connect the HiLo water system to the Drew Woods water system.

PWW Engineering and IS overhead totaled $8,320 and PWW labor totaled $3,056 on the Work Order Detail Report. The overhead rate charged was 80.27% on union employees with an additional 2% on the entire work order. Overhead charged to the work order totaled $2,074.

The initial estimate for the project was $100,000 per the Company's Capital Improvement Request. However the project cost for work order #1004357/01 is $197,314.08. The Company explained the increased cost was due to the final pipeline location being determined by the town of Derry, the NHDOT and the presence of buried utilities including electric and telecom. Also, due to unknown quantities, the work had to be handled on a time and material basis.

The project was charged to the general ledger as follows;

| | |
|---|---:|
| #2311-200-001 – Electric Pumping Equipment | $669 |
| #2320-200-001 – Water treatment Equipment | 690 |
| #2331-200-001 – Distribution Main-New | 190,972 |
| #2344-000-001 – Laboratory Equipment | 3,149 |
| #2346-000-001 – Communication Equipment | 1,834 |
| Total Project Cost per General Ledger | $197,314 |
| Project Costs per Work Order | $197,314 |

There were no retirement related to the new additions. Audit reviewed all invoices for timeliness, account distribution and proper approvals for payment provided for the project folder with no exceptions noted.

## Retirements

Combined plant retirements reported on the Asset Disposition Report totaled $1,505,156 for the 2012 test-year. This amount agreed with the PUC Annual Report Schedule F-8 - Utility Plant in Service.

### Meter and Meter Installation Retirements Account #334

The 2012 PUC Annual Report shows meter retirements for 2012 totaling $908,143. This amount agrees with the general ledger and the Asset Disposition Report. The Asset Disposition Report shows Cost of Removal totaling $18,766 and agrees with the 2012 general ledger.

### Computer Equipment Retirements Account #347

Retirements listed on the 2012 Annual Report of $352,468 tied to the general ledger and to the Asset Disposition Report. No cost of removal was recorded for Computer Equipment

All the above the retirements were traced to credit postings to the respective plant account. The debit offset for each was posted to accumulated depreciation, in compliance with the chart of accounts.

The Chart of Accounts requires that utilities book asset disposition and related cost or salvage to the appropriate plant account and accumulated depreciation account. PWW 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.

**Cost of Removal and Gain/Loss**

The Accumulated Depreciation – Gain/Loss account #2108-002-001 totaled $4,937,163 on the general ledger for 2012 and activity for the year totaled $438,993. Credits to the cost of removal account totaled $14,479 described on the general ledger as recording Neptune inventory. The Company explained that the first set of credits for $6,938 and $85 are for the sale of scrap meters that are retired and can no longer be repaired or used. The second set of quarterly credits (GJ0311) for $7,456 is for failed reader meters that are replaced at no cost by the vendor. The failed reader is retired and the new reader is recorded to inventory with the offset to the Gain/Loss account. Basically, the Loss recorded on the failed reader retirement is offset by the Gain related to the replacement value of the new meter.

The Company recorded salvage value for retired assets in the amount of $14,027.

**Vehicles**

Audit reviewed the detail of the 2012 vehicle account 2341-000-001 - Transportation Equipment. The general ledger showed additions of $258,835, retirements of $45,598 and a year-end balance of $2,814,721. These figures agree with the Annual Report, the filing schedule #3, Attachment A, Exhibit 1 and the Net Book Value Report which lists all transportation equipment activity for the year. The Company purchased five vehicles in total and retired two vehicles and a trailer. There was no salvage value on the retired vehicles and a net loss recorded of $10,225.

The accounting treatment of the retired vehicles was properly noted in the Accumulated Depreciation and Plant accounts. The 2012 cost basis of transportation equipment was $2,814,721, with depreciation expense of $220,910 and Accumulated Depreciation of $1,474,234.

Audit reviewed the Pennichuck Fleet Information document that listed eighteen employees that are authorized to use vehicles for personal use and the corresponding vehicles. Audit reviewed the benefit recorded on the W-2 per the IRS rules. The Company states that the taxable fringe is included in total wages and not broken out separately on the W-2. Audit noted the benefit on the Payroll Report by code “TFB” and was able to tie the employees Year-To-Date Payroll total to the W-2 with no exceptions noted.

**Construction Work in Progress and Completed Construction Not Classified**

The general ledger balance for CWIP account #2105-111-001 – Labor Clearing and #2105-222-001 – Contractor Clearing totaled $593,594 and consisted of 18 various projects. The three largest amounts expended for the test-year were for the Asset Management System of $177,637, the Emergency Generator Project of $93,320 and the implementation of the MUNIS Customer Service Portal for $56,372. Audit tied these projects from the 2012 Annual Report to the general ledger with no exceptions.

The total CWIP amount of $593,594 shown on the filing Schedule 2 agrees with the general ledger and the 2012 Annual Report.

**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-end management fee schedule of benefits.

**Contributions in Aid of Construction**

The general ledger shows the ending CIAC balance for the test-year 2012 of $30,223,478. This figure agrees with the Annual Report and the filing Schedule 2B, page 1. Additions to account #2271-200-001 - CIAC for the three years in review are as follows:

| | Beginning Balance | Contributions | Retirements | Year-End Balance |
|---|---|---|---|---|
| 2010 | $27,069,194 | $ 432,421 | ($3,000) | $27,498,615 |
| 2011 | $27,498,615 | $1,619,537 | $ -0- | $29,118,152 |
| 2012 | $29,118,152 | $1,105,326 | $ -0- | $30,223,478 |

Accumulated Amortization of CIAC, account 2272-101-001 – Reserve for Amortization of CIAC for the test-year 2012 totaled $5,806,396 on the general ledger and agrees with the Annual Report and the filing Schedule 2B, page 1. Audit traced the monthly debits for each account being amortized and recalculated amortization rates with no exceptions.

The general ledger shows Amortization Expense of CIAC, account 2405-300-001 for the test-year 2012 of $528,652. This figure agrees with the Annual Report and the filing Schedule 1. Audit traced the monthly credits for each account being amortized and recalculated amortization rates with no exceptions.

**Leasehold Improvements**

The general ledger reflects two leasehold improvement accounts as part of the overall Structures and Improvements account #2304:

| | |
|---|---|
| 2304-950-001 Manchester Street Leasehold Improvements | $477,208 |
| 2304-951-001 Leasehold Improvements, HecopIII Fitup Allow. | 292,020 |
| | $769,228 |

The above accounts have been fully amortized and the net book value is zero for the test year 2012.

**Acquisition Adjustments**

At year end, the net Acquisition Adjustment of $(453,793) was verified to the following general ledger accounts:

| | |
|---|---|
| 2114-100-001 Acquisition Adjustment Bon Terrain | $(384,880) |
| 2114-101-001 Acquisition Adjustment Souhegan Woods | $(460,025) |
| 2115-101-001 Accum. Amortization Souhegan Woods | $ 240,383 |
| 2115-102-001 Accum. Amortization Bon Terrain | $ 150,730 |
| | $(453,793) |

The adjustments and related accumulated amortization and resulting net were verified to the PUC annual report schedule F7 and to the filing schedule 2 without exception.

Refer to the Amortization portion of this report for review of the write off of these acquisition adjustments.

**Depreciation Expense**

The general ledger account #2108-000-001 - Accumulated Depreciation shows a December 31, 2012 year-end balance of $49,426. Accumulated Depreciation: Cost of Removal account 2108-001-001 totaled $25,510,131, Accumulated Depreciation: Gain/Loss account 2108-002-001 totaled $4,937,164 and Theoretical Depreciation Reserve totaled $2,118,960 for a net total Accumulated Depreciation of $39,860,448. These figures agree the NHPUC Annual Report and the filing Schedule 2, Attachment A.

| | |
|---|---|
| #2108-000-001 - Accumulated Depreciation | $49,426,703 |
| #2108-001-001 - Accumulated Depreciation: Cost of Removal | 25,510,131 |
| #2108-100-001 - Theoretical Depreciation Reserve | 2,118,960 |
| Total Account #2108 | $39,860,448 |

Depreciation Expense account 2403-000-001 totaled $4,191,987 on the general ledger, NHPUC Annual Report. Audit recalculated several accounts for accuracy and found no exceptions. The filing schedule 1 includes the depreciation expense and the amortization expense of acquisition adjustments (below). Specifically, the general ledger accounts supporting the filing are:

| | |
|---|---|
| Depreciation 2403-xxx-001 | $4,191,987 |
| Amortization 2406-xxx-001 | $ (27,026) |
| Filing schedule 1 | $4,164,961 |

The Chart of Accounts requires that utilities book asset disposition and related cost or salvage to the appropriate plant account and accumulated depreciation account. PWW 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.

**Amortization Expense**

Amortization of Utility Plant Acquisition Adjustment

| | |
|---|---|
| Bon Terrain Adjustment 2406-100-001 | $ (10,196) |
| Souhegan Woods Adjustment 2406-101-001 | $ (16,830) |
| Total account 2406 | $ (27,026) |

The preceding general ledger amounts are reflected on Annual Report, Schedule F-49. The basis for Bon Terrain is $384,880 amortized @ 2.6491% or 37.7487 years. The basis for Souhegan Woods is $460,025 amortized @ 3.6585% or 27.3336. The amortization was verified to the filing schedule 1 as part of the total depreciation expense.

Refer to the Acquisition Adjustment portion of this report for additional information.

The total of account 2406 is included within the Depreciation total on the filing schedule 1, Operating Income Statement, $4,164,961.

Amortization Expense-Other

| | |
|---|---|
| Acquisition Premium 2407-100-001 | $ 954,452 |
| | |
| Deferred Charges | $ 88,133 |
| Theoretical Reserve | $(353,160) |
| Subtotal 2407-320-001 | $(265,027) |
| | |
| Total Amortization Expenses 2407 | $ 689,425 |

Audit verified the net total of accounts 2407, $689,425 to the filing schedule 1 without exception.

The Acquisition Premium amortization of $86,768 was booked monthly beginning in March 2012. The offsets were originally posted to account 2188-100-001 through May 2012. In June the premium was transferred from 2188-100-001 to 2186-100-001. From June through December, the amortization offset posted to the 2186 account without exception. Refer for further information relating to the Acquisition Premium to the Final Audit Report-MARA issued November 19, 2013.

Of the $88,132 amortization expense, Audit noted the following:

- Relating to 2186-140-001, Sarbanes Oxley, the amortization expense $39,635 represented expenses January through March, at which point the deferral was fully amortized and the expense stopped. The filing includes the pro forma on schedule 2, attachment D, page 2.
- Relating to 2186-204-001, Union Negotiations, the expense for year $25,556 will be non-recurring, as the balance in the deferral at year-end was $2,130 which is one month's worth of amortization expense. The filing includes the pro forma on schedule 2, attachment D, page 2.
- Relating to 2186-455-001 relates to the Harris Pond Bathymetric Survey. Refer to the Deferred Debits portion of this report. The amortization of $5,039 (plus the $420 pro forma to account for 2011 activity) is based on a ten year life. Refer to Staff DR 2-24 for detailed description of the survey.
- Relating to 2186-485-001, Watershed Monitor Sediment, The amortization began in December 2012. Thus for the test year, $218 was included. Audit noted that a pro forma adjustment to include a full year's worth of amortization expense was included in the filing schedule 2, attachment D, page 1.
- Relating to 2186-510-001, Watershed Restoration Plan, one month's amortization expense in December 2012 in the amount of $1,006 was noted. Refer to the filing schedule 2, attachment D, page 1.
- Relating to 2186-670-001, Pennichuck Brook Watershed Web, an amortization expense of $277 will not be a recurring expense item. The reduction to expense was not noted in the pro forma entries. Immaterial.
- Relating to 2186-700-001, Ongoing Watershed Study 00-04, the account was closed to zero, with the total net activity included as a reduction to amortization expense. Refer to the filing Schedule 2 attachment D page 2.

## CURRENT AND ACCRUED ASSETS

### PWW Cash and Bank Reconciliation $5,218,209

Cash was verified to the filing schedule 2 and to the following general ledger accounts without exception:

| | | |
|---|---|---|
| 2131-110-001 | Petty Cash Water Treatment Plant | $ 2,000 |
| 2131-111-001 | Petty Cash Operations | $ 2,000 |
| 2131-112-001 | Petty Cash Office | $ 2,000 |
| 2131-120-001 | Cash-Bank of America – PWW | $ -0- |
| 2131-125-001 | Cash RBS Citizens Bank | $ -0- |
| 2131-200-001 | Cash Payroll | $ -0- |
| 2131-225-001 | Cash Payroll RBS Citizens Bank | $ -0- |
| 2131-300-001 | Restricted Cash Rate Stabilization Fund | $5,212,209 |
| | Total Cash at 12/31/2012 | $5,218,209 |

The Company was asked to provide the reconciliations affecting the entities involved in the rate filing Dockets. The responses "Please see attached reconciliation for PWW Rate Stabilization Fund (RSF) cash account. Please note that any other cash accounts for the utilities are zero balance disbursement and payroll accounts which are fully funded by the Parent's concentration account. Please the Treasury Narrative Section 12 (g) for further discussion."

The scanned Citizens accounts' documents appear to be in order. The referenced Treasury Narrative section 12(g) is:

**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

<u>Accounts Receivable $1,797,747</u>

Audit verified the total reported Accounts Receivable to the PUC annual report following general ledger accounts:

| | |
|---|---|
| 2141-000-001 A/R Billed Water Revenue | $1,786,663 |
| 2141-400-001 A/R Miscellaneous | $ 8,853 |
| 2141-450-001 A/R Miscellaneous Computers | $ 5,209 |
| 2142-220-001 A/R Jobbing | $ 15,234 |
| 2143-901-001 Allowance for Doubtful-Water | $ (25,000) |
| 2143-902-001 Allowance for Doubtful-Jobbing | $ 6,788 |
| Total Accounts Receivable | $1,797,747 |

| | |
|---|---|
| The filing reflects the Accounts Receivable | $1,782,512 |
| Accounts Receivable Other | $ 15,234 |
| | $1,797,747 |

Refer to the <u>Revenue</u> portion of this audit report for further detailed review.

Accrued Utility Revenues  $1,521,780

Unbilled revenue per the PUC annual report is the sum of the Unbilled Water Revenue and the Unbilled Recoupment:

| | |
|---|---|
| 2173-151-001 Accounts Receivable-Unbilled Water Revenue | $1,519,480 |
| 2173-152-001 Accounts Receivable-Unbilled Revenue Recoupment | $ 2,300 |
| | $1,521,780 |

Refer to the Revenue portion of this audit report for further detailed review.

Materials and Supplies Inventory  $711,344

Materials and Supplies were verified to the filing schedule 2 and to ten individual general ledger accounts (refer to 2151-xxx-001) without exception. The Company indicated that the inventory is verified annually, with the test-year inventory taken in October 2012.

Prepayments-Other  $384,110

Audit verified the total reported Prepayments-Other to the filing schedule 2 and to the following general ledger accounts:

| | | |
|---|---|---|
| 2162-100-001 | Prepaid Insurance | $ 61,550 |
| 2162-200-001 | Prepaid Computer Maintenance | $130,955 |
| 2162-450-001 | Prepaid HECOP III Office Lease | $ -0- |
| 2162-700-001 | Prepaid Expenses | $191,605 |
| | Total Prepayments-Other | $384,110 |

The Prepaid Insurance account contained monthly debits transactions to cash management and credit transactions to record monthly insurance expenses.

Prepaid Computer Maintenance account contains monthly entries to record computer maintenance and contains payments to vendors.

The Prepaid Lease account contains only three entries for the year. There was an entry in April for prepaid rent and there were debit and credit entries for an overpayment and the reversal of the overpayment resulting in a zero balance for 2012. Lease payments are made from account 2921-150-001, Rental Expense.

Account 2162-700-001, Prepaid Expenses, contains entries to record monthly health, dental, life, and other expenses. Payments to insurances companies are also noted in this account.

Audit reviewed all of the transactions for the 162 Prepayment accounts with no exceptions. Expenses throughout the test year were reviewed in the Operations and Management Expenses portion of this report.

Prepaid Taxes  $653,461

The PUC annual report reflects Prepaid Property Taxes as a net of a prepaid account and an accrued account. Audit also verified the total to the filing Schedule 2 without exception. Specifically:

| | | |
|---|---|---|
| 2163-310-001 | Prepaid Property Taxes | $674,052 |
| 2236-115-001 | Local Property Taxes Payable | $ (20,591) |
| | Net Prepaid | $653,461 |

For additional review, please see the Taxes portion of this audit report.

Unamortized Debt Discount and Expense  $3,713,996

The filing schedule 2 reflects Unamortized Debt Discount and Expense in the amount of $3,713,996, which was verified to the PUC annual report schedule F-25 and the general ledger without exception. Specifically:

| | | |
|---|---|---|
| 2181-000-001 | Unamortized Debt Expense | $3,438,152 |
| 2181-100-001 | Unamortized Debt Expense OID | $ 275,843 |
| | | $3,713,996 |

The amortization posts monthly to account 2428-000-001. Audit reviewed the activity in each account and noted one expense entry in the amount of $564 related to the ARRA debt for Glen Ridge. The Company indicated that the expense was too small to amortize over a 20 year period and thus expensed it completely in 2012. This therefore is a non-recurring expense item. Small monthly fees of $125 and $129 were noted as Bank of New York accruals for administrative fees. The Company noted that several debt instruments incur an administrative fee associated with the Bank of New York holding the bond. Finally, the regular recurring amortization amounts were not identical each month. The Company indicated the slight variances are due to new debt issuance costs added and fully amortized throughout the year.

Preliminary Survey and Investigation Charges  $17,592

The amount noted was verified to account 2183-100-001 and was included with the Deferred Debits total on the filing Schedule 2, Attachment C. Audit requested support for the eleven entries posted throughout the year, all of which posted in May 2012. The costs were originally incurred in 2011 relating to survey and design engineering costs for certain streets. The city of Nashua was to undertake certain sewer projects, and the water lines were to be replaced at the time the sewer projects were done. The original entries posted to Miscellaneous Non-utility expense, account 2426-001-001. With the approval of the Director of the Gas/Water Division of the NHPUC, the $17,592 was transferred to the noted deferred account with the understanding that the amount may not be amortized until a determination is made that the costs will be beneficial at some future time.  Audit verified that the amount has not been amortized during 2012.

<u>Clearing Accounts  $22,322</u>

This amount was verified to account 2184-100-001 without exception, and was also included with the Deferred Debits total on the filing Schedule 2, Attachment C.  In response to Staff data requests 1-21 and 2-14, the Company identified that the Clearing Account balance should not be included in the Deferred Debits total, and the related pro formas should have included, among others, an increase to vacation expense for the test year in the amount of $18,354.

<u>Miscellaneous Deferred Debits  $88,208,894</u>

Audit verified the total Deferred Debits to thirty three general ledger accounts without exception.  The specific accounts and balances were noted in the filing Schedule 2, Attachment C without exception.  The most significant account, 2186-100-001, Acquisition Premium-MARA represents $77,828,932 or 88% of the total.  Refer to the MARA audit report issued 11/19/2013.

Audit verified that the original posting of the MARA on 1/25/2012 was to account 2188-100-001 in the amount of $78,783,384.  Amortization of the deferral began in March 2012 at $86,768 per month.  The amortization expense was noted in account 2407-100-001 from March through December 2012 for a total amortization expense of $954,452.

Account 2186-241-001, 2010 Deferred Rate Case Expense, began the year with $96,248 which was collected through a surcharge to customers through October 2012, in compliance with Commission Order 25,278 issued 10/21/2011.  $93,812 was collected through the surcharge, and $2,436 was written off in November 2012 to Non-utility Expense account #2426-000-001.

Account 2186-440-001, VEBA Trust-Union reflected an increase of $63,003. Audit was provided with a copy of the Citizens Bank statement reflecting the net change in account value from 1/1/2012 to 12/31/2012.  The change in market value was an increase of $63,003.  Similarly, the VEBA Trust-Non-union in account 2186-450-001 reflected an increase of$ 28,376 which was verified to a Citizens Bank net change in market value during the test year of $28,376.  The offset was noted in account 2241-315-001, Post 65-Health Liability.

Account 2186-455-001 relates to the Harris Pond Bathymetric Survey.  There is a pro forma relating in the amount of $420.  The increase is the result of a reclassification from account 2305-000-001, Collection and Impounding Reservoirs, to the deferred account.  The asset had been depreciated in 2011 in the amount of $75.  The deferred account and related amortization at the end of 2012 reflects $50,393 and $5,459 representing the complete 13 months of amortization expenses that should have been posted since the initial booking in 2011.

Account 2186-485-001, Watershed Monitor Sediment, was opened in December 2012. The $26,169 was verified to three invoice copies from Comprehensive Environmental Inc. for review of sediment accumulations in ponds. The invoices reflect work which began in September 2012 and concluded in November 2012. The Company began amortizing the deferral in December, at $218 per month, over a ten year period. The filing includes a pro forma for a full year.

Account 2186-510-001, Watershed Restoration Plan, was created in November 2012 with two debit entries summing to $60,375. Audit was provided with a copy of the work orders and supporting contractor invoices from Comprehensive Environmental, Inc. which reflected a sediment analysis and watershed restoration plan update. The work was conducted in 2011 and 2012 and originally posted to the 2105 CWIP Contractor Clearing account. The amortization noted in December 2012, in the amount of $1,006 represented two months of amortization. The filing includes a pro forma for a full year of amortization expense.

Account 2186-550-001, OSHA Compliance, reflected two increases. One in the amount of $4,755 was paid to Aries Engineering, Inc. for training of Pittsfield WTP, Nashua WTP and Will Street Operations Center. The amount was fully charged to PWW. **Audit Issue #1.** The second debit in the amount of $9,708 was a "true-up amortization in CPR (BNA) system to correct the amortization from 3 to 5 years in May 2012".

Eminent domain expenses, in account 2186-650-001, in the amount of $8,841,369 were written off in June 2012 to Miscellaneous Non-utility Expenses, account 2426-001-001. A credit to the same account reflected the anticipated tax effect in the amount of $3,502,066. The offset was noted to the Intercompany Payable, PWW to PCP 2233-300-001.

$8,048 noted in account 2186-670-001 was written off to Miscellaneous Non-utility Expense at the suggestion of the NHPUC Staff. The amortization of $278 was not included as a non-recurring pro forma adjustment, but is considered immaterial.

Account 2186-680-001 reflected an upgrade to the Pennichuck website, which was verified to an invoice from Kim Corton. The total, $2,860, was allocated among PWW, PEU, and PAC based on customer count. Specifically:

| | | | |
|---|---|---|---|
| PWW | 26,665 | 78.10% | $2,233 |
| PEU | 6,887 | 20.10% | $ 575 |
| PAC | 640 | 1.80% | $ 51 |
| | 34,192 | | |

Account 2186-710-001 Watershed Protection Study 2005 was reduced from $13,646 to zero. There had been no amortization booked, and the total was transferred to Plant in Service account 2303-300-001, Easements. The work order and related supporting invoices dated in 2005, relate to legal services and watershed protection studies. An agreement between Holt Pond Estates, LLC and Pennichuck Water Works was also provided, which outlined a buffer zone of 300 feet between Holt Pond and the Holt Pond Estates Subdivision in Merrimack. The agreement, dated 7/14/2005 was signed by the Senior Vice President of PWW and by Lawrence Richards, the Managing Member of the Hold Pond Estates, LLC.

Account 2186-950-001, Deferred Asset Pension, was increased to reflect $7,874,370. The year-end figure was verified to the actuarial statement FAS 158 disclosure and reflects the net loss between the obligations and plan assets, as recognized in accumulated other comprehensive income, for the year ending 12/31/2012. Monthly entries (for eleven months) were noted as:

| | | |
|---|---|---|
| Debit 2926-200-001 Pension Plan DB Plan | $111,918 | |
| Credit 2186-950-001 Deferred Asset Pension | | $30,539 |
| Credit 2241-231-001 Accrued Liability Pension | | $81,379 |

True-ups to all accounts were noted at year end. The deferred account agrees with the actuarial statement as noted above. The Accrued Liability $(8,855,246) was verified to the total underfunded position per the actuarial statement, and to the general ledger account 2241-231-001 without exception.

Audit noted that debits to the Accrued Liability account, in the amount of $982,900, represent the difference between the actuarial net underfunding identified at year end and the net loss recognized in accumulated other comprehensive income (the deferred pension account).

Reductions to the amortization expenses, as identified in the filing Schedule 1 Attachment F, were verified to the general ledger and the related fully amortized deferred accounts, without exception.

**EQUITY**

Audit reviewed the annual report, general ledger, and filing schedule 2A and noted the following:

| | | |
|---|---|---|
| 2201-100-001 Common Stock | $ (30,000) | |
| 2211-000-001 Other Paid in Capital | $(127,658,435) | |
| 2215-500-001 Retained Earnings | $ (3,259,479) | after posting of net loss |

The Common Stock figure has remained unchanged for several years and was not impacted by the city of Nashua's purchase of PCP.

| | 1/1/2012 | Debits | Credits | 12/31/2012 |
|---|---|---|---|---|
| Paid in Capital | $(39,011,141) | $97,438,179 | $(186,085,474) | $(127,658,435) |
| Ret. Earnings | $(15,354,485) | $15,203,213 | | |
| | | $ 9,863,910 | | |
| | | $25,067,123 | $ (15,203,213) | $ (5,490,575) |

The Other Paid in Capital represents primarily the change in equity resulting from the allocation of the City's financing costs of $150,570,000. Audit verified that the beginning balance of $(39,011,141) agrees with the figure noted in the filing schedule 3, attachment A, a pro forma as required by Order 25,292.

The Retained Earnings represent the net change caused by activity as ordered by the Commission (Order #25,292) and net income for 2012. The Debit entry of $9,863,910 was noted in the pro forma schedule 3 attachment A.

The Retained Earnings figure on schedule 3, attachment A of the filing includes $9,863,910. Audit noted this debit entry in the activity of the account.

**DEBT**

Long-term Debt

The filing schedule 2A reflects bonds, notes and mortgages of $50,580,169 with a current portion of $849,962. The combined total, $51,430,131 was noted on the PUC annual report F35. Audit verified the total $51,430,131 to fourteen specific general ledger accounts 2221-xxx-001 without exception. All debt was approved by Commission Orders as appropriate.

Interest related to the long term debt in the amount of $2,686,699 was verified to the general ledger account 2427-115-001 without exception.

Four revolving loan funds were issued during the test year 2012 through the State Revolving Loan Fund were advances made for SRF which were approved in docket DW 09-063.

Audit was not able to recalculate the interest associated with four loans and requested an explanation from the Company. In response, the Company noted:

> *"For 3 of the 4 loans, there were true up calculations that added to the interest expense. Generally, the Company will pay a 1% interest until the SRF documents are finalized and the principal repayment begins. The Company accrues by estimating when this will happen. Additionally, for 2 of the loans, there appeared to be an administrative backlog at the NHDES that created a difference between when the loan stated interest payment started and when the principal repayment started*."

A reconciliation was provided from the Company which summarized the interest and related 2011 true-ups. The interest expense for the year is overstated by the 2011 true-ups in the amount of $19,652. **Audit Issue #2**

Audit verified the gains from four ARRA loans, $35,966 to the PUC annual report schedule F-52 and to the general ledger account 2414-000-001.

Advances from Associated Companies

The filing schedule 2A reflects intercompany advances as receivables in the amount of $11,197,306. Audit verified the total to six general ledger accounts each identified with #2233-XX0-001 without exception.

Activity noted throughout the test year, and verified to the affiliated general ledgers, indicates that at the beginning of the year, only the payable to PCP was a credit balance, with the remaining affiliates representing PWW receivables. Because the debt at year end was a debit balance, there was not an issue with the 10% of net plant. Audit reviewed the monthly balances throughout the test year, and at no time was the short term debt in excess of 10% of net plant.

| | 1/1/2012 | Debits | Credits | 12/31/2012 |
|---|---|---|---|---|
| PCP | $(22,225,348) | $58,568,290 | $(25,150,632) | $11,192,310 |
| TSC | $ 774,777 | $ 41,427 | $ (816,204) | $ -0- |
| PWS | $ 11,548,113 | $ 2,403,628 | $(13,951,742) | $ -0- |
| PAC | $ 3,121,581 | $ 431,213 | $ (3,552,794) | $ -0- |
| PAC RSF | $ -0- | $ 4,996 | $ -0- | $ 4,996 |
| PEU | $ 15,737,317 | $ 3,116,515 | $(18,853,832) | $ -0- |
| NET | $ 8,956,440 | $64,566,069 | $(62,325,204) | $11,197,306 |

Audit verified that the $11,192,310, which represents a year-end receivable, agrees with the general ledger of PCP which reflects it as payable to PWW.

The $4,996 represents a year-end receivable from PAC. Audit verified that the amount is on the PAC general ledger as payable at year end. The amount represents a net borrowing from the Rate Stabilization Fund. Refer to the Cash section of this report for additional information.

Intercompany Interest in account 2427-115-001 at year-end was a credit balance of $126,116. Throughout the year, interest is credited to this account with debit/credit offsets noted in the 2233 Intercompany Payables/Receivables as appropriate. Audit requested clarification of how the interest is calculated and was provided with the following:

> "*The following is an explanation of the intercompany interest process using January 2012 calculation as an example: 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. Journal entry #402 is the summation of these calculations, showing the beginning monthly balances of the intercompany accounts between subsidiary/parent companies, as well as the ending and average balances. The average balances are then assessed interest as described above, bases upon the overall borrowed (negative) or invested (positive) aggregate intercompany balance for each company. Journal entry #407 was a true-up, driven by the intercompany balances on PWW's books, as compared to the intercompany balances with PWW on all the other company books. To the extent there were any differences, the resulting difference were recorded on PWW's books (with the offset to intercompany interest). This "true-up" in essence would take the interest calculation and throw it to a net borrowed or invested position (for each intercompany balance on PWW's books, on a company by company basis), as it is reflected on the sister company books. In the example of the #407 entry for January 2012, the "true-up" entry takes the overall #402 entry on PWW's books which was recorded at the savings rate (.44%) for all intercompany accounts (as in the aggregate the intercompany balance for PWW was positive) and moves it to the borrowed rate (.75%) for the amount due from PEU (as PEU's average monthly ending intercompany balance to PWW is a payable). This is the monthly process that has been adhered to for a number of years*."

Audit reviewed the transaction attached to the explanation above and noted the overall reasonableness.

## <u>CURRENT LIABILITIES</u>

<u>Accounts Payable $(361,028)</u>

Audit verified the total Accounts Payable to the filing schedule 2A and to general ledger account 2231-000-001 without exception.

Audit reviewed all of the activity in the general ledger account and selected 42 general ledger transactions to review in detail. Supporting documentation for each selection was provided. Audit noted the following:

American Express

Audit reviewed an American Express statement and noted a $791.88 charge for PCP Board of Directors appreciation gifts. The credit noted in the accounts payable was offset with a debit to the PWW/PCP Intercompany account 2233-300-001 on January 25, 2012.

This American Express statement also included a $95.00 charge for a New England Water Works Association membership fee. Audit was able to trace this charge to the membership schedule provided in the filing pursuant to NHPUC Rule 1604.01(11). The debit offset was noted in the Training and Educational Seminars account 2926-610-001.

Also included on this American Express statement was a banquet event invoice from Crowne Plaza Nashua for $1,131.36. The debit offset was noted in the PWW/PCP Intercompany account 2233-300-001 on January 25, 2012.

CDM Smith

Audit reviewed two invoices from CDM Smith for professional engineering services conducted in accordance with the agreement dated 7/15/2011 for the Asset Management Gap Assessment. The first invoice paid in January 2012 was for the amount of $29,847 and the second invoice paid in April was for $42,672. Audit requested a copy of the agreement dated 7/15/2011 for the engineering services being provided. The agreement states that professional services were to be provided for a study and a report on Pennichuck's Asset Management Plan. The total project amount is $149,715 and is to be completed within 8 months of an executed contract. The expenses were posted to account 2105-222-001, CWIP: Contractor Clearing.

Curtis 1000 Inc.

Audit selected three invoices that were processed and paid with the same check. All three invoices have a portion allocated to Pennichuck East Utility Inc. PWW noted that allocated expenditures are recorded as transfers with month-end intercompany allocation entries. PWW provided an example and Audit was able to verify the allocation was properly made to Public Relations, account 2930-200-001.

Law Offices of Peter R. Kraft, Esq.

Audit reviewed two invoices from the Law Offices of Peter Kraft. One invoice totaling $11,850 appears to be for an issue with an employee. The second invoice for $2,350 appears to be for an issue regarding standby duty. The expenses were posted to Outside Services, account 2923-000-001. These expenses appear to be non-recurring. Refer to the Non-recurring portion of this audit report.

Nashua Airport Authority

Audit selected and reviewed a $43,790 invoice from Nashua Airport Authority for the relocation of a water main for a new runway. Audit questioned why PWW was paying for the main to be moved as it appears the Airport Authority should be responsible. PWW responded and noted that the $43,790 represented half of the total project bill and the Airport Authority was paying the remainder. The water main was originally installed on a public right of way and the City of Nashua granted an easement to Pennichuck when the right of way was abandoned so the airport could be built. When a water main is located within a right of way, the utility can install its facilities there but the municipality can require the utility to move its facilities at the utilities cost if the water main is in the way of a municipal project. The Airport claimed that Pennichuck was responsible for the relocation costs because Pennichuck did not pay for the easement and it was originally located in a public right of way. Pennichuck felt that it was the Airports responsibility to pay for the relocation costs because the water main exists in an easement not a public right of way. The easement granted by the City of Nashua did not include clear language as to who would be responsible if the water main needed to be relocated in the future. Rather than going to court and incurring significant attorney's fees by both sides, it was agreed that the relocation costs would be split between PWW and the Airport. The debit is posted in the work in process account 2105-222-001.

Nashua Wallpaper

Audit reviewed a statement with the closing date of 7/31/12 for Nashua Wallpaper. A small portion of the total statement ($36) was charged to PEU's general ledger account 7677-002-001. Audit was able to verify, through the general ledger, this charged was properly allocated to PEU.

Turning Point Development

Audit reviewed a $40,000 invoice from Turning Point Development for the generator project in which approximately half of the invoice was for PEU. Audit verified that $21,333.36 was charged to PEU and $18,666.64 was charged to PWW CWIP account 2105-222-001. Audit noted the transaction in each subsidiary's general ledger.

Travel & Expenses

Audit reviewed a travel and expense voucher for tolls and mileage and also for reimbursement for cell phone charge. No exceptions were noted.

Accrued Taxes $(9,922)

Accrued taxes were verified from the PUC annual report to the filing schedule 2A and the following general ledger accounts:

| | | |
|---|---|---|
| 2236-110-001 | Medicare Taxes | $ -0- |
| 2236-111-001 | FICA Payable | $ 31 |
| 2236-117-001 | Section 125 | $(9,953) |

Refer to the Payroll section of this report for verification of payroll related taxes.

Accrued Interest $(586,324)

Accrued Interest noted in the PUC annual report and filing schedule 2A was verified to the general ledger account 2237-110-001 without exception.

Other Accrued Expenses $(4,446,157)

Audit verified the total reported Other Accrued Expenses from the filing schedule 2A to the following general ledger accounts:

| | | |
|---|---|---|
| 2241-100-001 | Union Dues Payable | $ 2,508 |
| 2241-215-001 | 401K Loan Withholding Payable | $ -0- |
| 2241-218-001 | Long Term Care | $ (180) |
| 2241-220-001 | United Way Withheld | $ 586 |
| 2241-223-001 | Dependent Care – FSA | $ 1,129 |
| 2241-226-001 | LTD Insurance – UNUM | $ (591) |
| 2241-228-001 | Car and/or Home Ins Withheld | $ (109) |
| 2241-230-001 | Life Insurance Withheld | $ (701) |
| 2241-233-001 | Accrued Bonus | $ -0- |
| 2241-300-001 | Misc Current Accrued Liability | $ 165,934 |
| 2241-304-001 | Early Retiree Liab-Health-St | $ 25,987 |
| 2241-305-001 | Early Retiree Liability-Health | $ 445,717 |
| 2241-306-001 | Acc Liab: Sup Exec Retire Plan | $ 801,427 |
| 2241-315-001 | Post-65 Health Liability | $ 2,740,031 |
| 2241-350-001 | Accrued Liability – Retainage | $ 40,679 |
| 2241-900-001 | Accrued Payroll | $ 160,569 |
| 2241-905-001 | Accrued Employer Payroll Taxes | $ 13,891 |
| 2241-910-001 | Accrued Vacation – PWW | $ 49,279 |

Audit reviewed all of the general ledger entries for the each of the 2241 accounts and no exceptions were noted.

The Union Dues Payable account 2241-100-001 contains credit entries for the weekly payroll deductions for the year. It also contains debit entries for the monthly payment to the United Steel Workers union.

The 401K Loan Withholding Payable account 2241-215-001 account contained a credit for each of the weekly payroll 401K loan deductions. There are also "cash management" monthly debits totaling the sum of the weekly payroll.

The Long Term Care 2241-218-001 account's general ledger entries included weekly credits for the amount deducted from payroll and monthly debits to record the Long Term Care. There is also a payment to the insurance company.

The United Way Withheld 2241-220-001 general ledger account includes weekly credit entries for payroll deductions and monthly debit entries for the payments to United Way.

Transactions in the Dependent Care general ledger account 2241-223-001 include weekly credits, based on payroll deductions, and monthly debits to cash management.

Transactions in the LTD Insurance general ledger account 2241-226-001 reflect weekly credits and monthly debits to "record monthly life". There are also three payments to the insurance company in February, October and December.

The Car and/or Home Ins general ledger account 2241-228-001 includes weekly debit and credit transactions recording the payroll deduction and the payment to the insurance company.

Transactions in the Life Insurance account 2241-230-001 include weekly credits to record the payroll deduction and bi-weekly credits to record the payment to the insurance company.

The Accrued Bonus account 2241-233-001 contained two transactions. The first transaction was 1/25/2012 for $225,000 to reverse portion of the bonus accrual. The second transaction was 3/31/2012 for $138,697 to reverse the balance in bonus accrual. Per the Internal Procedures and Controls handbook for Payroll it is noted that, *" The Company no longer has an incentive bonus plan, effective post-merger with the City of Nashua*". Audit noted the credit postings in the Officers' Salaries and Wages account 2920-100-001.

Miscellaneous Current Accrued Liability account 2241-300-001 reflects accruals contained for purchased water, inspections, work orders, miscellaneous accounts payable, and others.

General ledger account 2241-304-001 contained one entry for the year. The entry was on 12/31/2012 and it was a year-end adjustment for $5,213.

General ledger account 2241-305-001 contained monthly entries to record health and pension expenses. There was one payment to the insurance company in February and two adjusting entries at year end.

The Accrued Liability SERP general ledger account 2241-306-001 contained monthly credit entries to accrue the liability. Debit entries include monthly payments and cash management entries. There are also quarterly adjustments.

Account 2241-315-001 contains debits entries at the beginning of each month for payment to individuals. Credit entries at the end of the month record the monthly health/pension amount.

Account 2241-350-001 Accrued Liability-Retainage reflected debit entries for payments to vendors and credit entries to record and accrue retainage.

Account 2241-900-001 includes all payroll accruals for Union and Non-Union labor.

The Accrued Employer Payroll Taxes general ledger account 2241-905-001 includes all accruals for payroll taxes, monthly.

The Accrued Vacation account 2241-910-001 is used to accrue unused vacation on a monthly basis.

Customer Deposits and Other $(135,058)

Audit verified the total from the PUC annual report, to the filing schedule 2A, to the general ledger and related Synergen reports. Audit was informed that there are no deposits held for reasons other than service installations, meter deposits.

| | | |
|---|---|---|
| 2235-100-001 | Service Installation Deposits | $ (94,074) |
| 2235-150-001 | Construction Meter Deposits | $ (4,400) |
| 2235-250-001 | Hardship Cases-Credits | $ (1,120) |
| 2235-550-001 | Service Deposits Salisbury | $ (3,575) |
| 2235-551-001 | Service Deposits Salisbury Meters | $ (6,976) |
| 2235-600-001 | Service Deposits-Installations PAC | $ -0- |
| 2235-700-001 | Service Deposits-Installations PEU | $ (24,913) |
| | | $(135,058) |

Audit requested clarification of each of the accounts and was told that the customers requesting service or meter related installations are held and applied against open invoices. If the deposit is held longer than two years, the customer is required to complete a new service request, and a two year cycle begins again.

Hardship Case credits reflect miscellaneous receivable credits which are used to offset small customer account balances.

Jobbing deposits related to work in Salisbury, PAC, and PEU relate to jobbing work performed by PWW and thus the deposits reside on the general ledger at PWW. As work is completed, the deposit is applied against the work orders and thus the deposit is reduced.

Audit requested clarification of this deposit account type and the Customer Advance for Construction, general ledger account 2252-001-001 which at year-end had

$(84,000).  The Company noted that the 2235 accounts relate to jobbing, while the 2252 deposits are received primarily from developers and relate to potential residential construction projects.

The deposits relating to PW/Salisbury/Construction Meter reflect those taken across several years.  The following timeframes summarize when the deposits were taken:

| | PWW | Salisbury | Construction Meter |
|---|---|---|---|
| 2003 | 1 | 2 | 0 |
| 2004 | 1 | 2 | 0 |
| 2005 | 0 | 3 | 0 |
| 2006 | 2 | 1 | 0 |
| 2007 | 3 | 5 | 0 |
| 2008 | 0 | 3 | 0 |
| 2009 | 1 | 1 | 0 |
| 2010 | 24 | 14 | 1 |
| 2011 | 25 | 17 | 0 |
| 2012 | 251 | 19 | 21 |
| Total | 308 | 67 | 22 |

## OTHER LIABILITIES and DEFERRED CREDITS per the Filing Schedule 2A

### Deferred Income Taxes $(19,236,964)

Noted on the filing schedule 2A as Other Deferred Credit was the Deferred Income Tax figure noted above and verified to the general ledger account 2282-200-001. Audit reviewed the federal tax return and noted the deferred income tax figure on schedule M without exception.

### Unamortized ITC $(668,814)

General ledger account 2255-100-001 Accumulated Deferred Investment Tax Credit agrees with the filing schedule 2A.  Audit reviewed the activity within the account and noted monthly debits of $2,753 to write down the Unamortized ITC.  The offsetting credits were verified to account 2412-000-001, Investment Tax Credits.

### Deferred Tax Liability and Other $(246,109)

Other Deferred Credits, in the amount of $(246,109) was verified to five general ledger accounts:

| | |
|---|---|
| 2282-201-001 Deferred Tax Offset to Reg Liability ITC | $ 438,677 |
| 2283-106-001 Def Tax Liability Unamortized ITC | $(438,677) |
| 2282-203-001 Deferred Tax Offset to GU Reg Liability | $ 161,424 |
| 2283-107-001 Gross-up to Reg Liability Excess Def | $(161,424) |
| 2283-105-001 Reg Liability-Excess Deferred Tax | $(246,109) |
| Net Other Deferred Credits | $(246,109) |

The first four accounts net to zero, with the 2283-105-001 Regulatory Liability-Excess Deferred Tax of $(246,109) agreeing with the PUC annual report and filing. The balance in the account has remained unchanged since 2010.

Customer Advances $(84,000)

Audit verified the total customer advance figure to account 2252-001-001. The Company noted that the account represents deposits received primarily from developers and relate to potential residential construction projects. Audit requested clarification of when the deposit was originally taken and for what purpose, as it appears on the PUC annual reports each year since 2006. The Company indicated that the deposit was taken in 1996 for the interconnection between PWW and the Merrimack Village Water District. MVD has yet to request construction of the interconnection. The agreement, dated 8/1996 between PWW and MVD will hold the deposit for 25 years or until the interconnection is begun.

CIAC net ($(24,417,083) refer to the CIAC portion of this audit report.

Accrued Pension Liability $(8,855,246)

Audit reviewed the actuarial statement for 2012 which was verified to the year-end balance in the general ledger. See the Deferred Assets section of this report for additional information.

Unamortized Premium on Debt $(463,841)

Audit verified the Unamortized Premium $(463,841) from the PUC annual report schedule F-25 to the year-end general ledger account 2251-000-001 without exception.

Audit requested clarification of the debt to which the annual amortization of $37,132 related and was provided with the following:

| | | Unamort. at 12/31/12 |
|---|---|---|
| Series B-1 bonds issued 10/1/2006 29 year amortization at | $ 2,185.44 | $ 49,717 |
| Series BC-3 bonds issued 5/1/2008 10 year amortization at | $21,894.16 | $117,030 |
| Series BC-4 bonds issued 5/1/2008 27.42 yr amortization at | $13,052.31 | $297,094 |
| Annual amortization | $37,131.91 | $463,841 |

**REVENUE**

The filing schedule 1 reflecting total revenue for the test year of $27,931,578 was verified to the PUC annual report and to the general ledger without exception. PWW has consolidated rates among the core Nashua system and the community water systems (CWS) outside of the city.

| | | |
|---|---|---|
| City Bond Fund Revenue Requirement (CBFRR) | | |
| 2460-200-001 | $(6,843,044) | |
| 2460-998-001 | $ 6,843,044 | $ -0- |
| Metered Sales | | |
| 2461-000-001 | $(23,930,525) | |
| 2461-001-001 | $ (942,620) | |
| 2461-100-001 | $ 294,725 | |
| 2461-200-001 | $ 942,670 | $(23,635,750) |
| Fire Protection Revenue | | |
| 2462-000-001 | $ (4,053,464) | $ (4,053,464) |
| Sales for Resale | | |
| 2466-000-001 | $ (5,297) | $ (5,297) |
| Miscellaneous Service Revenues | | |
| 2471-300-001 | $ (143,648) | $ (143,648) |
| Other Revenue | | |
| 2474-000-001 | $ (93,755) | |
| 2474-001-001 | $ 335 | $ (93,420) |
| | | $(23,931,579) |

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, $622,095, sum to the $6,843,044 which was noted in the general ledger. Refer to Docket DW 11-026.

Metered Sales in account 2461-000-001 represent Billed Revenue. Audit reviewed the account activity and noted one monthly credit entry throughout the test year. Ten abatement debits were also reviewed. The abatements represent cancel/rebills, or adjustments such as correcting for an estimated bill vs. actual meter read.

Account 2461-001-001, Water Sales Billed Recoupment, represents the remaining authorized amount of the difference between temporary and permanent rates from the prior rate case. See Docket DW 10-091, Order #25,280, issued on 10/21/2011. The recovery approved, to be spread over twelve months, was:

| | |
|---|---|
| General Metered Customers | $1,087,888.14 = $2.96 per month per customer |
| Anheuser-Busch, Inc. | $ 77,231.24 |
| The Town of Milford | $ 16,659.86 |
| The Town of Hudson | $ 31,899.70 |
| Public Fire-Nashua | $ 73,582.42 |

| | | |
|---|---|---|
| Public Fire-Bedford | $ | 5,127.86 |
| Public Fire-Merrimack | $ | 2,806.32 |
| Public Fire-Amherst | $ | 10,467.84 |
| Public Fire-Derry | $ | 1,124.69 |
| Private Fire Rebated | $ | (70,802.82) |
| Total to Recover | $1,219,325.39 | |

Anheuser-Busch requested that PWW bill them completely in 2011, which was done. Audit reviewed the Anheuser-Busch customer history and noted invoicing for the recoupment in November and December 2011 for the entire amount. The tariff Supplement No. 11 states the $77,231.24 explicitly, and also states that "the surcharge will be billed in twelve equal monthly installments…" **Audit Issue #3**

Audit reviewed the billing histories for each of the towns and public fire accounts, and verified that the authorized amount was collected between November 2011 and October 2012 for the amount noted. There was exception noted in the town of Merrimack, which had $2,306 recovered. When questioned about the $500 variance, the Company indicated that a typographical error had been made in the tariff table on which the invoices were based. The tariff filed with the Commission reflected the correct $2,806. **Audit Issue #4**

Audit recalculated the amount recovered from general metered customers, net of the private fire rebate, was reasonably based on 10 months in 2012. The Tariff states that the private fire surcharge (refund in this case) will be based on pipe size (4", 6", 8"). The Company noted that the credit was not set by size, but was based on what the customer had been billed. **Audit Issue #5**

Regarding account 2461-001-001-Refer to offsetting debits posted to account 2461-200-001. The variance between the two accounts, $50, is due to two small debits which posted to account 2461-100-001. Rate case expenses authorized by the same Order, in the amount of $114,066.08 were invoiced with the credits reducing the Deferred Asset account of Account 2186-241-001, 2010 Deferred Rate Case Expense. Refer to the <u>Deferred Asset</u> portion of this report for additional information.

Account 2461-100-001, Unbilled Revenue reflected a net change for the year of a debit $294,725. Audit reviewed the unbilled revenue calculations for the month end December 2012 and January 2013. Entries are automatic reversals. The December calculation of $1,519,480 was verified to a customer service billing cycle summary page outlining twenty read-date categories and the number of days from the prior billing cycle to the end of the year. The January entry, in the amount of $1,667,279 was similarly supported. There were no exceptions noted.

Account 2461-200-001, Water Sales-Unbilled Recoupment, offsets account 2461-001-001 monthly. The amount recovered complies with Order 25,278. Refer to 2461-001-001 for offsetting entries.

2462-000-001, Fire Protection revenue represents both public and private fire protection revenue streams. Audit reviewed a sample of both public and private fire protection customer invoices for compliance with the tariff. There were no exceptions. The $0.36 rate case recovery authorized by Order 25,278 was noted on the invoices through October 2012.

Sales for Resale in the amount of $5,297 were traced to sales to the Francoeur Brothers and Lawrence Tank. Audit reviewed October invoices related to this account, and noted bulk water sales in the amounts of $49.50 per load for one customer and $5.50 per thousand gallons for the other. The water is used to supply pool water for the eventual end customers. Audit was told that the sale of the water is not part of the tariff, as the customers can easily use other sources. The rate charged is deemed competitive, as the customers require no mains for the water. The trucks used by the customers are filled at the water treatment plant.

Account 2471-300-001, Miscellaneous Operating Revenues represent "utility service fees provided for in the tariff, such as initiation of service, service connection and disconnections, and returned check fees".

Account 2474-000-001, Other Water Revenue is used to account for the city of Nashua's purchase of PWW customers' water consumption data, which the city uses to calculate residents' sewer bills.

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.

Accounts Receivable $1,797,747

| | | |
|---|---|---|
| 2141-000-001 A/R Billed Water Revenue | | $1,786,663 |
| 2142-220-001 A/R Jobbing | | $ 15,234 |
| 2141-400-001 A/R Miscellaneous | $ 8,853 | |
| 2141-450-001 A/R Miscellaneous Computers | $ 5,209 | $ 14,062 |
| 2143-901-001 Allowance for Doubtful-Water | $ (25,000) | |
| 2143-902-001 Allowance for Doubtful-Jobbing | $ 6,788 | $ (18,212) |
| Total Accounts Receivable | | $1,797,747 |

Audit requested and was provided with the Accounts Receivable aged reconciliation for the period ended 12/31/2012.

| | |
|---|---|
| Current | 81% |
| 1-30 Days Past Due | 8% |
| 31-60 Days Past Due | 6% |
| 61-90 Days Past Due | 3% |
| 91-120 Days Past Due | 1% |
| Over 120 Days Past Due | 1% |

Based on a review of the aging, with the majority of customers current, the allowance for doubtful accounts, $(25,000) appears to be reasonable.

Accrued Utility Revenues  $1,521,780

| | |
|---|---|
| 2173-151-001 Accounts Receivable-Unbilled Water Revenue | $1,519,480 |
| 2173-152-001 Accounts Receivable-Unbilled Revenue Recoupment | $ 2,300 |
| | $1,521,780 |

Refer to the Revenue accounts 2461-001-001 and 2461-200-001 above for a discussion regarding the unbilled revenue calculations.

Tariff Test

Audit reviewed the tariff on file at the PUC as well as supplement No. 11 which specifies the permanent rate recoupment, and supplement No 12 which specifies the rate case expense recovery of $0.36 per customer for twelve months. Supplement No. 11, for general metered customers, private fire protection customers, and public fire hydrant customers reflects the correct dollar amounts authorized by Order 25,278. However, the text for each customer class reads: "The Company will recoup from (the customer class) for service rendered from June 16, 2010 through bills rendered June 9, 2011…" The tariff text is incorrect, as the Order was dated October 21, 2011.

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.

**OPERATIONS and MAINTENANCE   $11,471,231**

Audit verified the PUC annual report and filing Schedule 1 to the general ledger without exception.

Audit reviewed the PUC annual report and calculated the percentage change in all O&M accounts, based on the three digit NHPUC chart of accounts numbers. The annual report schedule F48 included 35 total O&M accounts. Audit focused on accounts that had changes greater than an increase of 10% or decrease of 10%, and reviewed all of the accounts under that category. The detailed general ledger activity was reviewed for all 114 accounts and five selections were made requesting additional support, which was provided.

**Production Expenses $3,918,901 is comprised of the following**:

2601-xxx-001 Operation Labor and Expenses $ 62,031

The total was verified to three individual general ledger accounts. The total of $62,031 reflected a net increase from 2011 of 31%.

2602-xxx-001 Purchased Water $ 417,588

The total was verified to ten individual general ledger accounts and represents an increase from 2011 of 16%

2603-xxx-001 Miscellaneous Expenses $ 11,331

The total was verified to two individual general ledger accounts and reflected a 6% increase over 2011. Specific documentation was not requested due to the change less than 10%.

2610-xxx-001 Maintenance Supervision and Engineering $ 390,345

The total was verified to two individual general ledger accounts and reflects an increase of 3% over 2011. Specific documentation was not requested due to the change less than 10%.

2623-xxx-001 Fuel or Power Purchased for Pumping $1,012,378

The total was verified to forty-three individual general ledger accounts. The percentage change over the 2011 year-end was 6%, thus specific documentation was not requested for further review. Audit did note one account, 2623-999-001 Power Purchased: Consulting, has a year-end balance of $8,000. The Company's response to Staff Data Request 2-22 noted that "*The Company uses an electric broker, the Axcess Group, to seek competitive pricing for its supply side electric costs. In 2012, the Company received bids from five electric suppliers to provide power to its electric accounts. The five bidding electric suppliers were ConEd Solutions, Constellation*

*NewEnergy, Hess Corporation, Nextera Energy Services and TransCanada Power Marketing."*

2624-100-001 Pumping Labor and Expenses $ 256,874

The total for the Pumping Labor and Expenses was verified to this general ledger account without exception. The account increased 4% over 2011 and as a result, further detailed supporting documentation was not requested.

2626-xxx-001 Miscellaneous Expenses $ 83,371

The total Miscellaneous Expenses was verified to five individual general ledger accounts and represents a reduction of 1% from the same period 2011.

2631-xxx-001 Maintenance of Structures and Improvements$ 92,228

The total Maintenance of Structures and Improvements was verified to four individual general ledger accounts without exception. For the year, the total represents an increase of 7% over the same period ending 2011.

2633-xxx-001 Maintenance of Pumping Equipment $ 271,584

The total of the Maintenance of Pumping Equipment was verified to nine specific general ledger accounts without exception. The net increase for the year over the prior year was 10%

2641-xxx-001 Chemicals $ 664,711

The total of the Chemicals accounts was verified to sixteen specific general ledger accounts without exception. The increase over 2011 was 15%. Specific source documentation was requested and reviewed without exception.

2642-xxx-001 Operation Labor and Expenses $ 521,003

Operation Labor and Expenses total was verified to six individual general ledger accounts without exception. The total for the year represented an increase over 2011 of 8%.

2643-xxx-001 Miscellaneous Expense $ (61,344)

The net credit was verified to eight individual general ledger accounts, each of which related to the Water Treatment Plant related vehicles. The net change over 2011 was an increase of 29%. Specific source documentation was requested and reviewed without exception.

2652-xxx-001 Maintenance of Water Treatment Equipment $ 99,770

The total of the Maintenance of Water Treatment Equipment was verified to three individual general ledger accounts. The change from 2011 was a reduction of 15%. Specific source documentation was requested and reviewed without exception.

2926-700-001 Employee Pension and Benefits $ 97,032

The Employee Pension and Benefits total was verified to one account, Vacation, Holiday, Boot Allowance-Treatment Plant. The change from 2011 was an increase of less than 1%.

**Transmission & Distribution Expenses $1,607,781 is comprised of the following:**

2660-xxx-001 Operation Supervision and Engineering $ 312,588

Operation Supervision and Engineering was verified to two specific general ledger accounts. The change from 2011 was an increase of 3%, thus further supporting documentation was not requested.

2662-xxx-001 Transmission & Distribution Lines Expenses $ 34,734

The transmission line expense total was verified to three individual general ledger accounts without exception. The account total represents a decrease of 3% over the period ended 2011.

2663-xxx-001 Meter Expenses $ 214,069

Total Meter expenses were verified to four specific general ledger accounts. The balance at year-end 2012 represents an increase of 17% over the same period 2011. Specific source documentation was requested and reviewed without exception.

2664-xxx-001 Customer Installation Expenses $ 5,640

The total Customer Installation Expense was verified to two specific general ledger accounts. The 2012 total represents an increase over 2011 of 33%. Specific source documentation was requested and reviewed without exception.

2665-xxx-001 Miscellaneous Expenses $ (129,968)

The balance of the Miscellaneous Expenses reflects a 31% increase over the 2011 year-end balance of $(189,050). Audit reviewed each of the twenty eight individual accounts and selected the following specific items for detailed review:

2665-000-001 Stores Expense: Audit selected an entry dated 12/31/12 for $16,587.36. This entry was selected because it was a much larger dollar amount than the other transactions.  $1,649.90 was the largest dollar amount of the other 10 monthly transactions.  PWW noted that this was for Union labor associated with the year-end inventory count.

2665-115-001 Ops-Veh Registrat:NC-Non-Union:   Audit questioned a transaction dated 9/30/12 for $532.  This transaction was selected because it appeared to be a payment to an individual whereas the other transaction in this account was made to the city for a renewal.  PWW produced a vehicle registration receipt from the City of Nashua with Pennichuck Water Works, Inc. as the Payer.

2665-117-001 Ops-Veh Registrat: Trailers:  Audit also questioned an entry on 9/30/12 for $17, as payment looked to be made to an individual rather than to the city or state.  PWW produced supporting documentation showing $17 was taken from petty cash to pay the State of NH to register OPS large equipment.

<u>2673-xxx-001</u> Maintenance of Transmission & Distribution Mains $   358,314

The total for the year represents a 10% decrease over the same period 2011 and was verified to nine specific general ledger accounts without exception.  Specific source documentation was requested and reviewed without exception.

<u>2675-xxx-001</u> Maintenance of Services $  205,595

Maintenance of Services total was verified to two individual general ledger accounts without exception.  The balance reflected a decrease of 11% over 2011.  Audit requested and was provided with specific source documentation.

<u>2676-xxx-001</u> Maintenance of Meters $    23,933

The account total was verified to two individual general ledger accounts without exception.  The balance at year-end represents an increase over the prior period of 45%.  The accounts and related activity were reviewed in detail with no exceptions noted.

<u>2677-xxx-001</u> Maintenance of Hydrants $  101,168

The Hydrant maintenance total was verified to six specific general ledger accounts without exception.  The total represents a decrease over 2011 of 19% and was reviewed in detail.  There were no exceptions noted.

<u>2678-xxx-001</u> Maintenance of Miscellaneous Equipment $  108,356

The Maintenance of Miscellaneous Equipment total was verified to three individual general ledger accounts which reflect activity such as contractor markings, communication systems, and general miscellaneous equipment.  The total for the year represents a decrease of 8% over the 2011 balance.

2921-xxx-001 Office Supplies and Other Expenses $ 52,317

The total Office Supplies and Other was verified to five individual accounts associated with Will Street expenses such as parking and utilities as allocated to PWW. The total for 2012 represents an increase of 6% over the same period ending 2011.

2926-002-001 Employee Pension and Benefits $ 247,964

2926-002-001 Emp Benefit-Boots, Vac, Hol-Ops reflects a balance for the year ended 2012 of $247,964 which is $30,120 higher than year-end 2011, or 13%.

2950-xxx-001 Maintenance of General Plant $ 73,071

Maintenance of General Plant was verified to two individual general ledger accounts without exception. The combined total represents a decrease of 13% from year-end 2011.

**Engineering Expense $691,374 is comprised of the following:**

| | |
|---|---|
| Operation Supervision and Engineering | |
| 2660-001-001 Engineering Vehicles | $ 8,303 |
| 2660-002-001 Engineering – Fuel Purchased | $ 21,957 |
| 2660-003-001 Engineering – Veh Registration | $ 1,956 |
| 2660-200-001 Salaries & Wages – Engineering | $654,294 |
| | $686,509 |
| Transmission & Distribution Lines Expense | |
| 2662-001-001 Engineering Dept: Expense | $ 4,865 |

The combined account total of $691,374 represents a decrease of 8% from the same period ended 2011.

**Customer Account & Collection Expense $458,587 is comprised of the following:**

2902-xxx-001 Meter Reading Expense $ 51,951

The total Meter Reading expense was verified to six individual general ledger accounts without exception. The combined balance represents a decrease of 3% from the prior year-end.

2902-xxx-001 Customer Records and Collection Expense $ 315,703

The total as noted on the PUC annual report in account 903 was verified to five specific accounts. The total for the year represents a decrease of 5% from the prior year.

2904-000-001 Uncollectible Accounts $ 90,933

Audit reviewed the activity in the Uncollectible account, as the balance at 12/31/2012 represented an increase from 2011 of 19%. The uncollected receivable figure represents 5% of the total receivables at year-end.

**Administrative & General Expense $6,631,510 is comprised of the following:**

2920-xxx-001 Administrative and General Salaries $2,423,338

Salaries were verified to seven individual general ledger accounts without exception. The total for the year represents a decrease of 19% over 2011. Each of the seven accounts was reviewed with no exceptions identified.

2921-xxx-001 Office Supplies and Other Expenses $ 428,294

The total was verified to nine individual general ledger accounts without exception. Audit reviewed the following:

2921-150-001 Rental Expense: HECOP III: During the year 2012, PWW's lease agreement was altered. The period of January 1, 2012 through July 31, 2012 had a monthly payable installment of $24,331.25. A new lease agreement was signed and for the period beginning August 1, 2012 through the calendar year, the lease payment decreased to $22,400.97. The current lease agreement is in effect until July 31, 2017. Audit reviewed the lease agreements and verified the accuracy of the payment amounts to the General Ledger. The March payment was for $24,286.25, which is $45 less than what the lease agreement notes. The reduction to the payment was due to a credit from November 2011. No exceptions were noted.

2922-xxx-001 Administrative Expenses Transferred-Cr $(1,172,304)

The total was verified to two specific general ledger accounts without exception. For the year, the total represents an increase of 8% over the same period 2011.

2923-000-001 Outside Services Employed $ 220,330

The balance in the Outside Services account increased 22% from the same period in 2011. Audit reviewed all of the general ledger transactions from 2012 and compared them to the 2011 general ledger and selected four items to review in further detail.

Aqueduct Technologies

Audit reviewed an invoice from 6/30/2012 in the amount of $1,480. The invoice activity notes "*SOW – Emergency Script Changes".*

Imtek Reprographics Inc.

Audit selected and reviewed a $275 invoice from 6/19/2012. The invoice was for a service call to repair a machine.

Paul Buffum

A July 13, 2012 invoice was selected for review by Audit. The invoice includes services rendered for the month of June for PWW and other entities. The total invoice was $5,325 and $4,575 was changed to PWW with $1,435 being reclassified in August 2012 resulting in PWW only being charged a total of $3,150.

Rath, Young and Pignatelli PC

The July 18 Rath, Young and Pignatelli invoice is for services rendered June $15^{th}$ and $17^{th}$ regarding smoking laws.

All of the above expenses appear to be non-recurring. Refer to the Non-recurring portion of this audit report.

2924-000-001 Property Insurance $ 592,140

The Insurance expense account reflects an increase from 2011 of 52%. Audit reviewed all of the general ledger transactions for the year. Audit noted that the monthly insurance expense being recorded is approximately $16,100 more than last year. Audit inquired with PWW as to the reason for the dramatic increase and PWW noted;

> "*The premiums for three of our coverages increased dramatically from the 2011 policy year to the 2012 policy year (related to claims experience and the rise in premiums due to losses in the overall reinsurance market during that time period). Our 2012 policies (vs. 2011) for the following three coverages, experienced the following premium increase percentages:*
> *Worker's Compensation up 76% from 2011, General Liability up 69% from 2011, Excess Umbrella Liability up 79% from 2011. The balance of our coverages (Auto, Property and Crime) were only up 11% from 2011 in the aggregate."*

2926-xxx-001 Employee Pension and Benefits $ 3,599,712

Audit verified the total noted to sixteen individual general ledger accounts. For the test year, the expense amount was noted to be 8% higher than 2011. Included within the 2012 total was the following:

2926-300-001 Employee Service Awards: The Employee Service Awards general ledger account contained four transactions. Audit determined that the transactions totaling $3,855 should be below the line. **Audit Issue #6**

| | | |
|---|---|---|
| 2928-000-001 | Regulatory Commission Expenses | $ 89,987 |

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.

| | | |
|---|---|---|
| 2930-xxx-001 | Miscellaneous General Expenses | $ 87,902 |

Audit verified the total to eight specific general ledger accounts without exception. The total for the year represents a decrease from 2011 of 38%
Audit reviewed each account individually and noted the following:

2930-400-001 Miscellaneous General Expense: Audit selected two entries from this account to review. The first entry was on 3/27/12 for $87.21 with a reference of Edible Arrangements. The second selection was from 4/18/12 for $84.95 with a reference of Collins Flowers. PWW produced invoices for each selection and noted that the "*Company provides arrangement for employees with illness or death in family*". Audit notes these transactions should be below the line. **Audit Issue #6**

2930-410-001 Charitable Contributions: Audit reviewed all of the general ledger transaction on account 2930-410-001 and was able to verify the amount to the Annual Report schedule F-57, Donations and Gifts. As donations and gifts are below the line, Pennichuck eliminated the entire amount with a pro forma adjustment on filing Schedule 1, Attachment C, Page 2

| | | |
|---|---|---|
| 2950-xxx-001 | Maintenance of General Plant | $ 362,111 |

Audit verified the total to four specific general ledger accounts without exception. The total for the year represents an increase of 4% over the year-end 2011 balance.

**Inter Div Management Fee $(1,836,922) is comprised of the following:**

Miscellaneous General Expenses

| | |
|---|---|
| 2930-500-001 Intercompany Mgmt Fee: PCP | $ 335,418 |
| 2930-510-001 Intco Mgmt Fee: PCP | $(2,177,458) |
| 2930-520-001 Interco Mgt: Inside Gen Counsel | $ 5,118 |

Refer to the Allocation portion of this audit report for detailed review and explanation of the accounts.

**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 reply upon and utilize PWW's employees. The payroll function is managed at the Company's corporate office in Merrimack, NH. Paylocity is used for the processing of PWW's payroll.

Audit obtained the Paylocity end of year payroll summary. This report is broken down between the different departments such as engineering, accounting and Union. Audit reviewed all of the salaries and wages general ledger accounts and their transactions. The total departments pay from the Paylocity summary, less certain deductions, was tied to the corresponding general ledger accounts without exception.

**Payroll Taxes**

Audit reviewed the payroll taxes reported on the Paylocity yearend summary and compared them to the general ledger accounts. Audit requested a reconciliation from PWW and it was noted that the payroll taxes paid was $118,773 more than the general ledger. PWW provided the quarterly tax returns which show a total of $658,341 being paid. The general ledger shows a total payroll tax of $539,568. There were payroll taxes recorded as merger related costs such as $36,892 for payroll taxes related to separation agreement payouts and $81,712 in payroll taxes related to buyout of options. The total merger related payroll taxes is $118,604 which makes the variance between the tax returns and the general ledger $169. However, Audit was not able to tie the Paylocity summary MASUI and NHSUI taxes to either the general ledger or tax returns. The FUTA, Social Security and Medicare Paylocity tax total matched the tax return total.

**TAXES**

Property Tax Expense

Audit verified the property taxes paid during the test year, $3,346,182 to the following:

| | |
|---|---|
| 2012 NH DRA Utility Property Tax | $ 763,699 |
| ½ of 2nd Issue 2011 municipal | $ 665,083 |
| Full 1st Issue 2012 municipal | $1,239,135 |
| ½ of 2nd Issue 2012 municipal | $ 677,071 |
| Property tax expense | $3,344,988 |
| Current use change tax | $ 830 |
| SBA tax | $ 360 |
| Total per GL 2408-110-001 | $3,346,178 |

Audit also verified that the reported expense agrees with the PUC annual report as well as with the filing schedule 1. The current use change tax of $830 was traced to a NH DRA current use land use change tax lien release form A-5. The expense includes 10% of the appraised $7,700 and interest at 18% totaling $60. The $60 should have posted to an account below the line, and the $770 is a one-time expense. Refer to the Non-recurring portion of this report.

Audit requested the lease or rental agreement on which the $360 tax is paid. The Company leases space on a tower on Warner Hill in Derry owned by SBA Properties, Inc. for SCADA equipment. Invoices are received monthly in the amount of $185.14. $30 posts to the property tax account 2408-110-001 and $155 posts to 2950-300-001, Maintenance Communication Equipment. The Company indicated that a written agreement could not be located, but the terms outlined above have been in place since the early 1990s.

Prepaid Property Taxes

Audit calculated the prepaid property tax figure to be $674,052, which agrees with the general ledger account 2163-310-001, Prepaid Property Taxes. The PUC annual report and the filing schedule 2 reflect the prepaid tax figure to be $653,461. That figure is comprised of an asset and a liability account:

| | |
|---|---|
| 2163-310-001 Prepaid Property Taxes | $674,052 |
| 2236-115-001 Local Property Taxes Payable | $ (20,591) |
| | $653,461 |

Property tax prepayment was verified to one half of the second issue 2012 municipal property tax invoices for 74 specific locations in which PWW operates. The payable was verified to the 4$^{th}$ quarter payable due to DRA in the amount of $(17,574) and one half of the second issue Plaistow invoice, $(3,019) which was not paid until January 2013. One half of the Plaistow second issue was properly noted as an expense for the year in the amount of $3,019. The invoice total of $6,038 was paid after the close of the 2012 books.

Federal and State Tax Returns

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. 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.

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.

**Non-recurring Items**

2930-520-001, Intercompany Management: Inside General Counsel, had an entry on 1/25/2012 and one on 2/29/2012 which sum to the account total of $5,118.

2408-110-001 Property Tax Expense includes a current land use change fee and interest. The total of $830 will be non-recurring.

2923-000-001 Outside Services includes:

| | |
|---|---|
| Legal invoices from the Law Offices of Peter Kraft totaling | $14,200 |
| Service invoice from Aqueduct Technologies totaling | $ 1,480 |
| Service invoice from Imtek Reprographics, Inc. for | $ 275 |
| Legal invoice from Paul Buffum for | $ 3,150 |
| Professional Services from Rath, Young and Pignatelli PC totaling | $ 503 |

| | |
|---|---|
| 2428-000-001 Amortization of Debt Discount | $ 564 |

PWW Exit Audit comment to above Audit Recommended Adjustments

The Company respectfully disagrees with the above recommendations related to Inside General Counsel and Outside Legal Services. The Company no longer has inside counsel but the services performed are still performed by outside counsel. For example, in 2013, Paul Buffum provided legal services of approximately $7,300 and Rath, Young and Pignatelli provided legal services of approximately $12,100. Some legal services have increased and other legal services have decreased reflecting the ebb and flow of legal services required. There will always be a certain level of legal activity that will not occur every year in one area vs. another area. The Company considers the 2012 run rate of outside legal services appropriate for the test year.

## Audit Issue #1

## Deferred Debit

### Background

Account 2186-550-001, OSHA Compliance, reflected two increases. One in the amount of $4,755 was paid to Aries Engineering, Inc. for training of Pittsfield WTP, Nashua WTP and Will Street Operations Center.

### Issue

The amount was fully charged to PWW.

### Recommendation

The invoice should be allocated between PWW and PAC rather than fully charged to PWW.

### Company Response

The Company respectfully disagrees**.** PAC does not have any employees of its own. All employees are employed by PWW, regardless of their geographical location, to provide for efficient and cost effective operations. For example, in the case of the Pittsfield WTP, employees at that location also service PEU customers

### Audit Response

After review of the entry and documentation, in conjunction with the response above, Audit concurs with the Company that the cost is reasonably posted to the PWW books.

## Audit Issue #2

## Long Term Debt Interest Expense

### Background

Interest related to the long term debt in the amount of $2,686,699 was verified to the general ledger account 2427-115-001 without exception.

### Issue

Audit was not able to recalculate the interest associated with four loans and requested an explanation from the Company. In response, the Company noted:

> *"For 3 of the 4 loans, there were true up calculations that added to the interest expense. Generally, the Company will pay a 1% interest until the SRF documents are finalized and the principal repayment begins. The Company accrues by estimating when this will happen. Additionally, for 2 of the loans, there appeared to be an administrative backlog at the NHDES that created a difference between when the loan stated interest payment started and when the principal repayment started*."

A reconciliation was provided from the Company which summarized the interest and related 2011 true-ups. The interest expense for the year is overstated by the 2011 true-ups in the amount of $19,652.

### Conclusion

The filing should be adjusted by $19,652 to exclude the 2011 related interest expense.

### Company Response

The Company respectfully disagrees. The annual interest expense utilized in the filing (Tab 12, Schedule 5) is calculated based on the stated interest rate multiplied by the outstanding balance for each loan. Therefore, no adjustment to the filing is required.

### Audit Conclusion

Audit concurs that the filing as noted does not require adjustment.

## Audit Issue #3

## Recoupment

### Background

Account 2461-001-001, Water Sales Billed Recoupment, represents the remaining authorized amount of the difference between temporary and permanent rates from the prior rate case. See Docket DW 10-091, Order #25,280, issued on 10/21/2011, spread over twelve months.

### Issue

The Order and corresponding tariff page indicate that Anheuser-Busch, Inc. would be charged a total of $77,231.24. While that figure was the total amount charged to Anheuser-Busch, it was assessed in two months in 2011, at their request, rather than over the twelve months as ordered.

### Recommendation

The recoupment should be accomplished in accordance with the Commission Order as well as with the tariff page filed.

### Company Response

The Commission and the Settling Parties' intent in spreading the recoupment over 12 months was to lessen the impact and burden on the Company's customers. As the customer requested accelerated billing and payment for the recoupment, the Company complied in an effort to respond to the customer needs and thereby, provide good customer service. The Company deems that it complied with the intent of the Commission Order.

### Audit Response

Audit understands that the customer requested a larger bill in calendar year 2011, rather than spreading the customer's increased expense across two separate years. However, Audit is reading the plain language of the tariff.

## Audit Issue #4

## Recoupment

### Background

Account 2461-001-001, Water Sales Billed Recoupment, represents the remaining authorized amount of the difference between temporary and permanent rates from the prior rate case. See Docket DW 10-091, Order #25,278, issued on 10/21/2011, spread over twelve months. Specific towns were documented to be assessed specific recoupment amounts.

### Issue

Audit reviewed the billing histories for each of the towns and public fire accounts, and verified that the authorized amount was collected between November 2011 and October 2012 for the amount noted.

The town of Merrimack was assessed $2,306. The amount in the Order and tariff reflect $2,806. When questioned about the $500 variance, the Company indicated that a typographical error had been made in the tariff table on which the invoices were based.

### Recommendation

The Company should ensure that the tariff tables reflect the accurate recoupment figures authorized by the Commission.

### Company Response

Although the tariff page states $2,806.32 for Town of Merrimack public hydrant recoupment, this was a typo and the customer was billed accurately for the correct amount of $2,306.00. If the Company billed the Town for the tariff amount, the Company would have overcharged its customer. The Company agrees that the tariff page should reflect the correct recoupment amount.

### Audit Response

The Order 25,278 also notes the Merrimack assessment to be $2,806.

## Audit Issue #5

## Tariff Language

**Background**

PWW was authorized by the Commission to recover the difference between temporary and permanent rates, as well as to recover rate case expenses associated with the prior rate case DW10-190.

**Issue**

The compliance tariff filed with the Commission states that the private fire surcharge (refund in this case) will be based on pipe size (4”, 6”, 8”). The Company noted that the credit was not set by size, but was based on what the customer had been billed.

**Recommendation**

The tariff must reflect what the Commission approves in any rate case, and the language must then translate to the actual billing of the customers as documented.

**Company Response**

The Company respectfully disagrees. The Private Fire Protection recoupment surcharge/refund is calculated based on the service size but may be affected by the following items:

a. Proration for service rendered – Recoupment was granted for the service period of 6/10/2010 through bills rendered 6/9/2011. Therefore, the first billing that would be eligible for recoupment was prorated based on the service on or after 6/10/2010 and therefore proration on the monthly cycle billing fee would be in affected. As customers are billed throughout the month and not all at once, each weekly billing of customers would have a different proration amount.
b. If service was initiated to a customer within the recoupment period of 6/10/2010 through 6/9/2011, they would only be eligible for recoupment/refund for the period during this time that they were billed for the flat private fire protection fee based on the size of the service.

Recoupment is calculated for each individual customer based on the services that were billed during the recoupment period. This is important as the customer should not be assessed recoupment for any period that they were not eligible.

**Audit Response**

Audit reviewed the calculations at the customer level, and understands the math and theory used. The issue relates to the language in the tariff. If the language should be expanded, the Company and the Commission Staff should determine the clarification required.

## Audit Issue #6

## Invoices which should post Below the Line

**Background**

From the PWW Accounts Payable general ledger, Audit made a selection of 41 journal entries. Audit requested the supporting documentation such as invoices and travel and expense reported for those selected entries.

**Issue**

The invoices noted in the following accounts should have posted below the line:

2926-300-001 Employee Service Awards $3,855
2930-400-001 Miscellaneous General Expenses   Edible Arrangements $87
2930-400-001 Miscellaneous General Expenses   Collins Flowers $85

**Conclusion**

The specific invoices reviewed were misposted to the accounts noted. Therefore the filing should be adjusted to exclude these expenses.

**Company Response**

The Company respectfully disagrees. The employee service awards are annual recognition of employees' years of service to the Company. The flowers or arrangements are provided to employee for serious illness or death in the immediate family. The Company deems the above as appropriate employee related costs and/or benefits and the costs have been recognized as above the line expenses in prior rate filings.

**Audit Conclusion**

Audit appreciates that the Company considers the awards and flowers as reasonable expenses. The issue, however is restated. Audit believes the shareholders and not ratepayers should bear these types of costs.