Pennichuck Water Works, Inc.
DW 21-137
Petition For Approved Modification Of Accounting Treatment Of Leases
Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 | Date of Response: 1/12/22
Request No. DOE 1-1 | Witness: George Torres

REQUEST:
It does not appear that the Company's petition addresses Puc 607.07 (a) which requires that, "Each utility shall maintain its accounts and records in conformity with the "Uniform Classification of Accounts for Water Utilities" established and issued by the commission as a uniform system of accounts pursuant to RSA 374:8." More specifically, the Company's petition does not appear to address Section 1 (e) (5) (Pages 18 and 19) of the Uniform System of Accounts for Water Utilities regarding "Utility Plant – Accounting for Capital and Operating Leases".

a) Please explain why the Company's petition does not appear to address the Company's compliance with the lease accounting requirements contained in the Uniform System of Accounts for Water Utilities.
b) Please discuss the merits of the Company's petition in terms of the specified lease accounting requirements contained in Section 1 (e) (5) (Pages 18 and 19) of the Uniform System of Accounts for Water Utilities.

RESPONSE:

The Company understands the modified accounting treatment for its operating lease obligations, as described in FAS Nos. 13 and 71 and allowable under US GAAP. The Company is simply seeking an order of approval from the NHPUC, at the request from its ***external auditors***, in support of the divergence from ASC 842, such that it can account for its lease obligations on its GAAP basis books and records. It is the goal of the Company, to the extent absolutely possible, to maintain one set of books and records for both GAAP reporting and regulatory reporting. This approval would give the Company the ability to do that for its lease obligations on its GAAP basis books and records, without the need to proform changes to that GAAP accounting as allowed for and in conformity with the requirements in the Uniform System of Accounts of Water Utilities, to report its lease obligations in conformity with its regulatory reporting and allowed revenue structure basis (which is cash flow based).

Additionally, without specific NHPUC approval on this request, if the Company adopted this accounting on its own as allowed for (or could be interpreted as such) in the Uniform System of Accounts for Water Utilities, it would influence or impede our external auditors' ability to issue an *unmodified opinion* on the Company's annual financial statements. The issuance of a *modified opinion* by an audit firm has *never* occurred since my tenure with the Company, since 2006. This can have a detrimental and direct impact on our ability to bond, borrow, finance, etc., and in determining what interest rates the Company would be subjected to. Not to be minimized, formal NHPUC approval of this request for modified treatment of leases diverging from ASC 842 will also allow for streamlining of the periodic financial reporting between its Regulatory and GAAP financials, for the NHPUC and the Company's external stakeholders, in all aspects.

Finally, the Company anticipates filing an amended petition with the Commission within the next day or two to clarify the modification request in the context with the existing PUC Rule 607.07, the Uniform Chart of Accounts and FAS Nos. 13 and 71. The Company recognizes that it must maintain its accounts in records in conformity with the Uniform Chart of Accounts as established and issued by the Commission pursuant to 607.07(a). While the current Uniform Chart of Accounts recognizes operating leases on a cash basis consistent with FAS Nos. 13 and 71, the Commission may approve entries made on the utility's accounts recording the effect of the utility leases per Section 1(e)(5)(B). If the Commission approves the divergence from ASC 842 it will set GAAP standards by virtue of FAS No. 71, Paragraph 32 for the Company to continue accounting on all aspects consistent with the Uniform Chart of Accounts. This will not be a modification of regulatory reporting obligations; however, the approval will modify the Company's GAAP accounting treatment of lease obligations for our external auditors and lenders and streamline future record keeping.

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 Date of Response: 1/12/22
Request No. DOE 1-2 Witness: George Torres

REQUEST:
Per the Uniform System of Accounts for Water Utilities, "[l]eases shall be accounted for by the utility as described in Statement of Financial Accounting Standards Nos. 13 (as amended) and 71 published by the Financial Accounting Standards Board." Please confirm that neither document cited provides for the accounting method requested, thus necessitating the relief in the Company's petition. If either document provides for the accounting methodology requested, please provide specific citations.

RESPONSE:

Respectfully request to refer to the response in DOE DR 1-1. In addition, the Company will submit an amended petition to the Commission clarifying the modification request and accounting treatments including the requested citations.

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 Date of Response: 1/12/22
Request No. DOE 1-3 Witness: George Torres

REQUEST:
Re: Direct Prefiled Testimony of George Torres (Torres Testimony), Page 2 (Bates 12), Lines 9-12: If a lease meets the criteria under ASC 840 for accounting for it as a capital lease, is it still the Company's intention to account for such as a capital lease or as, essentially, an operating lease? Please explain.

RESPONSE:

If an asset is assumed by the Company under ASC 840/842 and it meets ***one*** of the following conditions:

1. Ownership or title of the asset will be transferred to the renter when the lease term ends.
2. A "bargain" purchase option is available.
3. The lease life is equal to or greater than 75 percent of the remaining asset's economic life.
4. The present value of the lease payments equal to or greater than 90 percent of the asset's fair value.

Then the asset will qualify as a capital lease; otherwise it will be treated as an operating lease. Other companies typically use capital leases for land, buildings, vehicles and heave machinery.

Currently, the Company does not have any assets on its books that would qualify as a capital lease. Given the certain tax advantages of a capital lease over an operating lease and our current revenue and expense recovery model, the Company does not anticipate entering into a capital lease for the foreseeable future.

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 Date of Response: 1/12/22
Request No. DOE 1-4 Witness: George Torres

REQUEST:
Re: Torres Testimony, Page 2 (Bates 12), Lines 17-19: Please describe the terms of the Company's lease of its main office facility located at 25 Walnut Street in Nashua.

RESPONSE:

The Company's lease of its headquarters at 25 Walnut Street in Nashua is as follows:

- Lease commencement date of October 31, 2020.
- Rent commencement date of January 1, 2020.
- An initial 15-year term ending on December 31, 2035, with three additional five-year renewal options at the end of the initial term. This has the likely potential of a 30-year lease in total including all renewal options.
- The annual lease expenditure for the first five years of the lease is $330,000.00.
  The annual lease expenditure for years 6 - 10 of the lease is $363,000.00.
  The annual lease expenditure for years 11 - 15 of the lease is $399,300.00.
  The annual lease expenditure for years 16 - 20 of the lease is $399,300.00.
  The annual lease expenditure for years 20 - 25 of the lease is $399,300.00.
  The annual lease expenditure for years 25 - 30 of the lease is $399,300.00.
- Right-of-first-refusal option to purchase the building at fair market value if landlord receives a bona fide offer from a third party. The lease does not include a bargain price offer, or "BPO" or an option to purchase the property at the conclusion of the lease.

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 Date of Response: 1/12/22
Request No. DOE 1-5 Witness: George Torres

REQUEST:
Re: Torres Testimony, Page 2 (Bates 12), Line 23 through Page 3 (Bates 13), Line 3: Under the requirements of ASC 842, please specifically describe the pro forma adjustments that would be necessary to "properly align the Company's true cash needs in its revenue requirements being sought in . . . future rate cases."

RESPONSE:

Presented below is the schedule of pro forma adjustments that will be necessary for all future PWW rate cases during the entirety of its office lease term, to properly disclose the actual cash expended under the lease requirements. For example, if 2021 was used as a test year for expenses for PWW, total office lease expense would have to be adjusted ***down*** by $49,591.16 to reflect the actual expended cash amount of $330,000.00. Conversely, in 2031 total office lease expense would have to be adjusted ***up*** by $16,591.16, as the reported expenses would be lower than the cash amount of $399,300.00.

Additionally, pro forma adjustments will also be required for all future Pennichuck East Utility and Pittsfield Aqueduct rate filings as the office lease expense is an element of the monthly management fee allocation from PWW to its sister entities.

Year	Reported Annual Expense	-	Actual Annual Cash Outlay	=	Pro forma Adj.
2020	$63,265.19		$0		$63,265.19
2021	**$379,591.16**		**$330,000.00**		**$49,591.16**
2022	$379,591.16		$330,000.00		$49,591.16
2023	$379,591.16		$330,000.00		$49,591.16
2024	$379,591.16		$330,000.00		$49,591.16
2025	$379,591.16		$330,000.00		$49,591.16
2026	$379,591.16		$363,000.00		$16,591.16
2027	$379,591.16		$363,000.00		$16,591.16
2028	$379,591.16		$363,000.00		$16,591.16
2029	$379,591.16		$363,000.00		$16,591.16
2030	$379,591.16		$363,000.00		$16,591.16
2031	**$379,591.16**		**$399,300.00**		**-$19,708.84**
2032	$379,591.16		$399,300.00		-$19,708.84

2033	$379,591.16	$399,300.00	-$19,708.84
2034	$379,591.16	$399,300.00	-$19,708.84
2035	$379,591.16	$399,300.00	-$19,708.84
2036	$379,591.16	$399,300.00	-$19,708.84
2037	$379,591.16	$399,300.00	-$19,708.84
2038	$379,591.16	$399,300.00	-$19,708.84
2039	$379,591.16	$399,300.00	-$19,708.84
2040	$379,591.16	$399,300.00	-$19,708.84
2041	$379,591.16	$399,300.00	-$19,708.84
2042	$379,591.16	$399,300.00	-$19,708.84
2043	$379,591.16	$399,300.00	-$19,708.84
2044	$379,591.16	$399,300.00	-$19,708.84
2045	$379,591.16	$399,300.00	-$19,708.84
2046	$379,591.16	$399,300.00	-$19,708.84
2047	$379,591.16	$399,300.00	-$19,708.84
2048	$379,591.16	$399,300.00	-$19,708.84
2049	$379,591.16	$399,300.00	-$19,708.84
2050	$379,591.16	$399,300.00	-$19,708.84

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 | Date of Response: 1/12/22
Request No. DOE 1-6 | Witness: George Torres

REQUEST:
Re: Torres Testimony, Page 4 (Bates 14), Line 20 through Page 5 (Bates 15), Line 2: If, in the future, the Company enters a "lease-to-own" arrangement, how would the Company account for such relative to the methodology proposed in its petition? Please explain.

RESPONSE:

To remain consistent with the current petition, the Company would like to account for these potentially future arrangements in-line with their required cash expenditures as is consistent with the Uniform Chart of Accounts.

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DW 21-137
Petition For Approved Modification Of Accounting Treatment Of Leases
Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 Date of Response: 1/12/22
Request No. DOE 1-7 Witness: George Torres

REQUEST:
Re: Torres Testimony, Page 7 (Bates 17), Lines 9-16:

a) Please provide further explanation regarding the "two months of free rent at the end of 2020" indicated on Line 15 as well as how such was calculated and please clarify the impact of that amount on the calculations described in Lines 9-16.
b) Please show the detailed calculations resulting in:
   i) The total cash outlay over the entire 30-year lease of $11,451,000 (Lines 10-11).
   ii) The annual straight-line expense under ASC 842 of $379,591 (Lines 11-12).
   iii) The differential resulting in a total impact to the MOERR RSF account of $394,177 (Lines 14-15).

RESPONSE:

At the time of the lease signing, it was agreed between the parties that the lease would commence on October 31, 2020, but the rent payments would not begin until January 1, 2021. Thereby providing the Company with two months of "free rent" as an incentive to signing the lease.

Based on this, the calculations for this request is as follows:

a) 2020 Annual Lease Expense ("Free Rent Period") is the sum of:

- (Total cash outlay of entire lease term /(30 years + 2 months of "free rent"))
  = Straight-lined Monthly Lease Expense

  ($11,451,000 / 362 months) = $31,632.60 per month

- (Monthly Lease Expense x Free Rent Period) = 2020 Annual Expense

  ($31,632.60 x 2 months) = $63,265.19

b) i) Total cash outlay over the entire 30-year lease =

Years 1 – 5 annual outlay x 5 years = $330,000 x 5 = $1,650,000.00

Years 6 – 10 annual outlay x 5 years = $363,000 x 5 = $1,815,000.00
Years 11 – 30 annual outlay x 20 years = $399,300 x 20 = $7,986,000.00

Total cash outlay over the entire 30-year lease = $11,451,000.00

ii) The annual straight-line expense under ASC 842 of $379,591 =

(Total cash outlay of entire lease term / Total # of months during lease term) x 12 months =

Annual Straight-line Expense

($11,451,000.00 / 362) x 12 = $379,591.16

iii) The differential resulting in a total impact to the MOERR RSF account of $394,177 =

Sum of straight-line lease expense for years first 10 years of lease – Sum of cash outlay for first 10 years of lease =

Total MOERR RSF impairment (over-collection)

Year	Expense	-	Cash Outlay	=	Difference
2020	$63,265.19		$0		$63,265.19
2021	$379,591.16		$330,000.00		$49,591.16
2022	$379,591.16		$330,000.00		$49,591.16
2023	$379,591.16		$330,000.00		$49,591.16
2024	$379,591.16		$330,000.00		$49,591.16
2025	$379,591.16		$330,000.00		$49,591.16
2026	$379,591.16		$363,000.00		$16,591.16
2027	$379,591.16		$363,000.00		$16,591.16
2028	$379,591.16		$363,000.00		$16,591.16
2029	$379,591.16		$363,000.00		$16,591.16
2030	$379,591.16		$363,000.00		$16,591.16
Totals	$3,859,176.80		$3,465,000.00		$394,176.80

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 Date of Response: 1/12/22
Request No. DOE 1-8 Witness: George Torres

REQUEST:
Re: Torres Testimony, Page 8 (Bates 18), Lines 9-14:

a) Please provide further explanation regarding the specific "traditional bank/lender coverage ratios" that would be negatively impacted through the implementation of the new lease accounting standard.
b) Please specify the potential negative impact(s) of the new lease accounting standard on the Company's "Debt Service Coverage and Rate Covenants".

RESPONSE:

In response to a) and b) above, the current lender's covenants that could be negatively impacted with the adoption of ASC 842 on the Company's current lender covenants are as follows :

<u>2014 Bond Indenture Covenant/ TD Bank</u>

Rate Covenant #1 – **EBITDA** / Amounts Paid on Funded Debt =

Requirement of at least 1.1 or above

Due to the recognition of increased straight-line expensing versus the actual cash outlay in the first 10 years of the lease, it will have the potential to report a lower **EBITDA** amount in the calculation of the rate covenant.

Net Worth Covenant – **Net Worth** of at least $4.5M

Due to the recognition of increased straight-line expensing versus the actual cash outlay in the first 10 years of the lease, it will have the potential to report lower Net Income which reduces any possible contribution to Retained Earnings. This will have the impact of a lower reportable **Net Worth** in the calculation of this covenant.

Debt to Capital Covenant – Funded Debt / 85% of PWW's **Total Capital** =

Requirement of 1.0 or less

Due to the recognition of increased straight-line expensing versus the actual cash outlay in the first 10 years of the lease, it will have the potential to report lower Net Income which reduces any possible contribution to Retained Earnings. Lower Retained Earnings lowers the amount of **Total Capital** available for repayment.

All Bonds Test #2 – **EBITDA** / Max Future Amt Due on Funded Debt Incurred =

Requirement of at least 1.1 or above

Due to the recognition of increased straight-line expensing versus the actual cash outlay in the first 10 years of the lease, it will have the potential to report a lower **EBITDA** which can then be applied against the maximum future debt amounts due in any given year.

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 | Date of Response: 1/12/22
Request No. DOE 1-9 | Witness: George Torres

REQUEST:
Re: Torres Testimony, Page 9 (Bates 19), Line 5 and Page 10 (Bates 20), Lines 7-8: Please specify and briefly describe the Companies "other de minimis copier and equipment leases".

RESPONSE:

Lease Type	Term	Amount
Copiers:		
US Bank Equip. Finance	July 2019 – 2022	$19,447.44 / annually
Lease Administration Center	Dec 2019 – Nov 2024	$18,432.00 / annually
Conway Office Products	July 2019 – 2022	$6,600.00 / annually
Postage Machine	December 2017 – 2022	$2,580.00 / annually

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 Date of Response: 1/12/22
Request No. DOE 1-10 Witness: George Torres

REQUEST:
If approved, would the Company's proposed accounting methodology for leases also impact its methodology for accounting for future leasehold improvements? Please explain.

RESPONSE:

In general, under ASC 842 if a lease does not ***require*** the Company to make an improvement, the improvement would be considered an asset of the Company and would be ***excluded*** from lease payments and when measuring the right-of-use asset and the lease liability. If approved, the Company will continue to account for lease improvements pursuant to the Uniform Chart of Accounts Section 1(e)(6).

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Responses to DOE Data Requests –Set 1

Date Request Received: 1/5/21 | Date of Response: 1/12/22
Request No. DOE 1-11 | Witness: George Torres

REQUEST:
Has the Company informed its lenders/creditors of its requested accounting methodology for leases, and if so, are the Company's lenders/creditors supportive of the Company's proposed methodology? Please explain.

RESPONSE:

The Company had conversations with its current senior lender for Pennichuck Corporation and Fixed Asset Line of Credit lender for PWW (TD Bank) regarding the Company's intention to file this petition with the Commission. They were also asked to evaluate how ASC 842 may impact existing and future debt covenants. It was not imperative to have similar conversations with CoBank (the primary lender for sister subsidiary Pennichuck East Utility) as the leases that would be accounted for are not obligations of that Company.

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Date Request Received: 1/5/21	Date of Response: 1/12/22
Request No. DOE 1-12	Witness: George Torres

REQUEST:
Per the Company's petition, the effective date of the FASB accounting change was December 15, 2021. Further, per the Company's filing, FASB issued this update on February 25, 2016. Please explain the reason for the timing of the Company's petition.

RESPONSE:

When the FASB initially announced the new Accounting Standard Update "ASU" in 2016, it was with an original effective date for private companies with fiscal years beginning after December 15, 2019. However, after several subsequent postponements, the final deadline for implementation of ASC 842 now stands at for fiscal years beginning after ***December 15, 2021***. The Company needed to be cognizant that it did not file this request prematurely, with the deadline and requirements being deferred more than once. As such, it waited until this time to file for this approval, as it appears that the actual implementation date has now being "stabilized" and other activities for the Company impacted materially by this new pronouncement are fully in place.

A timeline for the new leasing standard is as follows:

February 2016 -	FASB published ASC 842 for companies reporting under US GAAP; effective for public business entities beginning after December 15, 2018. For all other entities, the standard is effective for fiscal years beginning after ***December 15, 2019***.
November 2019 -	FASB moved back by one year, the compliance deadline for private companies to now for fiscal years beginning after ***December 15, 2020.*** This was due to feedback from public companies regarding the difficulties in implementation of ASC 842.
June 2020 -	Due to COVID-19 market disruptions, the FASB again modified compliance deadlines for private and select not-for-profit organizations by one year. The new deadline for transition is now ***year-end December 31, 2022.***

This Company will also address this timeline in the amended petition it plans to file with the Commission as referenced in DOE DR 1-1.