

DW 08-070
Lakes Region Water Company, Inc.

Date of Record Request: 9/30/08
Record Request Exhibit No. 5

Date of Response: 10/21/08
Witness: Mark A. Naylor

RECORD REQUEST:

At the September 30 hearing the Chairman asked that Staff provide a clarification of an issue cited by Audit Staff in Exhibit 4, the Staff's audit report. On page 7 of Exhibit 4 Audit Staff made the following comments:

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

RESPONSE:

In consultation with the Audit Staff, Staff has reviewed several costs that were incurred by the company during the time that capital projects were underway. These related to repair and/or replacement of distribution valves or service valves at Hidden Valley totaling about \$1,585 and included as a part of Step 1. Because these activities took place at the same time as capital projects involving replacement of mains and services, Staff felt it appropriate to include such costs in the total of capital expenditures that are the subject of the step adjustments in this docket. The Audit Staff's caution, however, is appropriate, and could be further extended to establishing a standard cutoff limit (say \$500 or \$1,000) for capital repairs that may, to avoid unnecessary bookkeeping, be more appropriately expensed.

[WITNESS PANEL: Mason|St. Cyr|Naylor|LaFlamme]

- 1 Q. Turning back to the audit, which is Exhibit 4, on Page
2 7, there is an audit issue that's listed as Number 7,
3 and it refers to "several repairs that had been
4 questionably capitalized". I'm wondering if you know
5 -- I'm sorry, it's not in Number 7, it's on Page 7,
6 it's down in the conclusion, and it's in the second
7 paragraph of the conclusion. It says "Audit observed
8 several repairs that had been questionably
9 capitalized." Do you know what that's referring to?
- 10 A. (Naylor) I don't know specifically what it refers to.
11 Clearly, the Audit Staff had, in its review, come
12 across perhaps some work orders for repairs that the
13 Audit Staff had felt should have been booked as
14 expense, rather than capitalized. There's often a fine
15 line between those two. And, many times what looks
16 like a repair may appropriately be capitalized,
17 depending on the asset and what's being done to it.
18 So, I think what the Audit Staff is saying here is that
19 it observed some items that it had questions about, and
20 suggested that the Company be more cognizant of that
21 issue. And, that's, I think, an appropriate warning.
22 That's something that we see quite often in utilities.
- 23 Q. Do you know if any of those repairs are included in any
24 of the proposed step adjustments in this filing?

[WITNESS PANEL: Mason|St. Cyr|Naylor|LaFlamme]

1 A. (Naylor) I do not.

2 CHAIRMAN GETZ: Well, let's do this.
3 Let's hold Exhibit 5 and get a follow-up from Audit Staff
4 on what they're referring to there, in terms of the
5 repairs, and we'll get an idea of the magnitude nature of
6 what was being considered.

7 (Exhibit 5 reserved)

8 MR. ROBERGE: May I interject?

9 CHAIRMAN GETZ: You've got an attorney.

10 Let's --

11 MS. HATFIELD: Thank you, Mr. Chairman.

12 BY MS. HATFIELD:

13 Q. Turning to the issue of affiliate agreements, I believe
14 that, Mr. Naylor, you talked about the importance of
15 those, that was raised in the prior docket, 07-105, and
16 the fact that they were important because of "the two
17 hats", I think you said, that Mr. Mason is wearing.
18 And, I'm wondering if you were aware that, in the audit
19 report of the 2006 audit, that there was a finding that
20 the Company needed to update its agreement, and also
21 that the Company's response stated that it was updating
22 its agreement and would submit them to the PUC for
23 review?

24 A. (Naylor) Yes, I believe the OCA witnesses discussed

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