

STATE OF NEW HAMPSHIRE

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May 8, 2013

Debra A. Howland, Executive Director
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, New Hampshire 03301

Re: Docket No. DW 12-170: Hampstead Area Water Company, Inc.
Staff Audit Regarding Proposed Step Adjustment

Dear Ms. Howland:

On April 18, 2013, a Settlement Agreement (Agreement) between Hampstead Area Water Company, Inc. (Hampstead) and the Commission Staff (Staff) was presented to the Commission at hearing. Contained within the Agreement was a proposal for a step increase that would become effective as of the date of the Commission's order in this proceeding. The purpose of the proposed step increase is to enable Hampstead to recover through rates revenues related to certain capital improvements that it made during 2012. At the April 18 hearing, the parties to the Agreement indicated that the underlying assets of the step increase were being audited by the Commission's Audit Staff in order to verify that the proposed capital additions were prudent, used and useful and therefore qualified for inclusion in rates consistent with RSA 378:28. The parties further indicated that at the conclusion of the audit, Staff would issue a report to the Commission in order to report on the findings of the Audit Staff's examination.

On May 7, 2013, the Audit Staff issued a final report relative to Hampstead's 2012 capital additions. A copy of the Audit Staff's report is attached to this correspondence. Based upon the findings contained in that report, Staff believes that the underlying assets related to the proposed step increase are prudent, used and useful and thus qualify for inclusion in Hampstead's rates. Staff has also reviewed the effect on the proposed rates of the three audit finds contained in the report and concludes that those findings do not result in any material change in the rates contained in the Agreement.

Thank you for your assistance with this filing. If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jayson P. Laflamme".

Jayson P. Laflamme
Staff Analyst, Gas-Water Division

Attachment: Staff Audit Report

cc: Service List

STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: May 7, 2013
AT (OFFICE): NHPUC

FROM: Debra Piaseczny, Examiner
James Schuler, Examiner

SUBJECT: Hampstead Area Water Co., Inc.
DW 12-170
Hampstead Area Water Co., – Step Increase
FINAL Audit Report

TO: Mark Naylor, Director of Water and Gas Division
Jayson Laflamme, Utility Analyst
Karen Moran, Chief Auditor

HAMPSTEAD AREA WATER COMPANY STEP INCREASE

Scope of Plant Audit

The PUC Audit Staff (Audit) reviewed Hampstead Area Water Company's (HAWC) 2012 plant additions and improvements stipulated in Order No. 25,437 dated November 8, 2012. Audit reviewed outside vendor invoices and invoices from Lewis Builders Development (LBD) for engineering, legal, administration, materials and labor. Audit also reviewed job cost transaction reports and invoices from Lewis Equipment Co., Inc. (LEC) for heavy equipment rental. The filing total of \$288,415 and supplemental step additions of \$20,473 totaled \$308,888 and consisted of the following core system improvements:

Account # 331 - Pumping Equipment	\$2,842
Account # 320 - Water Treatment Equipment	62,060
Account # 333 - Services	149,134
Account # 334 - Meters	39,900
Account # 341 - Transportation Equipment	<u>34,479</u>
Sub - Total	\$288,415
Account # 307 - Supplemental Step Additions/Wells	<u>20,473</u>
Total	<u>\$308,888</u>

Audit did not analyze the 2012 labor burden and overhead components, rather how the rates were applied. The 2011 labor burden and overhead components were reviewed by Audit in DW 12-170 with the report dated 1/11/2013.

Management Agreement and Labor Burden and Overhead Rates

The Company provided a copy of the Management / Service / Rental Agreement between HAWC and LBD signed on July 1, 2012. The agreement explains the services to be provided by LBD to HAWC and when and how the labor burden and overhead rates will be calculated and applied. Section 6 B of the agreement indicates in part “No supply material cost, rental rate, labor charge, overhead or labor burden shall include any profit or “mark up” to Lewis or any related person or entity to either Lewis or HAWC.”

For 2012, labor burden and overhead percentages were 74% and 34% respectively. Markup calculations tested accurately. LBD multiplies the hourly rate first by the 74% labor burden. That result is then multiplied by the 34% overhead to arrive at the labor rate billed to HAWC by LBD. In most instances the overhead rate is also applied against materials and supplies billed by LBD to HAWC.

Plant Additions

Water Treatment Equipment, Account 320

HAWC replaced a filter and repaired the pump house with a new roof, new lighting and removing overgrown trees in the Bryant Woods development.

Audit verified the cost of the new filter \$31,495 to an invoice from Marlo Incorporated. Materials summed to \$9,969 and include a shipping invoice from Siam Transportation in the amount of \$2,500, miscellaneous invoices from USABlueBook and GSG Supply, and an invoice from Marlo Incorporated for six valves (2 capitalized, 4 placed in inventory).

Audit traced materials and filter costs to vendor invoiced amounts and LBD labor of \$41,462 with no exceptions. Vendor invoices for materials consisted of various plumbing and heating supplies. Audit recalculated and totaled the amounts with no exceptions. Audit traced LBD individual employee labor, engineering and equipment charges to LBD’s rate sheet totaling \$5,352. The rate sheet excluded the labor burden and the overhead percentages. Multiplying the rate by the labor burden of 74% and then multiplying that total by the overhead of 34%, the employee’s hourly rate would agree with the invoice with only minor differences in two employees. All others agreed with the hourly rate sheet.

Filter	\$31,495
Materials	9,969
LBD Labor & Equipment	<u>5,352</u>
Total Water Treatment Equipment	\$46,817

Distribution Reservoirs Account 330

LBD cleaned, primed and painted a holding tank in the Bryant Woods development. The cost of the project totaled \$15,242 and included engineering, LBD labor, LEC labor and vendor materials.

Audit recalculated a vendor invoice for epoxy modified cementitious mortar in the amount of \$4,743. Audit traced LBD individual employee labor and engineering charges to LBD rate sheet totaling \$5,651. Audit recalculated and totaled the invoices with no exceptions. However, the rate sheet excluded the labor burden and the overhead percentages.

LBD Labor	\$5,651
LEC Labor	4,848
Materials	<u>4,743</u>
Total Distribution Reservoirs	\$15,242

Transmission and Distribution Mains Account 331

LBD replaced a 4” gate valve and a 1” blow off at Summit Drive in the amount of \$2,842. Charged to the project were materials, labor and equipment. The materials were out of inventory and marked up 42%. Audit traced the materials used back to the inventory sheet with no exceptions. Equipment usage agreed to the timesheet and the equipment rate sheet. Audit verified hours worked with the timesheets and hourly rate with the rate sheet.

Materials and Overhead	\$1,464
Equipment Rental	368
LBD Labor	<u>1,010</u>
Total T & D Mains	\$2,842

Meters, Account 334

HAWC’s Annual Activity Report for 2012 showed 141, 5/8’ meter change outs and 3, 1” meter change outs. The Company stated that change outs are charged a standard cost of \$275 each for a 5/8” meter and that they do not track time for installation because the item is small. Shown on the change out sheet is 1” meters are charged \$375 and that 3 were changed out for the year.

Total meters retired from account #271 – CIAC were 143 meters, 141 5/8” meters and 2 1” meters on the general ledger. The Annual Activity Report shows 144 change outs with 3 1” meters in the amount of \$39,900. Audit traced the number of meters from the general ledger to the Annual Activity Reports with only 1 meter difference which is immaterial.

Transportation Equipment, Account 341

HAWC purchased a new 2012 pickup truck which was posted to the general ledger via an adjusting entry on 12/31/2012 in the amount of \$33,979. The cash price of the truck was \$38,295 with a cash rebate in the amount of \$4,500. The Company explained that \$500 was a cash rebate to HAWC posted to the general ledger on 12/5/2012 and a rebate described as other in the amount of \$4,000 that the dealer accepted.

The annual percentage rate is a fixed 2.49% for 60 months with payments of \$603 per month. The first payment was due on 1/16/2013. HAWC posted no payments in the test year.

Supplemental Step Additions/Wells Account 307

The Company replaced a well on Village Drive in Hampstead totaling \$20,473. Per conversation with the HAWC, the costs for the supplemental additions are to be amortized over 20 years.

Audit's review of invoices shows engineering charges, site work and labor charges from LBD in October and November, 2012. Audit recalculated 2 vendor invoices for well drilling, hydro-fracking and well casing totaling \$14,302 and 1 invoice for water testing with no exceptions noted. Audit tied hourly employee and equipment rental rates to the rate sheets and recalculated invoices with one exception. Invoice #11306 charges \$55 per hour for a D-12 dump truck while the equipment rental sheet shows the cost to be \$10, a difference of \$45 per hour. At 1.5 hours, the difference is \$68 which Audit considers immaterial. The following is a breakout of costs incurred:

Drilling and Materials	\$12,417
LBD Engineering, Materials and Labor	6,171
Hydro Fracking labor	1,800
Water Testing	<u>85</u>
Total	\$20,473

Services, Account 333

New Service - \$6,689

The Company installed a new service at 145 Main Street in Atkinson, which was part of the Walnut Ridge system. The job was started in March and completed in April 2012. HAWC supplied two LBD invoices both of which identified the installation as Job # 12-1811. The invoices #10768 and 10848 dated March 31, 2012 and April 30, 2012 respectively totaled \$6,689 for the new service which consisted of the following:

Materials	\$ 701
34% Overhead	238
Total Materials	939
Equipment Rental & Associated Labor	3,487
Other Labor	2,263
Total Invoice	\$ 6,689

Back-up support was also provided for \$664 of the \$701 of materials which consisted of two East Coast Lumber invoices which totaled \$144, \$150 of a Benevento paving invoice that totaled \$200 and \$370 (net) for items from the inventory of LBD. LBD applied a 34% overhead to the materials and inventory supplies.

Audit verified the equipment rates to the “In-House Rate” of the LBD equipment rate schedule and the equipment usage agreed to the LBD timesheets of the operators. Audit verified the labor hours billed against the LBD time sheets and the labor rates billed by LBD were recalculated by Audit using rates provided by the Company. The calculation in this case is the employees’ hourly rate times the 74% labor burden this result is then multiplied by the 34% overhead rate. No exceptions were noted.

When asked how the billing for the installation of new services is handled, the Company explained that generally LBD would bill the customer directly for the customer’s share of the service installation. “In this case HAWC paid for the entire installation because the customer’s well was impacted by new wells drilled by HAWC. To mitigate the customer’s water loss HAWC paid for the costs to hook up the customer to HAWC’s system.”

Audit verified the \$6,689 to the general ledger account # 333, Services.

Repaired Services -\$142,445

On October 6, 2011 HAWC petitioned Commission requesting authority to borrow up to \$180,000 Drinking Water State Revolving Funds (SRF) to replace 100 service lines in its Walnut Ridge system. HAWC initiated this project to reduce its water leaks in the Walnut Ridge system which NHDES required. On December 8, 2011 the Commission issued order # 25,299 that authorized HAWC to proceed.

HAWC repaired a total of 100 services in four different water systems in two towns. The majority, 96, were in the Walnut Ridge system (within the Atkinson core). The remaining four were in the core system in Hampstead. Specifically, two were in the Hampstead system, one was in the Bricketts Mill system and the last one was in the Village Green system.

The total posted to account # 333, Services, for the SRF project as of December 31, 2012 was \$144,631. The Company explained that the correct amount is actually \$142,445. After 2012 had already been closed they discovered that an LBD invoice (dated 12/31/12) in the amount of \$2,186 had been incorrectly coded to SRF services

rather than account 330. They will make the correction in 2013. The following summarizes the \$142,445:

Administrative Costs - LBD	\$ 1,482
Construction Administration - LBD	6,691
Construction	
Leak Detection	3,705
Material & Supplies -Other	23,125
Material & Supplies - LBD	12,394
Equipment	1,218
Equipment Rental	54
Paving	2,784
Police Detail	1,064
Heavy Equipment Rental -Lewis Equipment Co	42,928
HAWC labor	46,918
LBD-Repair UF cable	84
	\$142,446

Audit requested copies of the DES SRF disbursement requests and payment confirmations. As of the date of this report HAWC has requested \$128,996 of disbursement for costs incurred from May 26, 2012 through November 30, 2012.

The Company provided job cost transaction reports that summarized what the employee labor was and what portions were included in the SRF service repair project. Audit verified that the job cost transaction reports tied to the general ledger. Audit reviewed a sample of employee time sheets which agreed with the job cost transaction reports. While the labor rates reflected on the job cost transaction reports included a mark-up for the 74% labor burden in June, July and August the remaining months of September through December were not increased by the 74% labor burden or 34% overhead. The labor amounts ultimately transferred to account #333 did not include the labor burden. Audit asked if HAWC had a special arrangement for the labor for the SRF project. The Company explained that the labor rates were determined by the Davis-Bacon rules.

While the Company has not completed its DES disbursement requests, the labor included in the \$142,445 of repaired services and the DES requests for disbursement do not agree. **See Audit Issue # 1.**

	5/26/12 - 7/31/12	8/1/12 - 8/31/12	9/1/12 - 9/30/12	10/1/12 - 11/30/12	12/1/12 - 12/31/12	Total to Date
HAWC labor per DES Disbursements	7,298	9,997	14,021	16,968		48,284
HAWC labor transf. from CWIP to Services	6,042	8,407	11,545	13,811	7,113	46,918
	1,256	1,590	2,476	3,157	(7,113)	1,366

The labor included in the \$142,445 of repaired services placed in service consisted of the employees' regular hourly rate, the corresponding taxes and a charge for workers compensation (which is reflected as "injuries and damages" on the job cost reports).

The Company explained that the workers compensation amount is calculated based rates per \$100 of payroll provided to them by the insurance company. They have multiple different rates based on the services performed by the employee. For example an employee performing "landscaping, gardening and driving" has a 5.57 rate per \$100 of payroll as compared 8.59 per \$100 of payroll for an employee who is an "excavation/driver". Audit recalculated a sample of the workers compensation charges with no exceptions noted.

The labor costs reflected on the DES requests for disbursement reflect the Davis-Bacon labor rates which include hourly rate, 10% for payroll taxes, workers compensation and fringe benefits (holiday, vacation/sick, health and life insurance and HSA).

LBD billed HAWC for engineering, administration and legal services monthly which together totaled \$8,173. Audit reviewed the invoices and corresponding time sheets no exceptions were noted. Audit recalculated the labor rates in the usual LBD fashion [(hourly rate * 74% labor burden) * 34% overhead rate + hourly rate] no exceptions were noted.

LEC invoiced HAWC for heavy equipment rental monthly which totaled \$42,928 for the project. Audit reviewed the rental invoices from LEC for the SRF project. The invoices included a detailed listing of each piece of equipment, the dates and hours charged. Audit compared a selection of the employee time cards of the equipment operators to the equipment billing invoices no exceptions were noted. The charges were billed at the hourly "In-House Rate" plus, an additional mark-up of \$5 to \$10 for each piece of equipment. In light of section 6 B of the management agreement, Audit asked the Company about the higher rate used for the SRF project versus the regular billing arrangement. The Company explained that the rate was determined by DES. Audit requested a copy of the written authorization from DES. The Company could not provide a specific authorization but deferred to the fact that DES approved the disbursements. **See Audit Issue # 2.**

In an attempt to quantify what the variance would be if the equipment invoices had been calculated using the "In-House Rate" Audit recalculated two of the heavy equipment invoices, the results are reflected below.

	As Billed "In- House" Plus Mark-up	If Billed @ In- House	Variance
LEC - Equipment Rental 8/1/12 Inv.# 09264 for 6/1-7/27/12	\$ 6,060	\$ 5,520	\$ 540
LEC - Equipment Rental 9/1/12 Inv.# 09420 for 7/31 - 8/24/12	7,408	6,815	593
	\$ 13,468	\$ 12,335	\$ 1,133

LBD also invoiced HAWC monthly for materials and supplies provided by LBD and used on the HAWC jobs all which totaled \$12,394. Each invoice included a detailed listing of the dates and materials and supplies provided along with the employee providing the materials or supplies. Audit requested a copy of the LBD materials rate sheet, the Company did not provide the rate sheet because of the size (the rate sheet would be LBD's inventory list which consists of over 2,000 items) but did clarify that the material rates are not marked-up by the 34% but that the supplies were. This agrees with Audit's conclusion. Audit reviewed a sample of employee time cards against the materials portion of the invoice with no exceptions noted.

The remaining \$23,125 of materials and supplies consisted primarily of plumbing type supplies (saddles, curb stops, adaptors, PE Tube, SS rod, and clamps) and were purchased from the following:

Material & Supplies	
Stiles Company	\$ 19,328
Professional Drafting Inc.	197
East Coast Lumber	350
GSG Supply Inc.	2,148
Beacon Electrical Supply	51
EJ Prescott Inc.	283
Pollard Water	675
RE Prescott	93
	\$ 23,125

Audit requested clarification from the Company of the following items:

- A RE Prescott invoice from 7/23/12 for \$93.44 - no invoice support was provided and the general ledger indicated "BW Filter". The Company confirmed that this is part of the Bryant Woods Filter project not the SRF service repair project. **See Audit Issue #3.**
- A USA Blue invoice from 11/16/12 in the amount of \$1,218.08 for the purchase of a Rycom Stick Pipe & Cable Locator. The Company confirmed that this equipment should be included in the SRF services repair project. However, Audit feels that it would be more appropriate if this piece of equipment were booked to account # 343-Tools, Shop and Garage Equipment rather than account # 333-Services. **See Audit Issue #3.**

Retirements - while the settlement agreement addresses retirements associated with the SRF service repairs portion of the step adjustment, Audit was unable to identify any services being retired in either the settlement agreement or the general ledger. This will be further reviewed once the 2012 annual report has been reviewed.

Depreciation Expense – will be analyzed further once the 2012 annual report has been reviewed.

AUDIT ISSUE #1

Labor Rates on SRF project DES disbursement requests do not agree with labor rates on Services placed in plant

Background

Audit compared the labor of the SRF services project included in the \$142,445 recorded in account #333 with what was requested to be disbursed from DES.

Issue

It appears that HAWC is reporting one wage rate to the DES while actually paying the employees and posting that figure on the HAWC books at a lower rate.

Recommendation

The labor rates should be the same.

Company Response

HAWC's policy on capitalizing labor costs has been to use the employee's actual hourly rate plus payroll taxes, workers comp insurance and 401k matches. DES reimburses the Company for all these items plus other items that are allowable under the Davis-Bacon wage rules. These other items include holiday pay, health insurance, vacation\sick time, life insurance and HSA costs. The Company decided to capitalize the SRF costs without these extra costs to be consistent with its previous policies.

Audit Response

Audit is unable to quantify the difference between the capitalized labor and the requested labor reimbursement. However, Audit understands that the holiday pay, health insurance, vacation and sick time, life insurance and HSA costs are expensed as incurred and are legitimate HAWC costs.

AUDIT ISSUE #2

Heavy Equipment Rental Rates include a mark-up on the SRF Services Repair Project

Background

The Company provided a copy of the Management / Service / Rental Agreement between HAWC and LBD signed on July 1, 2012. Section 6 B of the agreement indicates in part “No supply material cost, rental rate, labor charge, overhead or labor burden shall include any profit or “mark up” to Lewis or any related person or entity to either Lewis or HAWC.”

Issue

Lewis Equipment Co. invoiced HAWC for heavy equipment rental at the hourly “In-House Rate” plus a mark-up of \$5 to \$10. All other invoices for equipment rental (generally invoiced through LBD) for projects other than the SRF project were billed at the “In-House Rate”.

Recommendation

The LEC heavy equipment invoices should have been invoiced at the usual “In-House Rate”.

Company Response

Agreed.

Audit Response

Audit concurs.

AUDIT ISSUE #3

Items to be removed from account # 333-Services

Background

HAWC transferred \$142,445 of items from CWIP to account # 333- Services in relation to the SRF services repair project.

Issue

A RE Prescott invoice from 7/23/12 for \$93.44 was booked to account # 333-Services as part of the SRF service repair project but should have been booked in account # 320- Filter as part of the Bryant Woods filter project.

A USA Blue invoice from 11/16/12 for \$1,218.08 for a Rycom Stick Pipe & Cable Locator was booked to account # 333-Services. However, Audit feels that it would be more appropriate if this piece of equipment were booked to account # 343-Tools, Shop and Garage Equipment.

Recommendation

The Company should remove the above items totaling \$1,311.52 from account # 333 –Services and reclass them as follows:

- \$93.44 to account # 320 – Water Treatment Equipment
- \$1,218.08 to account # 343 - Tools, Shop and Garage Equipment.

Company's Response

Agreed

Audit's Response

Audit concurs.