

STATE OF NEW HAMPSHIRE

Inter-Department Communication

ORIGINAL	
N.H.P.U.C. Case No.	DW 13-126
Exhibit No.	5
Witness	L. Goodhue, D. Waple J. LaFlamme
DATE:	January 21, 2014
AT (OFFICE):	NHPUC

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

SUBJECT: Pennichuck East Utilities
FINAL Audit Report – DW 13-126

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

INTRODUCTION

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

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

	<u>Estimated</u>	<u>Actual Costs</u>
Merger consideration	\$137,793,398	\$138,413,923
Bond issuance costs and fees	\$ 1,800,000	\$ 996,460
Transaction costs and fees	\$ 5,286,875	\$ 3,859,505
Severance costs	\$ 2,219,612	\$ 2,300,113
Rate Stabilization fund	\$ 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	<u>\$132,688,434</u>		<u>\$127,688,435</u>
Plus the Rate Stabilization Fund in 2131-300-001			<u>\$ 5,000,000</u>
PAC 6201-100-001 Common Stock	\$	100	
PAC 6211-000-001 Additional Paid in Capital	<u>\$ 2,506,739</u>		<u>\$ 2,506,839</u>
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	<u>\$ (529,702)</u>		<u>\$ 15,374,727</u>
Total Allocated City Bond Financing			\$150,570,000

Refer to the Equity portion of this report for further information relating to PEU. Refer to the audit reports for PWW and PAC 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	<u>\$ 8,964,574</u>	
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 PEU Acquisition Premium. Refer to the audit reports for PWW and PAC for further information.

PUC Audit also conducted a review of the eminent domain costs incurred by the City of Nashua. The Order indicates that Nashua can be paid for the eminent domain costs incurred by it through dividends paid by the utilities. The cap on the repayment in any year is \$500,000, with an overall repayment not to exceed \$5,000,000. Refer to the audit report issued October 1, 2013.

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

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

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

Allocation Factors

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

Allocation of Corporate Costs \$427,043

PWW	\$335,418	78.54%	
PEU	\$ 67,108	15.71%	verified to general ledger account 7930-500-001
PAC	\$ 7,450	1.74%	
PWSC	\$ 15,331	3.59%	
TSC	\$ 1,736	0.41%	

Allocation of Return on common Assets \$723,043

PWW	\$555,120	76.78%	
PEU	\$120,789	16.71%	verified to general ledger account 7930-510-001
PAC	\$ 11,550	1.60%	
PWSC	\$ 34,514	4.77%	
TSC	\$ 1,070	0.15%	

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

PWW	\$1,076,662	65.82%	
PEU	\$ 239,906	14.67%	verified to general ledger account 7930-510-001
PAC	\$ 21,245	1.30%	
PWSC	\$ 297,873	18.21%	
TSC	\$ -0-	0.00%	

Allocation of Management Fee \$5,737,028

PWW	\$4,286,519	74.73%
PEU	\$ 933,491	16.27% verified to general ledger account 7930-510-001
PAC	\$ 92,977	1.62%
PWSC	\$ 416,315	7.25%
TSC	\$ 7,726	0.13%

Audit reviewed the calculations and supporting detail for each of the allocations above. Refer to the audit report for PWW in DW 13-130.

Audit also noted an account on the general ledger, #7930-520-001, Interco Management: Inside General Counsel, which reflected two entries in January and February amounting to \$2,608. The debits were offset to the Intercompany 7233-700-001. The timing of the entries appears to relate to the transfer of ownership to Nashua, and should thus be considered non-recurring. Refer to the Non-recurring summary section of this report.

Dockets since the Prior Rate Case

PEU's last full rate case docket DW07-032 was for test year 2006. Since that time, the following dockets and related Orders have been issued:

DW 04-048 relating to the City of Nashua Eminent Domain proceeding.

DW 05-125 related to the PEU purchase of Northern Shores Water Company, originally contemplated to be completed in 2006, sale completed in 2010.

DW 07-032 relating to a settlement agreement, rate case and step adjustment for the Daniels Lake system.

DW08-052 and DW09-051 were consolidated regarding the North Country Systems of Locke Lake, Birch Hill, and Sunrise Estates, which were originally purchased by Pittsfield Aqueduct, and transferred via these dockets to Pennichuck East with rates established.

DW 09-102 increased certain fees.

DW 09-134 authorized a \$6million 20 year loan from CoBANK to refinance existing \$4.5million loan with Bank of America, repay \$1.5million short term debt owed to PCP, and fund ongoing capital improvements.

DW 09-276 authorized PEU to serve new customers at the Winnisquam Village Condo in Tilton and charge existing general meter rates.

DW 10-152 revised the town of Raymond fire protection rate to \$1.76 per customer and a town charge of \$600 per year for each of the twelve meters in town, subject to town approval of the budget each year.

DW 10-330 authorized the use of State Revolving Loan funds (SRF) in the amount of \$300,000 to replace 3,000 linear feet of water main at the Locke Lake system.

DW 11-026 relates to the purchase of the Pennichuck Corporation by the City of Nashua.

DW 11-108 authorized the use of \$400,000 SRF for replacement of a pump station in Raymond at the Liberty Tree water system.

DW 11-111 authorized an increase to the fire protection rates in Litchfield.

DW 11-224 approved the sale of three lots in Conway on West Side Road and retention of a 25 foot easement for the maintenance of the interconnection line between the North Conway Water Precinct and the Birch Hill system. Refer to the Property Tax portion of this audit report.

DW 11-262 authorized the use of \$400,000 SRF to replace 8,500 feet of water main in the Locke Lake system.

DW 11-267 approved an increase in the short-term debt limit from 10% of net plant to 15% in order for the existing Business Finance Authority loan could be repaid, and to retire the debt to the PCP.

The following dockets were opened during or after the 2012 test year:

DW 12-349 relating to an increase in the short term debt limit to 18%.

DW 13-017 relating to refinancing of two existing short term debt instruments and the refinancing of long term debt to the PCP.

DW 13-125 relates to the approval of \$850,000 SRF to replace 6,800 linear feet of main in the Locke Lake system and an interconnection of the Avery Estates with the Hudson water system.

DW 13-126 is the current full rate case docket.

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

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

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

Minutes of the 1/25/2013 meeting include the court concluding that employee salary information may be considered confidential, with the exception of the top three

executives. L. Goodhue requested Board approval of a loan from Pennichuck Corp to PEU in the amount of \$3million (10 year 2.65%) to replace short term intercompany receivables between the Company and PEU.

The annual meeting took place on March 23, 2013.

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

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

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

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

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

The Pennichuck East Utility, Inc. subsidiary Board of Directors met once in 2012 and twice in 2013:

- 12/18/2012 minutes reflect the Master Loan Agreement dated 2/9/2010 between PEU and CoBank and the need to enter into two new loans: \$950,000 over 20 years and \$1,723,150 over 10 years, with anticipated closing in March 2013. A resolution attached to the minutes authorized the officers of PEU to borrow money and execute all necessary documents.
- 1/25/2013 minutes authorized PEU to borrow \$3,000,000 from Pennichuck Corporation over a 10 year term at a rate of 2.65%. Proceeds of the loan will replace "*current short term intercompany debt between PEU and Pennichuck Corporation*".
- 2/22/2013 minutes authorized the distribution from PEU to Pennichuck Corporation of \$823,957.75, with \$71,786.64 from retained earnings and \$752,171.11 from additional paid in capital, to fund Pennichuck Corporation's payment of the City debt. Distribution authorized for 2/28/2013.

UTILITY PLANT

As of 12/31/2012, Audit verified the reported plant in service to the following:

General Ledger Account Name and Number		1/1/2012	debits	credits	12/31/2012
Organiza on Expense	7301-000-001	\$ 385,400	\$ 1,000	\$ -	\$ 386,400
Franchise Fees Castle Reach	7302-230-001	\$ 48,432	\$ -	\$ -	\$ 48,432
Land	7303-100-001	\$ 459,540	\$ 65,591	\$ (16,961)	\$ 508,170
Easements	7303-240-001	\$ 421,041	\$ 86,748	\$ (64,997)	\$ 442,792
Dstrbtn Reser&Standpipe Land	7303-500-001	\$ 5,096	\$ -	\$ (5,096)	\$ -
Distrbtn System RoW	7303-600-001	\$ 69,584	\$ -	\$ (69,584)	\$ -
		\$ 955,261	\$ 152,339	\$ (156,638)	\$ 950,962
Source of Supply Structures	7304-100-001	\$ 3,607,829	\$ 94,391	\$ -	\$ 3,702,220
Power & Pumping Structures	7304-200-001	\$ 1,686,638	\$ -	\$ -	\$ 1,686,638
Structures & Imprvmnts-Roo ng	7304-210-001	\$ 5,651	\$ -	\$ -	\$ 5,651
Booster Sta ons	7304-550-001	\$ 763,567	\$ 54,477	\$ (5,448)	\$ 812,597
WTP Structures	7304-800-001	\$ 51,801	\$ -	\$ -	\$ 51,801
		\$ 6,115,486	\$ 148,868	\$ (5,448)	\$ 6,258,906
Wells and Springs	7307-100-001	\$ 1,925,755	\$ 14,600	\$ (10,712)	\$ 1,929,643
Well Pumping & Piping	7307-210-001	\$ 133,767	\$ 30,332	\$ (10,327)	\$ 153,772
		\$ 2,059,522	\$ 44,932	\$ (21,039)	\$ 2,083,415
Supply Mains S/S Pumping Plant	7309-200-001	\$ 480,758	\$ -	\$ -	\$ 480,758
Power Genera on Equipment	7310-000-001	\$ 482,894	\$ 18,043	\$ (1,804)	\$ 499,132
Electric Pumping Equipment	7311-200-001	\$ 1,434,088	\$ 3,901	\$ (4,266)	\$ 1,433,724
Pumping Equipment-Pumps	7311-210-001	\$ 90,389	\$ 40,310	\$ (5,395)	\$ 125,304
Pumping Equipment-Meters	7311-220-001	\$ 18,639	\$ -	\$ -	\$ 18,639
Other Pumping Equipment	7311-600-001	\$ 4,176	\$ -	\$ -	\$ 4,176
		\$ 1,547,293	\$ 44,211	\$ (9,661)	\$ 1,581,842
Puri ca on System Equipment	7320-000-001	\$ 701,359	\$ 42,515	\$ -	\$ 743,874
Other Produc on Equipment	7320-100-001	\$ 19,383	\$ -	\$ -	\$ 19,383
Water Treatment Equipment	7320-200-001	\$ 351,108	\$ 50,403	\$ (777)	\$ 400,735
WTP Equipment Filter Media	7320-310-001	\$ 15,737	\$ 1,386	\$ -	\$ 17,124
		\$ 1,087,587	\$ 94,305	\$ (777)	\$ 1,181,115
Dstrbtn Resvrs & Standpipes	7330-000-001	\$ 1,769,826	\$ -	\$ -	\$ 1,769,826
Pavements-Transmission Mains	7331-001-001	\$ 877	\$ -	\$ -	\$ 877
Pavements-Distribu on Mains	7331-002-001	\$ 524,197	\$ 228,592	\$ -	\$ 752,789
Pavements-Gates	7331-003-001	\$ 5,827	\$ -	\$ -	\$ 5,827
Mains 6" & Larger	7331-100-001	\$ 10,162,569	\$ 546,575	\$ (73,032)	\$ 10,636,112
Mains 4" & Under	7331-101-001	\$ 1,010,429	\$ 349,628	\$ (52,948)	\$ 1,307,110
Mains Unknown Size	7331-102-001	\$ 5,300,147	\$ -	\$ (6,581)	\$ 5,293,566
Mains CIAC 6" & Larger	7331-150-001	\$ 5,305,695	\$ -	\$ -	\$ 5,305,695
Mains CIAC 4" & Under	7331-151-001	\$ 865,893	\$ -	\$ -	\$ 865,893
Mains CIAC Unknown Size	7331-152-001	\$ 622,095	\$ -	\$ -	\$ 622,095
Distribu ons Mains New	7331-200-001	\$ 48,550	\$ -	\$ (78)	\$ 48,473
Gates 4" & Under	7331-250-001	\$ 233,718	\$ 50,943	\$ (3,285)	\$ 281,376
Gates 6" & Larger	7331-251-001	\$ 44,441	\$ 11,840	\$ (1,184)	\$ 55,097
Gates Unknown Size	7331-252-001	\$ 153,606	\$ -	\$ -	\$ 153,606
Distribu on Mains CIAC	7331-300-001	\$ 182,718	\$ -	\$ -	\$ 182,718
		\$ 24,460,762	\$ 1,187,578	\$ (137,107)	\$ 25,511,233

General Ledger Account Name and Number		1/1/2012	debits	credits	12/31/2012
Pavements-Services	7333-004-001	\$ 71,474	\$ -	\$ -	\$ 71,474
New Services	7333-100-001	\$ 1,984,233	\$ 23,724	\$ (2,311)	\$ 2,005,647
Renewed Services	7333-200-001	\$ 552,197	\$ 168,906	\$ (18,525)	\$ 702,578
Services CIAC	7333-230-001	\$ 659,075	\$ 59,608	\$ (3,813)	\$ 714,870
CIAC Paid	7333-250-001	\$ 878,053	\$ 23,459	\$ (7,648)	\$ 893,863
		\$ 4,145,032	\$ 275,697	\$ (32,297)	\$ 4,388,432
Metering Equipment	7334-000-001	\$ 996,336	\$ 37,562	\$ (167,240)	\$ 866,658
Radios for Metering	7334-100-001	\$ 663,243	\$ 11,145	\$ (4,195)	\$ 670,194
		\$ 1,659,579	\$ 48,707	\$ (171,435)	\$ 1,536,851
Fire Protec on Equip-Hydrants	7335-000-001	\$ 428,476	\$ 22,250	\$ (2,225)	\$ 448,501
Hydrants-Paving	7335-005-001	\$ 4,606	\$ -	\$ -	\$ 4,606
Hydrants CIAC	7335-100-001	\$ 516,678	\$ -	\$ -	\$ 516,678
		\$ 949,760	\$ 22,250	\$ (2,225)	\$ 969,785
Other Trans/Dist Equip	7339-000-001	\$ 89,767	\$ -	\$ -	\$ 89,767
Office Furniture & Equipment	7340-100-001	\$ 2,689	\$ -	\$ -	\$ 2,689
Shop Equipment	7343-000-001	\$ 107,693	\$ -	\$ (14,044)	\$ 93,649
Lab Equipment	7344-000-001	\$ 9,529	\$ -	\$ -	\$ 9,529
Communication Equipment	7346-000-001	\$ 371,806	\$ 33,171	\$ -	\$ 404,977
Computer Equipment	7347-110-001	\$ 35,182	\$ -	\$ -	\$ 35,182
Miscellaneous General Equipment	7348-000-001	\$ 368	\$ -	\$ -	\$ 368
Total Plant in Service		\$ 46,764,626	\$ 2,071,100	\$ (552,475)	\$ 48,283,251

At year-end 2012, the total reported utility plant in service on the filing schedule 2 was \$48,293,325. That total is comprised of the above general ledger accounts which sum to \$48,283,314. The total on the filing also includes general ledger account #7103-000-001, Property Held for Future Use, \$10,012. This figure should not be considered as used and useful plant in service for ratemaking purposes.

Bidding

The Company states that they follow the general bid process for significant capital projects that exceed \$10,000 as defined by the Company's requisition policy. Audit received PAC's Record of Bids/Proposals from 2010 through 2012 and tested the policy against the sample of projects chosen for review. The Company's Bid Process Overview – Significant Capital Projects lists exceptions to the bid process as:

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

Additions and Retirements to Plant

Activity since the prior audit (DW 07-032, test year ended 2006) was reviewed with the following activity noted:

	Additions	Retirements	Adjustments	Adjustments
2007	\$1,355,788	\$(347,267)	\$ -0-	\$91,229
2008	\$1,391,896	\$(107,280)	\$ (2,396)	\$ 2,107
2009	\$1,923,548	\$(664,763)	\$ (1,042)	\$ -0-
2010	\$ 851,753	\$(241,971)	\$ -0-	\$ 7,084
2011	\$1,912,523	\$(188,942)	\$(56,240)	\$ -0-
2012	\$1,767,706	\$(249,081)	\$ -0-	\$ -0-

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 Schedule 2 with no exceptions.

The following are the specific projects Audit chose for review:

Birch Hill SCADA, North Conway, 2012 Work Order #1201769

The total work order for the above project was \$33,171. Audit could not match the project to the record of bids/proposal sheet, but the Company explained that Electrical Installations Inc. is the sole source SCADA integrator for the North Conway Water Precinct and for PEU. Also due to the fact that the work had to be completed before the winter, Electrical Installations Inc. was the most efficient procurement means to complete the work completely.

Electrical Installations, Inc. completed the work in late 2012 with the project posted to the general ledger on 12/01/2012. The system is a new asset with no retirements. This project makes a connection between the Birch Hill Chlorination Station, the Birch Hill Meter Station and the North Conway Water Precinct and was required by the purchase agreement with the North Conway Water Precinct.

Electrical Installation submitted a progress billing for \$32,900 and PEU inventory and materials of \$271. The project was charged to the general ledger as follows;

#7346-000-001 – Communication Equipment	<u>\$33,171</u>
Total Project Cost per General Ledger	\$33,171
Project Costs per Work Order	\$33,171

Audit reviewed the invoice for timeliness, account distribution and proper approval for payment provided for with the project with no exceptions noted.

Paint Storage Tanks, Airstrip Pump Station, Lock Lake, 2012 Work Order #1205634/01

This work order was for the repair and painting of two 18,000 gallon storage tanks at the Airstrip Pump Station in Locke Lake. No bids were taken because it was an emergency project in which time did not allow for the bidding process. The final costs were posted to the general ledger on 12/1/2012. There were no retirements or cost of removal associated with the repair and painting of the assets.

The project was charged to the general ledger as follows;

#7304-100-001 – Source of Supply Structures	<u>\$89,954</u>
Total Work Order Cost per General Ledger	\$89,954
Project Costs per Work Order	\$89,954

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

Castle Reach DBP Treatment, Windham, 2012 Work Order #1202153/01

The work order was for the engineering and installation of a treatment system to remove Disinfection Byproduct Precursors (DBP) at the Castle Reach pump station. There was no bidding due to the emergency situation which precludes the Company from bidding out the project. The total cost of the project was \$43,902 and the total for the work order reviewed was \$15,623 and posted to the general ledger plant account on 10/1/2012.

There were no Engineering and IS overhead charges to PEU on the work order with labor of \$2,747 posted to the general ledger account #7233-700-001 – Intercompany Payable/Receivable PEU/PWW. Overhead was charged at the 2012 rate of 68.42% and totaled \$1,879. The Water Treatment upgrades were all new assets with no retirements.

The project was charged to the general ledger as follows;

#7320-000-001 – Purification System Equipment	<u>\$15,623</u>
Total Project Cost per General Ledger	\$15,623
Project Costs per Work Order	\$15,623

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

Lock Lake Main Replacement, Center Barnstead, 2011 Work Order #1100884/01

The North Shore Drive project was for the replacement of 8,750' of 4" and 6" water main with a chronic leak and repair history on North Shore Road and the cul-de-sacs off of Varney and Rogers Road.

Three bids were received for the project with R.H White, the lowest bidder, was chosen for the job. The work order shows five progress payments to R.H. White totaling \$420,109 with the project 90.50% complete. The work order shows several \$75 credits totaling \$855 posted to the project for fees for the purchase of bid documents.

Engineering and IS overhead charged to the work order totaled \$22,887 with labor of \$2,072. Overhead was charged at the 2011 rate of 65.43% and totaled \$1,356.

The project was charged to the general ledger as follows;

#7331-002-001 – Pavements-Distribution Mains	\$ 4,505
#7331-100-001 – Distribution Mains-6” or Larger	266,545
Credit noted in 7331-100-001 for bid documents	(855)
#7331-101-001 – Distribution Mains-4” or Under	69,505
#7331-250-001 – Gates – 4” or Under	4,768
#7331-251-001 – Gates – 6” or Larger	20,528
#7333-200-001 – Renewed Services	<u>83,356</u>
Total Project Cost per General Ledger	\$448,352

The offset of the \$855 credit was posted to 7105, Work on Progress.

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

Spruce Pond Treatment, Windham, 2011 Work Order #1104250/01

The Spruce Pond Treatment project was for the installation of iron/manganese treatment system, brine backwash system and tank due to the high mineral levels found in the water. Three bids were received for the construction of the building with the two low bidders, Lewis Companies, chosen for the structural work and R.H White installing the tank. Two bids were received for the 6000 gallon fiberglass brine backwash tank with the low bidder Xerxes delivering the tank. R.J Prescott invoices totaled \$47,904 including a 15% mark-up, Lewis Companies totaled \$45,378 and Electrical Installations Inc. invoice totaled \$9,997 including a 15% mark-up. The project and the work order were completed in 2011 and totaled \$131,400 including other miscellaneous truck and equipment charges. The installation consisted of all new assets requiring no retirements.

Engineering and IS overhead charged to PEU totaled \$11,339 and labor totaled \$959 posted to the general ledger account #7233-700-001 – Intercompany Payable/Receivable PEU/PWW. Overhead was charged at the 2011 rate of 65.43% and totaled \$275. The project was charged to the general ledger as follows;

#7304-210-001 – Structure & Improvements – Roofing	\$ 1,090
#7304-800-001 – WTP – Structures	48,048
#7311-200-001 – Electric Pumping	19,261
#7320-200-001 – Water Treatment Equipment	61,889
#7334-000-001 – Metering Equipment	<u>1,112</u>
Total Work Order Cost per General Ledger	\$131,400
Project Costs per Work Order	\$131,400

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

Northern Shores Station Improvements, Winnisquam, 2012 Work Order #1205160/01

The Northern Shores Station Improvements include structural modifications, electrical system improvements, adding disinfection and iron/manganese filtration and installing communication equipment. Four bids were received for the project, with LWR Water services, Inc. who carried out the contract, chosen as the lowest bidder.

This work order totaled \$83,246 and appears still active at year-end 2012.

Engineering and IS overhead charged to PEU totaled \$2,030 and labor totaled \$915 posted to the general ledger account #7233-700-001 – Intercompany Payable/Receivable - PEU/PWW. Overhead was charged at the 2012 rate of 68.42% and totaled \$626.

The project was charged to the general ledger as follows;

#7304-550-001 – Booster Stations	\$54,477
#7310-000-001 – Power Generation Equipment	18,043
#7311-210-001 – Pumping Equipment: Pumps	2,946
#7320-200-001 – Water Treatment Equipment	<u>7,765</u>
Total Project Cost per General Ledger	\$83,231
Project Costs per Work Order	<u>\$83,246</u>
Variance	(\$15)

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

Retirements

Combined plant retirements reported on the Asset Disposition Report totaled \$249,081 for the 2012 test-year. This amount agreed with the PUC Annual Report Schedule F-8 - Utility Plant. The PUC annual reports reflect retirements and adjustments since the prior 2006 rate case of:

2007	\$(347,267)	
2008	\$(107,280)	
2009	\$(664,763)	
2010	\$(241,971)	
2011	\$(188,942)	\$(56,240) adjustment
2012	\$(249,081)	

Cost of Removal and Salvage

The Chart of Accounts requires that utilities book asset disposition and related cost or salvage to the appropriate plant account and accumulated depreciation account. PEU uses sub-accounts 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.

The Accumulated Depreciation - Cost of Removal account 7108-001-001 reflected \$408,233 at 12/31/2012 with net activity throughout the year of \$117,672.

The Accumulated Depreciation-Loss reflected a year-end balance of \$1,062,069, with net activity throughout the year of \$112,935.

2012 Retirement of Metering Equipment in account 7334-000-001

The 2012 PUC Annual Report shows meter retirements for 2012 totaling \$167,942. This amount agrees with the general ledger account 7334-000-001 and the Asset Disposition Report. The Asset Disposition Report shows Cost of Removal totaling \$18,766 and agrees with the 2012 general ledger. The total does not include retirements in account 7334-100-001, Radios for Metering, which sum to \$4,195. Activity on the annual report does not precisely coincide with the general ledger, although the total for the year of the combined 7334 accounts do agree without exception.

Retirement Locke Lake

In response to a request for the retirements related to the Locke Lake North Shore Drive main replacement (see Plant Additions), Audit was provided with the Asset Disposition report for 2011 which reflected a basis of \$8,169 and accumulated depreciation through 2011 of \$576, loss of \$7,593.

The cost of removal report for work order 1100884 was also provided which reflected the acquisition costs as of 12/1/2011 of \$448,327 and related cost of removal per basis item of \$44,470, resulting in a net book of \$403,857.

Retirement Northern Shores

In response to a request for the retirements related to the Northern Shores improvement project (see Plant Additions), Audit was provided with the cost of removal report for 2012 which reflected a basis of \$83,231 and related cost of removal per basis item of \$8,323 resulting in a net book of \$74,907.

Vehicles

All Company vehicles are owned by PWW and charged to PEU when utilized by the utility.

Construction Work in Progress (CWIP)

The 2012 ending general ledger balance for CWIP - Account #7105-222-001 of \$427,611 was verified to the PUC annual report and filing schedule 2 without exception. CWIP consists of 6 various projects. The three largest amounts expended for the test-year were the Liberty Tree Station Replacement in the amount of \$40,836, the Pelham Marsh Road Main Relocation project for \$257,595 and the Emergency Generator project for \$113,811.

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 Company explained that the hours worked for the project in the month are multiplied by the employee's hourly rate plus a factor in the overhead percentage based on the prior years-end management fee schedule of benefits. The total charge includes overhead at 38.33% and overtime at 38.33 + 1.5% or 39.83%. Audit traced the charges to the Work Order Detail Report for several projects that were reviewed and found no exceptions.

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.

Contributions in Aid of Construction (CIAC)

The PUC annual report and filing Schedule 2B, page 1 reflect CIAC in the amount of \$(9,711,811). Audit verified the total to the following general ledger accounts and related activity for 2012:

		1/1/2012	Debits	Credits	12/31/2012
7271-200-001	CIAC	\$ (4,015,528)	\$ 3,813	\$ (69,329)	\$(4,081,043)
7271-204-001	CIAC Maple Hills Grant	\$ -	\$ -	\$ (8,462)	\$ (8,462)
7271-206-001	CIAC Locke Lake Grant	\$ -	\$ -	\$ (1,196)	\$ (1,196)
7271-250-001	CIAC Londonderry MWW	\$ (603,000)	\$ -	\$ -	\$ (603,000)
7271-300-001	CIAC Season Lane Londonderry	\$ (15,400)	\$ -	\$ -	\$ (15,400)
7271-302-001	CIAC Pelham	\$ (84,300)	\$ -	\$ -	\$ (84,300)
7271-303-001	CIAC Litchfield	\$ (147,293)	\$ -	\$ (1,845)	\$ (149,138)
7271-304-001	CIAC Bow	\$ (9,600)	\$ -	\$ -	\$ (9,600)
7271-305-001	CIAC Lakeview Farms Windham	\$ (40,000)	\$ -	\$ (6,000)	\$ (46,000)
7271-325-001	CIAC Meadowbrook Pump Station	\$ (18,900)	\$ -	\$ -	\$ (18,900)
7271-350-001	CIAC Oakwood	\$ (36,000)	\$ -	\$ -	\$ (36,000)
7271-360-001	CIAC Smythe Woods Hooksett	\$ (20,690)	\$ -	\$ -	\$ (20,690)
7271-370-001	CIAC W&E	\$ (32,805)	\$ -	\$ -	\$ (32,805)
7271-380-001	CIAC Fletchers Corner Arsenic	\$ (68,650)	\$ -	\$ -	\$ (68,650)
7271-400-001	CIAC Dev Instal	\$ (4,536,626)	\$ -	\$ -	\$(4,536,626)
		\$ (9,628,792)	\$ 3,813	\$ (86,832)	\$(9,711,811)

Audit verified the offsetting CIAC related asset accounts to the net activity for the year. Specifically:

7333-250-001 Services-CIAC	\$55,795
Cash related to CIAC	\$ 9,720
Cash related to Maple Hills Grant	\$ 8,462
Cash related to Locke Lake Grant	\$ 1,196
Cash related to Litchfield	\$ 1,845
Cash related to Lakeview Farms	\$ 6,000

Accumulated Amortization of CIAC, account 7272-101-001, for the test-year 2012 totaled \$1,407,409 and agrees with the annual report and the filing schedule 2B, page 1. Audit traced twelve months of debits for each account being amortized and recalculated amortization rates with no exceptions. Offsetting credits totaling \$181,786 were verified to the Amortization Expense account 7405-300-001. The expense figure agrees with the PUC annual report and the filing schedule 1. Audit noted that the amortization rates and the depreciation rates agreed with only minor exceptions.

Accumulated Depreciation

The PUC annual report and the filing schedule 2 reflect total accumulated depreciation of \$(9,488,699). Audit verified the total to the following general ledger accounts and related activity throughout the test year:

		1/1/2012	debits	credits	12/31/2012
Accumulated Deprecia on	7108-000-001	\$ (9,961,498)	\$ 174,566	\$ (1,172,068)	\$ (10,959,000)
Accumulated Deprecia on-Cost of Removal	7108-001-001	\$ 290,561	\$ 118,050	\$ (379)	\$ 408,233
Accumulated Deprecia on-Loss	7108-002-001	\$ 949,134	\$ 214,929	\$ (101,994)	\$ 1,062,069
Net Accumulated Deprecia on		\$ (8,721,804)	\$ 507,545	\$ (1,274,440)	\$ (9,488,699)

Refer to the Retirements portion of this report for detailed discussion regarding the accounting for Cost of Removal and Loss.

Depreciation Expense

Depreciation Expense per the PUC annual report agrees with the general ledger account 7403-000-001 which totaled \$1,085,941. The filing schedule 1 reflects a total Depreciation and Amortization expense total of \$859,784 which is the sum of:

7403-000-001 Depreciation Expense	\$1,085,941
7406-xxx-001 Amortization Acquisition Adjustments	<u>\$(266,157)</u> see below
	\$ 859,784

Acquisition Adjustments

Audit verified the net acquisition adjustments noted on the PUC annual report schedule F7 and the filing schedule 1 to the following general ledger accounts:

<u>Acquisition Adjustments</u>	<u>Accumulated Amortization</u>	<u>Net</u>
7114-100-001 Acquisition Adj. \$ (8,985,743)	7115-100-001 \$2,829,588	\$(6,156,155)
7114-101-001 WESCO \$ (7940)	7115-101-001 \$ 2,340	\$ (5,700)
7114-102-001 Castle Reach \$ (185,750)	7115-102-001 \$ 62,713	\$ (123,037)
7114-103-001 White Rock \$ (230,800)	7115-103-001 \$ 75,092	\$ (155,708)
7114-104-001 Lamplighter \$ (276,667)	7115-104-001 \$ 91,211	\$ (185,455)
7114-105-001 Fletchers <u>\$ (331,667)</u>	7115-105-001 <u>\$ 108,692</u>	<u>\$ (222,975)</u>
<u>\$(10,018,567)</u>	<u>\$3,169,536</u>	<u>\$(6,849,030)</u>

The amortization of the adjustments is discussed below.

Amortization

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

7406-100-001 Amortization Acquisition Adjustment	\$(179,146)
7406-101-001 Amortization of WESCO Acq. Adj.	\$ (115)
7406-102-001 Amortization of Castle Reach Acq. Adj.	\$ (6,380)
7406-103-001 Amortization of White Rock Acq. Adj.	\$ (6,795)
7406-104-001 Amortization of Lamplighter Acq. Adj.	\$ (15,454)
7406-105-001 Amortization Fletchers Corner Acq. Adj.	<u>\$ (18,266)</u>
Total Amortization accounts 7406-xx	<u>\$(226,157)</u>

7407-100-001 Amortization Acquisition Premium	\$ 108,605
7407-320-001 Amortization Expense-Deferred Charges	<u>\$ 57,402</u>
Total Amortization Expense 7407-xx	\$ 166,007

Accounts 7406-xxx-001 were combined with the Depreciation Expense account 7403-000-001 \$1,085,941 which agree with the filing schedule 1 total Depreciation and Amortization expense of \$859,784. Audit noted that Organizational Costs of \$386,400 are being depreciated over 20 years at \$19,414 per year. The depreciation of this asset, rather than the amortization of it, has been discussed with the Company in prior rate case audits, as well as with the Director of the Gas/Water division of the NHPUC. The depreciation rather than amortization of the intangible asset was determined to be an acceptable manner of writing the value of the asset down over time. Refer for further information to the Depreciation portion of this report.

The Amortization Expense total of accounts 7407 was verified to the filing schedule 1 without exception.

The Amortization Acquisition Premium account activity was offset to the Acquisition Premium-MARA deferred accounts. On January 25, 2012, \$8,964,574 was posted to account 7188-100-001. Amortization began with the credits reducing the balance by \$9,873 February through May. In June 2012, the balance \$8,925,081 was transferred to account 7186-100-001 with monthly amortization of \$9,863 reducing the balance. Refer for further information to the Deferred Debits section of this report as well as to the MARA Final Audit report issued on 11/19/2013. Audit verified that the filing schedule 1 attachment F eliminated the amortization expense related to MARA, for ratemaking purposes as required by Order 25,292.

Audit verified that there were no deferred assets relating to the prior rate case, DW 07-032. Current expenses relating to this rate filing were posted to account 7186-410-001. The total of \$3,163 was not amortized during the test year.

The total amortization expense noted in account 7407-320-001 was verified to offsets posted to the eleven deferred accounts noted in the Deferred Debits portion of this report.

CURRENT ASSETS

Cash \$30,000

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

7131-120-001 Bank of America-PEU	\$ -0-
7131-125-001 RBS Citizens	\$ -0-
7133-100-001 Other Special Deposits	<u>\$30,000</u>
	\$30,000

Audit requested clarification of the Special deposit, and was informed by the Company: *“The special deposit of \$30,000 is an escrow account with the Town of Barnstead related to Locke Lake water system capital projects. The deposit was initially established in 2009 related to a 2010 water main capital project in Locke Lake. Water main projects have continued to occur in 2011, 2012 and for the foreseeable future. The escrow account is expected to remain in place for several more years as the Company replaces all the water mains and water services (main to stop) in the Locke Lake system that fail to meet AWWA standards for water main.”*

The Company was asked to provide the reconciliations affecting the entities involved in the rate filing Dockets. The scanned documents appear to be in order. The following Treasury Narrative section 12(g) outlines the cash reconciliation process:

- a) All RBS Citizens account reconciliations, including the investment accounts, are done as part of the month-end closing process, are tracked and scheduled within the Monthly Closing Checklist, by the Senior Accountant; these reconciliations are reviewed and approved by the Accounting Manager on a monthly basis. (TR-8)
 - ◆ The Company’s main account is a Concentration Account with RBS Citizens
 - ◆ This account is used as the main operating account to collect cash receipts and to fund the zero balance subsidiary accounts
 - ◆ On a daily basis, checks that clear through the zero balance subsidiary accounts are funded by the concentration account
 - ◆ If the concentration account does not have enough to fund the subsidiary account, the Company has setup an automatic withdrawal to occur from the Line of Credit to cover the shortage
 - ◆ The bank sends notification to the CFO that a transfer has occurred
 - ◆ The decision to initiate transfers shall depend primarily upon the likelihood that operating cash balances are trending towards a negative position (e.g., the need to draw on the Company’s line of credit), the incremental cost of drawing on the line of credit, and the interest income forgone
 - ◆ The company currently holds five zero balance disbursement accounts (“ZBA Accounts”) with the RBS Citizens, which are all funded by the concentration account
 - ◆ Pennichuck Water Works
 - ◆ Southwood Corporation
 - ◆ Pennichuck Water Service Company
 - ◆ Pittsfield Aqueduct Company
 - ◆ Pennichuck East Utility
 - ◆ The Company has one payroll account that is also funded by the concentration account, which Paylocity uses to do ACH transactions for the tax payment and forwards to the appropriate tax authority
 - ◆ Both direct deposit and live employee checks are drawn from the RBS Citizens account
 - ◆ Paylocity wires the money for the direct deposit to each employee’s account
 - ◆ The Company has a Section 125 plan that allows employees to designate a portion of their paycheck for childcare (up to the IRS mandated statutory limit) and medical expense (up to IRS mandated statutory limit) reimbursements (funds are drawn from the PCP Concentration account)

- ◆ These funds are tax exempt, but are forfeited and revert back to the Company if they are not used
- ◆ As claims are made by employees, they will be distributed to Combined Services or CGI (as the broker for these services was changed in mid-2013) LLC through an ACH payment
- ◆ The Senior Accountant uses Macola to reconcile each company's outstanding checks for the month with the aid of the bank statement, and then Macola generates a list to show what cleared during the month and what is still outstanding
- ◆ When a customer bounces a check due to non-sufficient funds in the customer's account, the Customer Service Department receives notification from the bank
 - ◆ The Customer Service Department maintains a list of the bounced checks and the resolution of each
 - ◆ If the check can be re-deposited, it will be included in a separate deposit to the bank
 - ◆ If the check cannot be re-deposited, it will be recorded through the MUNIS to Macola Interface at the end of the month
- ◆ Deposits from the Daily Cash Proof Sheet are compared to the bank statement at the end of each month by the Senior Accountant

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

Accounts Receivable – Billed net \$397,486

Audit verified the Accounts Receivable from the PUC annual report to the filing schedule 2 and the following general ledger accounts without exception:

7141-000-001	Accounts Receivable Billed Revenue	\$390,318
7141-400-001	Accounts Receivable Miscellaneous	\$ 14,296
7143-901-001	Allowance for Doubtful Accounts	\$ <u>(7,128)</u>
	Net Accounts Receivable	\$397,486

Audit requested and was provided with the accounts receivable aging as of 12/31/2013. The reconciliation total of \$394,614 includes the Munis billing system for PEU and PWS. The PEU charges agree with the \$390,318 in account 7173-150-001. The PWS \$4,296 was traced to Water Tight and Backflow net sales and receipts. The aging identifies the PEU system in one spreadsheet and the PEU-North Country system in another aged spreadsheet.

	PEU	PEU-NC
Current	79.46%	62.53%
1-30 days	10.10%	17.43%
31-60 days	07.22%	06.87%
61-90 days	02.18%	04.21%
91-120 days	00.67%	02.59%
Over 120	00.37%	06.37%

The total past due receivable in excess of 120 days amounts to \$1,142 for the PEU system and \$5,514 for the PEU-NC system.

Accounts Receivable Miscellaneous had no activity during the test year. Audit requested clarification of the amount and was told that *“the receivable was originally recorded on PEU books in April 2010. The receivable represents the balance owed by a developer related to the WESCO Booster Station Upgrade. The developer agreed to pay \$44,296 towards the upgrade costs. The Company received \$30,000 cash in 2010 with the balance of \$14,296 to be paid as new service applications are made. The cash contribution was recorded as CIAC. The offset to the \$14,296 was originally recorded to CWIP but in 2012 the Company reclassified to allowance for doubtful accounts in order to clear CWIP and fully reserve for the receivable.”*

The allowance for doubtful accounts was reviewed for reasonableness in conjunction with the aged receivables and the Uncollected Accounts expensed to account #904-000-001 in the amount of \$17,100. The amount expensed in 2011 was \$28,449.

Accrued Utility Revenues \$401,594

Audit verified the Accrued Revenue figure from the PUC annual report to the filing schedule 2 and the following general ledger accounts without exception:

7173-150-001 Unbilled Water Revenue	\$401,594
7173-153-001 Unbilled Revenue Recoupment	\$ -0-
7173-200-001 Unbilled Revenue Recoupment	<u>\$ -0-</u>
Total	\$401,594

Audit requested and was provided with both the December 2012 monthly unbilled revenue calculation as well as the January 2013 unbilled revenue calculation. The calculations reflect the twelve billing cycle and corresponding days between the prior meter read and the end of the year. The journal entry posted to the 7173-150-001 account for 12/31/2012 was \$401,594. The entry automatically reversed and the January 2013 entry in the amount of \$433,135 was posted. Supporting detail for both monthly entries was provided. Overall, the balance reflects a decrease over 12/2011 of \$57,120.

Account 7173-153-001 reflected activity in January and February of 2012 which amounted to \$13,851 in credits, thereby eliminating the beginning debit balance.

Inventory \$22,844

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

7151-101-001 Inventory	\$ 925
7151-101-001 Inventory Meters	<u>\$21,919</u>
Total Inventory	\$22,844

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

Prepaid Expenses \$15,791

Audit verified the total prepaid expenses noted on the filing schedule 2 to the PUC annual report schedules F1 and F23, as well as to the following general ledger accounts:

7162-100-001 Prepaid Insurance	\$10,259
7162-700-001 Prepaid Expenses	<u>\$ 5,532</u>
	\$15,791

7162-100-001 Prepaid Insurance

Account 7162-100-001, Prepaid Insurance, contained monthly debits transactions to cash management and credit transactions to record monthly insurance expenses.

7162-700-001 Prepaid Expenses

The Prepaid Expenses account contains entries to “record prepaid expenses”. Payments to the State of New Hampshire are also noted in this account.

Audit reviewed all of the transactions for the 7162 Prepayment accounts with no exceptions.

Prepaid Property Taxes \$141,200

Audit verified the prepaid property taxes noted on the filing schedule 2 to the PUC annual report schedules F1 and F38, as well as to the following general ledger accounts:

Asset 7163-310-001 Prepaid Property Taxes	\$176,147
Liability 7236-115-001 Local Property Tax Payable	\$ (34,947)
Liability 7236-116-001 Public Utility Tax Payable	<u>\$ -0-</u>
	\$141,200

Audit verified the prepaid figure to one half of the second issue 2012 property tax bills. The property tax payable account was verified to the fourth quarter DRA payment and ½ of the town of Plaistow second issue 2012, both of which were paid after the year-end close 12/31/2012.

Debt Issuance Expenses \$165,300

The Unamortized debt issuance expense noted in the filing on schedule 2 was verified to the PUC annual report schedules F1 and F25 as well as to account 7181-000-001 without exception.

Schedule F-25 of the Annual Report lists eight instruments, bonds and loans and the respective unamortized debt discount. Audit reviewed the amortization of each, and verified the totals to the general ledger. The Amortization of Debt Expense \$10,301, was verified to account 7428-000-001. Audit recalculated the expenses without exception.

Other and Deferred Charges \$9,516,163

Audit verified the total Deferred Assets from the PUC annual report to the filing schedule 1, and to twenty four general ledger accounts without exception. See the amortization of these assets in the Depreciation and Amortization portion of this report.

LIABILITIES and EQUITY

Equity

Common Stock \$(100)

Common Stock listed in the filing on schedule 2A in the amount of \$(100) agrees with the PUC annual report as well as with the general ledger account #7201-100-001. The figure has remained constant for several years.

Paid-in Capital \$(15,409,101)

Other Paid in Capital of \$(15,409,101) in the filing on schedule 2A and the PUC annual report was verified to the following general ledger accounts:

7211-000-001 Additional Paid in Capital	\$(15,904,329)
7219-000-001 Other Comprehensive Income	<u>\$ 495,228</u>
	\$15,409,101

The pro forma noted in the filing on schedule 3, attachment A reflects the elimination of \$(6,000,000) which was verified to the beginning balance in the general ledger, 7211-000-001 as well as to the 4/13/2012 Pennichuck Corporation filing noted in the pro forma.

Audit verified that the total Other Comprehensive Income figure represents 60% of the Derivative balance of \$(825,380) discussed in the Debt section of this report. The remaining 40% of the offsetting Derivative was noted in the Deferred Income Tax Swap account #7282-201-001 in the amount of \$330,152. Refer to the Tax section of this report for additional information. The pro forma noted in the filing on schedule 3, attachment A reflects the elimination of \$529,702 which was verified to the beginning balance in the general ledger, 7219-000-001 \$500,333 plus the 1/25/2012 FAS 133 debit

entry of \$29,368. The total \$529,702 was noted in the 4/13/2012 Pennichuck Corporation filing noted in the pro forma.

Retained Earnings \$(71,787)

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

7215-500-001 Retained Earnings Beginning Balance	\$(1,040,297)
Debit on 1/25/2012	<u>\$ 939,755</u>
7215-500-001 Preliminary Ending Balance	\$ (100,542) at 12/31/2012
Net Loss per Income Statement F2 Annual Report	<u>\$ 28,755</u>
Adjusted Retained Earnings at Year End F3 Annual Report	\$ (71,787)

Audit noted that the pro forma in the filing schedule 3, attachment A reflects elimination of \$939,755, a debit entry which posted on 1/25/2012. The entry was offset to Paid in Capital, 7211-000-001.

Long Term Debt

Bonds, Notes, Mortgages \$(7,978,791)

Audit verified the PUC annual report total of long term debt to the filing schedule 2A and the following general ledger accounts without exception:

		Debt per GL	Current LTD
Per PUC Annual Report F-35		7221-xxx-001	7221-100-001
CoBANK	\$ 4,057,854		
7221-000-001		\$ 3,885,760	
			\$ 172,094
Green Hills	\$ 276,558		
7221-002-001		\$ 189,613	
7221-052-001		\$ 62,378	
			\$ 24,567
Pelham SRF	\$ 435,240		
7221-003-001		\$ 408,807	
			\$ 26,433
Maple Hills SRF	\$ 538,349		
7221-004-001		\$ 512,474	
			\$ 25,875
Birch Hill SRF	\$ 1,732,287		
7221-005-001		\$ 1,656,770	
			\$ 75,517
Locke Lake 2007 SRF	\$ 263,022		
7221-006-001		\$ 185,361	
7221-056-001		\$ 61,411	
			\$ 16,250
Total PUC Annual Report F-35	\$ 7,303,310		
Total Long Term Debt 7221-xxx-001		\$ 6,962,574	
Total Current Portion LTD 7221-100-001			\$ 340,736
			\$ 7,303,310

7221-000-001 Long Term Bonds & Notes. Docket DW 09-134 Order 25,041 dated Nov. 09, 2009, PEU was granted authority to Borrow \$6 million with a 20-year term from CoBank, ACB (CoBank).

7221-002-001 SRF Green Hills. Docket DW 02-021 Order 23,922 of February 22, 2002, PEU was authorized to borrow an amount up to \$462,000 from the Drinking Water State Revolving Loan Funds (SRF) under the terms and conditions set forth by the New Hampshire Department of Environmental Services (DES) which administers those funds to finance improvements to the Green Hills community water system. At the end of the test year the outstanding balance was \$276,558. A footnote on the F-35 indicates *“deferred Gain on SRF Loan was reclassified to Account 7221-052-001 as forgivable debt to properly reflect the Company’s total liability as the amounts are repayable in the event of default: Green Hills SRF \$208,381 + Forgivable Debt \$68,177 = \$276,558.”*

7221-003-001, Pelham Tank Project. Docket DW 04-138 Order 24,375 dated 9/30/2004, PEU requested and received authorization to borrow an amount of \$750,000 from the State Revolving Loan Fund in order to finance the construction of a water

storage tank, the acquisition of land, and associated improvements at its Williamsburg Stonegate system in Pelham.

Under the anticipated terms of the SRF loan, PEU would pay 1% interest on amounts advanced and outstanding during construction. Once construction was completed, PEU began to make monthly payments of interest plus 1/240th of the total amount borrowed. PEU indicated that it provided loan documents to the Commission for review.

7221-004-001 SRF Maple Hills. Docket DW 08-022 Order 24,844 dated 04/04/2008 granted PEU authority to borrow up to \$595,000 in long term debt from the SRF in order to undertake certain capital improvements at its Maple Hills community water system in the Town of Derry.

Accounts 7221-005-001 and 7221-006-001, reflect PAC's request to borrow up to \$2,500,000 from the SRF administered by the DES for capital improvements at its Locke Lake water system in Barnstead and at its Birch Hill water system in Conway. The request was approved in docket DW 07-010 by Order 24,739 dated 4/13/2007. In dockets DW08-052 and DW09-051, via Order 25,051, the Locke Lake and Birch Hill systems (the North Country systems) were transferred from PAC to PEU, along with the long term indebtedness associated with them. Account 7221-056-001, as noted in the discussion of the SRF Green Hills, reflects the forgivable portion of the Locke Lake SRF in account 7221-006-001.

7221-007-001 SRF Loan/Locke Lake 2011. Docket DW 10-330 Order 25,209 dated March 29, 2011, reflects PEU's request and Commission approval to borrow up to \$300,000 in long term debt in order to finance replacement of approximately 3,000 linear feet of water main in the company's Locke Lake water system in the Town of Barnstead. The system serves approximately 850 homes and dates from the 1960's. Pittsfield Aqueduct Company, Inc. (PAC) acquired the system in 2006 and transferred it to PEU on January 1, 2010. The distribution system consists of approximately 97,000 LF of small diameter mains made of substandard materials that are prone to breakage and leakage. Pursuant to RSA 369:1, PEU proposed to borrow from the State Revolving Loan Fund.

The proposed project is also a continuation of needed capital improvements identified by its affiliate, PAC, to improve service at Locke Lake after it acquired the system. See *Pittsfield Aqueduct Company, Inc.*, Order No. 24,606, 91 NH PUC 137 (2006) and *Pennichuck East Utility, Inc.*, Docket No. DW 09-051, Order No. 25,051, 94 NH PUC 701 (2009).

7221-008-001, SRF Loan Liberty Tree. Docket DW 11-108 Order 25,248 of July 7, 2011, reflects PEU's request and Commission approval to borrow up to \$400,000 in long term debt pursuant to RSA 369:1. PEU proposed to borrow from the State Revolving Loan Fund

PEU used the financing for the replacement of the original 1973 pump station and associated water storage facilities serving its Liberty Tree water system in the Town of Raymond. Also included in the proposed project were upgraded treatment facilities and an emergency generator.

7221-009-001, SRF Loan Locke Lake 2012. Docket DW 11-262 Order 25,348 dated April 13, 2012 modifying Order 25,339 On December 2, 2011, PEU filed a petition seeking authority to borrow up to \$525,000 in long term debt pursuant to RSA 369:1. PEU proposed to borrow from the State Revolving Loan The Commission approved PEU's petition in Order No. 25,339 on March 29, 2012.

On April 11, 2012, PEU filed a letter modifying the borrowing to \$400,000 in light of the project no longer qualifying for the 30% principal loan forgiveness. The other terms of the loan remain the same. The purpose of the financing remains replacement of water mains in PEU's 850-customer Locke Lake water system in the Town of Barnstead. PEU originally sought to replace 8,500 linear feet of pipe, however, the median household income in the Town of Barnstead has increased such that it no longer qualifies for SRF loan principal forgiveness. Thus, PEU has reduced the scope of the project to 6,600 linear feet of pipe. The lower \$400,000 SRF loan amount will also allow PEU to keep the average per customer investment in Locke Lake consistent with the average per customer investment in PEU's remaining customer base. The main replacement project is a continuation of SRF-funded system replacement approved in 2011.

Interest Expense Long-term Debt

Interest expensed during the test year, per the general ledger 7427-300-001, was \$289,472.80. The filing schedule 5, PEU Weighted Average Cost of Long-Term Debt For the Twelve Months Ended December 31, 2012, includes a footnote which states "*The annual interest expense is calculated based on the outstanding balance at year multiplied by the stated interest rate. The calculated interest will differ from interest expense recorded in the test year due to loan repayments made during the year.*" The total on the Schedule 5 is \$360,450. Footnote 3 on the schedule states "*The interest rates reflected are expected interest rates per Order 25,248 (DW 11-108) for Liberty Tree and Order 25,348 (DW 11-262) for Locke Lake.*" The interest rates reflected are 1.00%.

Accrued interest appears on the general ledger 7237-110-001 as a \$32,061.

Intercompany Advances \$(6,359,294)

Audit verified the PUC annual report total of Intercompany Advances to the filing schedules 2A and 6, and the following general ledger accounts without exception:

7223-202-001 Interco Advance PCP Prom Note 5/18	\$(1,723,150)
7233-300-001 Interco Payable/Receivable PEU/PCP	\$(4,636,144)
7233-400-001 Interco Payable/Receivable PEU/TSC	\$ -0-

7233-500-001 Interco Payable/Receivable PEU/PWS	\$	-0-
7233-600-001 Interco Payable/Receivable PEU/PAC	\$	-0-
7233-700-001 Interco Payable/Receivable PEU/PWW	\$	-0-
Total Intercompany		\$(6,359,294)

Audit reviewed each of the accounts in detail. Those with zero balance had activity throughout the year which was transferred to the Intercompany 7233-300-001 at year-end. Audit also verified the receivable balances on the affiliate general ledger of PCP without exception.

Intercompany Interest expense in the amount of \$160,224 as noted on the PUC annual report was verified to the general ledger 7427-115-001. Audit verified the interest expense offsets posted to the intercompany accounts as follows:

	<u>12/31/2012</u>	true-up <u>GJ #453</u>	<u>Total</u>
7233-300-001 Interco Pay/Rec PEU/PCP	\$ 142,650	\$ 4,619	\$ 147,269
7233-300-001 Interco Pay/Rec PEU/PCP	\$(119,931)	\$ (9,994)	\$(129,926)
7233-400-001 Interco Pay/Rec PEU/TSC	\$ 4	\$ -0-	\$ 4
7233-500-001 Interco Pay/Rec PEU/PWS	\$ (1,164)	\$ (49)	\$ (1,212)
7233-600-001 Interco Pay/Rec PEU/PAC	\$(39,461)	\$ (1,657)	\$ (41,118)
7233-700-001 Interco Pay/Rec PEU/PWW	<u>\$(129,484)</u>	<u>\$ (5,757)</u>	<u>\$(135,242)</u>
	\$(147,386)	\$(12,838)	\$(160,224)

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

“...on a monthly basis, intercompany interest is calculated on the outstanding average monthly balance for the intercompany accounts. In 2012, amounts that were in a net borrowed position incurred interest at the Fed Discount Rate, while amounts that were in a net invested position earned interest at the MMA Rate. ...The average balances are then assessed interest as described above, based upon the overall borrowed (negative) or invested (positive) aggregate intercompany balance for each company...”

The variable rate interest on the actual intercompany payable/receivable PCP is listed on the first line above. Audit noted that the 7% interest on the \$1,723,150 intercompany advance from PCP is posted to the interest expense account and offset to the same payable/receivable 7233-300-001, at regular monthly payments of \$9,994.27. Audit also noted that the true-up represents thirteen months of interest, as the interest posted in December was not reversed to reflect the calculated true-up. **Audit Issue #1**

Other Long Term Debt \$(825,380)

Other long-term debt on the filing schedule 2A was verified to the general ledger account 7224-100-001, Derivative. Entries noted in the account during the year are offset 60% to 7219-000-001, Other Comprehensive Income, with the remaining 40% posting to Deferred Income Taxes, account 7282-200-001. SFAS 133, Accounting for Derivative

Instruments and Hedging Activities, outlines that derivative instruments should be measured at fair value with adjustments to the carrying amount reflecting changes to the fair value that are attributable to the risk being hedged.

Audit requested the supporting documentation and was provided with a master loan agreement between PEU and CoBANK dated 2/9/2010, the promissory note of the same date, and interest rate swap. The refinancing of the debt and related instruments was approved by the Commission in docket DW09-134, via Order 25,041. A valuation letter from CoBANK dated 12/31/2012 reflected the “dirty”MTM of \$(825,380). The reference of “dirty” MTM represents the value of the bond plus accrued interest, mark to market, as of the date of the valuation letter.

Current Liabilities on the Filing Schedule 2A

Accounts Payable \$(87,267)

The total on the filing was verified to the PUC annual report and general ledger account 7231-000-001 without exception.

Audit reviewed all of the activity in the one Accounts Payable account and selected 32 general ledger transactions to review in detail. Supporting documentation for each selection was provided to Audit. All of the selections made were charged straight to PEU. No invoices were allocated between other subsidiaries. Audit’s findings are noted below:

Customer’s Account

Audit reviewed 5 refunds to customers. Three refunds were for overpayments on the customer’s account and the other two were to correct consumption charges. No exceptions were noted.

Travel & Expenses

PEU did not have any Travel and Expense reimbursements during 2012. Since the acquisition by Nashua, all three companies (PAC, PWW and PEU) have reduced these expenses.

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

Accrued Interest Payable \$(32,061)

The accrued interest figure on the filing was verified to the PUC annual report and general ledger account 7237-110-001 without exception.

Other Accrued Expenses \$(207,662)

The balance noted on the filing was verified to the PUC annual report and the following general ledger accounts:

7241-300-001	Miscellaneous Current Accrued Liability	\$(161,581)
7241-350-001	Accrued Liability-Retainage	\$ (46,081)

7241-300-001 Misc Current Accrued Liability \$(161,581)

The Miscellaneous Current Accrued Liabilities account mostly contained accruals for purchased water, miscellaneous accounts payable, and work orders.

7241-350-001 Accrued Liability – Retainage \$(46,081)

The Accrued Liability- Retainage account contained nine accrual entries and five accounts payable entries.

Audit reviewed all of the transactions for the 7241 Accrued Expenses accounts with no exceptions.

Customer Deposits and Other \$(2,032)

The Customer Deposits total was verified to the PUC annual report and general ledger account 7235-250-001. The account represents hardship case credits which are used to offset small customer account balances.

Deferred Income Taxes \$(3,795,711)

The total deferred income tax figure noted on the filing was verified to the PUC annual report and the following two general ledger accounts:

7282-200-001	Deferred Income Taxes	\$(4,125,863)
7282-201-001	Deferred Income Tax-Swap	<u>\$ 330,152</u>
	Net Deferred Income Taxes	\$(3,795,711)

Refer to the Other Long Term Debt portion of this report regarding the Deferred Income Tax-Swap account and activity.

REVENUE

Revenue reported on the filing schedule 1 in the amount of \$6,283,366 was verified to the PUC annual report as well as to the following general ledger accounts.

7460-100-001	Capital Recovery Surcharge	\$ (300,353)
7460-200-001	CBFRR	\$ (823,958)
7460-998-001	CBFRR Contra	<u>\$ 823,958</u>
	Net Unmetered Sales to Customers	\$ (300,353)

7461-000-001 Water Sales Billed Revenue	\$(5,218,811)	
7461-001-001 Water Sales Billed Recoup	\$ 4,513	
7461-100-001 Unbilled Revenue	\$ 57,120	
7461-200-001 Unbilled Recoupment	\$ (2,579)	
7461-300-001 Unbilled Capital Recovery	\$ 13,851	
7461-400-001 Billed Capital Recovery	\$ (13,851)	
Total Metered Sales to Customers		\$(5,159,757)
Total Fire Protection 7462-000-001		\$ (775,061)
Total Miscellaneous Service Revenue 7471-300-001		<u>\$ (48,196)</u>
Total Revenue		<u>\$(6,283,366)</u>

The Capital Recovery Surcharge represents capital costs incurred when Pennichuck took over three small water systems and invested in the infrastructure of each. Dockets DW 08-052 and DW 09-051 approved the surcharge per settlement agreement dated 9/25/2009 and approved by Order 25,051. Specifically, the surcharge per system per customer was authorized over 30 years to be:

Locke Lake	\$17.00 per 824 customers = \$168,100 per year
Birch Hill	\$47.21 per 206 customers = \$116,702 per year
Sunrise Estates	\$11.01 per 79 customers = <u>\$ 10,440 per year</u>
	\$295,242

In response to Staff data request #2-15, the Company indicated that the surcharge for 2012 in the amount of \$300,353 was based on an increase in the number of customers in all three systems, as well as a decrease in the Birch Hill rate due to a sale of land approved in docket DW 11-224, by Order 25,309 dated 12/29/2011. The revised surcharge was approved as \$46.94 for the Birch Hill system. The revised tariff page issued 1/29/2012 was effective 7/10/2012. Audit noted the reflection of the surcharges on the first revised page 48, but the original page 49 reflects the original Birch Hill charge of \$47.21. The page should be updated with the \$46.94 authorized by Order 25,309. Refer to Staff data request and the Company response to DR 2-32. The Company stated that it should have updated the tariff page 40. Audit believes the reference should be that page 49 should be updated with the revised Birch Hill surcharge rate. The total surcharge for the test year was noted as a proforma reduction to sales on the filing schedule 1, attachment A.

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 7461-000-001 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 7461-001-001, Water Sales Billed Recoupment, represents the remaining authorized amount of the difference between temporary and permanent rates related to docket DW 08-052. The recovery period was authorized by Order 25,076 for an 18-month period. Audit requested clarification of the amounts noted in the test year, as the recovery should have been fully collected in 2011. The Company noted that the amounts should have been reversed, and will be written off during the 2013 close. There is no recommended adjustment, as the recovery amounts are not part of the revenue used for rate-making purposes.

Tariff Test

Audit reviewed twenty customer twelve month histories representing a variety of customer classes. Two specific invoices from each of the three North Country systems, Locke Lake, Birch Hill, and Sunrise Estates were included in the selection.

The capital recovery surcharge of \$11.01 per month was noted on the two Sunrise Estates customer histories. The capital recovery surcharge of \$17 per month was noted on the two Locke Lake customer histories. The capital recovery surcharge of \$47.21 per month through June 2012 was noted on the two Birch Hill customer histories, and \$46.94 for the months thereafter.

For those customers in the North Country systems, the billing histories reflected the surcharges noted above, a meter charge, a minimum charge of the usage rate of \$5.61 times 4 CCF = \$22.44. Actual usage over 4 CCF was calculated at the usage rate and noted as a separate line item charge. The overall monthly minimum charge and usage charges were accurately calculated for those selections tested. Meter charges were also verified to the tariff original page 47 without exception.

PEU customers outside of the North Country systems reflected the accurate meter charge noted on the Fifteenth revised page 38, and consumption charges of \$5.61 per 100 cubic feet. Public fire protection charges, which vary by town, were verified to the respective tariff pages without exception.

OPERATIONS and MAINTENANCE (O&M) Expenses \$4,096,873

The filing Schedule 1, reflects the total O&M Expenses of \$4,096,873. Audit reviewed the detailed general ledger activity for all of the O&M Expense accounts.

Production Expenses \$1,677,338 is comprised of the following:

<u>7601-100-001</u> Other Production Labor	\$ 22,499
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Audit reviewed the 12 monthly transactions in the general ledger account with no exceptions. The year-end total reflects an increase of 24% over 2011.

7602-xxx-001 Purchased Water \$ 729,948

Audit verified the total purchased water to thirteen individual general ledger accounts. Journal entries were reviewed for all thirteen accounts without exception. The percentage change over the 2011 year-end balance is 2%.

7610-xxx-001 Maintenance Supervision and Engineering \$ 38,868

The total Maintenance Supervision and Engineering was verified to two general ledger accounts and represents a 21% increase over 2011. Entries in the general ledger were to record and accrue labor, vacation and benefits of one individual.

7623-xxx-001 Fuel or Power Purchased for Pumping \$ 249,663

The total Fuel or Power Purchased for Pumping was reviewed and verified to forty-one general ledger accounts without exception. The majority of the transactions were to record the payment to the power company, with the minority of the transactions being for accruals. For the year, the total represents a decrease of 6% over the same period ending 2011.

7626-xxx-001 Miscellaneous Expenses \$ 11,435

The total Miscellaneous Expenses was verified to two individual general ledger accounts and represents an increase of 13% from the same period, 2011. Audit reviewed the general ledgers of the two accounts in detail and noted they contained entries for payments to vendors and reclasses from PWW. No exceptions were noted.

7631-100-001 Maintenance of Structures: Booster Stations \$ 207

Audit reviewed the detailed general ledger for account 7631-100-001. The account contained six transactions, a payment to a vendor, a reclass from PWW and four accruals. The year-end total of \$207 represents a 93% decrease over the year-end balance of 2011. No exceptions were noted.

7633-xxx-001 Maintenance of Pumping Equipment \$ 483,108

The total Maintenance of Structures and Improvements was reviewed and verified to five individual general ledger accounts without exception. For the year, the total represents an increase of less than 1% over the same period ending 2011.

USA BlueBook

Audit reviewed a 7/27/12 invoice from USA BlueBook in the amount of \$1,561.45 from account 7633-100-001, Maint of Struct: Booster Stat. The invoice detailed a pump valued at \$1,528.75 and freight of \$32.70 make up the total due. The purchase order and packing slip state this pump is for a Williamsburg well.
Audit Issue #2

7641-xxx-001 Chemicals \$ 69,239

The total of the Chemicals accounts was verified to eleven 7641 general ledger accounts and account 7633-212-001, W&E Pump Station: WM-Chemicals. The account balance decreased 22% over 2011. Audit reviewed the activity in all twelve accounts without exceptions.

7642-xxx-001 Operation Labor and Expenses \$ 62,076

Operation Labor and Expenses total was verified to two individual general ledger accounts without exception. Activity in the accounts included vendor invoices, lab fees, and a couple accruals. The total for the year represented a decrease over 2011 of 5%.

7652-220-001 Maintenance Proc. Equip: SCADA & Other \$ 10,295

Audit reviewed the detailed general ledger for account 7652-220-001 with no exceptions. Activity in the account included utility invoices, vendor invoices, and accruals. The change from 2011 was an increase of 24%.

Transmission & Distribution Expenses \$629,086 is comprised of the following:

7660-xxx-001 Operation Supervision and Engineering \$ 25,912

Operation Supervision and Engineering was verified to two specific general ledger accounts. Audit reviewed the general ledger detail for both accounts without exceptions. The year-end balance of \$25,912 is an increase of 20% over 2011.

7662-004-001 Misc: T&D Material & Supply \$ 209

Audit reviewed the one journal entry, for an AP payment, in the miscellaneous general expenses account without exception. The year-end balance increased by \$195 or 1,393% over 2011. Because of the large increase over the year, PEU provided an explanation with their annual report. PEU noted that the large increase was due to an increase in materials costs.

7663-xxx-001 Meter Expenses \$ 51,468

Total Meter expenses were verified to two specific general ledger accounts. Transactions in both accounts were for PEU Maintenance. The balance at year-end 2012 represents a decrease of 42% over the same period 2011. No exceptions were noted.

7664-200-001 Other Expense on Customer Premises \$ 20,106

Audit reviewed the general ledger transactions for account 7664-200-001. Transactions include PEU Maintenance, reclass water sales, and to pay water bill-hardship. The 2012 year-end balance increased 841% over 2011. This increase was noted by a memo attached to PEU's annual report as being "*primarily due to a reimbursement of water charges to customers as a result of an e-coli incident in the Locke Lake water system*". No exceptions were noted.

7665-100-001 Small Tools Expense: NC \$ 2,269

The balance in the Small Tools Expenses account reflects an 89% increase over the 2011 year-end balance. PEU noted in the memo attached to their annual report that the increase was due to increased small tools expenses. Entries included accruals, reclasses from other subsidiaries, and vendor payments. No exceptions were noted in the general ledger detail.

7673-xxx-001 Maintenance of Transmission & Distribution Mains \$ 304,660

Audit verified the Maintenance of Transmission and Distribution Mains total to four specific general ledger accounts. The activity in all four general ledgers was reviewed with no exceptions. The total for the year represents a 19% increase over the same period in 2011.

7675-000-001 Maintenance: Services \$ 149,347

Audit reviewed the detailed general ledger for the Maintenance: Services account. Entries included vendor invoices, intercompany expenses from PWW and PAC, accruals, and PEU Maintenance entries. No exceptions were noted. The Maintenance: Services account balance was a reduction of 22% from 2011.

7676-000-001 Maintenance: Meters \$ 10,388

The Maintenance: Meters account decreased 20% over 2011 ending balance. Transactions in general ledger account 7676-000-001 reflect entries for PEU maintenance and for recording the replacement of chamber components. Previously, the chamber components were capitalized but due to the low cost and frequency of replacement compared to the actual meter, PEU felt expensing the parts is a more appropriate accounting method.

7677-xxx-001 Maintenance of Hydrants \$ 22,932

The Hydrant maintenance total was verified to three specific general ledger accounts and contained eleven PEU Maintenance entries and two reclassify AP paid by PWW entries. The total represents a decrease over 2011 of 56%. There were no exceptions noted.

7678-000-001 Monitor Contractors Marking \$ 41,795

Account 7678-000-001 contained general ledger transaction for "PEU Maintenance" and reclassification of Verizon costs with no exceptions noted. The total for the year represents an increase of 30% over the 2011 balance.

Customer Account & Collection Expense \$158,703 is comprised of the following:

7902-xxx-001 Meter Reading Expenses \$ 41,151

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

7902-xxx-001 Customer Records and Collection Expense \$ 100,452

The total as noted on the PUC annual report, account 903 was verified to two specific accounts. The total for the year represents an increase of less than 1% from the prior year. No exceptions were noted in the review of the general ledger detail.

7904-000-001 Uncollectible Accounts \$ 17,100

Please see the Accounts Receivable section for a detailed review.

Administrative & General Expense \$267,841 is comprised of the following:

7921-xxx-001 Office Supplies and Other Expenses \$ 8,336

The total was verified to two individual general ledger accounts without exception. Activity in the accounts included monthly postage entries, phone entries, vendor invoices, and reclassifications. The total for the year was a reduction of 10% from 2011 year-end balance.

7923-000-001 Outside Services \$ 85,684

Audit reviewed the general ledger detail for the Outside Services account without exception. Due to an increase of 340% in the year-end balance from 2011, PEU provided a memo of explanation with the annual report. The memo states that the increase is, "*primarily legal and appraisal services related to property tax dispute with the town of Litchfield*". Audit reviewed the following three invoices relating to the Litchfield dispute.

Sulloway & Hollis Counselors at Law

Audit reviewed an invoice for \$2,826.90 for legal services rendered through February 28, 2012. Services provided were for the Litchfield property tax valuation.

Shaw Consultants International, Inc

Two invoice for \$28,796.06 and \$11,795.50 were reviewed for appraisal services for property in Litchfield.

The Sulloway & Hollis invoice and the two Shaw Consulting invoices associated with the Litchfield property tax valuation and legal services are included in the \$70,420 pro forma adjustment on filing Schedule 1, Attachment C, Page 1.

Rath, Young and Pignatelli PC

Audit reviewed an invoice in the amount of \$2,299.50 for legal services provided for November 2012. The expenses appear to be non-recurring. Please refer to the Non-recurring portion of this audit report.

7924-000-001 Insurance Expense \$ 132,780

Audit reviewed the general ledger detail for the Insurance Expense account without exceptions. The year-end balance reflects an increase of 169% over 2011 year-end balance. In a memo supplied with the annual report PEU noted that the increase was *“primarily due to increased General and Umbrella Liability and Workers Compensation Insurance. The increase was driven by a confluence of events: some large claims exposure on our WC and GL policies, the Umbrella insurer no longer offering that coverage, Liberty Mutual changing their nationwide portfolio for these underlying insurances, and lastly, an insurance marketplace at the end of 2011 that was not price sensitive to the extent we would have hoped”*.

7928-000-001 Regulatory Commission Expenses \$ 20,398

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.

7930-xxx-001 Miscellaneous General Expenses \$ 20,573

Four specific general ledger accounts were verified to the total without exception. The accounts and related activity were reviewed in detail with no exceptions noted. The total for the year represents a decrease from 2011 of 20%.

7950-500-001 Maintenance: Computer Equipment \$ 70

Audit reviewed the detailed general ledger for the Computer Equipment Maintenance account. Activity in the account was to record prepaid expenses. There was no increase in the year-end balance from 2011 to 2012. No exceptions were noted.

Inter-Division Management Fee \$(1,363,904) is comprised of the following:

Miscellaneous General Expenses		
7930-500-001 Intercompany Mgmt Fee: PCP	\$	67,108
7930-510-001 Intco Mgmt Fee: PWW	\$	1,294,188
7930-520-001 Interco Mgt: Inside Gen Counsel	\$	2,608

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 rely upon and utilize PWW's employees. The payroll function is managed at the Company's corporate office in Merrimack, NH. Monthly intercompany transfers are performed to allocate the payroll costs to each subsidiary.

Audit reviewed the filing Schedule 1B, Payroll Summary, for labor directly charged to PEU. Supporting documentation was requested for the Production, Distribution and Customer Service labor and Construction labor. PEU provided the "Journal for GL by WO Type Report" showing a breakdown of the work orders and general ledger accounts. PEU noted that the entries in the general ledger refer to a work order number and not a specific labor charge. The total labor on the report tied to

Schedule 1B. Audit also inquired on the Labor overhead rate of 68.43% being used. PEU referred Audit to the 2012 management fee support which showed the overhead was a total of benefits, payroll taxes, boot & clothing allowances, and other items totaling 68.42% of labor.

TAXES

Property Tax Expense

Audit verified the property taxes paid during the test year, \$848,403 to the following:

2012 NH DRA Utility Property Tax	\$210,209
½ of 2 nd Issue 2011 municipal	\$159,255
Full 1 st Issue 2012 municipal	\$ 300,905
½ of 2 nd Issue 2012 municipal	<u>\$ 178,088</u>
Property tax expense	\$848,458

The general ledger account 7408-110-001 reflects \$848,403. The variance of \$55 was noted to include a credit in the general ledger of \$14. The remaining calculated variance of \$41 is considered immaterial, based on the fifty-five municipal properties and the state utility property tax.

Audit also verified that the reported expense of \$848,403 agrees with the PUC annual report, and the filing schedule 1.

Based on a review of the second issue 2012 municipal invoices, the expense is overstated by \$469 due to inclusion of the statewide education tax. Specifically:

Bow map/parcel #28-3-43-B-UO was overpaid	\$ 85
Bow map/parcel #44-2-134-UO was overpaid	\$ 75
Conway map/parcel #231-28 was overpaid	\$ 37
Middleton map/parcel #000002-000013 was overpaid	\$ 68
Windham parcel #22L-00300-02441 was overpaid	<u>\$204</u>
Total state education tax included with municipal	\$469 Audit Issue #3

Audit also verified that the property tax expense summary provided in the filing on schedule 1A includes amounts related to properties which were sold (refer to DW11-224, Order 25,309). Therefore, the following should not have been expensed in 2012, nor included in the filing:

Barnstead map/parcel #000000-000006 Utility RoW 2011 valuation	\$1,300	\$ 18
Conway map/parcel #231-148 location West Side Rd 2011 valuation	\$2,200	\$ 21
Conway map/parcel #231-147 location West Side Rd 2011 valuation	\$5,700	\$ 55
Conway map/parcel #231-106 location West Side Rd 2011 valuation	\$15,000	<u>\$ 8</u>
	Audit Issue #4	\$102

Prepaid Property Taxes

Audit calculated the prepaid property tax figure to be \$176,147 which agrees with the general ledger account 7163-310-001, Prepaid Property Taxes. The PUC annual report and the filing schedule 2 reflect the prepaid tax figure to be \$141,200. That figure is comprised of an asset and a liability account:

Asset	7163-310-001	Prepaid Property Taxes	\$176,147
Liability	7236-115-001	Local Property Tax Payable	\$ (34,947)
Liability	7236-116-001	Public Utility Tax Payable	<u>\$ -0-</u>
			\$141,200

Audit verified the prepaid figure to one half of the second issue 2012 property tax bills. The property tax payable account was verified to the fourth quarter DRA payment and ½ of the town of Plaistow second issue 2012, both of which were paid after the year-end close 12/31/2012.

Federal and State Tax Returns

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

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

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

Audit verified the Deferred Income tax total of \$525,782 to two general ledger accounts 7282-xxx-001, as discussed in detail in the Miscellaneous Current Liability portion of this report.

The Provisions for Income Taxes, \$42,559 total was verified to the tax worksheets as well as the filing schedule 1 and the following accounts without exception:

7409-102-001	Provision for Fed Inc Tax Current	\$(243,516)
7409-113-001	Provision for NHBPT Current	\$ (6,183)
7410-102-001	Provision for Fed Inc Tax Deferred	\$ 277,019
7410-113-001	Provision for NHBPT Deferred	<u>\$ 15,239</u>
	Net Income Tax	\$ 42,559

Non-recurring Items

Audit noted the following items, which should be considered non-recurring:

7930-520-001 Legal services in the amount of \$2,608.

7923-000-001 Legal services in the amount of \$2,300.

PEU 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 that were performed are now performed by outside counsel. In 2013, the Company utilized legal services of approximately \$8,500. 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

Intercompany Interest Expense

Background

Interest expense in the amount of \$160,224 as noted on the PUC annual report was verified to the general ledger 7427-115-001. Audit verified the interest expense offsets posted to the intercompany 7233-xxx-001 payable accounts.

Issue

Audit reviewed the monthly interest journal entries and noted that for the December 2012 “true-up” the Company failed to reverse the initial interest entry for December, thus overstating the expense by \$12,928.

Recommendation

Audit recommends that process documented in response to the same issue in the PAC audit issued on 1/14/2014, which stated “*an error occurred at year-end 2012, in that the first entry to record intercompany interest for the month was not reversed, prior to the second entry being calculated for intercompany transactions during the month. This process has been enhanced to eliminate this from recurring on a going forward basis*” be implemented.

Company Response

Company agrees that the intercompany interest is overstated by the amount indicated. The error that occurred at year-end 2012 impacted PEU as well (as PAC).

Audit Conclusion

Audit believes that the process outlined in the Recommendation above be followed.

Audit Issue #2
Expense vs. Capital

Background

From the Pennichuck East Utility's general ledger, Audit made a selection of 32 journal entries. Audit requested the supporting documentation for those selected entries.

Issue

Audit reviewed an invoice from USA BlueBook in the amount of \$1,561.45. The supporting documentation to the invoice noted that the purchase was for a pump at a Williamsburg Well. The account to which the invoice posted was, 7633-100-001, Maintenance of Structure: Booster Station.

Recommendation

The Company should review the invoice and post to transaction to the appropriate general ledger account. In addition, the filing schedules should be adjusted to reflect the reduction of the expense account and the increase to plant.

Company Response

The Company agrees with the audit recommendation. The Company will reclassify the expense to a plant asset account in 2013.

Audit Conclusion

Audit concurs with the Company comment.

Audit Issue #3

Property Tax Expense

Background

Property Tax expenses paid during the test year were verified to the general ledger, filing, annual report and specific individual invoices from both the municipalities in which PEU operates and the state Department of Revenue. Because the utilities pay the state mandated \$6.60 per thousand education tax, the municipal invoices should not include that tax.

Issue

The Company was assessed and paid the statewide education tax on five different locations in four separate towns.

Recommendation

Audit recommends that the Company contact each of the towns identified and ensure that the statewide education tax portion of the municipal bills is removed. Audit also recommends that an adjustment be noted in the filing for the \$469 overpayment of the property taxes.

In the 2006 test year audit, the same issue was identified for the town of Pelham. That municipality has been corrected.

Company Response

The Company agrees with the audit recommendation and will follow up with the towns identified.

Audit Conclusion

Audit concurs with the Company comment.

Audit Issue #4

Property Tax Expense

Background

Audit also verified that the property tax expense summary provided in the filing on schedule 1A includes amounts related to properties which were sold (refer to DW11-224, Order 25,309).

Issue

The Company expensed \$102 more in the test year than was incurred, due to the sale of these three properties, and elimination of a small outbuilding in Barnstead.

Recommendation

The filing property tax expense should be reduced by \$102.

Company Response

The Company agrees with the audit recommendation.

Audit Conclusion

Audit concurs with the Company comment.

