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STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: February 15, 2011
AT (OFFICE): NHPUC

FEB 15 2011
CONSUMER ADVOCATE

FROM: Stuart Hodgdon, Chief Auditor
Karen Moran, Examiner
James Schuler, Examiner
Robyn Descoteau, Examiner

SUBJECT: Lakes Region Water Company, Inc.
DW 10-141
Final Audit Report

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

Introduction

Lakes Region Water Company, Inc., (LRWC, Company) is a regulated public utility that provides water service to approximately 1,615 customers. On May 19, 2010, LRWC filed a notice of intent to increase its rates. On July 19, 2010, the Company filed its rate schedules as well as materials supporting its proposed permanent rate increase.

The PUC Audit Staff has reviewed the books and records of the Lakes Region Water Company, Inc. for the test year 2009.

Audit appreciates the thorough and timely assistance provided to us by Norman Roberge, outside accountant, Tom Mason, President, Taryn Zambouras, Office Manager, and John Dawson, Company Supervisor. The unconditional access to original documentation assisted in the timely completion of the audit work.

Allocations

The books and records of LRWC have been set up by Norman Roberge to include one administrative division and seventeen operating divisions. Generally, costs that should not be direct charged are posted to Division 50 (Administrative), and then at a later time allocated to the other 17 divisions. The allocations are based on average customer count and are contained within the LRWC computer system. **Audit Issue #1**

Board of Directors

Audit requested the documented Board minutes, if any, and was told that due to the stockholders, officers, and directors being the same married couple, the running of the business was discussed and approved on a daily basis. Mr. Roberge recalled a meeting (during 2008) at which he and Mr. and Mrs. Mason were present, along with a telephone tie-in from Susan Mason who resides in Maryland. While no minutes were provided, Audit was told that at that meeting, Susan was appointed as a director. Also at that time, all of the activity over the course of the prior year was reviewed, including the Quality of Service docket DW 07-105, and pension payments to Barbara Mason. The Board then elected a new slate of directors, which included the three Masons plus Amy Mason. The new slate discussed and approved the pension for Tom Mason and then elected officers. One meeting in 2009 was held at which Tom Mason (Jr.) was appointed as president, with Barbara Mason appointed Treasurer, Amy Mason as Assistant Treasurer, and Susan Mason, Secretary.

Cash, Account 110-131, $5,034

For the test year ending 12/31/2009, Schedule F-1 of the PUC Annual Report, submitted by LRWC, reported a Cash balance at the beginning of the year of $663 and a year-end balance of $5,034. These amounts agree with the rate filing, Schedule 2, submitted by the Company.

LRWC has a small savings account with a year-end balance of $629. It also has a checking account with a year-end balance of $4,405.

The LRWC checking account was reconciled to the general ledger (G/L) on a monthly basis by Norman Roberge, the Company's outside accountant. During the test year, these reconciliations were all done at year-end. Adjustments/corrections to monthly reconciliations were booked as year-end entries.

Within the LRWC checking account, audit noted monthly fees booked totaling $1,093. Fees related to Non-Sufficient Fund (NSF) checks (bounces by the customers) were $390. The Company charges these NSF fees back to the customer. Bank service fees posted to the general ledger account 1-686-930-8 and for the year were $1,594.

Accounts Receivable, Account 120-141, $95,988

For the test year ending 12/31/2009, Schedule F-19 of the PUC Annual Report, submitted by LRWC, reported an Accounts Receivable balance at the beginning of the year of $84,041 and a year-end balance of $95,988. These amounts agree with the rate filing, Schedule 2, submitted by the Company.

Audit's analysis of the Aged A/R Balance showed that 76.94% of the receivables were current, 11.26% were aged 30 days, 4.27% were aged 60 days, and 7.53% were aged over 90 days. Audit requested status updates for five customers with balances aged more than 7 months. LRW submitted printouts of the customers' accounts. Three customers had paid the balance and accrued interest in full by March 2010. The other two accounts belong to customers who have vacated the residence and cannot be located. Per the Company's response to A/R #23, these accounts will be written off in 2011.

The Aged A/R Balance submitted to Audit did not show customer names. In order to test for outstanding employee billings, Audit randomly tested customers with balances aged more than 7 months. None of these customers was an employee. In addition, Audit reviewed the detailed trial balance, for consistent or high write off amounts. A list of amounts written off during the test year, provided by LRWC, did not contain employee billings.

Inventory, Account 130-151, $45,133

For the test year ending 12/31/2009, Schedule F-22 of the PUC Annual Report, submitted by LRWC, reported an Inventory balance at the beginning of the year of $73,567 and a year-end balance of $45,133. These amounts agree with the rate filing, Schedule 2, submitted by the Company. LRWC records inventory transactions throughout the year in Division 50, and then reallocates the inventory between divisions prior to closing the books at year-end.

The Company had not done a physical inventory since 2006. As a result, the inventory adjustment booked in 2009 contained inventory used in 2007, 2008 and 2009. The inventory missed in 2007 and 2008 was $7,578. Refer to proforma #8 as well as to the Operations and Maintenance section of this report.

Prepayments, Account 140-162, $23,240

For the test year ending 12/31/2009, Schedule F-23 of the PUC Annual Report, submitted by LRWC, reported a Prepayments balance of $27,901 at the beginning of the year and a year-end balance of $23,240. These amounts agree with the rate filing, Schedule 2, submitted by the Company. For further detail on prepayments, refer to the Operations and Maintenance section of this report.

Category	Amount
Insurance	$15,750
Computer Support	3,155
Operating Permits	2,550
Propane	415
One-Call	950
Water Monitoring Equipment	420
	$23,240

Debt Discount/ Expense, Unamortized Debt

The general ledger activity report shows account 155-181 Unamortized Debt Expense totaled $8,789. This amount was tied to the LRWC trial balance and agrees with the 2009 Annual Report schedule F-25. A debt expense supporting schedule provided by the LRWC Accountant shows that the amount above is for financing costs on the three TD BankNorth loans.

Schedule 4A of the filing showed Amortization of the Debt Expense, account 730-428 totaling $1,788 for the test-year 2009. This agreed with the PUC 2009 Annual Report

Deferred Rate Case Expenses, Account 153-186, $7,332

The balance in account 153-186, Deferred Rate Case Expenses, at the end of the test year was $7,332. The charges were traced to five invoices from Stephen P St. Cyr, the Company's regulatory reporting consultant. The charges indicated that the work done was relative to DW 09-184. DW 09-184 was a request for increase in water rates based on a 2008 test year. PUC Staff found deficiencies with the filing and it was closed on 04/07/2010. Because the rate filing (which was to be for test year 2008) was not pursued, these costs should be written off the books of the Company. **Audit Issue #10**

Capital Stock Expense, Account 330-213, $16,565

The balance in account 330-213 Capital Stock Expense, at the end of the test year was $16,565. During the test year, the Company reclassified $18,405 from Regulatory Expense, account 665-928 to Capital Stock Expense, account 330-213. These costs represent the remaining half of costs related to expenses incurred during PUC Docket DW 08-070 that were financed by an equity infusion by Thomas A. Mason and Barbara G. Mason (DW 08-070, Order #24,954). The balance in Capital Stock Expense is being amortized, using account 675-426, Amortization Expense-Capital Stock, over a 10-year period beginning in 2009. The total amount booked to amortization expense, account 675-426, for the test year 2009 was $1,841. Amortization Expense-Capital Stock, account 675-426, was not included in the filing. Therefore, the Company suggested that it be included as proforma #14 as an adjustment to Amortization Expense-Other, Account #407.

DEBT

Long-Term Debt

The LRWC trial balance reports the remaining balance on TD BankNorth long-term debt of $777,322 on 12/31/2009. This amount agrees with that listed on rate filing schedule 4A. The total is split among three loans with TD BankNorth. Two loans were approved by the PUC in DW 03-189, order #24,254 dated November 19, 2003. The first loan was for refinancing of existing loans and the second financing request was for construction and land purchase at the Paradise Shores system. The balance on these two loans as of December 31, 2009 total $667,508. The third loan was for the purchase of several small systems and was approved by the Commission in DW 04-185, order #24,401 dated November 19, 2004 and had a 2009 year-end balance of $109,815.

Audit recalculated and tied interest for the TD BankNorth loans to account 730-427 as follows:

Interest/Long-Term Debt

Loan	Reported Interest
TD BankNorth #5, Refinancing	$23,919
TD BankNorth #6, Construction	24,720
TD BankNorth #7, System Purchase	10,080
	$58,719

Other Long-Term Debt - Notes Payable

A review of the test year shows that there were eleven other long term debt notes. Two of the loans matured and one vehicle loan was paid in full due to insurance coverage for an auto accident. Therefore, the Company reported on schedule 4A of the filing eight Notes Payable at year-end 2009 totaling $382,596. This amount agreed with the 2009 NHPUC Annual Report.

One payable is to Tom and Barbara Mason who provides working capital as needed, through a personal home equity loan that totaled $190,855 at 12/31/2009. The year-end trial balances are listed as follows:

Citizens Bank – 2007 Sierra	$7,699
Santander – 2007 Silverado	20,986
St. Mary's Bank – 2008 Chevy Colorado	13,181
Bank of America – Copier	3,690
St. Mary's Bank – 2008 Chevy Colorado	16,542
NH Department of Corrections*	103,880
GEHL Finance – Mustang Excavator	25,763
Mason Loan (Stockholders)	190,855
	$382,596

The following ten long-term notes totaling $278,716 (excluding the DOC loan from the above amount) existed in the test year and did not have PUC approval: **Repeat Audit Issue #2**

1. N/P Citizens 2007 Sierra, $13,479 issued 7/16/2007 @ 8.49%, matures 7/16/2012
2. N/P LSB 2006 Sierra, $40,918 issued 8/14/2006 @ 7.49%, matures 7/14/2011
3. N/P GEHL Finance - Mustang Excavator, $20,350 issued 8/2/2004 @ 3%, matures 9/2/2009
4. N/P Key Equipment – Meter Reader, $9,048 issued 1/2/2007 @ 13%, matures 3/2/2009
5. N/P Santander – 2007 Silverado, $32,670 issued 11/17/2007 @ 6.39%, matures 12/31/2013
6. N/P St. Mary's Bk. – 2008 Chevy Colorado, $18,026 issued 5/28/2008 @ 5.75%, matures 7/12/2013.
7. N/P Bank of America – Copier, $5,689 issued 6/4/2008 @ 5.2%, matures 6/4/2012
8. N/P St. Mary's Bk. – 2009 Chevy Colorado, $18,865 issued 5/31/2009 @ 5.9%, matures 8/14/2013
9. N/P GEHL Finance – Mustang Excavator, $26,200 issued 11/13/2009 listed at 0%, matures 11/13/2014
10. N/P Mason Loan (Stockholders), Loan balance 12/31/2009 was $190,855 @ 9.75%.

The note payable to the NH Department of Corrections – $110,000 issued 10/7/2009 @ 0%, matures 10/31/2012 is a payment contract with Thomas Mason for Lakes Region Water Company. Payments of $3,060 are to be made monthly. Payments were made in November and December of 2010 which total $6,120.

An expense of $110,000 for the above fine was posted by LRWC accounting to below the line account #426, Miscellaneous Nonutility Expenses, therefore it is not included in ratemaking.

Audit submitted a request for a listing of what makes up the 2009 additions of $52,116 to the Mason note and for information on whether any Medicare and/or loan interest was rolled back into the loan principle. The Company responded that no interest is rolled back into the loan principle.

Interest Expense Other Long Term Debt-Notes Payable

Interest expense for the test-year for other long term debt-notes payable totals $23,514. This agrees with schedule 4A of the filing and with the 2009 PUC Annual Report.

Loan	Reported Interest
N/P Citizens 2007 Sierra	$802
N/P LSB 2006 Sierra	665
N/P GEHL Finance - Mustang Excavator	(29)
N/P Key Equipment – Meter Reader	137
N/P Santander – 2007 Silverado	1,880
N/P St. Mary's Bank – 2008 Chevy Colorado	862
N/P Bank of America – Copier (Capital Lease	230
N/P St. Mary's Bank – 2009 Chevy Colorado	636
N/P NH Department of Corrections	-0-
N/P GEHL Finance – Mustang Excavator	-0-
N/P Mason Loan (Stockholders)	18,331
Subtotal Interest	$23,514

Interest Expense /Other

General Ledger postings to account 730-427 for interest due to late payments, etc., to various vendors totaled $12,921. (See Schedule 4A) **Audit Issue #3**

Accrued Interest

Accrued interest, account 238-237 reflected $83,107 on the general ledger at year-end 2009. This amount agrees with the worksheet submitted with the 2009 Annual Report and schedule 4A of the filing. Audit analysis reflects that accrued interest was booked for the three TD BankNorth loans ($2,028), the note payable for the 2007 vehicle ($25), the Santander note payable ($51) and the Mason loan ($81,003).

Accounts Payable, Account 210-231, $374,804

For the test year ending 12/31/2009, Schedule F-1 of the PUC Annual Report, submitted by LRWC, reported an Accounts Payable balance of $249,881 at the beginning of the year and a year-end balance of $374,804. These amounts agreed with the rate filing, Schedule 2, submitted by the Company. The balance was carried on the LRWC ledger in three separate accounts:

Accounts Payable	50-210-231-1	$356,286
Account Payable-Manual	50-210-231-5	4,059
Accounts Payable-LRW Water Services	50-210-231-9	$14,459
		$374,804

Accounts Payable, Account 50-210-231-1, carried a balance at the end of the test year of $356,286. Audit's analysis of the Aged A/P Balance showed that 16.46% of the receivables were current, 5.25% were aged 30 days, 9.26% were aged 60 days, and *69.03% were aged over 90 days.* Audit's analysis of the past due amounts also revealed the following:

Expense Category	Amount Due
Engineering Services	$72,340
Accounting Services	61,936
LRW Water Services	38,541
Legal Services	31,630
Regulatory Reporting Consultant Services	30,717
Misc Supplies (vendors under $2,500)	23,362
Credit Cards	19,868
Property Taxes	17,517
Groundwater Exploration Services	16,742
Utilities	13,726
Health/Dental/Workers Comp Benefits	8,198
SCADA	5,918
State of NH Fees	5,876
Town Fees – Other (Police Services, Town Fees)	4,900
Tom Mason	2,975
Laboratory Testing	2,040
	$356,286

During Audit's review of the year-end Aged A/P Balance, it was noted that several companies had assessed finance/interest charges on the past due balances owed them; many of these amounts remained unpaid by LRWC. The exact amount of the finance/interest charges contained in the year-end Aged A/P Balance was not quantifiable by Audit.

Accounts Payable-Manual, Account 50-210-231-5, is used to record manual entries that affect A/P after year end. Audit confirmed that these items were not entered into the computerized system for payment processing. Per the computerized General Ledger at year end, the balance was $4,040. The Excel version of the Trial Balance Summary reported this account as $4,059, a variance of $19 (A/R 8). *The Excel amount of $4,059 was used in the filing.*

Audit analyzed the year-end 2009 entries provided by Norman Roberge to determine the following items that remain in the balance of A/P-Manual at 12/31/2009. *Because the Company uses this account to record manual entries that affect A/P after the year end close process, these do not necessarily represent monies owed.*

Expense Category	Amount Due
State of NH Fees	$11,400
Garage Rent 2008	5,400
Insurance	4,314
Legal	643
Accounting Services	260
Notes Payable-Hold January 2010 payment	(639)
Notes Payable-Hold January 2009 payment	(131)
Engineering Services	(17,207)
Variance	19
	$4,059

Accounts Payable-LRW Water Services, Account 50-210-231-9, had a balance of $14,459 at the end of the test year.

Customer Deposits, Account 220-235

The test year balance in the Customer Deposit account was $1,106. While on-site, Audit requested to review the LRWC detailed record of all deposits. Staff at the Company created an Excel spreadsheet that tied to the G/L amount. The spreadsheet provided the customer name, account number, location of service, date deposit made and amount of deposit.

Affiliate Agreement

During the DW 08-070, Step 3 Audit, the Audit Staff conducted a test of the Affiliate Agreement between Lakes Region Water Company, Inc. and LRW Water Services, Inc. dated April 1, 2009, signed February 15, 2010. The Affiliate Agreement was signed solely by Thomas Albert Mason ("Jr."), as both the President of Lakes Region Water Company, Inc. and the President of LRW Water Services, Inc.

The testing done for the DW 08-070, Step 3 Audit concentrated mainly on Appendix B of the Agreement, Water Company Utilization of Contractor Personnel and Equipment. Audit had selected five LRW Services invoices for testing purposes. Three invoices related to 2008 charges and were not included in the 2009 test-year of DW 10-141. Two of the invoices related to Plant in Service Additions detailed below in the Plant in Service section of this report. For further reference on the Affiliate Agreement testing done for DW 08-070, Step 3, please refer to the Audit Report for DW08-070, Step 3 issued on September 22, 2010.

Testing for Appendix A of the Agreement, Contractor Utilization of Water Company Personnel and Equipment was completed as part of the *current audit*. Audit was able to verify that the Compensation Rates for water sample pickup and pump station inspection of $250 per month was charged to LRWS and booked to Miscellaneous Revenue, account 471. In addition, the hourly vehicle rate of $19.00 was charged to LRWS and booked to Miscellaneous Revenue, account 471.

Plant in Service

For the test year ending 12/31/2009, Schedule F-8 of the PUC Annual Report, submitted by LRWC, reported a Utility Plant in Service balance at the beginning of the year of $4,125,217, additions of $233,201, and retirements of $89,424, for a year-end balance of $4,268,994. The beginning and year-end balances agree with the amounts submitted LRWC on Schedule 3 of the Permanent Rates Filing.

Additions

Audit reviewed the additions booked by LRWC during the test year of $233,201. The following analysis shows details for several of the 2009 property additions:

LRW Services (Pump Station Upgrade, excavation work)	$9,870	
Labor and Materials	4,837	
Frase Electric	5,456	
Premier Pump	400	
Structures – Waterville Valley Gateway	$20,563	
Dawson & Sons (Pump House)	$4,384	
Frase Electric (Wiring)	4,705	
Structures – Hidden Valley	$9,089	
LRW Services	$27,200 (Tested DW 08-070, Step 3)	
Labor and Materials	2,448	
Frase Electric	1,963	
Structures – Brake Hill	$31,611	
Total Additions for Structures were $66,216, subtotal of analysis;		$61,263
RE Prescott (Control Panels)	$10,000*[1]	
Pumping Equipment – Hidden Valley	$10,000	

*[1] The Asset card was $10,000, the 4/2/10 payment was $10,000, but the two invoices referenced on the payment stub, which were also attached, totaled $18,752.

EOS Research (Engineering Services)	$4,086	
Water Industries (2 HP 3-stage Booster)	4,128	
Pumping Equipment – Gunstock Glen	$8,214	
Total Additions for Pumping Equip were $28,959, subtotal of analysis;		$18,214
LRWS (replacement of main bedding)	$10,000	
Paradise Shores	$10,000	
Lewis Engineering (Engineering/DES approvals)	$4,032	
Hidden Valley	$4,032	
Install Valve (Labor-$141/Materials-$310)	$451	

Install Valve (Labor-$101/Materials-$508)	609	
New Lines (Labor-10hrs, $1,250/Inventory-$245/Materials-$200)	1,695	
Inlets (Labor-$159/Materials-$253)	412	
LRWS (2" Ball Valve)	1,402	
Lake Ossipee Village	$4,569	
LRWS (Site work w/ 4" main to St/Interconn to Brake Hill)	$36,500 (Tested DW 08-070, Step 3)	
Labor and Materials (leak repair/new valve/tie in pump house)	689	
Mains – Gunstock Glen	$37,189	
Total Additions for Mains were $57,858, subtotal of analysis;		$55,790
Labor/Materials (6 hrs-$113/EII-$288/USA BB-$1,167/Inve-$10)	$1,578	
Labor/Materials (8 hrs-$151/Webb-$209/USABB-$221/Inve-$47)	628	
Labor/Materials (9 hrs)	170	
Labor/Materials (6 hrs-$113, Inve-$10)	123	
Labor/Materials (4 hrs)	76	
Meters and Meter Installations – Hidden Valley	$2,575	
Generating Solutions (Monitoring hardware/antenna)	$1,085	
Other Miscellaneous Equipment– Hidden Valley	$1,085	
Labor and Materials (Tie in plumbing between tanks/refill tanks)	293	
Distribution Reservoirs – Gunstock Glen	$293	
Northwood Power Equipment – Mustang Backhoe	$41,200	
Cantin Chevrolet – 2008 Chevy Colorado	18,865	
Transportation Equipment	$60,065	

Retirements

Audit reviewed the retirements booked by LRWC during the test year of $89,420. Of particular interest during review were the retirements of two vehicles. A pickup truck was totaled in an accident and an excavator was traded for a new one. During the desk audit of the 2009 NHPUC Annual Report, the Audit Staff noted that the Company had not recorded these entries correctly and worked with LRWC to correct the entries. The insurance proceeds from the pickup truck accident and the trade-in value of the excavator had been recorded as Gains on Sale of Equipment, rather than credits to Accumulated Depreciation. Recent review proved that the retirement entries had been corrected per Audit's recommendations and were reflected in the test year.

Structures		$5,933
Pumping Equipment		6,965
Meters		171
Excavator	$35,433	
Pickup Truck	40,918	
Transportation Equipment		76,351
TOTAL RETIREMENTS:		$89,420

Unfinished Construction, Account 180-105, $77,095

For the test year ending 12/31/2009, Schedule F-6 of the PUC Annual Report, reported a Construction Work in Progress (Unfinished Construction) balance at the beginning of the year of $60,190 and a year-end balance of $77,095. The beginning and year-end balances agreed with the amounts submitted by LRWC on Schedule 3 of the Permanent Rates Filing.

Division 17, Gunstock Glen; $3,491 was duplicated on the G/L, but backed out of the Excel spreadsheet maintained by the Company and was not included in the filing. *The Company intends on correcting the entry in their Ledger for 2010.* (A/R #9)

Schedule F-10 of the PUC Annual Report, reports the following Construction Work in Progress (Unfinished Construction). The amounts reported were traced to the detailed General Ledger with the only exception being noted above, *the duplication of $3,491 to be corrected.* General Ledger detail showed that the open activity related to vendor charges. No internal labor or supplies were held in Unfinished Construction at the end of the test year.

Paradise Shore: Source Evaluation	$36,006	
Woodland Grove: Pump House, Storage & Treatment	14,173	
Gunstock Glen/Brake Hill: Distribution Improvements	13,505	(trial = 16,996-see above)
Tamworth Water Works: Uranium Treatment	8,240	
Far Echo Harbor: New Source	2,500	
Echo Lake Woods: Distribution Improvements	1,411	
175 Estates: Distribution Improvements	1,260	
	$77,095	

Depreciation, Accounts 165-108 and 166-108, $1,180,211
Depreciation Expense, Account 700-403, $165,259

For the test year ending 12/31/2009, Schedule F-11 of the PUC Annual Report, reported Accumulated Depreciation of Utility Plant in Service at the beginning of the year of $1,065,873, depreciation provision for the year of $165,259, book cost of plant retired of ($89,420), and a gain on sale of transportation equipment of 38,499 for a year-end balance of $1,180,211. The beginning and year-end balances agree with the amounts submitted by LRWC on Schedules 2 and 3 of the Permanent Rates Filing.

Source of Supply and Pumping Plant	$301,832
Water Treatment Plant	18,356
Transmission and Distribution Plant	552,528
General Plant	307,495
	$1,180,211

The Company depreciates its assets using the straight-line depreciation method. Audit traced the test year monthly depreciation entries between Accumulated Depreciation, account 165-108 and Depreciation Expense, account 700-403. The monthly depreciation entries were traced without exception. Total depreciation expense for the test year, account 700-403, was $165,259 per the filing, the PUC Annual Report and the Company's trial balance report.

While reviewing the Company's depreciation records associated with DW 08-070, Step 3, Audit noted several instances of calculation errors. An inconsistency was noted in the start up of the depreciation life of an asset. Some assets that had been placed in service during 2008 were correctly calculated with half year depreciation in 2008 and a full year in 2009, while other assets that had been put in service during 2008 had half year depreciation in 2008 and another half year in 2009, instead of the correct amount of a full year. Per the Company Comment to Audit Issue #2, found in the DW 08-070, Step 3 Audit Report; "*The Company completed a full review of its depreciation schedules and will correct those assets which are not being depreciated correctly in 2010. Based on the review, a net increase of $359 and $1,583 should be added to the 2008 and 2009 depreciation expense and accumulated depreciation, respectively.*" The amount related to 2008, $359, would be an adjustment to Retained Earnings. Depreciation Expense, account 700-403, would increase by $1,583 when the correction is made to the 2009 Depreciation Expense for the test year. **Audit Issue #4**

Amortization, Account 160-114 and 165-115, $110,515
Amortization of Acquisition Adjustment Expense, Account 702-406, $4,344

For the test year ending 12/31/2009, Schedule F-7 of the PUC Annual Report, submitted by LRWC, reported Accumulated Amortization that contained the combined balances of Asset Adjustment – Intangible, account 160-114 and Accumulated Amortization – Acquisition Adjustments, account 165-115. The combined balances at the beginning of the year were $139,166, the amortization provision, account 165-115, for the year was $5,716, and an adjustment to correct prior years' amortization provision, account 165-115, of ($1,372) was reported, summing a year-end balance of $143,510. No adjustments were made during the test-year to Asset Adjustment – Intangible, account 160-114. The beginning and year-end balances agree with the amounts submitted by LRWC on Schedules 2 and 3 of the Permanent Rates Filing.

Audit traced the test year monthly amortization entries between Accumulated Amortization of Acquisition Adjustment, account 165-115 and Amortization of Acquisition Adjustment, account 702-406. The monthly amortization entries were traced without exception, however; audit noted two entries (detailed below) that affect the rate case filing. Total amortization expense for the test year, account 702-406, was $4,344 per the filing, the PUC Annual Report and the Company's trial balance report. **Audit Issue #5**

The adjustment to Amortization of Acquisition Adjustment, account 165-115, of ($1,372) relates to an adjustment made to Indian Mound (Division 16) to correct the division's prior years' amortization provision. The test year should be corrected for this adjustment. The correcting entry would Debit Accumulated Amortization, account 165-115, $1,372 and Credit Amortization Expense, account 702-406, ($1,372). **Audit Issue #5**

During Audit's review of the NHPUC Annual Report, it was discovered that the Company had inadvertently booked the $4 amortization provision for Deer Cove (Division 14) the wrong way. It had been booked as a debit amount, when it was supposed to be a credit amount. The Company was notified and the Company has agreed to fix this during 2010.

However, for the test year, the entry was incorrect. The correcting entry would Debit Amortization Expense, account 702-406, for $8 and Credit Accumulated Amortization, account 165-115, for ($8). **Audit Issue #5**

Contributions in Aid of Construction, Account 350-271, $849,099
Amortization of Contributions in Aid of Construction, Account 350-272, $164,530
Amortization of CIAC Expense, Account 701-405, $16,911

For the test year ending 12/31/2009, Schedule F-46 of the PUC Annual Report, reported a CIAC balance at the beginning of the year of $849,099 and a year-end balance of $849,099. The reported Accumulated Amortization of CIAC balance at the beginning of the year was $147,619 and the year-end balance was $164,530. These amounts agree with the rate filing, Schedule 2, submitted by the Company. The annual report and filing amounts were also verified to the trial balance. There were no additions to CIAC during the test year. The following is a summary of the CIAC property by class and rate with corresponding Amortization:

Property Class	Rate	CIAC Amount	Amortization Amount
Tanks	2.22%	$210,000	$7,000
Mains	2.00%	586,034	143,960
Mains	2.50%	10,943	(2,365)
Services	3.33%	27,337	13,375
Services	2.00%	2,316	1,591
Hydrants	2.00%	8,974	269
Meters	5.00%	3,495	700
		$849,099	$164,530

Audit traced the test year monthly amortization entries between Accumulated Amortization of CIAC, account 350-272 and Amortization of CIAC, account 701-405. The monthly amortization entries were traced without exception. Total amortization expense for the test year, account 701-405, was $16,911 per the filing, the PUC Annual Report and the Company's trial balance report.

REVENUE

Total operating revenues of $990,964 consist of metered sales, unmetered sales, miscellaneous services revenues and other water revenues.

Metered and Unmetered

The LRWC metered systems are Far Echo Harbor (FEH), Paradise Shores (PS), West Point (WP), Waterville Valley Gateway (WVG), Hidden Valley (HV), Wentworth Cove (WG), Pendleton Cove (PC), Deer Run (DR), Woodland Grove (WG), Echo Lake Woods (EHW) and Brake Hill (BH). These customer meters are read with the use of STARS (Sensus Technologies Auto-read System). The hand held computer is then downloaded to the in-house computer system.

The non-metered systems of Tamworth Water Works (TWW), 175 Estates (175), Deer Cove (DC), Lake Ossipee Village (LOV), Indian Mound (IM) and Gunstock Glen (GG) are billed the quarterly non-metered fixed tariff rate.

Audit noted that LRWC billings to customers are for services rendered quarterly and that the Company staggers the billings so that cash comes in each month of the year. As an example, Paradise Shore customers are billed in March, June, September and December (cycle 1) while Waterville Valley Gateway customers are billed February, May, August, November (cycle 3) and Hidden Valley customers are billed January, April, July and October (cycle 2).

Audit reviewed Commission Order # 24,925, dated 12/30/08, which authorized LRWC to implement a rate increase for its consolidated rate for bills issued on or after November 30, 2008 with the condition that bills issued on or after November 30, 2008 may not charge customers the rate approved therein for service rendered prior to September 1, 2008. As a result of the above language customers of WVG, WC, PC, BH, DC and IM (cycle 3) received the new quarterly rate for Dec. Jan. and Feb. usage with their billing dated 2/29/2009 and <u>additionally</u> a billing adjustment for the quarterly period of September, October and November 2008.

Audit tied each system's monthly revenue reported on the LRWC trial balance, to the LRWC GL Activity Report, and then to the LRWC Billing Analysis report. The LRWC Billing Analysis report was created by Norman Roberge. The report shows each system's billing date, customer charge, volume charge, usage and amount billed. Audit also tied each system's reported customer charge and volume charge listed on the Accountant's LRWC Billing Analysis report to tariffs on file at the Commission.

Audit noted that the Paradise Shores sales included income from a special contract with Property Owners Association at Suissevale, Inc. (POASI) in the amount of $131,831 for the year. The special contract has two major elements; (1) a volume charge which accounted for $171,043 of income and offset by item (2) a fixed component dealing with the CIAC contribution and other miscellaneous administrative expenses, this portion of the contract provided a net credit to POASI in the amount of ($39,212) for the test year. POASI is an association of home owners located in Moultonborough, NH which owns and operates its own water distribution system. The NH Department of Environmental Services determined that POASI is not a public water system. On 9/22/2006, a water supply agreement was entered between LRWC and POASI. This agreement lists as recital #6, a separate agreement under which POASI shares financial contributions to help defray the cost to LRWC of constructing a water storage facility which will be used to serve POASI and other customers of LRWC's Paradise Shores System. POASI provided LRWC with $303,495 for contribution in aid for construction of water tank, mains and for a meter.

Audit's customer bill testing reveals that an Officer and Director that resides in Balmoral has not been charged for water usage. In addition, another Officer and Director that resides in Paradise Shores has been billed for water usage at the base rate of $91.25 per quarter but not for any metered usage. **Audit Issue #6.**

Total metered sales for the test year were $623,821 which includes the above POASI amount and total unmetered sales were $274,042.

Miscellaneous Service Revenues

Miscellaneous Service Revenues accounts were verified to the individual divisional general ledger activity reports as follows:

Disconnects/Reconnects	$13,428
House Transfers	3,063
Payment pickup	780
Meter Maintenance	221
Maintenance on Customer Property	10,409
Customer Bad Check Charge	180
Sales to Outside Contractors	47,020
	$75,100

An affiliate agreement between LRWC and LRW Water Services, Inc. (LRWS) dated 2/15/2010 was received by the Executive Director of the PUC on March 1, 2010 and became effective the 1st day of April 2009. Sales to Outside Contractors, general ledger account #415 with a total posting of $47,020 includes Utility Company work done for LRW Water Services Inc. Audit reviewed the LRWC billing to LRWS and verified that compensation for personnel, equipment and office services met the terms of the affiliate agreement.

Other Water Revenues

Commission Order #24,954, dated 3/27/2009 authorized LRWC to recover rate case expenses related to its request for new rates in docket DW 08-070. Audit verified that the approved rate of $11.06 per customer for one billing quarter was charged and booked to Rate Case Expense Surcharge, account 45-474.

OPERATIONS AND MAINTENANCE EXPENSES

Total reported Operations and Maintenance expenses for the test year were $802,295 which represents an increase over the same period in 2008 of 7%. Audit verified that the information on the F-2 Income Statement, as well as schedule F-48 agreed with the filing and the general ledger.

Purchased Water xx-610-**602**-1

The prepaid purchased water at year end 2008 in the amount of $2,287 in 50-140-162-1 was reduced to zero in the test year, as the amortization of the Hidden Valley purchased water resulting from the rate case settlement in DW05-137 was completed. The total purchased water expensed during the year was $4,387. As indicated with proforma #6 of the filing, and the testimony of Stephen St. Cyr, the total encompasses $2,100 of purchased water during 2009 and $2,287 of the final amortization.

Audit reviewed five invoices from R&TJ's Trucking which summed to $2,400. Accurate and timely posting of the invoices was noted in divisions 03 and 12. An adjustment in April credited the expense account for $300. Audit requested clarification of the credit and was told that the amount was listed in the Accounts Payable (in 2008), but the Company had been unable to locate an invoice for the expense entry posted to this general ledger expense account in

September 2008. Therefore, the expense was deducted from this general ledger expense account in April 2009. **Audit Issue #7**

Contracted Services xx-630-**603**-1

This general ledger account balance of $7,277, along with Materials xx-620-603-1 $15,081 was reviewed and verified to Miscellaneous Operations and Maintenance expenses on the annual report schedule F-48. Refer to the discussion below relating to Materials. The Contracted Services total was comprised of entries from the Lewis Companies, posted to the individual divisions for which the work was performed. One entry relating to a June work order in division 07 in the amount of $2,362 was traced to Frase Electric.

Chemicals xx-618-**641**-3

For the test year, the total reported expense was $19,507. Ti-Sales in the amount of $3,209 and Coyne Chemical in the amount of $6,080 were the two largest suppliers used. Each division also reflected work order labor expenses.

Water Tests xx-630-**643**-3

The total noted for water testing expenses for the test year was $20,043. Routine testing is performed by A&L Laboratory, Inc., and specific testing required by the Safe Drinking Water Act is performed by the New Hampshire Department of Environmental Services. Audit reviewed the DES invoices and found no exceptions. The routine invoicing from A&L Laboratory, Inc. reflected minimal expenses of $12-$15. Audit verified that the proforma #7 reflected the general ledger balance of $20,043.

This general ledger account, combined with account xx-620-642-3, Materials in the amount of $634 are reflected on the annual report schedule F-48 as Miscellaneous Expenses $20,677 in the Water Treatment Expenses-Operations section of the schedule. Because the inventory had not been updated until year end 2009, the expense account is overstated by 2008 inventory used but posted in 2009. See the entry below.

Total physical inventory, per records on file dated March 2010, was $45,133 which was verified to general ledger account 50-130-151-0 without exception. However, due to the fact that the <u>2008 inventory</u> was not reconciled with the accounting records until 2009, <u>the following adjusting entry was noted and is considered non-recurring (refer to proforma #8):</u>

Debit 02-160-307-2 Wells Asset	$5,000
Debit 05-620-603-1 Materials Expense Source of Supply	$ 207
Debit 08-620-603-1 Materials Expense Source of Supply	$ 238
Debit 10-620-603-1 Materials Expense Source of Supply	$ 395
Debit 12-620-603-1 Materials Expense Source of Supply	$ 606
Debit 16-620-603-1 Materials Expense Source of Supply`	$ 30
Debit 01-620-642-3 Inventory Expense Water Treatment	$ 45

Debit 01-620-662-5 Materials Expense T&D	$	55	
Debit 02-620-662-5 Materials Expense T&D	$	219	
Debit 05-620-662-5 Materials Expense T&D	$	100	
Debit 07-620-662-5 Materials Expense T&D	$	37	
Debit 08-620-662-5 Materials Expense T&D	$	400	
Debit 01-620-905-7 Materials Expense Customer Ops	$	3	
Debit 02-620-905-7 Materials Expense Customer Ops	$	26	
Debit 11-620-905-7 Materials Expense Customer Ops	$	17	
Debit 16-620-905-7 Materials Expense Customer Ops	$	300	
Credit 50-130-151-0 Inventory Asset			$7,578

The notation on Proforma #8, which reflects a proforma for the year of $-0-, with "actual 2009 expense of $11,375" indicates that the reduction of the $11,375 is to reduce the various expense accounts for adjustment to inventory. The account references are 603,642,662, and 903. Audit noted that the actual amounts at 12/31/2009 in the accounts above are:

603	$15,081
642	$ 634
662	$52,314
905	$ 6,651

Audit requested clarification of the proforma actual account reference and was told that "*in 2009 we adjusted inventory to actual inventory taken and expensed the difference based on items we knew we missed in 2008 (after reviewing work orders) and the adjustment to actual for unknown difference. The $11,375 proforma adjustment can be allocated to the following accounts:*

xx-620-603-1 Materials	*$2,316*
xx-620-642-3 Materials	*-0-*
xx-620-662-5 Materials	*8,035*
xx-620-905-7 Materials	*1,024*"

Purchased Power xx-615-**662**-5

Total purchased power for the test year was $77,405. The Company territory falls within the franchise boundaries of Public Service Company of New Hampshire (PSNH), the New Hampshire Electric Cooperative (NHEC) and Wolfeboro Electric. Audit reviewed invoices on file which reflected past due status on several, as well as reviewed the Purchased Power Analysis provided by Norm Roberge. Of the eighteen divisions (including Administration), nine are within the PSNH franchise and nine within the NHEC franchise. A portion of the Hidden Valley community water system receives electrical service from Wolfeboro Electric. Audit randomly reviewed invoices from each regulated utility and noted disconnection messages due to lack of timely payment of the invoices.

Vehicle Fuel 50-651-**662**-5

Audit reviewed the general ledger detail and traced invoices from AAA Financial Services, American Express, Exxon Mobil, and Townsend Hometown Grocery.

Credit card invoices from AAA in the names of Mr. and Mrs. Mason personally reflected gas purchases at Skelley's Market. Expenses were posted as the credit card statements from AAA were received. Finance charges on the card statements were posted to 50-730-427-0 Interest Expense. The interest rate noted during the test year was an APR of 27.24%. January through July the balances were generally below $1,000. Also noted during the first half of the year that, despite finance charges being assessed, it appears that the majority of the balance was paid. In June, no payment was made. Payments made thereafter were incremental only, as the balance forward was increased by $10,476. This was the result of a transfer of an ongoing balance on an American Express card corporate account. In August 2009, the activity on that card was halted due to past due status. Audit is unable to determine what comprises the balance, as it appears to go back several months if not years. It also appears that the transferred amount includes compounded finance charges accrued during the time the account was not paid in full. The credit limit at the beginning of the test year on the AAA card was $39,600. There was no change in the limit at year end.

The Exxon Mobil purchases reflected monthly activity (gas and diesel purchases) which was posted as the statement was received. Finance charges monthly were posted to the interest expense account 50-730-427-0. The credit limit during the year was $2,000 and APR at year end was 23%. None of the statements reviewed reflected full payment during the test year.

Townsend Hometown Grocery expenses were for fuel. The store itself allows for an account to be established by its known customers, who are required to pay it in full and on time monthly. The total paid to this store was $708.

Equipment Lease 50-641-**662-5**

Audit noted that the balance in the Equipment Lease account at year end was $3,175. This balance was traced to one entry in the amount of $2,700 for LRW Water Services on January 7, 2010. Audit requested and was provided with an invoice for the $300 monthly rent of a trackloader from April through December 2009. One entry for $230 and one entry for $245 (verified to a Taylor Rental invoice) were also noted. The $230 could not be verified to supporting documentation. Refer to the Non-recurring Expense Summary of this report.

Vehicle Maintenance xx-652-**662-5**

The balance at year end for Vehicle Maintenance was $12,108. Audit reviewed a repair invoice in the amount of $1,270 originally posted to the Equipment Lease account 50-641-662-5, Administration, but was corrected to the Vehicle Maintenance account Paradise Shores division through year-end journal entry #38. Paradise Shores was charged the full invoice amount, rather than the allocation to each division as was done for the other vehicle maintenance expenses. The truck was repaired in February 2009, but was subsequently involved in an accident in which it was totaled. Refer to the Plant Retirements section of this report.

Vehicle Registration 50-653-**662-5**

Audit reviewed the general ledger account noted above and verified that town registration expenses in the amount of $1,658 and state registration expenses of $582 posted to the GL in a timely manner and without exception. The figures were verified to the registration form received by LRWC from the town clerk of Moultonborough. In November 2009, there was an additional town posting of $329 and an additional state posting of $73. The registration documentation was provided to Audit and in response to OCA data request 2-10 indicates that the vehicle (a 2008 Chevrolet Colorado) is an asset of the Company.

Audit verified that the vehicles and equipment (trailers and excavators) for which registration expenses were incurred were noted on the asset list of the company. Audit then verified that the vehicles and equipment noted on the insurance policies of the Company reflected those vehicles and equipment on the asset list. Based on the response to audit request #47 which compared the asset listing to the registrations and insurance, there were four trailers which were either on the asset list but not insurance, or vice versa. These will be researched and the adjusted as appropriate. One Toyota truck (fully depreciated) on the asset list was not registered and not insured. Company indicated it should be removed from the depreciation list.

Uncollectible Accounts 50-670-**904**-7

During the audit and review of expense account 904, Uncollectible Accounts it was noted that a journal entry was made for $1,907 with a description of "Deposits not in Bank, 3/08 and 3/09." Upon questioning, the Company stated the following: *"On 3/30/09 the Company received and processed payments from customers in the amount of $1,907.06 contained in 2 bank deposits. The bank deposits never made it to the bank. All employees who normally or occasionally make the bank runs were asked to thoroughly search their vehicles to find the missing deposits. No success. The missing bank deposits were subsequently written off to the bad debt account. This incident is not a normal occurrence for the Company."* **Audit Issue #8**

Outside Services 50-631-**923-8**

Accounting Services in account 50-631-923-8 for the test year totaled $56,048. Audit reviewed invoices from Norm Roberge which summed to $40,768 and invoices from Stephen St. Cyr in the amount of $15,280.

Audit reviewed 52 weekly invoices received by the Company from Norman Roberge for accounting services. A flat weekly retainer of $784 was invoiced. None of the invoices had been paid, and a prior amount from pre-2009 remains on the accounts payable listing. Total amount owed to Mr. Roberge at the end of 2009 was $61,936. Audit reviewed the contract on file between Lakes Region Water Company, Inc. and Norm Roberge, dated 7/15/2009 (retro to June 2008) which identified weekly compensation of $764, an annual difference of $1,040. Refer to the Non-recurring Expense Summary of this report as well as to **Audit Issue #9**

Monthly invoices from Stephen P. St. Cyr related to accounting services provided in relation to a variety of dockets and the annual report. Audit summarized the invoice totals *as requested on the invoices* by Mr. St. Cyr and compared the requested postings to the actual postings:

As requested to be booked:

N. Roberge	Expense	$40,768	Defer	$-0-	Total Invoices	$40,768
S. St. Cyr	Expense	$ 4,121	Defer	$18,636	Total Invoices	$22,757
		$44,889		$18,636		$63,525

As booked:

N. Roberge	Expense	$40,768	Defer	$-0-	Total Invoices	$40,768
S. St. Cyr	Expense	$15,281	Defer	$8,158	Total Invoices	$23,439
		$56,049		$8,158		$64,207

Audit was told that the difference between the requested expense total of $44,889 and the as booked total of $56,049 is the result discussions between Mr. Roberge and Mr. St. Cyr at year end regarding what should be booked to expense accounts and what should be booked to deferred accounts. Proforma #9 reduced the $56,049 by $9,703 which represented accounting work associated with the ARRA financing docket DW09-098, as well as work done relating to the criminal case. Audit concurs with this portion of the proforma.

St. Cyr invoices relating to docket DW08-070 amounted to $1,652. When the invoices were presented, the full amount was requested to be deferred. However, at year end, the decision was made to defer $826 and expense $826. Audit recommends that the expensed $826 be considered non-recurring, and the deferred $826 be written off. Subsequent to the audit fieldwork, the Audit staff was provided with information which detailed that the entire $1,652 had been expensed. (As noted in the Deferred Rate Case section of this report, the year end deferred balance was $7,332 relating to docket DW09-184.) The Commission via Order 24,954 issued on March 27, 2009 approved rate case expenses associated with docket DW08-070. The Order approved recovery of $17,828 from customers through a one quarter surcharge. At year end 2009, there should not have been additions made to the amount already approved. Refer to the Non-recurring Expense Summary of this report and to **Audit Issue #10**

Audit reviewed the invoice portions identified as work relating to docket DW 09-184, a rate filing which was not pursued. The total associated with this docket, $7,332, was noted in a deferred account 50-153-186-1. Because the rate filing (which was to be for test year 2008) was not pursued, these costs should be written off the books of the Company. **Audit Issue #10**

An amount of $681 included in the Analysis of Professional Fees could not be supported. Audit therefore recommends that this figure be considered non-recurring. Refer to the Non-recurring Expense Summary of this report.

Computer Support 50-633-**923-8**

Audit verified that the expenses posted to the Computer Support general ledger expense account were for contractual services relating to both hardware and software support. Invoices from Northern Data Systems, Inc. were reviewed, and the calculated expenses and prepayments were verified. As of December 31, 2009, the expensed amount posted was $6,553, and an increase to the prepaid account in the amount of $242 was recalculated without exception. At year end, the total in the prepaid account 50-140-162-1 was $3,158. There were no exceptions.

Insurance 50-655-**924-8**

Insurance expenses related to property, liability, and workmen's compensation increased over 12/31/2008 by 18.5%. The Company noted in their PUC annual report that the change was due to "*industry rate increases, increase in property values covered, increase in number of* *personnel and increase in dollar amount of sales revenue. The increase was offset slightly by change of carrier.*"

Audit reviewed the insurance documents provided and noted that the Liberty Mutual workmen's compensation insurance was cancelled in April 2009, as was the Grundy general liability policy. The Company, during the remainder of the test year, utilized Cincinnati Insurance for all liability and workmen's compensation, and used Progressive for one of the vehicles used in the daily operation. Late payment issues were noted throughout the test year.

Audit reviewed the monthly recurring entry in the amount of $3,600 with an adjusting year end entry to record the proper prepaid amount for the year. Total calculated expenses were $48,317 and the prepayment (in 50-140-162-1) was $15,750. Of the policy premium financed for the Cincinnati coverage, $1,136 was a finance charge. This amount should be booked to the interest expense account, not the insurance expense account. **Audit Issue #11**

Heat/Electric Office 50-648-**930-8**

Entries to this expense account reflect invoices from Amerigas for propane as well as invoices from NHEC for electricity. Amerigas is calculated for prepayment as the tank is filled and used over the course of time. At year end 2009, the prepaid propane calculation was derived using the quantity delivered divided by the number of days since delivery, compared to the capacity remaining, then multiplied by the cost. The result of $415 was posted in the prepaid account 50-140-162-1. Expenses for the year on the worksheet were $1,689. Audit reviewed two delivery invoices during the test year which sum to $1,450. Late fees assessed on both invoices summed to $90 and were posted to interest expense account 50-730-427-0. The expense for the year was derived in the following manner:

Beginning prepaid	$ 654
Invoices in 2009	$1,450
Less 2009 prepaid	($ 415)
2009 Expense	$1,689

Total expenses paid to NHEC were $2,363. Disconnect notices were noted on several of the invoices.

Office Expenses 50-682-930-8

Total expense for the test year was $54,137. Audit reviewed the account activity and noted that it included expenses such as computer support, forms and envelope purchases, attendance at NHWWA seminars, monthly service fees, postage, etc.

Within the account, audit reviewed Northern Data Systems, Inc. invoices which reflected both computer hardware support as well as forms. The invoices were noted during the test year without exception. The annual hardware support contract was properly allocated to the prepaid account discussed earlier in this report.

Monthly service fee of $19.95 for the web connection GoToMyPC.com was noted on the American Express credit card, plus a finance charge in excess of $200 per month on the ongoing unpaid balance (refer to the Interest Expense portion of this report). The online access site provides access to the LRWC system for use by the Treasurer, Office Manager, and Field Supervisor from remote locations. Beginning in April 2009, the charge was noted on the GM Card rather than the American Express card. Audit noted that the credit limit at the beginning of the year was $23,600. At the end of the test year, the limit had been reduced to $1,800. Interest rate on this card was 27.24%

One general ledger entry in August 2009 in the amount of $2,853 was noted by the Company to "*represent an amount that had not been expensed during 2007 or 2008 and was not identified specifically but was discovered when the A/P clerk reconciled the American Express statement balance with the accounts payable open invoice report. The $2,853 was posted to office expense in order to bring American Express accounts payable in line with the American Express statement.*" Refer to the Non-recurring section of this report as well as to **Audit Issue #7**

Audit also reviewed entries posted to this account with the description of GM Card member Services. This credit card was used for miscellaneous ongoing purchases. The activity on the monthly statement was posted to the GL as the statement was received. Five months reflected late charge assessments, one statement had a phone payment fee, and nine of eleven statements had finance charges included. The Company was not able to pay the balances in full monthly, and the interest rate accrued at an APR of 30.99%. Audit noted that the late charge assessments and finance charges were posted to the interest expense account 50-730-427-0.

Operating Permits xx-688-**930**-8

Each of the seventeen divisions within Lakes Region Water Company, Inc. are assessed a $300 annual operating permit fee. The fees run with the state's fiscal year of July through June. Therefore, the Company provided a calculation of half-year in the prepaid account, used in the expense of the current test year, with half-year of the current fees expense and half posted to the prepaid account 50-140-162-1. At year end December 31, 2009, the expense was $5,100 and the prepaid account was $2,550.

Rents 14-640-**931**-8

The total expense for the test year, among all divisions was $1,000. Audit reviewed the detailed general ledger and noted one posting to division 14, Deer Cove, in the amount of $1,000. Audit reviewed the invoice from Deer Cove North Corporation for "annual rent for water pumped from the Deer Cove wells". Audit reviewed docket DW04-031, Order No. 24,376 issued on September 30, 2004 which authorized this annual payment amount to the prior owner of the Deer Cove water system.

PAYROLL

Payroll Expenses per Annual Report Schedule F50 as verified to the General Ledger

603-**920**-8	Officer Salary	$ 33,063
601-**601**-1	Employee Wages	$ 17,450
601-**642**-3	Employee Wages	$ 5,250

601-**662**-5 Employee Wages	$ 21,225	
601-**902**-7 Employee Wages	$ 15,341	
601-**920**-8 Salary Office	$ 12,977	
602-**920**-8 Office Salaries	$108,905	
Subtotal Expensed	$214,211	
Salaries in CWIP	$ 6,789	refer to Plant section of this report.
Total Salaries and Wages	$221,000	schedule F50

General Ledger wage expense accounts listed above were verified to the annual report schedule F50. Proforma #1 reflects expensed wages of $214,628., $417 higher than the actual general ledger accounts. Audit verified that the W-2 wage summaries provided to the OCA via the set 2 data requests summed to $221,419. The Company responded to an audit request for clarification of the variances and was told that the variance is "*attributable to errors in moving work order amounts from LOTUS based program to Excel and sorting and summarizing information for entry to GL. We have found in the past that a row or two were summarized into another account with the difference being 0.19% no search was conducted to correct.*"

Audit verified the total of the reported salaries in CWIP to 57 individual 2009 work orders. Audit verified the total payroll reported on the QuickBooks (Excel) summary of payroll for 2009 $221,628. There were seven active employees during the test year.

In response to **Staff data request 1-7,** the Company indicated that pensions paid to the current stockholders were $36,040 and $16,297 for a total of $52,337 during the test year. This figure represents 52 weeks of $987.50 weekly payments. Audit noted a total of $53,390 in account 606-926-8, Disability Insurance (also known as Pensions). This figure is $1,053 higher than the data request information provided. Audit noted that the total on the general ledger appeared to represent 53 weeks, plus two miscellaneous entries in the amount of $526 each. When questioned, Audit was told that the payroll periods run from Friday through Thursday, with payroll checks issued on Friday. A 53rd payroll was in fact paid to all pension recipients and employees due to the typical Friday pay date at the end of the year falling on January 1, 2010, a holiday. Thus, the payroll for that period was paid on Thursday December 31, 2009. **SEE OCA 1-17**

Audit verified that the pension portion (noted on the summary as) used to pay down the Note Payable to the Masons, in account 50-265-224-0 reflected 53 weeks of debits in the amount of $575, which for the year represented $30,484. This weekly figure does not agree with the $571 reflected in the response to the OCA Data Request #1-17, which appears to be a typographical error.

Social Security and FICA taxes are not withheld from the pension payments, although an accounting error throughout most of the test year continued to withhold taxes from Mr. Mason's pension. The error was identified, and a request for reimbursement was sent to the Internal Revenue Service, and said overpayment of payroll taxes was reimbursed to the Company. The amount owed back to Mr. Mason was noted in account 50-121-145-1. $9,671 (per the Payroll Summary provided to Audit) Audit was told, is comprised primarily of taxes withheld in error. The account began 2009 with a zero balance. Reimbursement to Mr. Mason, in the amount of $193 weekly (credit) was noted in the receivable account, and offset to account 50-265-224-0, note payable Masons.

Employee Benefits

Health and dental insurance plans are offered to employees. In 2009, the employee co-payment of health premiums was 50% for employee coverage, and 100% co-pay for family coverage. One office employee who had been "grandfathered" had no premium co-pay (for individual coverage). All employees who chose to enroll in the dental insurance plan paid 100% of the premium.

For the first half of the test year, the health insurance was purchased through Cigna. At July 1, coverage changed from Cigna to Anthem, due to the decrease in cost from $486 per employee to $411. Audit reviewed all monthly invoices from Cigna, Anthem, and Delta Dental without exception.

General

Audit was informed that all employees (at the time of the audit fieldwork) have a minimum license to operate a water utility, including the office staff who are certified as basic water inspectors and meter readers. Three field personnel are licensed at a basic level and also authorized for sampling, pump house inspection, and meter reading. Two field personnel are certified at all levels and are authorized to cross train. (Refer to the OCA set 2 data requests for current certifications).

TAXES

Federal and State Income Taxes

Audit verified that the accumulated deferred income tax figure noted on the annual report schedule F-38 of $105,511 agrees with the general ledger account 50-280-283-0, Deferred Income Tax-Other. There was no activity in the account during the test year.

Audit reviewed the Federal income tax return and noted no tax due. This agrees with the general ledger which showed no activity in income tax expense accounts 1-850-409-1, Federal Income Taxes, or 1-850-410-1, Deferred Federal Income Tax. This also agrees with the filing proforma #17 which detailed actual Federal income taxes for 2009 of zero.

Audit reviewed the New Hampshire State Business Profits tax forms for the test year and noted that the net operating loss carry-forward balance at the end of 2009 was reported to be $269,600. The decrease during 2009 of $2,370 was noted on the general ledger as an estimated expense in account 1-852-409-1, State Income Tax. The actual calculated Business Enterprise Tax (BET) as reported on the BT-Summary Business Enterprise Tax (BET) form was $2,334. The difference between the estimated figure noted on the DP-132 Net Operating Loss Deduction and the BET will be adjusted on the general ledger as part of the 2010 financial closing of the books of the Company. Audit noted that the filing includes (in the proforma section, #18) the actual $2,370 which is $36 more than the actual tax owed and paid.

The Federal income tax return was signed and dated November 3, 2010. The NH State form was signed and dated November 4, 2010. There were no late filing assessments noted, either on the forms or on the general ledger.

Property Taxes

The property tax expense for the test year noted in the filing included $10,167 for the State Utility Property tax and $17,476 for municipal property taxes for a total of $27,643. This sum was noted on schedule F-38, Accrued and Prepaid Taxes in the annual report as the amount of taxes charged during 2009. The prepayment beginning balance $5,464 on F-38 was noted on the property tax worksheet compiled by the Company's CPA. Expenses paid to each municipality and calculation of year end prepayments for each were included on the worksheet. All totals agree with F-38 and the filing actuals (see proforma #15 and proforma #16). All figures noted were verified to the general ledger without exception.

Audit verified that the expense total represented prepayments from the prior tax period, the full 1st issue 2009, and1/4 of the second issue total tax year figure municipal invoices. Audit also verified that the expensed portion of the Utility Property tax for tax year 2009 represented 3 months of the 2008 assessment and nine months of the 2009 assessment, in accordance with RSA 83-F. In addition, it was noted that none of the municipal property tax invoices included the statewide portion of the municipal tax.

Audit reviewed the *first and second issue municipal property tax bills* from each city and town and found 88% to be past due as of year-end 2009. Below is the summary by LRWC system, by town and the amount owed (per the second issue tax bill). *The list does not represent the expense and prepaid general ledger account totals, nor the amount within the Accounts Payable list at year end.*

Division 50-Administration-Moultonboro	$ 307 excluding interest*
Division 01-Far Echo Harbor-Moultonborough	$ 253 excluding interest
Division 02-Paradise Shores-Moultonborough	$2,935 excluding interest*
Division 03-West Point-Moultonborough	$ 397 excluding interest*
	$3,892

*Four individual properties in the town of Moultonborough have reflected on the property tax bills an assessed land value and a credit (negative) building value. Using the 2009 second issue invoices, the four properties had reductions to the assessed value in the amount of ($998,900). Audit was informed by the Moultonborough town appraiser that the reduced valuation was done to attempt to align the municipal property values with the valuation provided by the Department of Revenue for the Utility Property Tax. Had the reduced valuation not been used by Moultonborough, the property tax expense would have been $9,275 vs. $3,892 for the tax year 2009.

Division 04-Waterville Valley Gateway- Thornton	$2,311 includes 1st issue interest $76
Division 05-Hidden Valley-Tuftonboro	$1,602 includes 1st issue interest $33
Division 05-Hidden Valley Prop. Own. Asscn.	$1,069 includes interest $69

Divisions 06, 07-Wentworth Cove and Pendleton Cover-Laconia	$1,131 includes 1st issue interest $10
Division 08-Deer Run-Campton	$ 409 includes 2009 interest $10
Division 13-175 Estates-Campton	$ -0- no separate assessment or invoice
Division 09-Woodland Grove-Conway	$1,391 includes 1st issue interest $24
Division 10-Echo Lake Woods-Conway	$ 749 2nd issue $449 outstanding
Division 11-Brake Hill-Gilford	$ 244 excluding interest
Division 17-Gunstock Glen-Gilford	$ 438 excluding interest
Division 12-Tamworth Water Works-Tamworth	$3,385 includes 1st issue interest $90
Division 14-Deer Cove-Ossipee	$ 47 includes 1st issue interest $0.26
Division 16-Indian Mound-Ossipee	$ 431 includes 1st issue interest $1
Division 15-Lake Ossipee Village-Freedom	$ 986 excluding interest

Utility Property Tax Return

In accordance with RSA 83-F, the Company calculated the utility property tax for tax year 2009 to be $11,150. The form outlined an additional $250 Financial Statement Penalty which is owed to the State of New Hampshire. Audit was informed that the tax return was completed and filed in August 2010, with a partial payment made to the state with the filing, and the remainder paid in November 2010. The total amount paid included the penalty, and amounted to $$11,400. The penalty portion of the return was not included in the calculation of the property tax expense for the test year.

Payroll Taxes

Audit noted that the payroll tax expense for the year, in the amount of $17,191 agreed with the annual report schedule F-50, and general ledger accounts:

604-408-8	$ 1,446
604-926-8	$15,745
Total	$17,191

The filing identified payroll tax expenses for the actual test year of $18,805 (see proforma #3). Audit requested clarification of the variance between the general ledger total and the proforma "actual" and was told that the "*Company started with the actual payroll for 2009 and adjusted the payroll for 1 employee to a full year. The adjusted full year was used in the calculation of payroll taxes.*" Supporting spreadsheets were provided to Audit.

Accrued Taxes

50-230-236-0 Accrued Payroll Taxes	($3,599)
50-235-236-1 Accrued Federal Income Taxes	($ 27)

50-235-236-2 Accrued NHBPT $ 321

The accrued payroll tax debit balance at year end was caused by the overpayment of estimated payroll taxes during the year.

Deferred Taxes

Account 50-280-283-0, Deferred Income Tax-Other, reflected a year-end balance of ($105,511). There was no activity during the test year in this account. The total agrees with the annual report schedule F-45.

Regulatory Commission Expense

The total Regulatory Commission expense noted in the annual report was $20,522. The total is the sum of two accounts, Rate Case Expenses $18,001 and Commission Expenses $2,521. Audit reviewed the proforma entry #11 which excluded the full Rate Case Expense figure of $18,001 from the current rate case. Account 665-928-8 reflected a total of $2,521 for the test year. Audit verified the Commission quarterly assessments which total $2,297, to the NH PUC Business Office records which agree with the activity in account 50-665-928-8.

One additional entry to account 665-928-8 was an invoice in the amount of $224 received from the Union Leader for publication of a notice relating to American Recovery and Reinvestment Act (ARRA) funding. Ultimately, the funding was not utilized. Therefore, the $224 should be considered a non-recurring expense. Refer to the Non-recurring Expense Summary of this report.

Non-recurring Expense Summary

As noted within the text of this report, the following are considered non-recurring entries. Audit recommends that these expenses be either excluded from the current rate case or considered for amortization, rather than 100% expensed during the test year:

12-610-602-1	Purchased Water	($300)	
xx-620-603-1	Materials Source of Supply	$1,476	see proforma #8
01-620-642-3	Inventory Expense Water Treatment	$ 45	see proforma #8
xx-620-662-5	Materials T&D	$ 811	see proforma #8
02-641-662-5	Equipment Lease	$ 230	
xx-620-905-7	Materials Customer Ops	$ 346	see proforma #8
50-631-923-8	General Accounting	$3,373	
50-665-928-8	Regulatory Commission Expense	$ 224	
50-682-930-8	Office Expense	$2,853	

AUDIT ISSUE #1

Allocation Percentages

Background

The books and records of LRWC have been set up by Norman Roberge to include one administrative division and seventeen operating divisions. Generally, costs that should not be direct charged are posted to Division 50 (Administrative), and then at a later time allocated. For the test year LRWC accounting allocated to 17 divisions. The allocations are based on average customer count and are contained within the LRWC computer system.

Issue

Audit found that for the test year computer allocations were done based on the average customer count for year 2005.

For manual entries made during the 2009 year end an allocation based on either the 4th qtr 2009 numbers or the average 2009 number was used.

In addition, Audit questions why the books and records consisted of 17 separate operating divisions in the test year. It is understood that at least one franchise, Paradise Shores, must be kept separate due to the POASI agreement. However, as there are consolidated tariff rates, why the need for 17 operating divisions?

Audit Recommendation

The LRWC computer system for accounting should have been programmed to use the previous year's average customer count for allocating common costs. For test year 2009 the average year 2008 customer count should have been used instead of year 2005.

Additionally, the Company should review why it is necessary to keep the books and records by 17separate operating divisions.

In summary, Audit recommends that an internal management review be done with the objective to simplify the accounting process.

Company's Response

The Company acknowledges that the incorrect allocation percentages were used in 2009 but must pointout that the maximum difference between the 2005 percentages used and the correct 2009 percentages would have accounted for no greater increase than .33% or $3 per $1,000 of allocation for BH and IM, .11% or $1 per $1,000 of allocation for HV and LOV, no greater decrease that (.19%) or ($2) per $1000 of allocation for FEH, PS, WP, WVG, and 175E and no difference for WC, PC, DR, TWW, DC and GG. The Company will update its allocation data parameters in 2011.

The Company has over the years conducted many internal management reviews of its accounting processes on the view of simplification and has found it very difficult to "simplify" in the face of the Company's need for internal management data for individual systems and the need to provide the Commission with data when the Company applies for any rate relief.

The Company has found over the last 20 years that it is easier to maintain separate divisions as the Company moved from 7 divisions with 4 rates to 13 divisions with 7 rates then to 13 divisions with 2 rates then to 17 divisions with 5 rates then to the 17 divisions with 2 rates.

Currently the Company must maintain divisional information on Paradise Shores due to the special contract with POASI and we must maintain separate operating information for Gunstock Glen since it is not currently under a common rate. The Company finds it easier to accumulate the operating divisions into a single total by expense than it is to separate a total into its various operating divisions as it would likely be required to do by some data request in some proceeding.

Audit's Response

Audit is of the opinion that the books and records need only be kept by division for Paradise Shores, Gunstock Glen and then consolidated. Therefore, Division 50 (Administrative) would require only three allocations instead of seventeen. LRWC could still use the number of customers as the allocator.

Audit suggests that during this rate case proceeding LRWC accounting and management discuss with Commission Staff and other parties the desire to simplify their record keeping. Audit agrees that this simplification will mean that going forward the Company will no longer be able to provide individual division information. However, Audit believes that it would be beneficial to discontinue keeping the books and records of seventeen separate operating divisions but instead only have three.

REPEAT AUDIT ISSUE #2

Notes Payable

Background

The Company incurred three new notes payable with a year-end 2009 balance of $42,305. The notes began in 2009 and have various beginning dates as well as varying terms and rates. Also, the loan from the Masons to provide operating cash to the Company as necessary has a year-end 2009 balance of $190,855. Unauthorized notes incurred prior to year 2009 had a balance of $45,556. The total of notes payable as of year-end 2009 without Commission approval is $278,716.

Issue

None of the debt issues described above which are for years 2004, 2006, 2007, 2008 and 2009 has been approved by the Commission, in violation of RSA 369:1.

Audit Recommendation

The Company must comply with RSA 369. Audit understands that on January 24, 2011 the Company filed a petition with the PUC requesting approval of the above debt as well as new debt for year 2010. Refer to docket DW11-021.

Company's Response

As noted above, the Company has filed in docket DW11-021 for approval of previous debt including that of 2010 and for anticipated debt in 2011. In the future, the Company anticipates to be timely in its financing petitions.

Audit's Response

Audit concurs with the Company's response.

AUDIT ISSUE #3

Late payment fees/Interest

Background

During the test year LRWC incurred many late payment fees for not paying bills on a timely basis.

Issue

Late payment fees totaling $12,921 were posted to interest account 50-730-427.

Audit Recommendation

Audit recommends that the sum of $12,921 not be included in the cost of capital or any ratemaking as it was incurred for not making payments on a timely basis and consequently considered an imprudent expense.

Company's Response

The Company accepts the audit recommendation. The Company did not include the late payment fees in its DW10-141 and has not included the costs in the cost of capital calculation.

Audit's Response

Audit agrees that these late fees should not be in ratemaking.

AUDIT ISSUE #4

Inconsistent Depreciation Calculations

Background

While reviewing the Company's depreciation records for DW 08-070, Step 3 an inconsistency was noted in the start up of the depreciation life of an asset. Some assets that had been placed in service during 2008 were calculated with half year depreciation in 2008 and another half year in 2009, instead of the correct amount of a full year.

Issue

Depreciation Expense and Net Book Values are incorrect.

Audit Recommendation

Per the Company Comment to Audit Issue #2 found in the DW 08-070, Step 3 Audit Report; "The Company completed a full review of its depreciation schedules and will correct those assets which are not being depreciated correctly in 2010. Based on the review, a net increase of $359 and $1,583 should be added to the 2008 and 2009 depreciation expense and accumulated depreciation, respectively."

Based on the Company's Comment above, Depreciation Expense, account 700-403, would increase by $1,583 when the correction is made to the 2009 Depreciation Expense for the test year. The amount related to 2008, $359, would be an adjustment to Retained Earnings.

Company's Response

Company accepts audit recommendation for Audit Issue #4.

Audit's Response

Audit concurs with the Company's response.

AUDIT ISSUE #5

Amortization Adjustments

Background:

Audit's review of Amortization revealed an adjustment to Indian Mound's Amortization of Acquisition Adjustment, account 165-115, of ($1,372) related to an adjustment to correct the division's prior years' amortization provision.

During Audit's review of the NHPUC Annual Report, it was discovered that the Company had inadvertently booked the amortization provision for Deer Cove the wrong way. It had been booked as a debit, when it was supposed to be a credit. The Company was notified and the Company has agreed to fix this during 2010.

Issue:

The adjustment for Indian Mound relates to prior years and not the test year. As a result, the accumulated amortization and expense amounts used in the filing were incorrect.

For the test-year, the entry for Deer Cove was incorrect. As a result, the accumulated amortization and expense amounts used in the filing were incorrect.

Recommendation:

A rate case entry Debiting Accumulated Amortization, account 165-115, $1,372 and Crediting Amortization Expense, account 702-406, ($1,372) is recommended.

A rate case entry Debiting Amortization Expense, account 702-406, $8 and Crediting Accumulated Amortization, account 165-115, ($8) is recommended.

Company's Response

Company accepts audit recommendation for Audit Issue #5.

Audit's Response

Audit concurs with the Company's response.

AUDIT ISSUE #6

Officer and Director Customer Billing

Background

Audit conducted a customer billing test. On 1/10/11 an Audit Request was sent seeking additional information concerning certain Officer's and Director's. As of the date of this Final Audit Report the Company has not responded in writing to that request.

Issue

Audit's customer bill testing reveals that an Officer and Director that resides in Balmoral is not on the Company's list of customers being charged for water usage. In addition, another Officer and Director that resides in Paradise Shores has been billed for water usage at the base rate, but not for any metered usage. The meter read for prior and present has been recorded on the Company's billing records as 331 for the whole year.

Audit Recommendation

The Officer's and Director's of LRWC that are also using water from the franchise should be billed and make payment just as any other customer.

A test year adjustment to the filing for missed revenue should be done as a result of the above issues.

Company's Response

Company accepts audit recommendation for Audit Issue #6.

Audit Response

Even though the Company has not responded to audit request #21 concerning employee customer billings, Audit does concur with above Company response that certain Officer's and Director's have not been billed properly.

AUDIT ISSUE #7

General Accounting

Background

The Company reconciled several expense accounts to the accounts payable listing and invoices on file, and made adjustments to the 2009 expense accounts as they deemed appropriate.

Issue

The reconciliation mechanisms used to account for the adjustments crossed accounting periods. That is, several accounting adjustments made to the income statement expense accounts were the result of errors or omission which took place in prior accounting years, such as 2007 or 2008. Specifically:

Account 12-610-602-1 is understated for the test year by $300 due to an adjustment in April 2009 for an incorrect entry to the account in September 2008

Account 50-682-930-8 is overstated by $2,853 due to a debit entry to this expense account resulting from the reconciliation of the American Express credit card statements to the accounts payable listing.

Lack of a physical inventory during the years 2007 and 2008 caused an overstatement of accounts xx-620-603-1 $1,476; 01-620-642-3 $45; xx-620-662-5 $811; xx-620-905-7 $346.

Audit Recommendation

While Audit noted that the inventory adjustments were deducted from the rate filing via proforma #8, the accounting treatment of expensing items as reconciliations from prior periods are accomplished does not reflect the matching principal and should be offset to retained earnings in the future.

Company's Response

The Company accepts Audit Recommendation for Audit Issue #7. The Company is striving to have physical inventories on an annual basis.

Audit's Response

Audit appreciates the anticipated annual physical inventory, and reminds the Company of the Uniform System of Accounts requirement that inventories "shall be taken at least annually". The Company is also reminded of the proper accounting for "out of period" adjustments.

AUDIT ISSUE #8

Deposits - Write Off

Background

During the audit and review of expense account 670-904, Uncollectible Accounts it was noted that a journal entry was made for $1,907 with a description of "Deposits not in Bank, 3/08 and 3/09." The credit was made to cash.

Issue

Upon questioning the Company stated the following: *"On 3/30/09 the Company received and processed payments from customers in the amount of $1,907.06 contained in 2 bank deposits. The bank deposits never made it to the bank.* All employees *who normally or occasionally make the bank runs were asked to thoroughly search their vehicles to find the missing deposits. No success. The missing bank deposits were subsequently written off to the bad debt account. This incident is not a normal occurrence for the Company."*

Audit Recommendation

Proper cash controls require that there be a segregation of cash handling duties. Cash deposits should be prepared by one person and verified by a second person; both should initial the deposit slip to indicate their responsibilities. One office person should be given the responsibility of making bank deposits and receive a stamped deposit confirmation.

The Company should institute a policy of consequences for missing money. Make employees aware of what happens if they don't have the money that they are responsible for. A policy making the responsible employee pay back the money is recommended.

In summary, the sum of $1,907 should not be borne by ratepayers as the two missing deposits were the result of lack of controls by LRWC management.

Company's Response

The Company accepts Audit Issue #8.

Audit's Response

Audit concurs with Company's response.

AUDIT ISSUE #9

General Accounting

Background

A contract dated July 15, 2009 (retroactive to June 1, 2008) between Lakes Region Water Company Inc. and Norman Roberge for professional services was reviewed.

Issue

The weekly compensation was stated to be $764 for an annual total of $39,728. Audit reviewed the weekly invoices and expense account postings and noted the amount on each to be $784 for an annual total of $40,768.

Audit Recommendation

It is recommended that the expense account 50-631-923-8 be reduced by $1,040 with the offsetting entry made to the accounts payable account.

Company's Response

The Company accepts Audit Issue #9. The Company this date 2/8/11 has received a credit from Mr. Roberge in the amount of $1,040 and is reducing its accounting expenses and related accounts payable accounts.

Audit's Response

Audit concurs with the Company's response.

AUDIT ISSUE #10

General Accounting

Background

At year end 2009, Mr. Roberge and Mr. St. Cyr reviewed the accounting invoices of Mr. St. Cyr and determined at that time whether to post the invoices as expenses or deferred expenses.

Issue

$7,332 posted to the deferred expense account 50-153-186-1 related to docket DW09-184, a rate filing for test year 2008. That filing was not pursued.

$826 posted to the deferred expense account 50-153-186-1, related to docket DW08-070. Another $826 posted to general accounting expense account 50-631-923-8.

Audit Recommendation

Audit recommends that both the $7,332 and $826 in the deferred expense account be written off. Audit further recommends that the $826 which posted to the expense account be deducted from the test year rate filing, as the Company had Commission approval, via Order 24,954, to recover expenses associated with docket DW08-070. The determination at December 31, 2009 to split the additional cost between expenses and deferred expenses relating to this docket does not represent recurring expenses.

Company's Response

The Company disagrees with the audit recommendation. The Company anticipates filing for some portion of the DW 09-184 rate case expenditures as part of DW10-141. The Company used much of the DW 09-184 rate case exhibits, testimony and other rate case requirements when it prepared the rate filing for DW10-141.

The Company anticipates filing for recovery of the $826 as part of the rate case expenditures in the step 3 increase in DW08-070.

The Company will reclassify the $826 posted to expense to Capital Stock Expense account 330-213 and amortize it over 10 year period.

Audit's Response

Audit encourages the Company and Staff to discuss the appropriateness of any portion of the DW09-184 expenses which could be recovered as part of the current rate case expenses. Documentation should be available to support the use of the same exhibits, testimony and other rate case requirements. As a result, Audit supports the continued deferral of the $7,332 until such time as a filing for any recovery is made, properly reviewed, and approved by the Commission.

The expenses and deferrals relating to DW 08-070, as originally identified in the Issue above and to which the Company responded, were subsequently related to Audit to have been completely expensed and not deferred. While Audit understands that the third step adjustment in docket DW 08-070 continues, and therefore, the regulatory expertise of Mr. St. Cyr continues to be utilized, none of the costs should have been included as ongoing expenses. The reclassification should not take place as noted in the Company's response.

Audit recommends that the Company clearly identify to what accounts the two portions of the DW 08-070 $1,652 did in fact post. While adjusting entry information was provided in response to the draft report, given the Company's Response above, it is not clear that all of the adjusting entries had been communicated. Once clarified, any amount for which recovery may be sought by the Company should be reclassified to a deferred account.

AUDIT ISSUE #11

Premium Financing Charge

Background

The insurance premium for the Cincinnati Insurance Company coverage was financed through AICCO. The policy premium of $40,278, less a down payment of $8,055, was financed over nine months, at a financing cost of $1,136.

Issue

The financing cost of $1,136 was included in the insurance expense general ledger account 50-655-924-8.

Audit Recommendation

The financing cost should be reflected in the interest expense general ledger account, not in the insurance expense account.

Company's Response

Historically the Company has included the financing cost of its annual insurance policies in the cost of the insurance. We cannot remember an audit issue on this subject in prior years. We believe that the practice that the Company has maintained in the past should continue.

If Audit strongly believes that the financing cost of the insurance should be relegated to interest, than the Company believes that the financed amount and rate should be part of the Capital structure for rate making purposes.

Audit's Response

Audit understands the cash flow restrictions which limit the Company's ability to pay the insurance cost in full. The resulting financing costs should be posted as the type of expense incurred, interest, and any ratemaking consideration should be considered as part of the rate case settlement discussions.