

Consolidated Financial Statements

**NEW ENGLAND SERVICE COMPANY, INC.
AND SUBSIDIARIES**

Years Ended December 31, 2014 and 2013



DWORKEN, HILLMAN, LAMORTE & STERCZALA, P.C.
Certified Public Accountants / Business Consultants

**NEW ENGLAND SERVICE COMPANY, INC.
AND SUBSIDIARIES**

Years Ended December 31, 2014 and 2013

CONTENTS

	Page
Independent auditors' report	1-2
Consolidated financial statements:	
Balance sheets.....	3
Statements of income and comprehensive income	4
Statement of changes in stockholders' equity.....	5
Statements of cash flows.....	6
Notes to consolidated financial statements	7-23



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Independent Auditors' Report

Board of Directors and Stockholders
New England Service Company, Inc. and Subsidiaries
Plainville, Connecticut

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of New England Service Company, Inc. and Subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.



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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Method:

As discussed in Note 2 of the consolidated financial statements, in connection with the adoption of tangible property regulations issued by the Internal Revenue Service, the Company elected to change its method of accounting for income taxes. This method has been applied retrospectively to all periods presented.

Dworken, Hillman, LaMorte & Sterczala, P.C.

April 1, 2015
Shelton, Connecticut

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31,	
	<u>2014</u>	<u>2013</u>
		(as restated)
Assets		
Utility plant, at cost	\$38,824,458	\$36,127,940
Less: accumulated depreciation	(<u>11,301,683</u>)	(<u>10,248,137</u>)
	<u>27,522,775</u>	<u>25,879,803</u>
Non-utility property, plant and equipment	1,444,430	1,422,366
Less: accumulated depreciation	(<u>523,752</u>)	(<u>480,315</u>)
	<u>920,678</u>	<u>942,051</u>
Current assets:		
Cash and cash equivalents	1,818,255	2,397,368
Marketable securities	591,423	506,586
Accounts receivable	611,893	489,431
Accrued unbilled revenues	349,190	276,485
Regulatory asset-revenue adjustment mechanism current portion	167,175	111,996
Income taxes receivable	243,176	176,300
Materials and supplies inventory	73,079	65,403
Prepaid expenses	<u>142,554</u>	<u>30,654</u>
Total current assets	<u>3,996,745</u>	<u>4,054,223</u>
Utility deposits	450	450
Investment in cooperative capital plan	1,638	
Deferred costs and other regulatory assets	983,913	914,679
Regulatory asset-revenue adjustment mechanism, net of current portion	43,671	37,332
Preliminary survey and investigation	75,245	75,245
Regulatory asset – income taxes recoverable	<u>5,836,800</u>	<u>5,397,700</u>
	<u>6,941,717</u>	<u>6,425,406</u>
Total Assets	<u>\$39,381,915</u>	<u>\$37,301,483</u>

See notes to financial statements.

	December 31,	
	<u>2014</u>	<u>2013</u>
		(as restated)
Stockholders' Equity and Liabilities		
Stockholders' equity:		
Common stock, no par, 3,000,000 shares authorized, 295,022 shares issued and outstanding at December 31, 2014 and 287,267 shares issued and outstanding at December 31, 2013	\$ 3,339,670	\$ 2,945,096
Additional paid-in capital	297,426	297,426
Accumulated other comprehensive income	112,451	113,586
Retained earnings	<u>9,398,843</u>	<u>8,516,262</u>
Total stockholders' equity	<u>13,148,390</u>	<u>11,872,370</u>
Long-term debt, net of current portion	<u>8,342,111</u>	<u>8,434,774</u>
Current liabilities:		
Notes payable, bank	20,000	
Current portion of long-term debt	365,870	313,813
Accounts payable and accrued expenses	392,671	344,496
Accrued property and other taxes	206,777	214,801
Accrued income taxes		10,642
Accrued interest	15,863	21,620
Deferred revenues	<u>37,364</u>	<u>36,656</u>
Total current liabilities	<u>1,038,545</u>	<u>942,028</u>
Deferred income taxes	7,436,891	6,927,787
Security deposits and other credits	18,999	18,497
Customer advances for construction	38,222	40,222
Contributions in aid of construction	8,014,577	7,775,625
Amortized contributions in aid of construction	<u>1,344,180</u>	<u>1,290,180</u>
	<u>16,852,869</u>	<u>16,052,311</u>
Commitments (Notes 7 and 14)		
Total Stockholders' Equity and Liabilities	<u>\$39,381,915</u>	<u>\$37,301,483</u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME**

	Year Ended December 31,	
	<u>2014</u>	<u>2013</u>
		(as restated)
Operating revenues		
Utility revenues	\$5,140,003	\$4,533,433
Contracting and jobbing revenues	<u>711,557</u>	<u>409,700</u>
	<u>5,851,560</u>	<u>4,943,133</u>
Operating expenses:		
Operation	2,198,283	1,799,149
Maintenance	332,326	236,646
Cost of contracting and jobbing	348,493	207,369
Depreciation and amortization	886,143	731,266
Taxes other than income taxes	549,106	505,680
Interest charges	<u>279,537</u>	<u>298,029</u>
Total operating expenses	<u>4,593,888</u>	<u>3,778,139</u>
Income from operations	<u>1,257,672</u>	<u>1,164,994</u>
Other income and (deductions):		
Rental income	20,352	20,556
Investment income	36,890	20,303
Allowance for funds used during construction	9,502	10,357
Non-operating expense	<u>(3,285)</u>	<u>(8,360)</u>
Total other income	<u>63,459</u>	<u>42,856</u>
Income before income taxes	1,321,131	1,207,850
Income taxes	<u>105,700</u>	<u>101,231</u>
Net income	1,215,431	1,106,619
Other comprehensive income loss:		
Unrealized gain (loss) on marketable securities	<u>(1,135)</u>	<u>40,779</u>
Comprehensive income	<u>\$1,214,296</u>	<u>\$1,065,840</u>
Per share amounts:		
Weighted average shares outstanding	<u>291,745</u>	<u>278,802</u>
Net income	<u>\$ 4.17</u>	<u>\$ 3.97</u>
Dividends	<u>\$ 1.14</u>	<u>\$ 1.06</u>
Book value	<u>\$ 45.07</u>	<u>\$ 42.58</u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Treasury Stock</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Retained Earnings</u>
Balance January 1, 2013	\$2,686,112	\$ 9,920	(\$765,643)	\$ 72,807	\$7,706,202
Common stock issued (5,087 shares)	258,984				
Net income					1,106,619
Dividends issued					(296,559)
Treasury stock sold (20,650 shares)		287,506	765,643		
Unrealized gain on marketable securities				40,779	
Balance, December 31, 2013	<u>2,945,096</u>	<u>297,426</u>	<u>0</u>	<u>113,586</u>	<u>8,516,262</u>
Common stock issued (7,755 shares)	394,574				
Net income					1,215,431
Dividends issued					(332,850)
Unrealized loss on marketable securities				(1,135)	
Balance, December 31, 2014	<u><u>\$3,339,670</u></u>	<u><u>\$297,426</u></u>	<u><u>\$ 0</u></u>	<u><u>\$112,451</u></u>	<u><u>\$9,398,843</u></u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	<u>Year Ended December 31,</u>	
	<u>2014</u>	<u>2013</u>
		(as restated)
Cash flows from operating activities:		
Net income	\$1,215,431	\$1,106,619
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	913,672	878,639
Deferred income taxes	37,900	143,020
Allowance for funds used during construction	(9,128)	(10,357)
Bad debt and project write-offs	9,435	13,570
Investment (gains) losses	(8,047)	62
Directors' stock compensation	30,408	41,568
Change in operating assets and liabilities		
Accounts receivable and accrued unbilled revenues	(204,602)	24,777
Regulatory asset-revenue adjustment mechanism	(61,518)	(149,328)
Income tax receivable	(77,518)	45,800
Materials and supplies inventory	4,194	(7,103)
Prepaid expenses and utility deposits	(56,900)	10,174
Deferred costs and other regulatory assets	(174,163)	(277,928)
Accounts payable and accrued expenses	48,175	58,132
Accrued property and other taxes	(8,024)	20,408
Accrued interest and deferred revenues	(4,547)	5,439
Net cash provided by operating activities	<u>1,654,768</u>	<u>1,903,492</u>
Cash flows from investing activities:		
Purchase of marketable securities	(129,750)	(116,914)
Proceeds from sale of marketable securities	51,187	
Additions to utility plant and nonutility property	(1,820,050)	(1,589,669)
Payment for purchase of PWC, net of cash acquired		(307,473)
Payment for purchase of AWC, net of assets acquired	(97,894)	
Payment for purchase of C&C contracts	(55,000)	
Contribution in aid of construction	104,000	209,370
Proceeds from sale of utility plant assets	5,245	646
Security deposit collections		1,951
Purchase of investment in cooperative capital plan	(1,000)	
Net cash used in investing activities	<u>(1,943,262)</u>	<u>(1,802,089)</u>
Cash flow from financing activities:		
Borrowings on notes payable, bank	20,000	
Repayment of long-term debt	(286,934)	(268,179)
Proceeds from issuance of long-term debt		1,178,319
Proceeds from issuance of common stock	309,165	217,416
Treasury stock sales		1,053,149
Dividends paid	(332,850)	(296,559)
Net cash provided by (used in) financing activities	<u>(290,619)</u>	<u>1,884,146</u>
Net change in cash and cash equivalents	(579,113)	1,985,549
Cash and cash equivalents, beginning	<u>2,397,268</u>	<u>411,819</u>
Cash and cash equivalents, ending	<u>\$1,818,255</u>	<u>\$2,397,368</u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

1. Summary of significant accounting policies:

General:

New England Service Company (the “Parent”) pursues business opportunities in unregulated water related markets that include plumbing services and water utility operations and management. The income and expenses for such activities are reported as contracting and jobbing revenues and costs in these financial statements.

The Company has four public utility subsidiaries, Valley Water Systems, Inc., (VWS) distributing water to approximately 6,700 customers in Plainville, Farmington and Southington, Connecticut, Colonial Water Company (CWC), organized through acquisition of rate base assets of Dover Water Company, distributing water to approximately 580 customers in Dover, Massachusetts, Plymouth Water Company (PWC), acquired in December 2013, distributing water to approximately 800 customers in Plymouth, Massachusetts, and Abenaki Water Company (AWC), which began operations on February 14, 2014 through the acquisition of the rate base assets of Lakeland Management Company, Inc. and White Rock Water Company, Inc., distributing water and sewer services to approximately 250 customers in Belmont and Bow, New Hampshire.

The consolidated financial statements include the accounts of the Parent and its wholly owned subsidiaries (collectively, the Company). All significant intercompany transactions have been eliminated in consolidation.

Regulation of the subsidiaries:

VWS is regulated by the State of Connecticut Public Utilities Regulatory Authority (“PURA”), CWC and PWC are regulated by the State of Massachusetts Department of Public Utilities (DPU), AWC is regulated by the State of New Hampshire Public Utilities Commission (NH PUC) (collectively, the Regulators) and as such each subsidiary maintains its accounts in accordance with the accounting methods prescribed by the respective state Regulators. The subsidiaries prepare their financial statements in accordance with accounting principles generally accepted in the United States of America which include the provisions of the Financial Accounting Standards Board Accounting Standards Codification (“ASC”) No. 980, *Regulated Operations* (“ASC 980”). Under ASC 980, deferred costs and credits will be recognized in the rate setting process in a period different from the period in which they would have been reflected in income by an unregulated company. These deferred regulatory assets and liabilities are then reflected in the income statement in the period in which the same amounts are reflected in rates charged for service.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

1. **Summary of significant accounting policies** (continued):

Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

Utility plant:

The cost of additions to utility plant and improvements are capitalized. Costs include labor, materials, services and charges for such indirect costs as engineering, supervision, payroll taxes, employee benefits, transportation and certain preliminary survey and investigation charges. The cost of repairs and maintenance is expensed. When depreciable utility plant is retired or disposed of its book cost along with the cost of removal, less salvage value, is charged to accumulated depreciation.

Utility plant as of December 31, 2014 and 2013 consists of the following:

	<u>2014</u>	<u>2013</u>
Organization and intangible	\$ 169,776	\$ 169,776
Source of supply plant	4,103,665	3,687,591
Pumping plant	3,256,412	2,798,583
Water treatment plant	1,421,998	1,255,731
Transmission and distribution plant	27,861,489	26,310,882
General plant	1,898,711	1,766,364
Miscellaneous plant	36,492	
Construction work in progress	75,915	139,013
	<u>\$38,824,458</u>	<u>\$36,127,940</u>

Nonutility property, plant and equipment:

VWS owns land and two abandoned wells with an original cost of \$44,893 that are currently not used in utility service. Depreciation in the amount of \$38,921 was accumulated during the period these wells were in service and for financial statement presentation this amount has been netted against the original cost. No depreciation for these wells is currently being

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

1. **Summary of significant accounting policies** (continued):

Nonutility property, plant and equipment (continued):

charged to income. Upon retirement or disposal, the book cost, accumulated depreciation and any salvage are netted and any gain or loss is recognized in the statement of income. The Parent also has nonutility property, plant and equipment which are stated at cost. This property is not subject to rate regulation and is depreciated for financial reporting purposes primarily by use of the straight-line method over their estimated useful lives.

Depreciation:

The Company uses the straight-line method of depreciation over the estimated service lives of utility depreciable plant ranging from 3 to 80 years as approved by the Regulators. No depreciation for financial statement purposes is charged to income relating to utility plant constructed with developers' contributions after 1988 as the Regulators do not allow the Company to recover this expense through rates.

The cost of this plant, offset by an equal corresponding amount reported within Customers' Advances for Construction, Contributions in Aid of Construction and Amortized Contributions in Aid of Construction is \$9,396,979 and \$9,106,027 as of December 31, 2014 and 2013, respectively.

Cash and cash equivalents:

The Company considers all highly liquid investments that have an original maturity of less than three months to be cash equivalents. The Company maintains its cash in bank deposit accounts, which, at times, exceed federally insured limits. The Company has not experienced any losses in such accounts and does not believe it is exposed to any significant risk on cash and cash equivalents.

Marketable securities:

The Company classifies its marketable securities as available-for-sale. The securities are carried at fair value, with unrealized gains and losses reported as a component of other comprehensive income (loss).

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

1. **Summary of significant accounting policies** (continued):

Fair value:

Estimated fair value is based on the criteria outlined in ASC No. 820, “*Fair Value Measurements and Disclosures*” (“ASC 820”). ASC 820 established a “three-tier” valuation hierarchy to prioritize the assumptions used in valuation techniques to measure fair value. The three levels of fair value hierarchy under ASC 820 are detailed below:

- **Level 1** – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- **Level 2** – Quoted prices in active markets for similar assets and liabilities or quoted prices in less active, dealer or broker markets;
- **Level 3** – Prices or valuations that require inputs that are both significant to the fair value measurements and are unobservable.

Accounts receivable:

The Company continuously monitors the creditworthiness of customers and establishes, when necessary, an allowance for amounts that may become uncollectible in the future based on current economic trends, historical payment and bad debt write-off experience, and any specific customer related collection issues.

Materials and supplies inventory:

Materials and supplies inventory, which is stated at the lower of cost or market using the weighted average cost method, is primarily for the construction and maintenance of utility plant.

Deferred costs and other regulatory assets:

Costs of certain administrative projects relating to the subsidiaries’ regulatory processes and costs of items which benefit more than one accounting period are deferred and amortized to income over their respective lives and/or periods allowed by the Regulators using the straight-line method.

Costs which are “not yet amortizable” may be entirely charged to income if and when the Company believes it is probable that the Regulators will not allow the Company to recover these costs through rates.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

1. Summary of significant accounting policies (continued):

Deferred costs and other regulatory assets (continued):

The following costs have been deferred as of December 31, 2014 and 2013:

	<u>Original Cost</u>	<u>2014</u>	<u>2013</u>	<u>Amortization Period Ends</u>
VWS:				
Deferred power costs	\$131,651		\$ 6,582	September 2014
2010 rate case	104,688		21,382	October 2014
Diversion permit	24,439	\$ 622	3,064	March 2015
Cost of service study	21,961	4,941	7,137	March 2017
Tank cleaning	4,242	1,838	2,262	April 2019
Level A mapping	158,806	78,080	93,960	November 2019
WA diversion permit	24,375	22,357	23,366	January 2037
Other deferred costs	80,758	80,758	80,534	Not yet amortizable
Land development	48,668	48,668	27,384	Not yet amortizable
Storm related expenses	11,303	11,303	11,303	Not yet amortizable
MPA water testing	24,924	24,924	24,924	Not yet amortizable
2012 leak detections	20,082	13,417	17,416	March 2018
Debt refinancing	8,899	8,387	8,842	May 2033
ROE docket	6,901	6,901	6,901	Not yet amortizable
Tangible property regulation study	33,695	33,695	5,634	Not yet amortizable
UCMR testing	5,493	4,543	3,868	November 2018
Tank inspection	10,822	<u>10,526</u>	<u>344,559</u>	November 2017
		<u>350,960</u>	<u>344,559</u>	
CWC:				
Deferred financing costs	25,508	20,084	21,081	December 2035
2011 rate case	102,990		35,580	December 2014
Acquisition regulatory asset	75,852	75,852	75,852	Not yet amortizable
Other deferred costs	17,271	17,271	4,462	Not yet amortizable
Main installation projects	10,515	7,886	10,515	Transferred to utility plant
Develop hydraulic model	9,867		9,867	Transferred to utility plant
		<u>121,093</u>	<u>157,357</u>	
PWC:				
Deferred financing costs	23,900	22,860	18,601	December 2033
2014 rate case	65,153	65,153	7,593	Not yet amortizable
Acquisition regulatory asset	295,925	295,925	295,925	Not yet amortizable
Other deferred costs	3,679	3,679		Not yet amortizable
		<u>387,617</u>	<u>322,119</u>	

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

1. **Summary of significant accounting policies** (continued):

Deferred costs and other regulatory assets (continued):

	<u>Original Cost</u>	<u>2014</u>	<u>2013</u>	<u>Amortization Period Ends</u>
AWC:				
Deferred organization costs	\$102,233	\$102,233		Not yet amortizable
Deferred financing costs	20,551	18,831		February 2024
Other deferred costs	1,992	<u>1,992</u>	_____	Not yet amortizable
		<u>123,056</u>	_____	
Parent:				
Other deferred costs	90,644	<u>1,187</u>	<u>90,644</u>	Not amortizable
Total deferred costs and other regulatory assets		<u>\$983,913</u>	<u>\$914,679</u>	

Preliminary survey and investigation charges:

Costs of studies for specific construction projects are deferred until the start of the project at which time the costs are capitalized. If a project is abandoned or if it is determined that any of these costs may not be allowed to be recovered in future rates by the Regulators, the accumulated costs relating to that project are written off during the year of abandonment or determination. There were no project abandonments during 2014 or 2013.

Income taxes:

Deferred income taxes are provided for the expected future tax consequences of events that have been included in the financial statement or tax returns, on a normalized basis. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which differences are expected to reverse. Deferred income tax liabilities result principally from the use of accelerated depreciation for income tax purposes and the future benefits to be recognized upon the utilization of operating loss carryforwards. Deferred tax assets not expected to be realized are reduced by a valuation allowance.

Additionally, the Company provides a regulatory asset for income tax benefits (primarily federal and state income tax reductions due to the adoption of tangible property regulations issued by the Internal Revenue Service (IRS) in 2014 (see Note 2) and state income tax reductions due to accelerated depreciation) which have been flowed-through to the ratepayers under ratemaking policies of the Regulators and which the Company believes it will recover in rates when these income tax benefits reverse in the future.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

1. **Summary of significant accounting policies** (continued):

Customer advances for construction/contributions in aid of construction:

In certain cases real estate developers and others advance funds to the Company for the construction of water main extension projects. A portion of these funds are potentially refundable, without interest, usually within a ten year period.

Advances which have not been refunded within this period are reclassified to Contributions in Aid of Construction. The potential amount refundable on completed projects as of December 31, 2014 and 2013 is estimated to be \$102,000, respectively.

Amortized contributions in aid of construction:

Contributions in Aid of Construction that were received prior to 1989 are amortized over the remaining useful life of the related “contributed” utility plant item to Amortized Contributions in Aid of Construction.

Revenue recognition:

Revenues include amounts billed to customers on a monthly basis, adjusted for accrued unbilled amounts based on estimated water and sewer usage from the latest meter reading to the end of each year.

Beginning in 2013, as permitted by PURA, operating revenues also include amounts related to the Revenue Adjustment Mechanism (RAM). The RAM allows VWS to record, on an annual basis, the amount by which actual revenues from water customers were less than revenues allowed in VWS’ most recent rate decisions. The goal of the RAM is to remove any disincentive to implement conservation rates and programs, postpone the filing of general rate increase applications, and reduce overall water consumption.

VWS recorded \$174,685 and \$149,328 in operating revenues related to the RAM in 2014 and 2013, respectively, with a corresponding entry to a regulatory asset representing the future collection of the RAM surcharge.

The Company recognizes AFUDC, which is a non-cash increase to income and a corresponding increase to utility plant, by applying the last allowed rate of return on rate base approved by the Regulators to costs on large construction projects lasting longer than three months. The inclusion of AFUDC in utility plant enables the Company to earn a fair return on its utility plant, and the recovery of these capitalized costs by their inclusion in rate base and depreciation in the ratemaking process.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

2. **Change in accounting method:**

Effective January 1, 2014, the Company adopted, for tax purposes, tangible property regulations issued by the IRS in September 2013. The regulations, among other things, allow for the immediate deduction for tax purposes, as an ordinary and necessary repair expense, qualifying expenditures that previously would have been capitalized and depreciated over the estimated useful life of the asset. In connection with this adoption, the Company elected to change, retrospectively, its method of accounting for the timing differences between these book and tax expenditures. In accordance with ASC 980 and previous regulatory decisions, the Company elected to flow-through, rather than normalize, these timing differences.

The financial statements as of and for the year ended December 31, 2013 have been retrospectively and cumulatively adjusted to reflect this change in accounting method as follows:

	December 31, 2013		
	As previously reported	To reflect change in accounting for income taxes	As currently reported
Income tax receivable		\$ 176,300	\$ 176,300
Total current assets	<u>\$ 3,877,923</u>	<u>176,300</u>	<u>4,054,223</u>
Regulatory asset-income taxes recoverable	643,000	4,754,700	5,397,700
Total Assets	<u>32,370,483</u>	<u>4,931,000</u>	<u>37,301,483</u>
Retained earnings	7,120,862	1,395,400	8,516,262
Total Stockholders' Equity	<u>10,476,970</u>	<u>1,395,400</u>	<u>11,872,370</u>
Deferred income taxes	3,392,187	3,535,600	6,927,787
Total Stockholders' Equity and Liabilities	<u>\$32,370,483</u>	<u>\$4,931,000</u>	<u>\$37,301,483</u>
	December 31, 2012		
	As previously reported	To reflect change in accounting for income taxes	As currently reported
Retained earnings	\$6,611,002	\$1,095,200	\$7,706,202
Total Stockholders' Equity	<u>\$8,614,198</u>	<u>\$1,095,200</u>	<u>\$9,709,398</u>
	Year Ended December 31, 2013		
	As previously reported	To reflect change in accounting for income taxes	As currently reported
Income taxes	\$ 401,431	(\$300,200)	\$ 101,231
Net income	<u>\$ 806,419</u>	<u>\$300,200</u>	<u>\$1,106,619</u>
Net income per share, basic	<u>\$ 2.89</u>	<u>\$ 0.45</u>	<u>\$ 3.97</u>

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

3. Business combinations:

On February 14, 2014, AWC acquired the rate base assets of Lakeland Management Company, Inc. (“LMC”) and White Rock Company, Inc. (“WRC”) and the Parent acquired operation and maintenance contracts of C&C Water Services, Inc. (“C&C”). Simultaneously with the closings, AWC obtained regulatory approval for and issued long-term debt in exchange for proceeds of \$300,000. See Note 8.

The acquisition has been accounted for in accordance with the provisions of the Financial Accounting Standards Board ASC No. 805, *Business Combinations*. Accordingly, the cost of acquisition was allocated to the assets acquired and liabilities assumed based on estimates of their respective fair values at the date of acquisition.

The following table summarizes the consideration paid by the Company and the amounts of assets acquired and liabilities assumed recognized at the acquisition date:

Consideration:

Issuance of long-term debt	\$300,000
Issuance of common stock	55,000
Cash	<u>152,894</u>
	<u>\$507,894</u>

Recognized amounts of identified assets acquired and liabilities assumed:

Utility plant, net of accumulated depreciation	\$558,373
Operation and maintenance contracts	110,000
Materials and supplies inventory	10,403
Deferred income taxes	(32,134)
Contribution in aid of construction, net of accumulated amortization	<u>(138,748)</u>
	<u>\$507,894</u>

On December 31, 2013, the Parent acquired 100% of the issued and outstanding common shares of PWC. Simultaneously with the closing, PWC obtained regulatory approval and issued a mortgage payable in exchange for proceeds of \$500,000. See Note 8.

The acquisition has been accounted for in accordance with the provisions of the Financial Accounting Standards Board ASC No. 805, *Business Combinations*. Accordingly, the cost of acquisition was allocated to the assets acquired and liabilities assumed based on estimates of their respective fair values at the date of acquisition.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

3. **Business combinations** (continued):

The following table summarizes the consideration paid PWC and the amounts of assets acquired and liabilities assumed recognized at the acquisition date:

Consideration:

Cash	<u>\$500,000</u>
------	-------------------------

Recognized amounts of identified assets acquired and liabilities assumed:

Utility plant, net of accumulated depreciation	\$3,446,543
Cash	192,527
Accounts receivable	68,959
Other assets	18,285
Deferred costs and other regulatory assets	157,208
Long-term debt	(500,000)
Accounts payable	(27,670)
Deferred income taxes	(60,337)
Contribution in aid of construction	(<u>2,795,515</u>)
	<u>\$ 500,000</u>

The difference between the consideration given and net assets acquired and liabilities assumed of \$157,208 was allocated to the deferred regulatory asset. PWC believes, based on current regulatory circumstances and preliminary approval, that the regulatory assets recorded are likely to be recovered and that its use of regulatory accounting is appropriate.

4. **Accounts receivable:**

The balance of accounts receivable as of December 31, 2014 and 2013 are comprised of the following:

	<u>2014</u>	<u>2013</u>
Contract customers	<u>\$204,201</u>	\$ 31,999
Water customers	<u>396,205</u>	431,789
Other	<u>11,487</u>	25,643
	<u>\$611,893</u>	<u>\$489,431</u>

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

5. Marketable securities:

The Company holds as available for sale marketable equity securities valued using Level 1 inputs. Information related to these marketable securities is as follows:

	December 31,			
	2014		2013	
	<u>Cost</u>	<u>Market Value</u>	<u>Cost</u>	<u>Market Value</u>
Marketable securities	<u>\$483,597</u>	<u>\$591,423</u>	<u>\$397,627</u>	<u>\$506,586</u>

6. Treasury stock:

During 2013, the Company sold 20,650 shares of common stock previously held in the treasury for \$1,053,150. The aggregate sales price of the treasury shares sold exceeded the aggregate purchase price by \$287,507 and has been credited to “Additional paid-in capital”.

7. Notes payable, bank:

The Parent has a \$200,000 secured line of credit with interest at prime (3.25%) due on demand. As of December 2014 and 2013, there were no outstanding balances.

VWS has a \$500,000 secured line of credit with interest at 1.5% under prime, subject to a floor rate of 2.25%, which expires June 2015. As of December 2014 and 2013, there were no outstanding balances.

CWC has a \$100,000 secured line of credit with interest at prime (3.25%) which expires June 2015. As of December 31, 2014 and 2013, there were no outstanding balances.

PWC has a \$100,000 secured line of credit with interest at prime (3.25%) which expires June 2015. As of December 31, 2014, the outstanding balance was \$20,000.

AWC has a \$50,000 secured line of credit with interest at LIBOR plus 1.75% (as defined) (1.87% at December 31, 2014). The line expires in March 2015. There was no outstanding balance as of December 31, 2014.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

8. Long-term debt:

Long-term debt consists of the following:

	December 31,	
	<u>2014</u>	<u>2013</u>
Mortgage payable, bank, 3.0%, \$36,192 of interest and principal due monthly through June 2023 with adjusted monthly payments thereafter based on the applicable interest rates, as defined, with a balloon payment due June 2033.	\$6,137,834	\$6,381,275
Mortgage payable, bank, 3.25%, \$7,348 of interest and principal due monthly through December 2015 with adjusted monthly payments thereafter based on the applicable interest rates, as defined, through December 2035.	1,378,213	1,420,185
Mortgage payable, bank, 3.0%, \$2,431 of interest and principal due monthly through June 2019 with adjusted monthly payments thereafter based on the applicable interest rates, as defined, through June 2029.	328,368	353,624
Construction note payable, bank, 3.0%, \$647 due monthly through June 2019 with adjusted monthly payments thereafter based on the applicable interest rates, as defined, through June 2029.	86,080	93,503
Mortgage payable, bank, 3.38%, interest only through December 2014 followed by \$2,974 of interest and principal through December 2023 with adjusted monthly payments thereafter based on the applicable interest rates, as defined, through December 2033.	498,479	500,000
Mortgage payable, bank, 3.68%, \$3,003 of interest and principal due monthly through February 2024.	<u>279,007</u>	
	8,707,981	8,748,587
Less current portion	<u>365,870</u>	<u>313,813</u>
	<u>\$8,342,111</u>	<u>\$8,434,774</u>

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

8. Long-term debt (continued):

The long-term debt of the Company is secured by the Company's real estate and assets.

Principal repayments are as follows:

<u>Year ending December 31:</u>	<u>Amount</u>
2015	\$ 365,870
2016	381,898
2017	393,905
2018	406,291
2019	420,347
Thereafter	<u>6,739,670</u>
	<u>\$8,707,981</u>

The mortgages payable and construction note payable are secured by substantially all assets of the Company.

The Company's mortgages payable and construction note payable agreements contain certain financial covenants that require among other things, maintenance of minimum funded debt to capitalization ratio and minimum debt service coverage ratio, as defined.

9. Retirement plan:

The Company maintains a multi-employer contributory employee pension plan (401k) that covers substantially all full-time employees. Contributions to the plan amounted to \$55,796 and \$49,710 for the years ended December 31, 2014 and 2013, respectively.

10. Employee stock purchase program:

In May 2013, the Company's Board of Directors voted to amend the Employee Purchase Plan whereby eligible employees, as defined, have the right to purchase common stock of the Parent at a 7.5% discount of the higher of the current bid price or the most recent trade price. The number of shares which an employee may purchase is subject to certain annual limits, as defined in the agreement. The Company issued 860 and 170 shares of common stock under the Company's Employee Stock Purchase Program at a weighted-average price of \$48 per share in 2014 and 2013, respectively.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

11. Taxes other than income taxes:

Taxes other than income taxes for the years ended December 31, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Property taxes	\$493,791	\$454,354
Payroll taxes	58,913	55,398
	552,704	509,752
Less amounts capitalized	(3,598)	(4,072)
	<u>\$549,106</u>	<u>\$505,680</u>

12. Income taxes:

Income tax expense for the years ended December 31, 2014 and 2013 are as follows:

	<u>2014</u>		<u>2013</u>	
	<u>Current</u>	<u>Deferred</u>	<u>Current</u>	<u>Deferred</u>
Income tax expense (benefit) before application of operating loss carryforwards	\$213,000	\$ 37,900	(\$41,789)	\$143,020
Income tax expense (benefit) of operating loss carryforwards	(145,200)	145,200		
Change in valuation allowance		(145,200)		
Income tax expense (benefit)	<u>\$ 67,800</u>	<u>\$ 37,900</u>	<u>(\$41,789)</u>	<u>\$143,020</u>

The Company files a consolidated federal income tax return. The Parent and VWS file a combined Connecticut corporate business income tax return. PWC and CWC file a combined Massachusetts corporate business tax return and AWC files a separate New Hampshire business tax return.

The Company has net operating loss carryforwards of approximately \$2,900,000 to offset federal and state taxable income through 2034. For financial reporting purposes, a valuation allowance of \$1,070,000 has been recognized for the related deferred tax asset at December 31, 2014. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Realization of the deferred income tax asset is dependent on generating sufficient taxable income in future years.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

12. Income taxes (continued):

The conclusions of the Company's management regarding tax positions may be subject to review and adjustment at a later date based on an ongoing analysis of tax laws, regulations, and interpretations. Generally, federal and state authorities may examine the Company's tax returns three years from date of filing. Consequently, income tax returns for years prior to 2011, except for certain amended stated tax returns for 2008, as discussed below, are no longer subject to examination by taxing authorities.

Uncertain tax positions:

The Company's 2013 tax provision includes fixed capital investment credits (FCIC) of \$31,000, calculated based on the Company's interpretation of the Connecticut General Statutes related to fixed capital additions that qualify for the FCIC.

In 2012, the Company amended its Connecticut corporate income tax returns for the years ended December 31, 2008 through 2010, requesting a refund of \$85,000 related to the utilization of the FCIC. The refund was received in full.

The Company is aware that, in the case of an unrelated water utility, the Connecticut Department of Revenue Services (DRS) has taken the position that certain fixed capital additions do not qualify for the FCIC and that DRS has disallowed these additions. As a result of this disallowance, the unrelated water utility's refund claims have been significantly reduced, and DRS has assessed taxes and interest related to the refunds and FCIC credits claimed.

As a result of the Company's adoption of the tangible property regulations issued by the IRS in 2014, utilization of the FCIC is no longer expected to be a material component of the Company's tax provision.

13. Earnings per share:

Earnings per share on common stock are computed by dividing net income by the weighted average number of shares outstanding.

14. Commitments:

Capital budget:

VWS has a continuous capital/construction program which includes the replacement of aging and inadequately sized water mains.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

14. **Commitments** (continued):

Capital budget (continued):

Management estimates that the main replacement and treatment plant program will cost \$4,000,000 over the next five years. It also expects to spend approximately \$110,000 annually on capital projects other than water mains and treatment plants. A majority of this program is expected to be financed with internally generated funds.

CWC is engaged in a continuous construction program and expects to spend approximately \$725,000 over the next five years for new utility plant and/or improvements to existing infrastructure. A majority of this program is expected to be financed with internally generated funds.

PWC is engaged in a continuous construction program and expects to spend approximately \$420,000 over the next five years for new utility plant and/or improvements to existing infrastructure. A majority of this program is expected to be financed with internally generated funds.

AWC is engaged in a continuous construction program and expects to spend approximately \$225,000 over the next five years for new utility plant and/or improvements to existing infrastructure. A majority of this program is expected to be financed with internally generated funds.

15. **Supplemental disclosure of cash flow information:**

	<u>2014</u>	<u>2013</u>
Interest paid	\$280,900	\$276,941
Income taxes paid	\$ 99,000	\$ 16,643

Supplemental disclosure of non-cash investing and financing activities:

During 2014, the Parent issued 1,063 shares of common stock valued at \$55,000 in exchange for the operation and maintenance contracts of C&C.

During 2014, AWC issued a long-term debt of \$300,000 in connection with the acquisition of the rate base assets of LMC and WRC.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2014 and 2013

15. Supplemental disclosure of cash flow information (continued):

Supplemental disclosure of non-cash investing and financing activities (continued):

Each member of the board of directors is remunerated with 5 shares of common stock of the Parent for every board of directors' meeting of the Parent the member attends and with 25 shares of common stock of the Parent for every board of directors' meeting of VWS the member attends. Certain members of the board of directors are also remunerated with 10 shares of common stock of the Parent for every board of directors' meeting of CWC the member attends and one member of the board of directors is also remunerated with \$250 in either cash or shares of common stock of the Parent for every board of directors' meeting of AWC the member attends. A total of 344 shares of stock, valued at \$17,880, and 815 shares of stock, valued at \$41,565, were issued to the Directors during 2014 and 2013, respectively.

16. Concentration:

Significant customer:

The Company generated 12% and 14% of operating revenues from one customer, the Town of Plainville, in 2014 and 2013, respectively. The Company had outstanding accounts receivable from this customer of approximately \$59,000 and \$56,000 at December 31, 2014 and 2013, respectively.

17. Subsequent events:

Management has evaluated subsequent events through April 1, 2015, the date which the financial statements were available for issue.

