

Consolidated Financial Statements

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

Years Ended December 31, 2012 and 2011



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

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

Years Ended December 31, 2012 and 2011

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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, 2012 and 2011, and the related consolidated statements of income and comprehensive income, 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, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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

April 2, 2013
Shelton, Connecticut

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31,	
	<u>2012</u>	<u>2011</u>
Assets (Note 4)		
Utility plant, at cost	\$30,581,946	\$29,515,271
Less: accumulated depreciation	<u>9,036,975</u>	<u>8,539,940</u>
	<u>21,544,971</u>	<u>20,975,331</u>
Non-utility property, plant and equipment	1,417,598	1,399,777
Less: accumulated depreciation	<u>435,388</u>	<u>409,462</u>
	<u>982,210</u>	<u>990,315</u>
Current assets:		
Cash and cash equivalents	411,819	563,208
Marketable securities (Note 3)	348,955	270,146
Accounts receivable (Notes 2 and 13)	465,047	412,856
Accrued unbilled revenues	270,258	345,695
Prepaid income taxes	209,458	145,813
Materials and supplies inventory	44,743	58,510
Prepaid expenses	<u>35,128</u>	<u>41,576</u>
Total current assets	<u>1,785,408</u>	<u>1,837,804</u>
Utility deposits	3,520	3,835
Deferred costs and other regulatory assets	606,834	647,973
Preliminary survey and investigation	75,245	50,312
Regulatory asset – income taxes recoverable	<u>616,200</u>	<u>599,795</u>
	<u>1,301,799</u>	<u>1,301,915</u>
Total Assets	<u>\$25,614,388</u>	<u>\$25,105,365</u>

See notes to financial statements.

	December 31,	
	<u>2012</u>	<u>2011</u>
Stockholders' Equity and Liabilities		
Stockholders' equity:		
Common stock, no par, 1,000,000 shares authorized, 282,180 shares issued and 261,530 outstanding at December 31, 2012 and 281,485 shares issued and 260,850 outstanding at December 31, 2011	\$ 2,686,112	\$ 2,650,672
Additional paid-in capital	9,920	9,920
Treasury stock, at cost, 20,650 and 20,635 shares at December 31, 2012 and 2011, respectively	(765,643)	(764,873)
Accumulated other comprehensive income	72,807	43,506
Retained earnings	<u>6,611,002</u>	<u>6,131,197</u>
Total stockholders' equity	<u>8,614,198</u>	<u>8,070,422</u>
Long-term debt, net of current portion (Note 4)	<u>7,074,263</u>	<u>7,339,532</u>
Current liabilities:		
Current portion of long-term debt (Note 4)	264,184	249,118
Accounts payable	174,557	214,062
Accrued taxes	194,395	185,051
Accrued interest	22,189	27,982
Deferred revenues	30,648	29,211
Other current liabilities	<u>82,295</u>	<u>79,188</u>
Total current liabilities	<u>768,268</u>	<u>784,612</u>
Deferred income taxes	3,038,130	2,790,210
Deferred credits (Note 6)	3,917	3,917
Security deposits	12,629	12,769
Customer advances for construction	138,994	429,685
Contributions in aid of construction	4,727,809	4,492,038
Amortized contributions in aid of construction	<u>1,236,180</u>	<u>1,182,180</u>
	<u>9,157,659</u>	<u>8,910,799</u>
Commitments (Notes 5 and 11)		
Total Stockholders' Equity and Liabilities	<u>\$25,614,388</u>	<u>\$25,105,365</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>2012</u>	<u>2011</u>
Operating revenues (Note 13)		
Utility revenues	\$4,371,121	\$4,328,465
Contracting and jobbing revenues	<u>303,136</u>	<u>274,070</u>
	<u>4,674,257</u>	<u>4,602,535</u>
Operating expenses:		
Operation	1,835,845	1,783,027
Maintenance	186,926	208,619
Cost of contracting and jobbing	115,952	114,272
Depreciation	707,590	681,003
Taxes other than income taxes (Note 8)	487,663	470,727
Interest charges	<u>326,252</u>	<u>333,825</u>
Total operating expenses	<u>3,660,228</u>	<u>3,591,473</u>
Income from operations	<u>1,014,029</u>	<u>1,011,062</u>
Other income and (deductions):		
Rental income	24,396	9,636
Investment income	19,566	27,865
Allowance for funds used during construction	9,153	10,530
Nonrecurring, non-operating income (expense) (Note 9)	<u>(31,657)</u>	<u>49,547</u>
Total other income	<u>21,458</u>	<u>97,578</u>
Income before income taxes	<u>1,035,487</u>	<u>1,108,640</u>
Income taxes (Note 9)	<u>299,627</u>	<u>396,378</u>
Net income	<u>735,860</u>	<u>712,262</u>
Other comprehensive income (loss):		
Unrealized gain (loss) on marketable securities	<u>29,301</u>	<u>(25,764)</u>
Comprehensive income	<u><u>765,161</u></u>	<u><u>686,498</u></u>
Per share amounts:		
Weighted average shares outstanding	<u><u>261,226</u></u>	<u><u>260,989</u></u>
Net income	<u><u>\$ 2.82</u></u>	<u><u>\$ 2.73</u></u>
Dividends	<u><u>\$ 0.98</u></u>	<u><u>\$ 0.82</u></u>
Book value	<u><u>\$ 32.98</u></u>	<u><u>\$ 30.94</u></u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF 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, 2011	\$2,620,447	\$9,920	(\$696,012)	\$69,270	\$5,631,652
Common stock issued (600 shares)	30,225				
Net income					712,262
Dividends issued					(212,717)
Treasury stock sold (160 shares)			7,248		
Treasury stock acquired (1,520 shares)			(76,109)		
Unrealized loss on marketable securities				(25,764)	
Balance, December 31, 2011	<u>2,650,672</u>	<u>9,920</u>	<u>(764,873)</u>	<u>43,506</u>	<u>6,131,197</u>
Common stock issued (695 shares)	35,440				
Net income					735,860
Dividends issued					(256,055)
Treasury stock sold (15 shares)			760		
Treasury stock acquired (30 shares)			(1,530)		
Unrealized gain on marketable securities				29,301	
Balance, December 31, 2012	<u><u>\$2,686,112</u></u>	<u><u>\$9,920</u></u>	<u><u>(\$765,643)</u></u>	<u><u>\$72,807</u></u>	<u><u>\$6,611,002</u></u>

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Net income	\$ 735,860	\$ 712,262
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	841,263	787,263
Deferred income taxes	231,515	329,943
Allowance for funds used during construction	(9,153)	(10,530)
Bad debt and project write-offs	19,331	24,585
Investment gains	(1,655)	(29,673)
Directors' stock compensation	35,440	30,225
Change in operating assets and liabilities:		
Accounts receivable and accrued unbilled revenues	17,194	(118,666)
Prepaid income taxes	(63,645)	(90,255)
Materials and supplies inventory	13,767	1,533
Prepaid expenses	6,448	(4,714)
Deferred charges	(64,267)	(134,785)
Accounts payable	(40,427)	(10,179)
Accrued taxes	9,343	10,862
Accrued interest and other liabilities	(2,686)	(52,844)
Deferred revenues	1,437	18,996
Other assets	(20,145)	
Net cash provided by operating activities	<u>1,709,620</u>	<u>1,464,023</u>
Cash flows from investing activities:		
Purchase of marketable securities	(74,138)	(104,144)
Proceeds from sale of marketable securities	26,285	47,097
Additions to utility plant and nonutility property	(1,291,684)	(976,205)
Proceeds from sale of utility plant assets	10,629	
Reductions (additions) to preliminary survey and investigation charges	(24,933)	8,251
Security deposit refunds	(140)	(59,120)
Net cash used in investing activities	<u>(1,353,981)</u>	<u>(1,084,121)</u>
Cash flow from financing activities:		
Repayment of long-term debt	(250,203)	(201,209)
Repayment of line of credit		(60,000)
Treasury stock sales/purchases, net	(770)	(68,861)
Dividends paid	(256,055)	(212,717)
Net cash used in financing activities	<u>(507,028)</u>	<u>(542,787)</u>
Net change in cash and cash equivalents	(151,389)	(162,885)
Cash and cash equivalents, beginning	<u>563,208</u>	<u>726,093</u>
Cash and cash equivalents, ending	<u>\$ 411,819</u>	<u>\$ 563,208</u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

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 two public utility subsidiaries, Valley Water Systems, Inc., (VWS) distributing water to approximately 6,700 customers in Plainville, Farmington and Southington, Connecticut and Colonial Water Company (CWC), organized in 2010 through acquisition of rate base assets of Dover Water Company, distributing water to approximately 550 customers in Dover, Massachusetts.

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”) and CWC is regulated by the State of Massachusetts Department of Public Utilities (DPU) (collectively, the Regulators) and as such each subsidiary maintains its accounts in accordance with the accounting methods prescribed by the respective States. 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, regulated companies 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.

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.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

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

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, 2012 and 2011 consists of the following:

	<u>2012</u>	<u>2011</u>
Organization and intangible	\$ 169,576	\$ 169,576
Source of supply	2,410,101	2,368,870
Pumping	2,179,116	2,007,715
Water treatment	1,252,931	1,241,439
Transmission and distribution	22,848,415	22,037,166
General plant	1,678,566	1,638,768
Construction work in progress	<u>43,241</u>	<u>51,737</u>
	<u>\$30,581,946</u>	<u>\$29,515,271</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 items were in service and for financial statement presentation this amount has been netted against the original cost. No depreciation for this property is currently being charged to income. Upon retirement or disposal of this plant the book cost, accumulated depreciation and any salvage are netted and any gain or loss is recognized in the statement of net income. The Parent also has property 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 the estimated useful lives.

Depreciation:

The Company uses the straight-line method of depreciation over the estimated service lives of utility depreciable plant ranging from 5 to 50 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.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

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

Depreciation (continued):

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 \$3,925,519 as of December 31, 2012 and 2011.

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).

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.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

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

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.

The following costs have been deferred as of December 31, 2012 and 2011:

	<u>Original Cost</u>	<u>2012</u>	<u>2011</u>	<u>Amortization Period Ends</u>
VWS:				
Deferred power costs	\$131,651	\$ 15,359	\$ 24,136	September 2014
Leak detection	11,145		992	June 2012
Hydraulic model update	41,672	1,057	9,180	March 2013
Tank painting	287,034	7,175	35,879	March 2013
UCMR2 testing	7,962	421	2,003	June 2013
2010 rate case	104,688	47,041	72,700	October 2014
Supply plan update	22,836	4,567	9,134	December 2013
Diversion permit	24,439	5,507	7,950	March 2015
Cost of service study	21,961	9,333	11,529	March 2017
Tank cleaning	4,242	2,687	3,111	April 2019
Level A mapping	158,806	109,841	125,721	November 2019
Long-term financing	23,412	20,250	21,750	July 2026

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

1. Summary of significant accounting policies (continued):

Deferred costs and other regulatory assets (continued):

	<u>Original Cost</u>	<u>2012</u>	<u>2011</u>	<u>Amortization Period Ends</u>
VWS (continued):				
Other deferrals	79,867	79,867	74,592	Not yet amortizable
WA diversion permit	24,375	24,375	22,735	Not yet amortizable
Land development	17,692	17,692	3,710	Not yet amortizable
Storm related expenses	11,033	11,033	7,276	Not yet amortizable
MPA water testing	24,924	24,924	12,077	Not yet amortizable
Prepaid income taxes	745	745	745	Not yet amortizable
2012 leak detections	10,358	10,358		Not yet amortizable
Debt refinancing	209	209		Not yet amortizable
		<u>\$392,441</u>	<u>\$445,220</u>	
CWC:				
Deferred financing costs	\$ 25,508	\$ 22,076	\$ 23,072	December 2035
2011 rate case	102,990	71,161	102,990	January 2015
Acquisition regulatory asset	75,852	75,852	75,852	Not yet amortizable
Other deferred costs	4,462	4,462	839	Not yet amortizable
Main installation projects	10,515	10,515		Not yet amortizable
Develop hydraulic model	9,867	9,867		Not yet amortizable
		<u>\$193,933</u>	<u>\$202,753</u>	
Parent:				
Other deferred costs	\$ 20,460	\$ 20,460		Not amortizable
Total deferred costs and other regulatory assets		<u>\$606,834</u>	<u>\$647,973</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. Project abandonments totaled \$0 and \$8,251 during December 31, 2012 and 2011, respectively.

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. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

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

Income taxes (continued):

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 also from deferring investment credits for financial reporting purposes.

Additionally, the Company provides a regulatory asset for income tax benefits (primarily state income tax reductions due to accelerated depreciation) which have been flowed-through to the ratepayers under regulators ratemaking policies and which the Company believes it will recover in rates when these income tax benefits reverse in the future.

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, 2012 and 2011 is estimated to be \$102,000 and \$105,000, 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 usage from the latest meter reading to the end of each year.

Allowance for funds used during construction (AFUDC):

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, 2012 and 2011

2. Accounts receivable:

The balance of accounts receivable as of December 31, 2012 and 2011 are comprised of the following:

	<u>2012</u>	<u>2011</u>
Contract customers	\$ 57,575	\$ 28,447
Water customers	376,038	284,018
Other	31,434	100,391
	<u>\$465,047</u>	<u>\$412,856</u>

3. 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,			
	<u>2012</u>		<u>2011</u>	
	<u>Cost</u>	<u>Market Value</u>	<u>Cost</u>	<u>Market Value</u>
Marketable securities	<u>\$280,787</u>	<u>\$348,955</u>	<u>\$226,640</u>	<u>\$270,146</u>

4. Long-term debt:

Long-term debt consists of the following:

	December 31,	
	<u>2012</u>	<u>2011</u>
Mortgage payable, bank, 4.5%, \$36,856 of interest and principal due monthly with a balloon payment due July 2026.	\$5,404,499	\$5,594,619
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.	1,457,566	1,500,000
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.	376,236	390,166

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

4. **Long-term debt** (continued):

	December 31,	
	<u>2012</u>	<u>2011</u>
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.	<u>100,146</u>	<u>103,865</u>
	<u>\$7,338,447</u>	<u>\$7,588,650</u>
Less current portion	<u>264,184</u>	<u>249,118</u>
	<u>\$7,074,263</u>	<u>\$7,339,532</u>

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>
2013	\$ 264,184
2014	275,558
2015	287,433
2016	302,349
2017	318,743
Thereafter	<u>5,890,180</u>
	<u>\$7,338,447</u>

5. **Notes payable:**

The Parent has a \$200,000 line of credit with interest at prime (3.25%) due on demand. As of December 2012 and 2011, there were no outstanding balances.

VWS has a \$500,000 line of credit with interest at 1.5% under prime which expires June 2013. As of December 2012 and 2011, there were no outstanding balances.

During 2012, CWC obtained a \$100,000 line of credit, renewable in September 2013, with interest at a floating rate per annum equal to the Prime Rate on the relevant date (as published in the Wall Street Journal – 3.25% at December 31, 2012). As of December 31, 2012, there was no outstanding balance.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

6. Deferred credits:

Deferred credits include funds advanced from developers for water main extensions that were not completed and/or started as of the balance sheet date. When a project is completed the amount related to the project is reclassified to Customer Advances for Construction with any advance in excess of the project cost reimbursable back to the developer. The following summarizes this account as of December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Developers advances and deposits	<u>\$3,917</u>	<u>\$3,917</u>

7. 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 \$48,595 and \$45,212 for the years ended December 31, 2012 and 2011, respectively.

8. Taxes other than income taxes:

Taxes other than income taxes for the years ended December 31, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Property taxes	<u>\$434,855</u>	<u>\$418,406</u>
Payroll taxes	<u>57,727</u>	<u>56,666</u>
	<u>492,582</u>	<u>475,072</u>
Less amounts capitalized	<u>(4,919)</u>	<u>(4,345)</u>
	<u>\$487,663</u>	<u>\$470,727</u>

9. Income taxes:

Income tax expense for the years ended December 31, 2012 and 2011 are as follows:

	<u>2012</u>			<u>2011</u>
	<u>Federal</u>	<u>State</u>	<u>Total</u>	
Current	<u>\$ 38,762</u>	<u>\$29,350</u>	<u>\$ 68,112</u>	\$ 66,435
Deferred	<u>231,515</u>		<u>231,515</u>	329,943
	<u>\$270,277</u>	<u>\$29,350</u>	<u>\$299,627</u>	<u>\$396,378</u>

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

9. **Income taxes:** (continued):

The Company files a consolidated federal income tax return and a combined Connecticut corporate business tax return. CWC also files a single company Massachusetts business tax return. The consolidated federal income tax returns have been audited through 2005 by the Internal Revenue Service with “no change”. The state returns have not been audited by the Connecticut Department of Revenue Services or the Massachusetts Department of Revenue Services.

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 2009, except for certain amended state tax returns for 2008 as discussed below, are no longer subject to examination by taxing authorities.

Uncertain tax positions:

The Company’s 2012 tax provision includes fixed capital investment credits (FCIC) of \$32,400, calculated 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 Company’s refund is included in nonrecurring, non-operating income on the 2011 statement of income and retained earnings. The Company received a refund of \$69,577 related to the 2008 and 2010 amended returns. As of December 31, 2012, no refund has been received for the 2009 amended return.

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.

The Company believes the DRS’ position is both factually and legally incorrect and, accordingly, will continue to claim the FCIC credit in current and future years. The Company and several other Connecticut water utilities are sharing legal costs associated with an appeal of the DRS ruling described above. These costs are included in legal expenses on the December 31, 2012 statement of income and retained earnings.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

10. Earnings per share:

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

11. Commitments:

Capital budget:

VWS has a continuous capital/construction program which includes the replacement of aging and inadequately sized water mains. Management estimates that the main replacement and treatment plant program will cost \$3,400,000 over the next ten years. It also expects to spend approximately \$100,000 annually on capital projects other than water mains and treatment plants.

CWC is engaged in a continuous construction program and expects to spend approximately \$1,000,000 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.

12. Supplemental disclosure of cash flow information:

	<u>2012</u>	<u>2011</u>
Interest paid	\$328,786	\$331,106
Income taxes paid	\$139,000	\$150,697

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 5 shares of common stock of Parent for every board of directors' meeting of Colonial the member attends. A total of 670 shares of stock, valued at \$34,170 and 600 shares of stock, valued at \$30,225, were issued to the Directors during 2012 and 2011, respectively.

13. Concentration:

Significant customer:

The Company generated 13% and 15% of operating revenues from one customer, the Town of Plainville, in 2012 and 2011, respectively. The Company had outstanding accounts receivable from this customer of approximately \$56,000 at December 31, 2012 and 2011.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2012 and 2011

14. Subsequent events:

Subsequent to year-end, 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 the price equal to 95% of the current bid price or the most recent trade price, whichever is higher. The number of shares which an employee may purchase is subject to certain annual limits, as defined in the agreement.

Management has evaluated subsequent events through April 2, 2013, the date which the financial statements were available for issue.

