

Consolidated Financial Statements

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

Years Ended December 31, 2013 and 2012

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

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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, 2013 and 2012, 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, 2013 and 2012, 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.

March 31, 2014
Shelton, Connecticut

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31,	
	<u>2013</u>	<u>2012</u>
Assets (Note 6)		
Utility plant, at cost	\$36,127,940	\$30,581,946
Less: accumulated depreciation	<u>10,248,137</u>	<u>9,036,975</u>
	<u>25,879,803</u>	<u>21,544,971</u>
Non-utility property, plant and equipment	1,422,366	1,417,598
Less: accumulated depreciation	<u>480,315</u>	<u>435,388</u>
	<u>942,051</u>	<u>982,210</u>
Current assets:		
Cash and cash equivalents	2,397,368	411,819
Marketable securities (Note 4)	506,586	348,955
Accounts receivable (Notes 3 and 15)	489,431	465,047
Accrued unbilled revenues	276,485	270,258
Regulatory asset-water revenue adjustment current portion	111,996	
Prepaid income taxes		209,458
Materials and supplies inventory	65,403	44,743
Prepaid expenses	<u>30,654</u>	<u>35,128</u>
Total current assets	<u>3,877,923</u>	<u>1,785,408</u>
Utility deposits	450	3,520
Deferred costs and other regulatory assets	914,679	606,834
Regulatory asset-water revenue adjustment, net of current portion	37,332	
Preliminary survey and investigation	75,245	75,245
Regulatory asset – income taxes recoverable	<u>643,000</u>	<u>616,200</u>
	<u>1,670,706</u>	<u>1,301,799</u>
Total Assets	<u>\$32,370,483</u>	<u>\$25,614,388</u>

See notes to financial statements.

	December 31,	
	<u>2013</u>	<u>2012</u>
Stockholders' Equity and Liabilities		
Stockholders' equity: (Note 5)		
Common stock, no par, 1,000,000 shares authorized, 287,267 shares issued and outstanding at December 31, 2013 and 282,180 shares issued and 261,530 outstanding at December 31, 2012	\$ 2,945,096	\$ 2,686,112
Additional paid-in capital	297,426	9,920
Treasury stock, at cost, 0 and 20,650 shares at December 31, 2013 and 2012, respectively		(765,643)
Accumulated other comprehensive income	113,586	72,807
Retained earnings	<u>7,120,862</u>	<u>6,611,002</u>
Total stockholders' equity	<u>10,476,970</u>	<u>8,614,198</u>
Long-term debt, net of current portion (Note 6)	<u>8,434,774</u>	<u>7,074,263</u>
Current liabilities:		
Current portion of long-term debt (Note 6)	313,813	264,184
Accounts payable and accrued expenses	344,496	256,852
Accrued property and other taxes	214,801	194,395
Accrued income taxes	10,642	
Accrued interest	21,620	22,189
Deferred revenues	<u>36,656</u>	<u>30,648</u>
Total current liabilities	<u>942,028</u>	<u>768,268</u>
Deferred income taxes	3,392,187	3,038,130
Security deposits and other credits	18,497	16,546
Customer advances for construction	40,222	138,994
Contributions in aid of construction	7,775,625	4,727,809
Amortized contributions in aid of construction	<u>1,290,180</u>	<u>1,236,180</u>
	<u>12,516,711</u>	<u>9,157,659</u>
Commitments (Notes 7 and 13)		
Total Stockholders' Equity and Liabilities	<u>\$32,370,483</u>	<u>\$25,614,388</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>2013</u>	<u>2012</u>
Operating revenues (Note 15)		
Utility revenues	\$4,533,433	\$4,371,121
Contracting and jobbing revenues	<u>409,700</u>	<u>303,136</u>
	<u>4,943,133</u>	<u>4,674,257</u>
Operating expenses:		
Operation	1,799,149	1,835,845
Maintenance	236,646	186,926
Cost of contracting and jobbing	207,369	115,952
Depreciation and amortization	731,266	707,590
Taxes other than income taxes (Note 10)	505,680	487,663
Interest charges	<u>298,029</u>	<u>326,252</u>
Total operating expenses	<u>3,778,139</u>	<u>3,660,228</u>
Income from operations	<u>1,164,994</u>	<u>1,014,029</u>
Other income and (deductions):		
Rental income	20,556	24,396
Investment income	20,303	19,566
Allowance for funds used during construction	10,357	9,153
Non-operating expense	(8,360)	(31,657)
Total other income	<u>42,856</u>	<u>21,458</u>
Income before income taxes	1,207,850	1,035,487
Income taxes (Note 11)	<u>401,431</u>	<u>299,627</u>
Net income	806,419	735,860
Other comprehensive income loss:		
Unrealized gain on marketable securities	<u>40,779</u>	<u>29,301</u>
Comprehensive income	<u><u>847,198</u></u>	<u><u>765,161</u></u>
Per share amounts:		
Weighted average shares outstanding	<u>278,802</u>	<u>261,226</u>
Net income	<u>\$ 2.89</u>	<u>\$ 2.82</u>
Dividends	<u>\$ 1.06</u>	<u>\$ 0.98</u>
Book value	<u>\$ 37.58</u>	<u>\$ 32.98</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, 2012	\$2,650,672	\$9,920	(\$764,873)	\$ 43,506	\$6,131,197
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				<u>29,301</u>	
Balance, December 31, 2012	<u>2,686,112</u>	<u>9,920</u>	<u>(765,643)</u>	<u>72,807</u>	<u>6,611,002</u>
Common stock issued (5,087 shares)	258,984				
Net income					806,419
Dividends issued					(296,559)
Treasury stock sold (20,650 shares)		287,506	765,643		
Unrealized gain on marketable securities				<u>40,779</u>	
Balance, December 31, 2013	<u>\$2,945,096</u>	<u>\$297,426</u>	<u>\$ 0</u>	<u>\$113,586</u>	<u>\$7,120,862</u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Net income	\$ 806,419	\$ 735,860
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	878,639	841,263
Deferred income taxes	266,920	231,515
Allowance for funds used during construction	(10,357)	(9,153)
Bad debt and project write-offs	13,570	19,331
Investment (gains) losses	62	(1,655)
Directors' stock compensation	41,568	35,440
Change in operating assets and liabilities, net of effects from acquisition:		
Accounts receivable and accrued unbilled revenues	24,777	17,194
Regulatory asset-water revenue adjustment	(149,328)	
Prepaid income taxes	222,100	(63,645)
Materials and supplies inventory	(7,103)	13,767
Prepaid expenses and utility deposits	10,174	6,448
Deferred costs and other regulatory assets	(277,928)	(84,412)
Accounts payable and accrued expenses	58,132	(40,427)
Accrued property and other taxes	20,408	9,343
Accrued interest and other liabilities	(569)	(2,686)
Deferred revenues	6,008	1,437
Net cash provided by operating activities	<u>1,903,492</u>	<u>1,709,620</u>
Cash flows from investing activities:		
Purchase of marketable securities	(116,914)	(74,138)
Proceeds from sale of marketable securities		26,285
Additions to utility plant and nonutility property	(1,589,669)	(1,291,684)
Payment for purchase of PWC, net of cash acquired	(307,473)	
Contribution in aid of construction	209,370	
Proceeds from sale of utility plant assets	646	10,629
Additions to preliminary survey and investigation charges		(24,933)
Security deposit collections (refunds)	1,951	(140)
Net cash used in investing activities	<u>(1,802,089)</u>	<u>(1,353,981)</u>
Cash flow from financing activities:		
Repayment of long-term debt	(268,179)	(250,203)
Proceeds from issuance of long-term debt	1,178,319	
Proceeds from issuance of common stock	217,416	
Treasury stock sales (purchases)	1,053,149	(770)
Dividends paid	(296,559)	(256,055)
Net cash provided by (used in) financing activities	<u>1,884,146</u>	<u>(507,028)</u>
Net change in cash and cash equivalents	1,985,549	(151,389)
Cash and cash equivalents, beginning	411,819	563,208
Cash and cash equivalents, ending	<u>\$2,397,368</u>	<u>\$ 411,819</u>

See notes to financial statements.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

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 three 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 in 2010 through acquisition of rate base assets of Dover Water Company, distributing water to approximately 580 customers in Dover, Massachusetts and Plymouth Water Company (PWC), acquired in December 2013, distributing water to approximately 800 customers in Plymouth, 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”), CWC and PWC are 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, 2013 and 2012

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, 2013 and 2012 consists of the following:

	<u>2013</u>	<u>2012</u>
Organization and intangible	\$ 169,776	\$ 169,576
Source of supply plant	3,687,591	2,410,101
Pumping plant	2,798,583	2,179,116
Water treatment plant	1,255,731	1,252,931
Transmission and distribution plant	26,310,882	22,848,415
General plant	1,766,364	1,678,566
Construction work in progress	<u>139,013</u>	<u>43,241</u>
	<u>\$36,127,940</u>	<u>\$30,581,946</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, 2013 and 2012

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 \$6,927,642 and \$3,924,598 as of December 31, 2013 and 2012, 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).

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, 2013 and 2012

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, 2013 and 2012:

	<u>Original Cost</u>	<u>2013</u>	<u>2012</u>	<u>Amortization Period Ends</u>
VWS:				
Deferred power costs	\$131,651	\$ 6,582	\$ 15,359	September 2014
Hydraulic model update	41,672		1,057	March 2013
Tank painting	287,034		7,175	March 2013
UCMR2 testing	7,962		421	June 2013
2010 rate case	104,688	21,382	47,041	October 2014
Supply plan update	22,836		4,567	December 2013
Diversion permit	24,439	3,064	5,507	March 2015
Cost of service study	21,961	7,137	9,333	March 2017
Tank cleaning	4,242	2,262	2,687	April 2019
Level A mapping	158,806	93,960	109,841	November 2019
Long-term financing	23,412		20,250	July 2013

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

1. Summary of significant accounting policies (continued):

Deferred costs and other regulatory assets (continued):

	<u>Original Cost</u>	<u>2013</u>	<u>2012</u>	<u>Amortization Period Ends</u>
VWS (continued):				
Other deferrals	80,534	80,534	79,867	Not yet amortizable
WA diversion permit	24,375	23,366	24,375	January 2037
Land development	27,384	27,384	17,692	Not yet amortizable
Storm related expenses	11,033	11,303	11,033	Not yet amortizable
MPA water testing	24,924	24,924	24,924	Not yet amortizable
Prepaid income taxes	745		745	December 2013
2012 leak detections	17,416	17,416	10,358	Not yet amortizable
Debt refinancing	8,899	8,842	209	May 2033
ROE Docket	6,901	6,901		Not yet amortizable
Tangible property regulation study	5,634	5,634		Not yet amortizable
UCMR testing	3,868	3,868		Not yet amortizable
		<u>\$344,559</u>	<u>\$392,441</u>	
CWC:				
Deferred financing costs	\$ 25,508	\$ 21,081	\$ 22,076	December 2035
2011 rate case	102,990	35,580	71,161	January 2015
Acquisition regulatory asset	75,852	75,852	75,852	Not yet amortizable
Other deferred costs	4,462	4,462	4,462	Not yet amortizable
Main installation projects	10,515	10,515	10,515	Not yet amortizable
Develop hydraulic model	9,867	9,867	9,867	Not yet amortizable
		<u>\$157,357</u>	<u>\$193,933</u>	
PWC:				
Regulatory asset	\$157,208	\$157,208		Not yet amortizable
Deferred financing costs	18,601	18,601		December 2033
Rate case	7,593	7,593		Not yet amortizable
Acquisition regulatory asset	138,717	138,717		Not yet amortizable
		<u>\$322,119</u>	<u>\$</u>	
Parent:				
Other deferred costs	\$ 90,644	\$ 90,644	\$ 20,460	Not amortizable
Total deferred costs and other regulatory assets		<u>\$914,679</u>	<u>\$606,834</u>	

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

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

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 2013 or 2012.

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 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, 2013 and 2012 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.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

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

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.

Beginning in 2013, as permitted by PURA, operating revenues also include amounts related to the Water Revenue Adjustment (WRA). The WRA 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 WRA 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 \$149,328 in operating revenues related to the implementation of the WRA in 2013, with a corresponding entry to a regulatory asset representing the future collection of the WRA surcharge, which is expected to begin in April 2014.

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.

2. **Business combination:**

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 6.

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 PWC and the amounts of assets acquired and liabilities assumed recognized at the acquisition date:

Consideration:

Cash	<u>\$500,000</u>
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NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

2. **Business combination** (continued):

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	(2,795,515)
	<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.

3. **Accounts receivable:**

The balance of accounts receivable as of December 31, 2013 and 2012 are comprised of the following:

	<u>2013</u>	<u>2012</u>
Contract customers	\$ 31,999	\$ 57,575
Water customers	431,789	376,038
Other	25,643	31,434
	<u>\$489,431</u>	<u>\$465,047</u>

4. **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>2013</u>		<u>2012</u>	
	<u>Cost</u>	<u>Market Value</u>	<u>Cost</u>	<u>Market Value</u>
Marketable securities	<u>\$397,627</u>	<u>\$506,586</u>	<u>\$280,787</u>	<u>\$348,955</u>

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

5. 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”.

6. Long-term debt:

Long-term debt consists of the following:

	December 31,	
	<u>2013</u>	<u>2012</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.	\$6,381,275	\$5,404,499
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.	1,420,185	1,457,566
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.	353,624	376,236
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.	93,503	100,146
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.	<u>500,000</u>	<u> </u>
	\$8,748,587	\$7,338,447
Less current portion	<u>313,813</u>	<u>264,184</u>
	<u>\$8,434,774</u>	<u>\$7,074,263</u>

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

6. 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>
2014	\$ 313,813
2015	341,460
2016	354,551
2017	365,535
2018	376,860
Thereafter	<u>6,996,368</u>
	<u>\$8,748,587</u>

7. Notes payable:

The Parent has a \$200,000 line of credit with interest at prime (3.25%) due on demand. As of December 2013 and 2012, there were no outstanding balances.

VWS has a \$500,000 line of credit with interest at 1.5% under prime which expires May 2014. As of December 2013 and 2012, there were no outstanding balances.

CWC has a \$100,000 line of credit, 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, 2013). As of December 31, 2013 and 2012, there was no outstanding balances.

8. 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 \$49,710 and \$48,595 for the years ended December 31, 2013 and 2012, respectively.

9. 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,

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

9. Employee stock purchase program (continued):

whichever is higher. The number of shares which an employee may purchase is subject to certain annual limits, as defined in the agreement. During 2013, the Company issued 170 shares of common stock under the Company's Employee Stock Purchase Program at a weighted-average price of \$48 per share.

10. Taxes other than income taxes:

Taxes other than income taxes for the years ended December 31, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Property taxes	<u>\$454,354</u>	\$434,855
Payroll taxes	<u>55,398</u>	<u>57,727</u>
	<u>509,752</u>	492,582
Less amounts capitalized	<u>(4,072)</u>	<u>(4,919)</u>
	<u>\$505,680</u>	<u>\$487,663</u>

11. Income taxes:

Income tax expense for the years ended December 31, 2013 and 2012 are as follows:

	<u>2013</u>			<u>2012</u>
	<u>Federal</u>	<u>State</u>	<u>Total</u>	
Current	<u>\$100,511</u>	<u>\$34,000</u>	<u>\$134,511</u>	\$ 68,112
Deferred	<u>266,820</u>	<u>100</u>	<u>266,920</u>	<u>231,515</u>
	<u>\$367,331</u>	<u>\$34,100</u>	<u>\$401,431</u>	<u>\$299,627</u>

The Company files a consolidated federal income tax return and a combined Connecticut corporate business tax return. CWC and PWC also file separate Massachusetts business tax returns. 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 2010, except for certain amended state tax returns for 2008 as discussed below, are no longer subject to examination by taxing authorities.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

11. Income taxes (continued):

Uncertain tax positions:

The Company's 2013 tax provision includes fixed capital investment credits (FCIC) of \$31,000, 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 received a refund of \$69,577 related to the 2008 and 2010 amended returns. As of December 31, 2013, 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, 2013 and 2012 statement of income and retained earnings.

12. Earnings per share:

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

13. 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.

NEW ENGLAND SERVICE COMPANY, INC. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

Years Ended December 31, 2013 and 2012

13. **Commitments** (continued):

Capital budget (continued):

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.

PWC expects to spend approximately \$400,000 over the next five years for various improvements to existing infrastructure.

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

	<u>2013</u>	<u>2012</u>
Interest paid	\$276,941	\$328,786
Income taxes paid	\$ 16,643	\$139,000

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 Parent for every board of directors' meeting of Colonial the member attends. A total of 815 shares of stock, valued at \$41,565 and 670 shares of stock, valued at \$34,170, were issued to the Directors during 2013 and 2012, respectively.

15. **Concentration:**

Significant customer:

The Company generated 14% and 13% of operating revenues from one customer, the Town of Plainville, in 2013 and 2012, respectively. The Company had outstanding accounts receivable from this customer of approximately \$56,000 at December 31, 2013 and 2012.

16. **Subsequent events:**

Management has evaluated subsequent events through March 31, 2014, the date which the financial statements were available for issue.