

Financial Statements
and Other Financial Information

BLOCK ISLAND POWER COMPANY

Years Ended May 31, 2013 and 2012

BLOCK ISLAND POWER COMPANY

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Block Island Power Company
Block Island, Rhode Island

Report on the Financial Statements

We have audited the accompanying financial statements of Block Island Power Company, which comprise the balance sheet as of May 31, 2013, and the related statements of operations and retained earnings, and cash flows for the year then ended, and the related notes to the 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 auditors' 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 financial statements.

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 financial statements referred to above present fairly, in all material respects, the financial position of Block Island Power Company as of May 31, 2013, and the changes in its retained earnings and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITORS' REPORT (Continued)

Other Matters

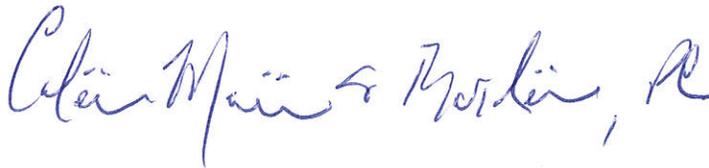
Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying supplemental schedules of expenses on pages 15 to 17 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

The prior year comparative information has been derived from Block Island Power Company's 2012 financial statements that were audited by other auditors. Those auditors expressed an unqualified opinion on those financial statements in their report dated January 3, 2013.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 5, 2014, on our consideration of Block Island Power Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Block Island Power Company's internal control over financial reporting and compliance.

Cranston, Rhode Island
March 5, 2014

A handwritten signature in blue ink, reading "Alan Martin & Gordon, PC". The signature is written in a cursive style.

BLOCK ISLAND POWER COMPANY
BALANCE SHEETS
May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
UTILITY PLANT		
Property, Plant and Equipment	\$ 8,803,148	\$ 8,732,806
Less Accumulated Depreciation	<u>5,582,362</u>	<u>5,278,185</u>
NET UTILITY PLANT	<u>3,220,786</u>	<u>3,454,621</u>
CURRENT ASSETS		
Cash	694,926	496,183
Accounts Receivable:		
Trade, Less Allowance for Credit Losses of \$21,706 in 2013 and \$21,846 in 2012	491,892	497,689
Due from Related Parties	-	18,866
Other	<u>92,605</u>	<u>113,037</u>
Accounts Receivable, Net	<u>584,497</u>	<u>629,592</u>
Inventory:		
Fuel	157,035	187,805
Purchased Parts Inventory	<u>56,828</u>	<u>98,091</u>
	<u>213,863</u>	<u>285,896</u>
Prepaid Expenses	27,190	24,192
Current Portion of Deferred Regulatory Retirement Asset	27,578	38,106
Current Portion of Deferred Regulatory Rate Asset	-	24,535
Deferred Regulatory Engine and SCR Maintenance Asset	(76,534)	158,503
Deferred Income Tax	<u>9,928</u>	<u>6,470</u>
TOTAL CURRENT ASSETS	<u>1,481,448</u>	<u>1,663,477</u>
DEFERRED CHARGES		
Deferred Regulatory Retirement Asset	<u>169,671</u>	<u>196,462</u>
TOTAL DEFERRED CHARGES	<u>169,671</u>	<u>196,462</u>
RESTRICTED ASSETS		
Cash - DSI and DSM/IRP Surcharges	40,031	64,169
TOTAL ASSETS	<u>\$ 4,911,936</u>	<u>\$ 5,378,729</u>

See independent auditors' report and accompanying notes to financial statements..

BLOCK ISLAND POWER COMPANY
BALANCE SHEETS (Continued)
May 31, 2013 and 2012

	2013	2012
STOCKHOLDERS' EQUITY AND LIABILITIES		
STOCKHOLDERS' EQUITY		
Common Stock, \$25 Par Value, 8,000 Shares Authorized, Issued and Outstanding	\$ 200,000	\$ 200,000
Premium on Common Stock	13,000	13,000
Retained Earnings	893,950	938,896
	1,106,950	1,151,896
Less Cost of 180 Shares of Treasury Stock	21,485	21,485
	1,085,465	1,130,411
LIABILITIES		
LONG-TERM LIABILITIES		
Retirement Obligation	169,671	196,462
Deferred Tower Lease Revenue	33,329	49,996
Long-Term Debt, Less Current Portion	2,701,862	2,884,389
	2,904,862	3,130,847
CURRENT LIABILITIES		
Accounts Payable	409,779	371,447
Customer Deposits	53,946	47,603
Accrued Payroll	27,132	22,944
Accrued Other Expenses	55,928	56,672
Deferred Regulatory Engine and SCR Maintenance Obligation	(76,534)	158,503
Current Portion of Retirement Obligation	27,578	38,106
Current Portion of Deferred Tower Lease Revenue	16,667	16,667
Current Portion of Long-Term Debt	182,413	175,776
	696,909	887,718
DEFERRED CREDITS		
Deferred Income Tax	149,671	145,675
Accrued Deferred Income Tax - Other	75,028	84,078
	224,699	229,753
	3,826,470	4,248,318
TOTAL STOCKHOLDERS' EQUITY AND LIABILITIES	\$ 4,911,935	\$ 5,378,729

See independent auditors' report and accompanying notes to financial statements..

BLOCK ISLAND POWER COMPANY
STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
Years Ended May 31, 2013 and 2012

	2013	2012
OPERATING REVENUES		
Electricity Charges	\$ 2,439,940	\$ 2,356,240
Fuel Surcharge	3,223,080	3,212,041
TOTAL OPERATING REVENUES	5,663,020	5,568,281
OPERATING EXPENSES		
Operations	4,531,341	4,445,753
Maintenance	583,650	363,851
Taxes	298,527	292,821
Depreciation	304,177	312,829
TOTAL OPERATING EXPENSES	5,717,695	5,415,254
INCOME (LOSS) FROM OPERATIONS	(54,675)	153,027
OTHER INCOME		
Rental of Utility Poles and Towers	193,216	188,823
Interest	596	446
Miscellaneous	24,921	25,729
TOTAL OTHER INCOME	218,733	214,998
OTHER EXPENSES		
Interest	150,287	164,273
Loss on Sale of Asset	18,179	-
TOTAL OTHER EXPENSES	168,466	164,273
INCOME (LOSS) BEFORE INCOME TAXES	(4,408)	203,752
INCOME TAX EXPENSE	538	25,676
NET INCOME (LOSS)	(4,946)	178,076
RETAINED EARNINGS AT BEGINNING OF YEAR	938,896	790,820
Less Dividends	40,000	30,000
RETAINED EARNINGS AT END OF YEAR	\$ 893,950	\$ 938,896

See independent auditors' report and accompanying notes to financial statements.

BLOCK ISLAND POWER COMPANY
STATEMENTS OF CASH FLOWS
Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income (Loss)	\$ (4,946)	\$ 178,076
Adjustments to Reconcile Net Income to		
Net Cash Provided by Operating Activities:		
Depreciation	304,177	312,829
Amortization of Deferred Regulatory Rate Asset	24,535	55,000
Amortization of Deferred Tower Lease Income	(16,667)	(16,667)
Provision for Bad Debts	(141)	(772)
Deferred Income Tax Expense	538	25,676
Amortization of Accrued Deferred Income Tax - Other	(9,050)	(9,900)
Changes In Operating Assets and Liabilities:		
Accounts Receivable	45,236	7,660
Fuel and Other Inventory	72,033	(73,434)
Prepaid Expenses	(2,998)	30
Accounts Payable	55,490	(109,102)
Deferred DSM and IRP Surcharge Revenues	(17,157)	(55,104)
Customer Deposits	6,343	(1,484)
Accrued Payroll and Other Accrued Expenses	3,444	(11,893)
Total Adjustments	<u>465,783</u>	<u>122,839</u>
NET CASH FROM OPERATING ACTIVITIES	<u>460,837</u>	<u>300,915</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of Property, Plant and Equipment	(70,342)	(20,551)
Excess Collection of Aid to Construct Utility Plant Assets	-	735
NET CASH USED IN INVESTING ACTIVITIES	<u>(70,342)</u>	<u>(19,816)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of Long-Term Debt	(175,890)	(164,713)
Dividends	(40,000)	(30,000)
NET CASH USED IN FINANCING ACTIVITIES	<u>(215,890)</u>	<u>(194,713)</u>
NET INCREASE IN CASH	174,605	86,386
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>560,352</u>	<u>473,966</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 734,957</u>	<u>\$ 560,352</u>

See independent auditors' report and accompanying notes to financial statements.

BLOCK ISLAND POWER COMPANY

Notes to Financial Statements

May 31, 2013 and 2012

NOTE 1 – NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES:

Nature of Business: The Block Island Power Company (the “Company”), a privately held regulated utility entity, provides electricity to users located on Block Island, Rhode Island. The Company conforms to accounting principles generally accepted in the United States of America (GAAP) which includes the accounting requirement and rate-making practices of the Federal Energy Regulatory Commission (FERC) and the state public utilities commission.

Use of Estimates: The preparation of the 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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management’s most significant estimates relate to the allowance for doubtful accounts, inventory valuation and depreciable lives of utility plant and equipment.

Property, Plant and Equipment: Depreciation is computed using the straight-line method generally for a period of between three (3) and forty (40) years in accordance with the Public Utility Commission guidelines with regard to asset classification and useful life. The Company expenses the cost of planned major maintenance activities as they are incurred.

Cash and Cash Equivalents: The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash. The Company maintains its cash accounts in one financial institution. The balances are insured by the Federal Deposit Insurance Corporation up to \$250,000. At May 31, 2013 and 2012, the Company’s uninsured cash bank balances totaled \$419,036 and \$334,375, respectively.

Accounts Receivable: All of the accounts receivable are stated at the amount management expects to collect from the outstanding balances. Management provides on the trade receivables for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to trade accounts receivable. Based on management’s assessment of the other outstanding accounts receivable, it has concluded that realization losses will be immaterial.

Fuel and Other Inventory: Fuel inventory is valued at cost determined on the specific identification method. Other inventories, consisting primarily of plant replacement parts, are valued at the lower of cost or market, determined on the first-in, first-out (FIFO) method.

Presentation of Sales and Excise Taxes: The State of Rhode Island imposes certain taxes on all of the Company’s sales to non-exempt customers. The Company collects the taxes from customers and remits the entire amount to the State. The Company includes these taxes collected and remitted to the State as revenues and as operating expenses.

BLOCK ISLAND POWER COMPANY

Notes to Financial Statements

May 31, 2013 and 2012

**NOTE 1 – NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES:
(Continued)**

Income Taxes: The Company recognizes income tax expense based on income reported for financial statement purposes. Income tax expense differs from amounts currently payable because of timing differences in the recognition of certain income and expense items, primarily depreciation, tax loss carryforwards, and contributions in aid. For income tax reporting purposes, the Company depreciates newly acquired assets on the accelerated basis. Further, for income tax purposes, regulatory commission expense is expensed as incurred. Contributions in aid revenue are taxable in the year received but recorded in part as a reduction of basis in property and equipment and deferred income (Note K) for financial statement purposes.

Accounting for Uncertain Tax Positions: The Company accounts for the effect of any uncertain tax positions based on a “more likely than not” threshold to the recognition of the tax positions being sustained based on the technical merits of the position under scrutiny by the applicable taxing authority. If a tax position or positions are deemed to result in uncertainties of those positions, the unrecognized tax benefit is estimated based on a “cumulative probability assessment” that aggregates the estimated tax liability for all uncertain tax positions. Interest and penalties assessed, if any, are accrued as income tax expense. The Company has tax positions that have been determined to be highly certain and, therefore, no accrual for unrecognized tax liability is deemed necessary. The Company is not currently under examination by any taxing jurisdiction. Its federal and state income tax returns are generally open for examination for the past 6 years.

Subsequent Events: The Company has evaluated subsequent events for potential disclosure or recognition after May 31, 2013 through March 5, 2014, the date the financial statements were available to be issued.

NOTE B – UTILITY PLANT

The property, plant and equipment consists of the following at May 31:

	<u>2013</u>	<u>2012</u>
Land and Land Rights	\$ 79,720	\$ 79,610
Building	507,289	507,289
Machinery and Equipment	4,701,085	4,698,200
Distribution System	3,426,043	3,358,696
Furniture and Fixtures	<u>89,011</u>	<u>89,011</u>
Property, Plant and Equipment	<u>\$8,803,148</u>	<u>\$8,732,806</u>

BLOCK ISLAND POWER COMPANY

Notes to Financial Statements

May 31, 2013 and 2012

NOTE C – DEFERRED REGULATORY RATE ASSET

On November 9, 2007, the Company filed an application with the Commission of Public Utilities (Commission) to increase its rates above its then authorized rates. In response to the Company's filing, the Commission conducted a standards investigation of the Company's increase request through extensive discovery methods and testimony. The details to this filing and settlement of the increase in rates can be found in the Commission Docket No. 3900. The Company's rate increase became effective for the June 2008 consumption period.

As of May 31, 2012, the Company incurred various legal and consulting costs during this rate filing process that amounted to \$200,862. These costs, plus \$43,673 from a prior rate filing process, have been amortized beginning June 1, 2008. The Commission approved the funding of the rate case expense in the amount of \$55,000 per year for the first three years. The remaining balance of approximately \$24,535 will be amortized during the year ended May 31, 2013. This method amortizes the rate filing costs incurred with the related future revenues to be recognized through the approved rate increases.

NOTE D – DEFERRED REGULATORY ENGINE AND SCR MAINTENANCE ASSET

The Company is required to reserve \$210,272 each year, beginning with the fiscal year ended May 31, 2006, to be spent for catalysts for the SCR system, for related SCR work, and for engine maintenance, installation, and related work. This requirement is detailed in the Commission of Public Utilities Docket No. 3655 and is a stipulation agreed to by the Company as part of the December 17, 2004 rate increase filing request. The actual cash costs for engine and SCR maintenance, installation and related work are required to be charged to this reserve each year. Any difference between the reserve which has been included in the increased rates and actual costs is required to be addressed in a future proceeding. The actual amount reserved based on the mandated regulatory calculation was \$240,874 in 2013 and \$233,543 in 2012, of which \$475,911 and \$266,256 was actually spent in 2013 and 2012, respectively. The accumulated difference of (\$76,533) as of May 31, 2013 represents the amount which has been expended on engine and SCR related items in excess of the regulatory calculation. The accumulated difference of \$158,503 as of May 31, 2012 represents the amount not yet expended on engine and SCR related items and is required to be stated as a deferred regulatory liability with a corresponding deferred regulatory asset.

NOTE E – OTHER ACCOUNTS RECEIVABLE

Other accounts receivable consists of the following at May 31:

	<u>2013</u>	<u>2012</u>
Refundable Fuel Excise Tax	\$32,003	\$ 37,000
Advances on Rhode Island Gross Receipts Tax	27,097	24,370
Rental Income	<u>33,505</u>	<u>51,667</u>
Other Accounts Receivable, Net	<u>\$92,605</u>	<u>\$113,037</u>

BLOCK ISLAND POWER COMPANY

Notes to Financial Statements

May 31, 2013 and 2012

NOTE F – RESTRICTED CASH ACCOUNT

The Company was required to, and did establish, a restricted cash account during the fiscal year ended May 31, 2006, to separately account for revenue required to be reserved for Demand Side Management (DSM) and Integrated Resource Planning (IRP) expenses. The DSM and IRP revenues were derived from a surcharge in the four summer months of \$.01 per kilowatt hour (KWH) for a period of 3 years ended May 31, 2008. The Company continues to include a surcharge in the four summer months to be used to improve the Company's distribution system (DSI) as stipulated in part of the November 2007 rate increase filing request and is detailed in the Commission of Public Utilities Docket No. 3900, effective June 1, 2008. The Company earned revenue from this surcharge of \$57,265 in 2013 and \$54,343 in 2012, and incurred DSI expenses of \$74,447 in 2013 and \$111,943 in 2012. As of May 31, 2013 and 2012, the restricted cash balances were \$40,031 and \$64,169, respectively, which represents deferred surcharge revenues not yet expended on DSI and DSM/IRP expenses.

NOTE G – RETIREMENT OBLIGATION

The Company has agreed to continue to pay the widow of a retired Vice President of the Company a pension benefit of \$1,000 per month, in addition to paying her Blue Cross health insurance premiums. The Company also has agreements with three individuals, a retired watchman operator, a retired general manager, and a retired lineman, to pay each a monthly pension benefit of \$1,000. None of the agreements are part of a qualified plan, and payments will end upon each recipient's death, except for the retired general manager, who will receive payment until age 65.

The Company's regulatory agency has authorized the Company to record these obligations as deferred regulatory asset and amortize them at the same rate as the retirement obligation is reduced.

The present value of these obligations over a life expectancy of 75 years for each recipient, except for the general manager who was calculated to age 75, is \$197,249 at May 31, 2013, of which \$27,578 is considered current and \$169,671 is considered non-current, and is \$234,568 at May 31, 2012, of which \$38,106 is considered current and \$196,462 is considered non-current. The interest rate imputed in determining this obligation was 5.0%. The obligation, which is based on the life expectancy of each recipient, is expected to be paid through 2015 for the retired Vice President, through 2018 for the retired watchman operator, through 2013 for the retired general manager, and through 2027 for the retired lineman. The Company also has an agreement with a retired President to pay him a pension benefit of \$2,000 per month. He is currently over 78 years old.

These retirement obligations totaling \$63,000 and \$72,000 for 2013 and 2012, respectively, were charged to operations.

BLOCK ISLAND POWER COMPANY

Notes to Financial Statements

May 31, 2013 and 2012

NOTE H – DEFERRED TOWER LEASE REVENUE

The Company has two agreements with two entities to broadcast from a tower and maintenance building (facility) built on the Company's land by these two entities and donated to the Company. In exchange, these two entities have the right to broadcast from the tower for a fifteen year period expiring in May 2016. The Company capitalized \$250,000 as the estimated cost of the facility with a corresponding deferred credit for the estimated forgone tower lease income that the Company would have received from the entities. Both the cost of the facility and the deferred revenues are being amortized over the term of the agreements. Deferred tower lease revenue is scheduled to be recognized at \$16,667 for each year ending May 31, 2001 through 2016.

NOTE I – LONG-TERM DEBT

Long-term debt consists of the following at May 31:

	<u>2013</u>	<u>2012</u>
Note Payable – In June 2000, the Company entered into an agreement with Rural Utilities Services (RUS) to obtain low interest loan advances through the Federal Financing Bank (FFB). The financing was used to improve its generation and distribution systems as well as restructure some of its outstanding debt. RUS has a first position security interest in all assets. There were eight separate Advances from August 2000 to June 2008 which totaled \$3,939,963. The eight individual advances to the Company Require quarterly payments totaling \$72,181 including Interest, with various fixed rates from 4.392% to 5.915% and final payments in December 2024 and 2031.	\$2,749,628	\$2,901,040
7.07% Note payable to bank in monthly payments of \$2,925 including interest, until November 2017, secured by a second position after RUS on certain equipment costing \$253,614	<u>134,647</u>	<u>159,125</u>
	2,884,275	3,060,165
Less Current Portions	<u>182,413</u>	<u>175,776</u>
Total Long-term Portions	<u>\$2,701,862</u>	<u>\$2,884,389</u>

Interest paid was \$157,071 and \$175,542 for the years ended May 31, 2013 and 2012, respectively.

BLOCK ISLAND POWER COMPANY

Notes to Financial Statements

May 31, 2013 and 2012

NOTE I – LONG-TERM DEBT (Continued)

The aggregate annual maturities of the long-term debt are as follows:

Year ending May 31,	2014	185,177
	2015	195,065
	2016	205,671
	2017	217,585
	2018	211,111
	Thereafter	<u>1,869,666</u>
		<u>\$2,884,275</u>

NOTE J – INCOME TAX EXPENSE

Income tax expense consists of deferred income tax expense of \$538 and \$25,676 for the years ended May 31, 2013 and 2012, respectively.

A reconciliation of expected income tax expense calculated by applying the statutory federal tax rate to pretax income is as follows:

	<u>2013</u>	<u>2012</u>
Expected Income Tax Expense	\$ (661)	\$ 30,563
Tax Depreciation in Excess of Book Depreciation	10,347	12,815
Change in Collection of Fuel Excise Tax	(750)	(4,740)
Amortization of Deferred Regulatory Rate Asset	(3,680)	(8,250)
Change in Allowance for Credit Losses	21	116
Net Operating Loss Carryover (Utilization)	(6,096)	(6,203)
Rental Income	<u>1,357</u>	<u>1,375</u>
Income Tax Expense	<u>\$ 538</u>	<u>\$25,676</u>

The Company has a net operating loss carryforward of \$181,790 available, which begins to expire in May 2025.

BLOCK ISLAND POWER COMPANY
Notes to Financial Statements
May 31, 2013 and 2012

NOTE J – INCOME TAX EXPENSE (Continued)

The tax effect of significant temporary differences that result in deferred tax assets and liabilities are as follows:

	<u>2013</u>	<u>2012</u>
Deferred Tax Assets:		
Utility Plant Basis	\$ 16,258	\$ 26,094
Net Operating Loss Carryover	27,269	20,510
Allowance for Credit Losses	3,256	3,277
Aid-in-Construction Contribution	<u>11,254</u>	<u>12,612</u>
	<u>58,037</u>	<u>62,493</u>
Deferred Tax Liabilities:		
Utility Plant Basis	(192,980)	(192,468)
Deferred Regulatory Rate Asset	-	(3,680)
Accounts Receivable Fuel Excise	<u>(4,800)</u>	<u>(5,550)</u>
	<u>(197,780)</u>	<u>(201,698)</u>
	<u>\$(139,743)</u>	<u>\$(139,205)</u>

The components of deferred tax assets and liabilities are as follows:

	<u>2013</u>	<u>2012</u>
Current Assets	\$ 14,729	\$ 15,700
Current Liabilities	<u>(4,800)</u>	<u>(9,230)</u>
Net Current Deferred Tax Assets (Liabilities)	<u>\$ 9,929</u>	<u>\$ 6,470</u>
Non-current Assets	\$ 43,308	46,793
Non-current Liabilities	<u>(192,980)</u>	<u>(192,468)</u>
Net Non-current Deferred Tax Liabilities	<u>\$(149,672)</u>	<u>\$(145,675)</u>

NOTE K – ACCRUED DEFERRED INCOME TAX – OTHER

The Company collects excess amounts necessary to construct utility plant assets from contributions in aid to construction. This “gross up” amount represents the difference between the cost of paying federal income taxes in the year the contribution in aid is received and the present value of the future depreciation stream allowed for federal income tax purposes.

Each year’s gross up amount is amortized over 15 years (tax useful life) and credited against interest expense. The amount amortized against interest expense was \$9,050 in 2013 and \$9,900 in 2012. In order to properly reflect the utility plant assets, the accrued deferred income tax – other account was established. This presentation is consistent with the Uniform System of Accounts for Class A and B Electric Utilities promulgated by the National Associations of Regulatory Utility Commissioners.

BLOCK ISLAND POWER COMPANY
Notes to Financial Statements
May 31, 2013 and 2012

NOTE L – COMMITMENTS AND CONTINGENCIES

Litigation: During the ordinary course of business, the Company is a party to various claims, legal actions, and complaints, including regulatory environmental compliance matters. In the opinion of management and legal counsel, these matters are not anticipated to have a material financial impact on the Company.

Commitments

The Company has a credit agreement with the Washington Trust Company that requires the submission of audited financial statements for each fiscal year end.

The Company has complied with this requirement for the fiscal years ended May 31, 2012 and 2011, and will for the fiscal year ended May 31, 2013 after the issuance of this report. The Company has a credit agreement with the U.S. Department of Agriculture Rural Utilities Service (RUS) Guaranteed Loan Program that requires the submission of information regarding net worth, current ratio, cash flow coverage, and earnings for each fiscal year through December 31, 2024.

NOTE M – LEASES

The Company leases certain vehicles which are used by management and staff. The leases are renewable and recurring in nature, and all are classified as operating leases. The leases stipulate the company pay for certain costs such as taxes, maintenance and insurance. In addition, the leases require contingent rental fees based on mileage in excess of the specified minimums. Scheduled future annual minimum lease payments are expected to be \$18,597.

Lease expense was \$20,888 for 2013 and \$21,459 for 2012.

NOTE N – DEFINED CONTRIBUTION 401(K) PLAN

The Company maintains a qualified defined contribution 401(K) plan which covers all employees that meet the Plan's eligibility requirements. The contribution for each fiscal year is an amount determined by calculation of 3% of individual salaries and approved by a vote of the directors and communicated to the participants on or before the end of each year. Contributions charged to operations were \$13,953 in 2013 and \$13,547 in 2012.

BLOCK ISLAND POWER COMPANY

Notes to Financial Statements

May 31, 2013 and 2012

NOTE O – RELATED PARTY TRANSACTIONS

During 2013 and 2012, the following related party transactions occurred:

- a) The Company receives fuel deliveries from IFR Trucking which is owned by a stockholder of the Company. The total delivery expense was \$26,250 for 2013 and \$31,500 for 2012.
- b) The Company had leased land to the son of the Vice President of Plant Operations for storage of his boat. The total related income was \$1,300 for 2013 and \$1,000 for 2012.
- c) The Company purchases heating oil from the Ballard Oil Company. The Ballard Oil Company is owned by a son of the Vice President of Plant Operations. The total related oil expense was \$18,550 for 2013 and \$10,265 for 2012.
- d) The Company rents an oil storage tank to the Ballard Oil Company. The Ballard Oil Company is owned by a son of the Vice President of Plant Operations. The total related income was \$4,678 for 2013 and \$6,733 for 2012.
- e) The Company provides free electricity to its President and Vice President of Operations. The total value of the related free electricity, based on usage, was \$6,273 for 2013 and \$7,049 for 2012.

BLOCK ISLAND POWER COMPANY
SUPPLEMENTAL SCHEDULE OF EXPENSES
Years Ended May 31, 2013 and 2012

	2013	2012
<u>OPERATIONS</u>		
POWER PRODUCTION EXPENSES		
Supervision	\$ 18,897	\$ 18,608
Fuel Purchases (Net of Inventory Changes)	2,892,449	2,911,470
Fuel Handling	454	1,034
Fuel Procurement	207,115	173,603
Watchman	81,088	70,848
Lubrication	35,822	30,455
Inside Maintenance Payroll	106,906	99,896
Automobile Repairs	4,455	7,977
Purchased Power	3,347	1,448
Miscellaneous Costs (Includes Purchased Parts Inventory Change)	18,342	8,656
TOTAL POWER PRODUCTION EXPENSES	3,368,875	3,323,995
DISTRIBUTION EXPENSES		
Supervision	20,563	20,296
Overhead Linesmen Payroll	82,974	79,267
Meters	1,309	1,107
Lease Motor Vehicle	20,888	21,459
Outside Lineman Services	5,360	7,109
Miscellaneous	24,398	17,960
TOTAL DISTRIBUTION EXPENSES	155,492	147,198
CUSTOMER ACCOUNT EXPENSES		
Meter Reading Payroll	13,268	14,342
Records and Collection Payroll	21,034	20,920
Miscellaneous	550	-
TOTAL CUSTOMER ACCOUNT EXPENSES	34,852	35,262

- Continues on Next Page -

See independent auditors' report and accompanying notes to financial statements.

BLOCK ISLAND POWER COMPANY
SUPPLEMENTAL SCHEDULE OF EXPENSES (Continued from Prior Page)
Years Ended May 31, 2013 and 2012

	2013	2012
<u>OPERATIONS (Continued)</u>		
ADMINISTRATIVE AND GENERAL EXPENSES		
Office Salaries	20,415	19,779
Vacation Pay	31,217	27,924
Holiday Pay	689	-
Holiday Not Worked	12,251	12,856
Sick Leave Pay	7,354	6,146
Personal Days	3,008	2,183
Office Supplies	28,306	32,176
Outside Services	72,398	50,513
Apartment Rent	-	12,000
Employee Private Pension	63,000	72,000
Pension	13,953	13,547
Insurance	157,026	139,229
Accounting	73,314	73,847
Travel	3,553	2,214
Employee Benefits	109,143	106,996
Employee Bonus	19,529	18,378
Management Bonus	20,000	1,500
Regulatory Commission	43,415	67,671
Provision for Bad Debts	(141)	(772)
Officers' Salaries	181,692	176,400
Directors' Meetings	6,337	5,750
Clean Air Compliance	-	38,532
Environmental	68,887	36,527
Miscellaneous Plant	5,848	1,508
Utilities and Telephone	25,302	17,802
Trash Disposal	5,626	4,593
TOTAL ADMINISTRATIVE AND GENERAL EXPENSES	972,122	939,299
TOTAL OPERATIONS \$	4,531,341	\$ 4,445,754

- Continues on Next Page -

See independent auditors' report and accompanying notes to financial statements.

BLOCK ISLAND POWER COMPANY
SUPPLEMENTAL SCHEDULE OF EXPENSES (Continued from Prior Page)
Years Ended May 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<u>MAINTENANCE</u>		
GENERATION OF ELECTRICAL PLANT EXPENSES		
Supervision	\$ 18,693	\$ 19,337
Gasoline	14,305	13,688
Miscellaneous	1,781	858
TOTAL GENERATION OF ELECTRICAL PLANT EXPENSES	<u>34,779</u>	<u>33,883</u>
DISTRIBUTION EXPENSES		
Supervision	18,693	18,938
Overhead Line	5,563	3,089
Underground Lines	1,582	3,095
Street Lights	-	55
Backhoe Repairs	1,316	-
TOTAL DISTRIBUTION EXPENSES	<u>27,154</u>	<u>25,177</u>
GENERAL PLANT EXPENSES		
Generator and General Plant Maintenance	515,155	291,824
Small Tools	2,330	4,000
Hazardous Removal	4,232	8,967
TOTAL GENERAL PLANT EXPENSES	<u>521,717</u>	<u>304,791</u>
TOTAL MAINTENANCE	<u>\$ 583,650</u>	<u>\$ 363,851</u>
<u>TAXES</u>		
Payroll	\$ 42,413	\$ 41,315
Registrations	3,433	1,962
Sales	1,595	3,443
Rhode Island Gross Earnings Tax	237,162	232,786
Property Tax	13,924	13,315
TOTAL TAXES	<u>\$ 298,527</u>	<u>\$ 292,821</u>

See independent auditors' report and accompanying notes to financial statements.



**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Block Island Power Company
Block Island, Rhode Island

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Block Island Power Company (the Company), which comprise the balance sheet as of May 31, 2013, and the related statements of operations and retained earnings, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report dated March 5, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Block Island Power Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Block Island Power Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified a certain deficiency in internal control that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the company's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiency to be a material weakness.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*
(Continued)**

The Company's controls over accounts payable cut-off failed to identify a \$63,196 vendor invoice that should have been accrued in the current fiscal year and was identified during audit testing. The Company has since corrected the related accounts for this amount.

The Company believes their cut-off procedures are strong; however, this was an isolated instance where an item was missed.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Block Island Power Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards*.

Block Island Power Company's Response to Finding

Block Island Power Company's response to the finding identified in our audit is described previously.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the Company's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Cranston, Rhode Island
March 16, 2014

